

**SMALL AND MEDUIM ENTERPRISE IN ETHIOPIA: THE CHALLENGES AND  
PROSPECTS**

**By**

**HAGOS, Yared Haftay**

**CAPSTONE**

Submitted to  
KDI School of Public Policy and Management  
in partial fulfillment of the requirements  
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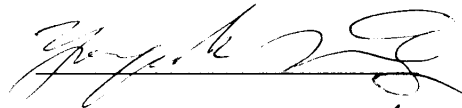
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Committee in charge:

Professor Kang, Younguck, Supervisor



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# **SMALL AND MEDUIM ENTERPRISE IN ETHIOPIA: THE CHALLENGES AND PROSPECTS**

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Small and Medium Enterprises have been widely credited for being an indispensable part of economic development. Its strength is gauged by the dexterity to create jobs, contribute to industrialization and boost national economic output. As a developing country, Ethiopia stands to gain by tapping into this sector. This study therefore seeks to among other things to conduct an exhaustive appraisal of the state of SMEs in Ethiopia and crucially identifying how they can be leveraged to augment the developmental quest of the country. It highlights structural and policy weaknesses that are badly in need of reform that can facilitate the goal of wrestling down poverty, improving business climate by creating the leeway for SMEs to take hold of the commanding heights of the economy.

**Key Words:** Small and Medium Enterprises, Deregulation, Employment, Development

**Dedicated to Yeshiwork Yazew, and  
Aklilu Haftay**

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## ACRONYMS

SMEs:	Small and Medium Enterprises
MSMEs:	Micro, Small and Medium Enterprise
ADLI:	Agricultural Development Lead Industrialization
GDP:	Gross Domestic Product
UNCTAD:	United Nations Conference on Trade and Development
ECA:	Economic Commission for Africa
EEA:	Ethiopian Economic Association
CBE:	Commercial Bank of Ethiopia
DBE:	Development Bank of Ethiopia
MSEDA:	Micro and Small Enterprise Development Agency
IFC:	International Financial Corporation
WB:	World Bank
FeMSEDA:	Federal Micro and Small Enterprises Development Agency
ReMSEDA:	Regional Micro and Small Enterprises Development agency
PASEDP:	Plan for Accelerated and Sustained Development to End Poverty
MoTI:	Ministry of Trade and Industry
NGOs:	Non-Governmental Organizations
OECD:	Organization for Economic Cooperation and Development

## **Chapter One: Introduction\**

For all intents and purposes, the contribution of Small and Medium Enterprises (SMEs) in spurring the development of world economy, has become an established fact. Feeney and Riding (1997) concede that by dint of their inherent potential to create jobs, unleashing the entrepreneurial spirits, laying the foundational structures for industrialization amongst many others, governments are increasingly motivated to channel their development momentum towards the promotion of SMEs at all levels. Moreover as the old economic structures of central planning give way to freer markets in developing and transition economies, SMES are by and large viewed as the bedrocks upon which the goals of the free market can be realized.

In contrast to the classical gains of multinational corporations, SMES are better suited to serve the developmental needs of poor countries than the former. Nowhere is this assertion more self-evident than in Africa where a colossal sum of 90% of all private businesses fall within the bracket of SMEs; by this same estimate their chip of the employment strata also stands at 50% with a correspondingly high contribution to the overall productivity output of most African economies (UNIDO, 1999). For instance, according to a study by Aryeetey (2001) on the role of SMEs in the development of Ghana's economy shows that a whopping 85% employment within the manufacturing sector comes from SMES, which is equally not surprising that 92% of private businesses are within this same category. The same is true for the Republic of South Africa, arguably the most advanced economy in Africa, where SMEs' contribution to the total production output is above 50% and also employers a little over 60% of the labor force of the country.

Whilst recognizing the centrality of SMEs in charting the development trajectory of an economy the full potential of SMEs have not been adequately utilized in Ethiopia. It

particularly smacks of gross failure following the almost two decades of structural reforms that began in the early 1990s following the deregulation policies of that were set in motion. The Ethiopian Central Statistical Authority (2004) states that, more than half percentage of job opportunities created in the given year are derived from SMEs and take a form of one-man business, partnership, family business and private limited companies.” Indeed, this leans credence to the existing near-universal confidence reposed on SMEs albeit the seemingly lackadaisical state commitment to this end.

The lack of appropriate policy, development strategy, and sector oriented support agencies restrain the development and expansion of SMEs. Study by Eshetu and Mammo (2009,10) stated that “Ethiopia have [has] failed to benefit from the phenomenal growth in the SMEs sector,” This emerges from the fact that the sector lacks appropriate policy, development strategy and support services. This implies that in Ethiopian SMEs operate in a difficult business environment due to the government failure in addressing the above overall problems. Among other things the lack of sources and access to finance, overregulated business environment, limited support services for innovation, technology development, and marketing limit their contribution to economic development.

In the light of the foregoing, this thesis carried out by employing qualitative methods seeks to appraise how Ethiopia can tap into the gains of the burgeoning SME development tide. It approaches the subject matter by reviewing the current state of SMEs in the country in ways that will enable weaknesses to be identified leading to the prescription of viable policy options to address the nagging concerns. To this purpose, this paper is divided into three categories, with each serving to enforce the tenets of the central thesis. The first section introduces the background stakes of the paper, the second section deals with the review of

literature and theory of the subject matter and the third section highlights the policy discourse arising out of the study with a fitting conclusion to end the study.

Taking cognizance of the foregoing, a sober assessment of the operational environment of SMEs in Ethiopia as argued in the most part of this paper reveals a barrage of challenges spanning lack of national policy dynamism, an overly regulated business sector, financing and an incoherent support mechanism. Government policies have traditionally failed to recognize the sheer enormity of the SMEs resulting in the inability to “benefit from the phenomenal growth in the SMEs sector” (Eshetu and Mammo, 2009). Government policy has prioritized the agriculture sector, with the perceived goal of bolstering the production of primary commodities as way of promoting economic development. Though well intentioned, the industrial sector has not been well served in ways that resources it to propel even field economic development.

According to a recent 2012 report by the UNDP, currently, the industrial sector’s contribution to total national out is estimated to be within the range of 13% in contrast to the agriculture sector<sup>1</sup> which stands at 43% of total GDP<sup>2</sup>. Again, though the Ethiopian economy has been experiencing relatively stable growth levels, my concern and that of other related pundits stems from the fact that much of the gains are falling through the cracks of the weak industrial sector driven by SMEs. It is also further projected that the Ethiopian economy will maintain a steady growth rate over a period of five years beginning from 2010. Given the

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1 Ethiopia’s agriculture sector is not commercially mechanized and still heavily relies on primitive production technologies as well as dependence on rain-fed processes which in and of itself is limiting the scope of overall output over the long term. The core government policy undergirding Agriculture is conceptualized within the *Agricultural Development Lead Industrialization* (ADLI).

