



Small and Micro Enterprises (SMEs) Development in Ethiopia: Policies, Performances, Constraints and Prospects

1. Introduction

The Micro and Small Enterprises (MSEs) are described as the natural home of entrepreneurship. Most big businesses in Ethiopia have started as SMEs and have grown to their maturity over long period by cumulating capital and business management experiences.

Despite the importance of SMEs in the national economy, no significant studies have been conducted on the sector. Having identified the research gap, a study entitled “**Small and Micro Enterprises (SMEs) Development in Ethiopia: Policies, Performances, Constraints and Prospects**” was conducted and published by EEA in 2014.

This is a brief report of the key findings of a study on ‘Small and Micro Enterprises (SMEs) Development in Ethiopia: Policies, Performances, Constraints and Prospects’. The full report can be obtained from the Ethiopian Economics Association, Report on the Ethiopian Economy, 2014.

2. Summary of key Findings

2.1. The Recent Performances

2.1.1. Growth

The promotion of MSEs is one of the strategic directions pursued by the government during the GTP implementation period (2010/11-2014/15), focusing on promoting the development and competitiveness of MSEs. The various business and public development programs have been used to promote the development of SMEs and generate employment opportunities.

Of SMEs, the small scale and cottage manufacturing industries has grown, on average, by 4.8 percent during the first three GTP implementation years which is lower than the average growth (6.0 percent) registered during preceding plan (PASDEP) period despite heavy promotion activities. Moreover, SMEs engaged in manufacturing activities have been growing by rate slower than the growth by large and medium scale manufacturing industries over the last decade.

The share of manufacturing SMEs in GDP has declined from about 1.6 percent in 2004/05 to 1.3 percent in 2012/13. Despite the significance of their number in the economy, their share in GDP is lower than the share of large and medium scale manufacturing industries throughout the period.

2.1.2. Number of SMEs

The Growth and Transformation Plan (GTP) envisages creating a total of three million Micro and Small-Scale Enterprises (MSE's) at the end of the Plan period. According to the Federal Micro and Small Enterprise Development Agency (FMESDA), a total of 70.5 thousand new MSEs were established in 2011/12 employing 806.3 thousand people across the country. The performance is below the target set in GTP.

As there has been SMEs graduating into medium size enterprises, there are also those dying ones due to a variety of reasons. These developments tend to reduce the number of SMEs actually operating and the size of employment in the sector.



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2.1.3. Employment

Of the arguments in favor of the promotion of SMEs, the creation of employment for urban youth is the major one. According to FMSEDA, jobs created by SMEs have been growing since 2010/11. The total number of jobs in 2010/11, 2011/12, 2012/13 and the first 9 months of 2013/14 were 289 thousand, 806.3 thousand, 1223.7 thousand and 963.8 thousand, respectively.

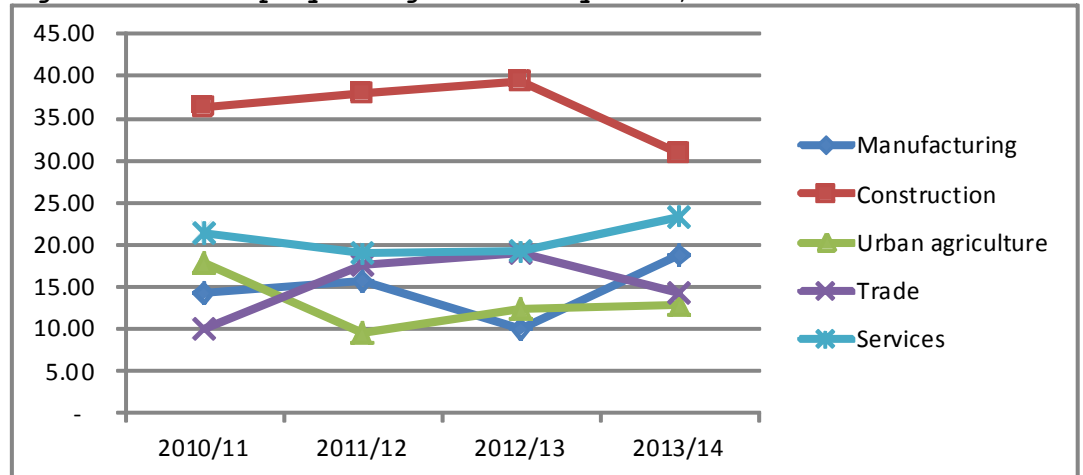
Disaggregation of SMEs by sub-sectors enables us to see the relative importance of each sub-sector. It also enable us to judge whether the performance is going as planned in meeting the other objectives, other than job creation, such as facilitating technology transfer, creating and strengthening linkages with medium and large scale industries, etc. According to the data, the biggest employment has been generated by the construction sector, accounting, on the average, for about 36.2 percent over the four GTP implementation years, followed by services with 20.8 percent, trade with 15.2 percent, manufacturing with 14.7 percent and urban agriculture taking 13.1 percent over the four GTP implementation years (see figure 1).

The biggest issue which requires close scrutiny is the sustainability of the established and operating SMEs. Unless the established enterprises continue graduating to higher scales or at least continue to survive, unemployment will increase. The major sustainability challenging factor is the rising living condition in urban centers. This is because the income that is generated by the majority of SMEs fall short of covering the basic expenses of those operating small businesses in urban areas thereby compelling them close down and search for other better paying jobs.