2 See *Ethiopia United Nations Development Assistance Framework 2012 to 2015*.

scale of the developmental challenges<sup>3</sup> dogging the country, rapid growth as opposed to a steady one is what is required to pull it out of its abyss.

In undertaking this study I am guided by the need to pursue the following goals below:

Identify and analyze the national policy challenges that are inadvertently undermining the implicit development of SMEs;

Assess the credit situation in the country, vis-à-vis how that corresponds to the financing needs of SMEs across the board in their bid to expand;

To provide policy suggestions and recommendations those target the challenges and constraints of SMEs.

Thus said, it is worth acknowledging at this juncture that the process of economic development is largely a work in-progress, revolving around the fulcrum of innovation, improvement and commitment to best practices at different levels. History further proves that it is the preferred path towed by successful fore-bearers, with notable examples of coming from Taiwan and South Korea as they moved from poverty to industrialization within a short span. As a result of appropriate policies and special programs their SMEs operate in a functional business environment and have strong capacity in terms of innovation, new product and technology development, and reaching distant and foreign markets.

Therefore, it is imperative for policymakers in Ethiopia to become abreast with best practices from successful countries with the view of effectively replicating such policies by laying focus on reforming the regulatory dispensation, incorporating dynamic strategic policies as well as offering support services for the development and expansion of endogenous Ethiopian SMEs. To this end, it works to facilitate the competitiveness and

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<sup>3</sup> It remains one of the desperately poor countries in Sub Saharan Africa seeking to break the shackles of poverty and one of such measures is through the government's "*Plan for Accelerated and Sustained Development to End Poverty (PASDEP)*" agenda.

capacity of the sector thereby laying the building blocks for sustainable economic development of the country leading to reductions in poverty through improved living conditions. Besides, it is further envisaged that the findings of this study will be used for strengthening and improving the business environment of SMEs in Ethiopia. It will also use to guide policymakers in formulating dynamic policies for the purpose of achieving the broader goals of economic development. Moreover, it can serve as a source for future reference in both my academic and professional engagements.

Building on the depth of the scores of scholarly work already published within the realm of SMEs in general or much closer to home, those related to Africa, the paper will be guided by some of the established claims put forward, however, It will scrupulously fashion the claims to reflect the objectives of the study. To this end, the claims to be used are stated below:

Claim 1: The development and expansion of SMEs can be achieved devoid of policy support at all levels.

Claim 2: SMEs cannot thrive in an economy that is dogged with other more pressing development challenges such as is the case of the Ethiopian economy.

The required data for this study are mainly categorized into two kinds of data sources, namely primary and secondary data sources. The collated data are analyzed using both quantitative and qualitative instruments. In the case of the primary data, they were obtained from contacting local government agencies including the Federal Micro and Small Enterprises Development Agency (FeMSEDA) and the Regional Micro and Small Enterprises Development agency (ReMSEDA). Interviews were arranged with specific schedule officers in each of the named agencies for the purposes of verification of data as

well as getting answers for some of the questions of relevance to this current study. Regarding the secondary data, its resorted to published literature by a number of independent researchers including those by affiliated reputed institutions vested with authority on SMEs.

In order to address the overarching concerns of my study, descriptive and explanatory way of analysis technique is used for discussion and analysis. The required data are presented mostly in tabular forms and some graphical illustration. In the analysis part, the challenges and constraints of SMEs that emerges from the current policy and strategy, source and access to finance and the policy regulatory environment are discussed. This helps to identify the main obstacle that prevent the development of SMEs and used as a bases in recommending improvements on policies, strategies, facilities, and support services.

The study is only limited to identify and analyze the challenges and constraints of SMEs which emerges from the policy and regulatory framework, sources and access to finance, and lack of appropriate support services. Absence of some required data and time shortage may prevent investigation of few topics and limit the scope of the paper. Generally, the paper is mainly focus on the general problems confronting SMEs and their future prospects.

## Chapter Two: Theory and Review of Literature

### 2.1 Theoretical Definition of SMEs

There is no universally accepted definition of SMEs because in each economic system every country has its own classification according to their industrial regulation. The categorization of SMEs depends on qualitative judgment such as number of paid up employees, size of enterprise, and amount of capital employed. In Britain and USA small and medium scale industries classified based on yearly gross revenue and the number of workers they employ. In Britain small scale businesses classified based on paid up employees that do not exceed 200 and annual gross revenue of 2 million pound. Japan classifies SMEs as manufacturing enterprises with total capital not exceeding 100 million yen with 300 employees. In the whole sale trade the classification requires capital not exceeding 30 million yen and less than 100 employees. In retail and service trade SMEs classified based on total capital not exceeding 10 million yen and 50 employees respectively, Ekpenyong and Nyong (1992, p 4). This indicates that the industrial regulation of different country treat and categorize SMEs in different ways.

The Ethiopian Ministry of Trade and Industry (MoTI) defines SMEs as follows:

*Micro enterprises*: are small businesses with total capital investment not exceeding Birr<sup>4</sup>, 20,000 and excluding these enterprises with high technical consultancy and other high-tech establishment.

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<sup>4</sup> The Birr is the official currency of Ethiopia. Follow the links below for a regular updates of exchange rates, news alerts and related pieces of information about the Ethiopian Birr: <http://www.xe.com/currency/etb-ethiopian-birr>



*Small enterprises:* are businesses with a total investment between Birr, 20,000 up to Birr, 500,000 and do not include these enterprises with advanced technology and high technical consultancy.

*Medium enterprises:* are these business enterprises with a total investment between Birr, 500,000 up to Birr 1 million and including those enterprises that have high technical consultancy and excluding other high-tech establishment.

Therefore, MoTI classifies SMEs in Ethiopia based on capital investment and on the bases of establishment. This is important because the sector accounts for large businesses throughout the country so that proper definition and classification is of essence for policymakers in their dealings with SMEs.

Judging from the foregoing, it is easy to see that the main criteria for the definition of what constitutes SMEs stem from considerations of the labor pool and turnover level, also viewed as capitalization of a firm. Yet still, a number of scholars prefer to use the legal terminology to serve their definition goals. In an apparent effort to reconcile the widening gulf in conceptualization of firms, Storey (1994) takes issue with the use of size to define firms as one that is inherently limiting. The crust of his contention is that sizes vary often times based on the standard benchmark used by a specific industry. Thereby, insisting that using firm size alone lacks the tentative whims to be universally accepted.

A pioneering effort at putting forward a credible definition of SMEs began in the UK with the publication of the so-called Bolton Committee Report of 1971. The author sought to categorize his definitions in terms of a statistical and an economic model. By way of summary, the report's statistical categorization outlined three features to suit the statistical definition. They are:

1. Measuring the changing trend of a small firm's overall economic contribution;
2. How the size of the small business enterprise influences its input to overall national output measured in terms of GDP;
3. Resorting to off-road assessment to know what constitutes small firms using verifiable statistical instruments.

On the other hand the economic categorization has the following related three features as presented by the Bolton Committee:

1. A small firm is one whose management style is not within the conventional style but run along the interests of the owners;
2. The firm occupies a limited share of the total market of the industry within which it operates;
3. Its operations are independently run without representing any external parent company.

As noted in the preceding paragraph, the definitions put forward by the UK's Bolton Committee (1971), though commendable is wrought with technical difficulties in the phase of evolving trends in the conduct of businesses over the last several decades. Consequently, other attempts have come from among others the European Commission, whose chief criteria for defining SMEs<sup>5</sup> is drawn from the employee size of the firm. The European Commission has therefore defined Micro enterprises as those employing less than 10 employees. Those that employ between 10 and 99 are classified as small enterprises and those that employ between 100 to less than 500 are considered medium enterprises.

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<sup>5</sup> The definition of SMEs as used in this paper and other published work clearly excludes the agriculture sector and its constituent sections of hunting and fishing.

Storey (1994) says, by the definition put forward by the European Commission the blanket definition of SMEs in terms of employee pool is simply a labor force that is less than 500 people. Apart from aggregating the SME sector along employee lines, the European Commission's definition highlights the different subsectors within the industry to the extent that it separates them into micro, small and medium enterprises. Going by what is already known, Weston and Copeland (1998) acknowledge that the main challenge within the SME literature is the explicitly lack of consensus regarding theoretical definitions. For this reason, it is left to individual scholars to pick and choose from the definition pool the one that best suits their interest at any given moment.

## **2.2 Contemporary Scope of SMEs in African Economies**

SMEs are typically owned, operated and managed by proprietors sometimes in the form of sole or joint ownership. According to a study by Reuber and Fisher (2000) of SMEs in developing countries, most of firms under the broad category of SMEs are family owned mainly engaging the services of kindred and other related instances of hired external hands. There are cases of the externally hired hands merely serving apprenticeship roles, which in this case may not be eligible for salaries.

Schmitz (1995) posits that given the low level of capitalization of SMEs most of them tend to operate in sectors utilizing extensive laborious techniques in contrast to largely established firms. Their primary activities according to Reuber and Fisher (2000) are mainly within the areas of primary sector manufacturing, retail and trading. Again, the question of the operational activities of SMEs is also largely influenced by the location, be it within an urban setting or a rural one for that matter. Retail activities are ideally suited for urban settings where as basic manufacturing can be carried out both in rural and urban areas.

There are also related questions of national disparities when answering the question of SME activities. A country's resource availability will invariably determine the specifics of the types of activities that will take place there. It naturally behooves on a resource endowed country to allow SMEs to engage in manufacturing, meanwhile, resource endowment in and of itself is not a sufficient barometer to gauge activity. Consumer and market trends are inordinate factors that should not be left out in the equation. For instance, it is important to put into proper perspective whether products or services will be targeting a domestic market or a foreign one. Doing so requires a comprehensive analysis of imperative considerations.

In a related study Quartey and Kayanula (2000) looked at SMEs activities and operational scope in Ghana. Similar to the findings of Reuber and Fisher (2000), their study also subdivided SMEs into rural and urban operators. Within the urban group of firms there were those "formally organized" on the one hand against those that are "informally organized" on the other hand. The rural enterprises are generally informally organized and made up of individuals bonded by kinship or other forms of social connections. They engage in activities utilizing primary resources within their catchment areas. Products that typically come out of their activities include fabrics and leather, ceramic designs, blacksmithing etc.

Abor and Biekpe (2006) found that most SMEs in Africa are family businesses, with the majority of the operators being females. Because of their extensive engagement within the informal domain they are mostly not captured in official statistical recordings of national production and output. A resulting consequence of this anomaly is that they are left out in policy formulation thereby inhibiting any prospect for expansion and developments. Funding, a crucial life-line for business growth is also conspicuously denied them thanks to their informal status.

As stated in the opening section of this paper, the role of SMEs in facilitating economic and social development cannot be overemphasized, particularly for developing

countries seeking to place a foot on the development radar. Among other reasons, the level of adaptability of SMEs to changing market trends is relatively more versatile than larger traditional firms (Quartey and Kayanula 2000). When it comes to the question of job creation they are also better placed to serve this purpose than classical large firms, firstly because of the fact that their production activities tend to be more laborious in nature (See Schmitz 1995). By this singular fact their role in employment is acknowledged.

Their demand for extra labor makes them more suited to serve the employment needs of rural and sub-urban populations in ways that offers opportunities for indigenes. They are further seen as a channel through which economic activities can be distributed to reduce regional discrepancies in job opportunities—moreover they trigger a move towards enhancing income distribution thanks to the dispersive scope of their activities in contrast to huge enterprises. Unlike the huge corporations, SMEs are able to judiciously use resources at all levels thereby leading to efficiency, an important ingredient for sustainable economic growth.

### **2.3 Current Policy Related Challenges of SMEs**

Policy and regulatory problems constitutes the primary obstacles for the growth and expansion of SMEs. An ECA (2001) report attributes the challenges faced by SMEs to the legacy of past structural economic<sup>6</sup> and industrial strategies used by a good number of African countries but most crucially the inertia of transition is by far the most conspicuous fallout factor. Indeed, the ECA finding is more of a buildup of Spath (1992), as they both points to a number of hurdles for SME development in Africa. First, discriminative policies

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<sup>6</sup> The geopolitical atmosphere of post-independent African states pegged them between the choices of Western backed capitalism or the Eastern socialism/communism. A significant number of African countries opted for the latter, with the failuræ of communism as an economic model the stage was thus set for transition, of which African countries are part of.

set against SMEs. This is mainly informed by a lopsided favorable view of for large industrial corporations at the expense of smaller ones. Second, high degree of centralized administration and decision making practice which implies policies are formulated and controlled by central authorities. Third, the misguided notion of industrialization has resulted in the promulgation of fiscal policies that ultimately offers seductive tax breaks for large corporations without due consideration for related factors of growth promotion for indigenous industries.

A 2005 World Bank report discussing SMEs in Africa cited red tape and injurious regulatory business climate as yet another source of impediment for operating SMEs. Consequently, under such a milieu SMEs have to reckon with one of the following options-- to struggle with compliance or be relegated to the informal sector. Suffice to acknowledge that regulations by themselves are an integral part of governance, they only become a problem if they act to militate against growth and expansion and undermining overall profitability.

Working in the informal sector prevents SMEs from obtaining available limited services like borrowing from the formal sector, getting work permits, training, and other related services (Eshetu and Mammo 2009, 12-13). By this governments dent their credibility as facilitators for the creation of functional and attractive business environment for business to thrive and grow the economy with it.

Policy formulation and strategic development of SMEs is literally controlled by central authorities and do not allow participation of owners who run their business in this sector. As a result, policies, strategies and support services are not alleviating the problems of the sector. ECA (2001,39), asserted that, “policy makers intending to foster the development of a particular industry sector should be aware of the great benefits of sector-oriented

institution and the importance of SMEs' involvement and participation in policy design and intervention.” The involvement of SMEs and support institution in the formulation of policy and development program will allow policymakers to understand the problem of the sector and help them to develop appropriate policy, strategy and various incentive schemes.

## **2.4 SMEs in Japan, South Korea, and Taiwan**

As I seek to make a strong case for SME development in Ethiopia, it is prudent to make reference to contemporary mavericks in the SME rhetoric with the view of setting the mode for learning for best practice cases that can potentially be replicated and where possible improved upon to fit the circumstance of Ethiopia. Under such a scenario, Taiwan, Korea and Japan will be critically evaluated in ways that will highlight their peculiar cases.

### **2.4.1 SMEs in Taiwan**

SMEs sector has been very phenomenal in the economic development of Taiwan. Today Taiwan is a home of around 1.4 million innovative SMEs which represents around 98% of all businesses. The government of Taiwan formulates and implements a number of policies and special programs to create first class environment for growth and development of SMEs. In 1997 the government of Taiwan established incubator centers to enhance the start ups, development of new products, and new technology of SMES. According to Gilberto M. Llanto “the incubator centers provide SMEs with space and facility as well as technical, manpower, commercial, information, and administration supports, funding, and managerial service.” (2010, P. 4). The incubator center plays a vital role in enhancing the competitiveness and capacity by being a regional innovative center.

The Taiwan government adjusts and revises its SMEs development strategy and policy with the aim to overcome constraints and to create a legal and regulatory environment

conductive to SMEs business to reflect the changing dynamics of the country's economic system. New policy and programs are being implemented to create activities that can boost innovation and upgrading of the sector. Gilberto M. Llanto (2010) states that currently "the government of Taiwan encourage SMEs to focus on research and development (R&D), new technology application, brand development, and marketing activities." Two programs are launched for the implementation of this policy such as Small Business Innovative Research Program which supports innovation and Assistant Service Sector Technology Development Plan which subsidize innovative technology service facilities for SMEs. It clearly points to R&D as the backbone of the advancement of SMEs.

The financing mechanism of SMEs is almost the same with South Korea, in Taiwan the government and private banks have an obligation to lend certain percentage of their total loan to SMEs. In addition, SMEs also have loan facility from different sources. The government set up "SMEs Development Fund, which has also established a number of SMEs Development Corporations. Besides ensuring credit facility to SMEs, the corporations also provide assistance with domestic and intentional technology collaboration, market and product development and management consulting services" White Paper (2009, P. 241). By this move, it ensures that sources and access to finance for small business are made available thanks to their credit guarantee mechanism and the Development Fund that provide over 24 different types of loans. The policy to finance SMEs in Taiwan is implemented through the "Three Support Policy" mechanism which implies that government supports the bank, the bank support business enterprises, and business enterprise support employees.

The SMEs Guarantee Fund is the largest and specialist guarantor of funds and its main target is to provide collateral needed to secure the loan for SMEs. The Guarantee Fund encourages financial institution to provide their loan to SMEs and provide 20 different credit



guarantees to the sector, White Paper (2009). In addition, guarantee services, venture capital play a considerable role to the growth of SMEs not only providing capital but also ensures management assistance. Moreover, the government of Taiwan made a considerable effort to enhance the development of SMEs through its policy and special program by ensuring faire and equitable working environment, finance support, and a number of support services. On the other hand the Ethiopian SMEs lack the above all important support services and special programs.

#### **2.4.2 SMEs in Republic of Korea**

Corresponding to Taiwan, SMEs play a vital role in economic development of South Korea. Currently there are three million SMEs representing 99% of all enterprises throughout the country and employ around eleven million people, Gilberto M. Llanto (2010). Until 1980 the development plan of the government favored large scale firms or conglomerates and neglect SMEs. Specific policy measures and special programs were implemented to promote the development of SMEs by providing various incentives, supporting innovation and R&D activities, and ensuring sources and access to finance.

To implement various policies and special programs the government established strong coordination and network between all 70 public and private organizations which support SMEs sector. The three most important players are, The Small and Medium Industry Bureau (SMIB), which responsible for harmonization and take action for the implementation of policies. The Korean Federation of Small Business (KFSB) is in authority to create coordination among rural and urban SMEs, make available government backed endowments, loans, and exemption of tax. Small and Medium Industry Promotion Corporation (SMIPC), is responsible for various activities such as to create financial and technical program, to

coordinate all 70 support organization, and to promote joint venture and sub contracting, Philippe Regnier (1993, P 29). This shows that the government is committed to ensure appropriate business environment through addressing the financial and non financial needs of the sector.

Korean SMEs begin business with lower capital in contrast to Japanese. But in Korea the monetary policy require banks to provide a credit facility of certain percentage from their total loans (Joo Park 2001 P.851). The government used mandatory credit extension system to enforce private and stated owned banks to provide a certain percentage of their loans to SMEs. Moon-Soo Kang (2000). For instance, all commercial banks in Korea are required to extend above 45% of their total loan to SMEs. The mandatory credit extension and other alternative systems alleviate working capital problems of the sector.

In addition to mandatory credit extension system, the government develops the Korea Credit Guarantee Fund (KCGF) and the Korea Technology Credit Guarantee Fund (KTCGF) to arrange and impart the guarantee businesses for SMEs that have difficulties in qualifying for bank loans. As a result of credit guarantee mechanism SMEs which lack adequate collateral can easily access available credits in formal financial banks, Philippe Regnier (1993, P.29). Therefore, this can be an important best practice that can be easily adopted to alleviate financial problems of SMEs in Ethiopia. Especially mandatory credit extension system and credit guarantee service is an effective policy that eliminate keen financial problem of SMEs.

### **2.4.3 SMEs in Japan**

In the past decades Japan has recorded a remarkable economic growth with its industry being highly competitive in the world. The secret behind achieving this economic

success is in many ways credited to the small business sector. Government has prioritized the sector through creating strong inter-firm linkage and applying state of the art management system. In the past when developing countries restructure their industry, Japan made the first move to give priority to SMEs sector because they believe that the restructuring and development of industry will not be achieved without developing the small business sector. But in a country like Japan SMEs prove that they accelerate economic growth with innovation and growth potential and serve as a means for large scale industry.

The government ensure enabling business environment through various appropriate policies and support programs. The government of Japan ratify a law called “Creative Business Promotional Law (CBPL)” in 1995 to provide appropriate support and assistance for SMEs effort in innovation, R&D, subcontracting and market activities, and encourage new entrants in to the business. Honjo and Harada (2006) noted that the newly enacted law addresses all support services for SMEs such as support for innovation, technology, and marketing as well as it responds to the financial problem by ensuring loans and guarantees. Moreover, the regulation provides a fiscal incentive which includes subsidies and tax breaks. This is to show that government involve from encouraging entrants to the business till market activities to accelerate the development of the sector.

In order to respond to the financial need of SMEs, Japan established a strong financial support mechanism through local banks and credit cooperatives to finance the sector with no collateral program of People Finance Corporation, Joo Park (2001). This shows that the financial policies address the primary problem of SMEs to obtain credits for formal financial sector which is collateral. In addition, Japan has unique financial system Honjo and Harada (2006) stated that in Japan banks have classifications based on their ranks, and these small financial sectors such as credit associations made great contribution in ensuring funds to

SMEs (p. 290). This shows that the Japanese banks are classified in to class of banks and service directly SMEs. Shinkin bank is established in 1951 and they are cooperative regional financial institutions serving SMEs and local residents. Generally, appropriate policy in terms of incentives, innovation, finance, and marketing are more or less addressed for SMEs.

Generally, these three leading country in SMEs development, especially South Korea and Taiwan develop and implement several similar policies and development programs to enhance the development of SMEs. Their common strategy is to develop functional business environment for SMEs through appropriate and equitable policies and regulation. Both countries develop a systematic approach to alleviate the financial, support services, and policy problems. Therefore, to enhance the development of SMEs in Ethiopian focusing on this best practice is the best strategy.

## **Chapter Three: Findings and Discussions**

### **3.1 Economic Share of SMEs and their Status in Ethiopia**

In 1992, Ethiopia's new government pushed through reform to the business environment leading to deregulation to support the pillars of its embrace of the free market economy. Consequently, Legislative Act no 36/1998 became the reference point for the economic reforms which hammered entity and ownership laws, investment incentives, labor law, immigration and work permit, settlement of dispute, guarantee and protection, investment administration and access to land.

The Act further allows enterprises to operate and run their business without intervention of the government. The removal of price controls, flexible labor code, liberalization of foreign trade and exchange were also part of the reform agenda. The

government also privatizes various state owned enterprises and completely removes capital ceilings which are imposed by the previous military government. By these reforms, the stage was thus set for the private sector to participate in economic activities by breaking the state monopoly Befekadu and Berhanu (2000). By all accounts they constituted marked improvement from the previous state of affairs. This notwithstanding, whilst deregulation in its apparent form is well-intentioned it only served the interest of the giant corporations as stated earlier in this paper.

After the Ethiopian government's sweeping economic reforms geared at improving industrial production amongst many other objectives, the gains have not been adequately reflected on SMEs as mentioned in earlier sections of this paper. In their current state, SMEs account for the main share of non-agricultural employment in Ethiopia, yet due to the reasons articulated in previous sections, its full potential in reducing poverty has not been fully tapped.

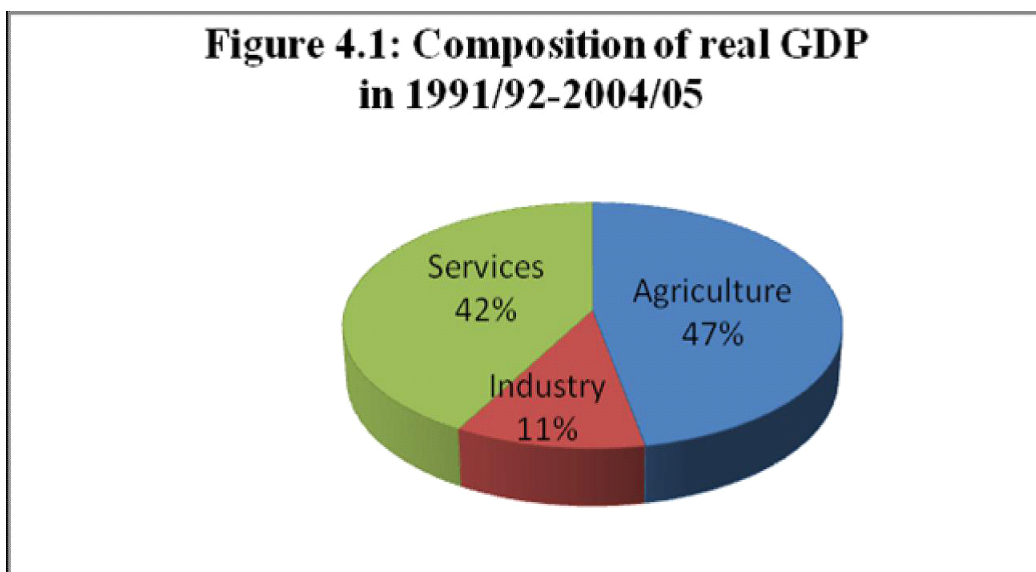
Largely due to the lax in the productivity of mechanisms of SMEs they are incapacitated in reducing poverty in real terms (Aftab and Rahim, 1999). Chief among the reasons for this trend as raised by Aftab and Rahim (1999) is the level of enumeration for employees of SMEs. The income generated from their activities is very meager in gross and real terms, incapable of breaking through the poverty cascade. This is true for Ethiopia cases that majority of skilled and unskilled workers are employed in this lower productive sector. As a result the sector is not playing its role to alleviate the level of poverty through ensuring higher level of income to the poor.

It further smacks of ineptitude given that micro, small, and medium enterprises are the largest businesses in Ethiopia which accounts over 98% of all business firms and out of this figure the small firms represent around 65% of all businesses in the country. (See Aregash A.

2005). This translates into an enormous potential to contribute to economic development and improve the living standard of the people with a corresponding potential to grow faster than larger contributions.

Unfortunately the industrial sectors including SMEs did not grow as fast as service and agricultural sector; as a result it's potential to contribute for economic development is near to the ground and is not even partially utilized. In addition, currently the service sector contribution is surpassing the agricultural sector. This is because of that the industrial sector which provides advanced technology to agricultural sector is not developed in first place. Especially SMEs that can be used as a means for the development of large-scale firms did not get a favorable business environment. Eshetu and Mammo (2009, 13) opine in a study targeting SMEs that out of a total sample of MSMEs in their study, 74% of the respondents replied that the legal, regulatory, and development strategy problems are the main obstacles for their growth. Therefore, as long as this sector remains under-developed the quest to wrestle down poverty will remain illusory.

Figure 1: Composition of real GDP



Source: Ministry of Finance and Economic Development of Ethiopia (2005)

In terms of contribution to total output, it is evident from Figure 1 that the industrial sector's contribution is very low relative to other sectors such as agricultural and service sector. During the above stated period the industrial sector contributes only 11% to the national GDP and creates 22% of total employment at that year. The manufacturing sub sector contributes about 7% including SMEs. It is therefore telling that creating a functional business environment for the sector will accelerate the growth of the national economy.

### **3.2 The policy and Regulatory Framework**

Recall that it was mentioned earlier in this paper that government policy bias favoring larger corporations was cited as a challenge for development of SMEs. They take the form of various incentives targeting the large corporations under the guise that they will speed up industrialization. For instance, in the last five year development policy, dubbed the “Plan for Accelerated and Sustained Development to End Poverty (PASDEP)” is a proof for the above claim because the plan grants various financial and nonfinancial benefits for large scale firms. The PASDEP provides mechanisms to waive taxes on imported raw materials and industrial machineries specifically for textile and garment, cement and steel, meat and leather, and sugar industries with little benefit for SMEs (MoFD, 2006).

The absence of government commitment to ensure an enabling business environment and enhance the capacity of SMEs is another obstacle. According to World Bank (2005), in developing countries such as Ethiopia the legal and policy framework that govern the business environment is heavily regulated. Consequently SMEs' operate in this difficult policy and regulatory environment have two alternative options; to compliance with rules and regulations and or to operate the business in informal manner. But study shows that, conforming the regulation create a problem for SMEs operation in terms of expansion, access

to competitive market, and securing profit. Working in the informal sector prevents MSMEs from obtaining available limited services (Eshetu and Mammo 2009, 12-13).

Table 1, Regulatory environment in African countries: Current state and recent changes

	Current State			Change		
	Enabling	Variable	Disabling	Improved	Same	Deteriorated
Cameroon			•		•	
Côte d'Ivoire		•		•		
Ethiopia			•		•	
Gabon		•			•	
Kenya		•		•		
Mauritius	•			•		
Morocco		•		•		
Namibia		•		•		
Nigeria			•		•	
Senegal			•	•		
South Africa		•		•		
Tunisia	•			•		
Uganda			•		•	

Source: Economic Commission for Africa (2001)

As indicated in Table 1, from the thirteen African countries the current regulatory and policy environment of Ethiopia for the enhancement of SMEs is disabled without any signs of improvement. According to ECA (2001), the regulatory and general business environment has had adverse impacts. Therefore, the general legal and regulatory environment over which SMEs operate is the primary impediment for their growth and expansion. As stated in the table, Mauritius and Tunisia are clearly set on course for SME for the proliferation of the sector through flexible regulatory structure and alleviating the financial need of the sector.

As it was mentioned in the literature review of this paper majority of challenges and constraints come out from the policy and regulatory frameworks of the government. It is the policy and development strategy that the government can use in order to shape the economy



and create enabling business environment. Eshetu and Mammo (2009, 13) opine in a study targeting SMEs, that out of a total sample of 500 MSMEs in their study, 74% of the respondents replied that the policy, legal and regulatory problem are main obstacles which includes registration and licensing process, high custom duties and taxes, corruption, and sources and access to finance. Especially, the development and expansion of SMEs is severely constrained by lacking alternative means of finance.

### **3.3 The Challenges of Sources and Access to Finance**

SMEs in Ethiopia, like in most developing countries are confronted with the same challenging of accessing financing in their bid to expand. Mainstream financial institutions are not willing to provide loans to the sector rather large amount of money is given to large scale firms. Eshetu and Mammo (2009, 15) states that, “commercial banks are reluctant to lend small amount of money to small business because the cost of administering the loan exceed the benefit accrued to them.” This shows that banks are not inclined to develop an innovative and systematic approach that minimizes risk and administrative cost to serve the sector. As a result the traditional approach used by banks and financial institution does not enable them overcome the risk and transaction cost of lending to SMEs (ECA 2001, 12).

The monetary policy of the government does not compel banks to extend their loans to SMEs. Mulu (2007) and Etsegenet (2000) shows that about 76% of SMEs obtain their startup and expansion capital from informal financial sources such as, own saving, money lenders, relatives and friends. The table bellow shows the principal sources of capital for MSMEs based on selected 500 small businesses and enterprise in Ethiopia. As indicated large portion of capital around 41% is come from own saving and friends and relatives are the second largest financial sources for MSMEs which amount 18% respectively. However, as it can be seen from the table the formal financial sector which can be used as a primary source

of finance have a low ranking order in terms of contribution. Banks and micro finances contribute only 8% and 9.2% which is lower than friends. This forces SMEs to rely on informal financial sources for their financial need but the credit facility through this informal sector creates disadvantage for SMEs.

Table 2: Principal source of initial capital of MSMEs

Source	Micro	Small	Medium	Total (%)
Banks	1.9	14.8	36.7	8
Microfinance	17	7.4	3.3	9.2
Iqqub schemes (social capital)	13.2	12.1	3.3	11.8
Friends and/or relatives	11.3	19.2	26.7	18
Own saving	40.6	42.9	23.3	41
Donation	5.7	3.0	16.7	4.8
Moneylenders	10.4	6.9	3.3	7.2
Total	21.2	72.8	6.0	100%

Source: Eshetu and Mammo, (2009)

This indicates that the financial sector in Ethiopia is not adequately developed, coordinated and lacks competition. The lack of alternative financial sources and access increases the difficulty of obtaining credit facilities for SMEs. Mulu (2009) identifies that “the financial markets in Ethiopia are underdeveloped and most of the small firms rely on the informal market for external finance. Policy makers, therefore, need to facilitate alternative channels of access to finance for small firms” (P. 17). This implies that due to weak competition and undeveloped financial markets, SMEs face serious problems lacking sources and access of capital for startup and expansion.

Funds and their accessibility in formal banks remain in principle and banks are reluctant to serve SMEs. It is inferred from Table 3 that in Ethiopia, in terms of the

availability and accessibility of credit facility from formal banks remains very low. Moreover, instead of formal banks that are responsible to extend their services to SMEs, the availability of finance by NGOs is higher (ECA 2001, 27).

Table 3: Availability and access to loans in African countries

Commercial and Development Banks							NGO Finance		
Availability			Accessibility				Availability		
	High	Medium	Low	High	Medium	Low	High	Medium	Low
Cameroon			•			•		•	
Côte d'Ivoire			•			•		•	
Ethiopia			•			•		•	
Gabon			•			•		•	
Kenya		•				•	•		
Mauritius		•			•			n.i.	
Morocco		•			•				•
Namibia						•		n.i	
Nigeria		•				•			•
Senegal			•			•			•
South Africa	•				•			n.i	
Tunisia	•				•				•
Uganda			•			•	•		

Source: Economic Commission for Africa (2001)

Notwithstanding their salient role as drivers of economic growth, financing has been cited as a primary factor that negatively affects the development and expansion of SMEs in Ethiopia, indeed as many other developing countries. Out of a sample of 100 SMEs questioned, 87 of them cited financing as their number one constrain. In response, banks contend that shy of accessing to finance, there are related complications arising from legal and regulatory bottlenecks that hamper their overall ability to extend credit to lenders from the SME sector—thus leaving an undiversified financing market for SMEs.

Indeed, as a consequence debt financing has become a very sticky point in the development and capital mobilization efforts of SMEs across the board. In an ideal world, financial institutions including banks should entertain no fears in extending financing options to SMEs, but under conditions such as those that prevail in Ethiopia, one that is informed by an interconnecting legion of problems it will be appropriate to holistically understand them appropriately as the first step towards resolving them. For instance, domestic financial institutions are haunted by very high risk perception; the absence of intermediary skill factors also speaks of a related complication, and then comes the question of the scope of the capacity of SMEs to be viable and competitive.

Strictly speaking, the issue of debt financing for SMEs as a problem is not exclusive to Ethiopia, but one that has dogged many developing countries. Most of debt financing to SMEs by the banking institutions often goes into OECD countries, further proven by a recent IFC Report which states that a very meager 20 percent of SMEs in non-OECD member countries are serviced by the top five leading investment banks<sup>7</sup>. Whilst this figure holds true for non-OECD countries, generally Africa's chunk within the 20% figure stands at almost 5%. It evidently points to a serious challenge that cannot be overlooked.

The financial regulatory environment in Ethiopia gives a near monopoly status for banks thus shielding them from the possibility of external competition. In that regard the motivation to extend beyond their core markets with motivated by threats of entry is ostensibly coiled. Banks are therefore in the business of extending credit to large enterprises, with some sense of guaranteed profiting. The natural inclination is to remain within their core

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<sup>7</sup>See details in IFC, (2011) "Posing the Challenge on SME Finance" DFI Meeting Paris, March 2011.

market as long as the returns are good without neither incurring risks nor threats from competition<sup>8</sup>.

Another dimension to the financing constraint by Ethiopian banks has to do with their own internal limitations of running their operations on short-term liabilities mainly from the deposits of customers as opposed to resorting to long-term liabilities from sources such as pension funds which have on average longer maturity periods. Under such a condition, there is just so much that banks can do in terms of extending credit to customers including SMEs. Besides, domestic banking and financial regulation in Ethiopia does not encourage banks to aspire to solicit long-term maturing liabilities, especially those that can facilitate aggressive lending.

Other factors also come into play when considering the possibility of extending credit to a customer, such as the financial standing of the borrower. Under a dispensation characterized by coarse accounting procedures that provides little to no relevant information about financial standing becomes a disincentive for lending. Banks would have to resort to the so-called relationship-based lending process, which may be substituted for demands for huge collaterals. On the question of capacity, it is apparent that both lenders in this case banks and borrowers from the SME sector are battling the same challenge, to the extent that banks are not able to establish the definitive terms of credit worthiness within the domestic market.

Taking cognizance of all the factors discussed above, the natural inclination for banks to enter the SME market albeit some reluctance is to push all the attendant risks into higher

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<sup>8</sup> Paul Collier, "Rethinking Finance for Africa's small firms". Proparco Private Sector Development, Issue 1, May 20

than average interest rates for borrowers. Interest rates currently stand at almost 9 per cent in Ethiopia, as shown in the table below.

Table 4: Interest rate spread at Ethiopia banks

	Interest Rate Spread		Lending Rate		Deposit Rate	
	State-Owned	Private	State-Owned	Private	State-Owned	Private
2006	5.0%	6.0%	8.0%	9.0%	3.0%	3.0%
2005	5.0%	6.0%	8.0%	9.0%	3.0%	3.0%
2004	5.0%	6.4%	8.0%	9.4%	3.0%	3.0%
2003	5.0%	6.5%	8.0%	9.5%	3.0%	3.0%
2002	5.0%	6.4%	8.0%	9.4%	3.0%	3.0%
2001	4.5%	5.4%	10.5%	11.4%	6.0%	6.0%
2000	4.5%	5.3%	10.5%	11.3%	6.0%	6.0%
1999	4.5%	5.0%	10.5%	11.0%	6.0%	6.0%
1998	4.5%	5.0%	10.5%	11.0%	6.0%	6.0%

Source: Reported from kiyota (2007)

There is reason to question the role of collateral demands in facilitating loans programs, one that is based on an entrenched weak legal environment capable of sternly enforcing property rights and indeed the enforcement of other related forms of contract. For the most part, SME owners are often lacking specified title deeds to properties cited for possible collaterals.

In light of the difficulty associated with debt financing for the growth and expansion of SMEs, it has become increasingly imperative to consider alternative arrangements all within the framework of improving the funding accessibility for SMEs in general. One of such recent innovations would be to consider allocating an increase role for international financial intermediaries in serving the sector. In some respects international financial intermediaries fit within the caveat of the aid policy discourse of most donor countries. It is worthy of note that the term international financial intermediaries is used to loosely refer to

the range of development financing institutions that have been operational for decades in developing countries, including Ethiopia<sup>9</sup>. By this association, their experience in development in its holistic sense can be leveraged for the extended cause of development. It also comes with the added advantage of placing premium on sustainability and efficiency within its overall operational goals.

Financial intermediaries have acclaimed a wealth of experience in financing SMEs based on a cardinal set of priority objectives that have facilitated the broadening of the space for financial accessibility, promoting the growth of SME ultimately supplemented by the assertive development of the private sector<sup>10</sup>. A plausible area for international intermediary institutions to address some of the nagging bottlenecks to overcoming financing challenges is to make available capital alongside their regular technical support programs to ensure that long-term assert liabilities can be readily put on offer to extend lending.

Another crucial ligament worth consideration is the question behind public involvement in the management of SME financing. Indeed, this comes against the backdrop of explicit doubts about the ultimate efficiency of government involvement in financing SMEs<sup>11</sup>. Some of the main factors accounting for this supposed lack of confidence in direct government involvement in lending to SMEs has to do with the wave of political undercurrents that turns to take precedence over legitimate economic considerations. Domestic special interests that often characterize the direction of government policies are not directly capable of standing in the way of the economic ends desired by external financial

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<sup>9</sup> Some of the major international development financing institutions includes the World Bank, IMF, DANIDA, ADB and AfDB. Most of them operate in partnership with governments across the various operational regions.

<sup>10</sup> The 2010 Seoul G20 Summit amongst other things recommitted to the goal of pursuing innovative ways of financing SMEs in developing countries as a means to sustainable development.

<sup>11</sup> A Comprehensive review can be seen from “Scaling-Up SME Access to Financial Services in the Developing World, Financial Inclusion Experts Group, SME Finance Sub-Group; October 2010, International Finance Cooperation, World Bank Group, G 20 Seoul Summit 2010.”

institutions, who work in concert with intermediaries to implement programs, which is consistent with SME growth.

### **3.4 Laying the Foundations for the Development of SMEs**

Having discussed the question of the constraints to the development of SMEs, spanning the financial and regulatory limitations this section will be shifted to how to steer them to growth by augmenting the foundational pillars for effective takeoff. The first point of interest has to do with the provision of incentives--incentives are important for SMEs because it allows them to strengthen their capacity to engage in greater production and innovation. Incentive schemes should be directly tailored to the need of the sector. One such way to achieve this is to leverage the tax regime through provisions under the custom duty and other related taxes.

It ultimately offers the seedbed for the promulgation of innovation activities with the added benefit of efficient utilization of scarce resources. Fiscal incentives as mentioned above have the inherent tenacity to free up resources for expansion and innovation. It also affects the way accumulated capital and the existing endowments are exploited (Lall, 1992:171). This is to show that incentives are a mechanism to strengthen the capacity and competitiveness of firms.

Additionally, consistent efforts should be put in place to ensure access to technology and skill development. Gebreeyesus (2009) contends that supporting the innovation activities of SMEs through improving their technological capacity and technical skill is not only used to strengthen the competitiveness of the sector but also used to create alternative job opportunities. In a country such as Ethiopia, where cutting-edge technology and its diffusion is virtually non-existent it is imperative to look into that sub-section with keen interest. Given



such support enterprises will be able to focus their attention on innovation and new product development.

Whilst true, SMEs across the country are confronted with the lack of technical skill and business knowhow. Owners technical skill and business knowhow is inadequate to engage them in new product and technology development. Managerial competence through skill development and capacity building is an indispensable ingredient required to navigate through the competitive and dynamic contemporary business environment, if for no other reason at all on the global platform.

For the simple reason that SMEs are dogged with lack of managerial competence and robustness to transform themselves into viable profit entities, because of reasons which are both internal and external, it is imperative to explore ways of mitigating the challenges. As a result, Support services for SMEs are a critical means for their competitiveness and growth. Going through the market dynamism phases is an integral facet for the consolidation of the existing gains—these include elements of innovation in management and product development.

## **Chapter Four: Conclusion and Recommendation**

There is no gain denying that in our contemporary dispensation, SMEs are an important economic development engine by dint of their ability to churn out new ideas and innovation, bolster job creation, serve as the seedbed for nurturing the industrial base of an economy and above all a viable income generator source for fighting poverty. Indeed, needless to say that the optimal gains for the Ethiopian economy granted SMEs are developed will trigger a corresponding windfall in economic progress as itemized here. The country's quest for industrialization will be bolstered by promoting even growth in ways that shifts focus from the current state of agro-dependence that characterizes the economy.

As a sector, its collective impact is judged by offering salient employment for both skilled and unskilled labor. With this in mind, government policy should take keen interest in incorporating this facet of development to drive the quest for national development by crafting the policies to facilitate a favorable business environment suitable and attractive not only for the development and expansion of SMEs but also for large scale enterprises in a way to attract domestic and foreign investors.

Even though SMEs are a potential source for economic development of Ethiopia the sector has not received a commensurate policy attention thereby hamstringing its capacity to access to finance as well as a poorly regulated dispensation. A glaring weakness is revealed in the contents of the five year development plan of the government of Ethiopia, which ostensibly places premium on the expansion and growth of large scale firms whilst giving little to no focus for SMEs. As a result SMEs are beset by poor product quality, low productivity, absence of innovation, and lack incremental growth over several years.

Access to finance has emerged time and again as a critical congenital limitation to the success of the sector. They typically come with consolidated demands for collaterals, high interest rate payments for procured loans amongst many others. A critical legacy is the fact that mainstream financial institutions turn to shun SMEs, and an over-regulated financial sector in the country further conspires to entrench this sad state of affairs for burgeoning SMEs.

Generally, majority of the constraints and problems in relation to the sector appears from government policies and development strategies. Thus, the focus should be on pursuing alternative mechanisms as principally argued here that deregulating the banking and financial sector to make room for international financial intermediary funding with its wealth of technical expertise to augment the credit acquisition process for SMEs.

It is also not farfetched to make a case for fiscal policy support for SMEs, alongside such concessions as simple business registration and licensing, reduction of unfair custom duties and taxes, elimination of differential treatment of trade policies and incentives, and creation of new financing mechanism to serve SMEs. Moreover, special incentives programs such as no custom duty for imported machinery and equipments, lower or fixed tax rates, sharing costs of credit at the bank, and tax exemption for all imported raw materials.

To overcome the financial problem of SMEs the government should ensure access for credit service from banks and other financial institutions. Through using the monetary policy that governs banks, the government can enforce public and private banks to extend loan quotas to SMEs which is under a so-called “mandatory credit extension system”. Simultaneously the government should give practical assistant and consultancy for banks and financial institutions in order to create an effective mechanism that reduces the cost and associated risk of lending to SMEs to create mutual benefit. In addition, one powerful

mechanism to alleviate the financial problem of the sector is establishing a formal financial institution or bank to facilitate and provide loans at lower interest rate, flexible and affordable collateral, and long repayment period to secure the financial needs of SMEs.

To encourage innovation and new product development in SMEs, the government and support agencies should focus on providing appropriate training to improve technical and managerial skill of enterprises owners. Provide support for R&D activities, establish business development centers, and create inter-firm linkage through various business premises. Moreover, to accelerate innovation and entrepreneurial activities of SMEs the government should support and facilitate the acquisition of new technology and skill required to operate machinery. Support services for the acquisition of new technology and skill development will lead SMEs to acquire the necessary tools for innovation, where as this can increase the capacity and productivity of SMEs.

The Ethiopian government should learn and implement best practices and special programs from other countries to alleviate the problem of SMEs and ensure their development because such best practices are already implemented and become effective. Ethiopia should learn from South Korea and Taiwanese legal, policy, and development strategy for SMEs because the two countries implement diverse policies and special programs. The credit guarantee system, incubator centers for innovation and development, market supports, and enforcement of banks to lend their credits to SMEs are important practices. In addition, African countries such as South Africa and Mauritius develop and implement effective policies and programs which ensure access to market, technology, and infrastructural facilities.

Generally, the above best practices should be adopted to overcome the problems and constraints that emerge from lack of appropriate policy and development plan. By way of the

possible direction of future research work on the question of enhancing the development of SMEs in Ethiopia, it will be appropriate to consider how the government of Ethiopia can use macroeconomic policy and its regulatory leverage as a tool to make the general business environment suitable and attractive for the growth and expansion of SME. Crucially, all the issues discussed in this study are direct precincts of government policies, which for all intents and purposes are not cast in iron and stone. Another plausible area of research interest includes the credit guarantee system and the mandatory credit extension system from banks.

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