2.1.4. Credit to SMEs and Repayments

The initial capital for SMEs emanate from diverse sources, the major one being loans. Since most MSEs lack the initial start-up capital, facilitating access to loan would definitely help establish new SMEs and address working capital problems of existing ones. All those SMEs which have accessed loans for their businesses may not repay their debts as scheduled due to variety of problems.

Figure 1: The employment generated by SMEs, share of sectors in %



Source: FMSEDA, various reports

NB: - Data for 2013/14 is only nine months performance

These include taking of below optimal level of loan and the debt repayment schedule. The repayment schedule which compels SMEs to settle their debt immediately would reduce the working capital and hence affects their smooth operation.

According to FMSEDA, total savings mobilized by MFIs and loan extended to SMEs by the same institutions has been increasing during the first four GTP implementation years. In the first 9 months of 2013/14, for instance, Birr 3.6 billion is mobilized in saving and Birr 2.4 billion extended in loans to the various SMEs operating in the economy depicting a loan to saving ratio of 65.4 percent. This is remarkable. The loan repayment performance, however, has declined from 89.6 percent in 2010/11 to 68.0 percent in 2013/14. This could be due to the provision of big size loans per enterprise and longer repayment schedule (Table 1).

Table 1: Savings, Loans and Loan Repayment by SMEs

| | 2010/11 | 2011/12 | 2012/13 | 2013/14, 9 months |
|--|---------|---------|---------|----------------------|
| Value in million Birr | | | | |
| Saving | 318.0 | 1,455.5 | 3,418.4 | 3,598.9 |
| Total Loan | 994.1 | 1,088.1 | 2,725.1 | 2,355.3 |
| Loan repayment | 890.3 | 741.7 | 1,761.4 | 1,602.0 |
| Enterprizes, in number | 135,897 | 81,744 | 77,451 | 135,561 |
| share in percent(unless otherwise indicated) | | | | |
| Loan repayment/Total Loan | 89.6 | 68.2 | 64.6 | 68.0 |
| Total Loans/Saving | 312.6 | 74.8 | 79.7 | 65.4 |
| Loan per enterprize, in 000 Birr | 7.3 | 13.3 | 35.2 | 17.4 |

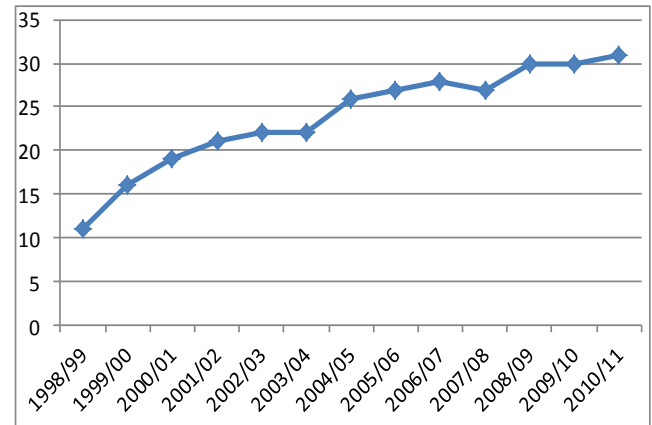
Source: FMSEDA, Various Reports

2.1.5. Micro Finance Institutions (MFIs)

Although it is not limited to MFIs, they are the major lenders to SMEs throughout the country. Obviously, large scale commercial banks do not extend loans to SMEs due to high transaction costs and inability of SMEs to fulfill the various requirements of big banks. The number of MFIs increased from 11 in 1998/99 to 31 in 2010/11 depicting slower growth in the face of the mushrooming of SMEs in the country. Some of the MFIs

are growing to big banks thereby mobilizing huge deposits and extending larger loans to the bulk of SMEs. (see figure 2)

Figure 2: Trends in the Number of MFIs



Source: NBE, Annual report, Macro-economic and Social Indicators
[http://www.nbe.gov.et/pdf/annualbulletin/Annual%20Report%202010-2011/Macro_Economic%20and%20Social%20Indicators%20\(2010-11\)](http://www.nbe.gov.et/pdf/annualbulletin/Annual%20Report%202010-2011/Macro_Economic%20and%20Social%20Indicators%20(2010-11))

3. Challenges and Prospects

3.1 Challenges

The study on SMEs has revealed that there has been a phenomenal growth in the number of SMEs and the size of employment generated by the sector in the last few years. Moreover, the growing tendency to be self employed by many young university graduates instead of waiting for employment from public or private sector has been encouraging.

Although improvements have been registered during the last few years, the performance of SMEs has fallen short of expectations due to various challenges. These include, problems related to finance, access to market and low competitiveness, business information, working premises, poor acquisition of technical skills and managerial expertise, appropriate technology, and access to quality infrastructure.

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3.2 Prospects

The increasing demand for consumer products produced by SMEs thereby creating a large market for SMEs and this added to improving the business environment and government commitment to promoting and supporting the sector provide bright future prospects for small and medium enterprise.

MSEs have been getting utmost attention from the government due to their indispensable role in curving some of the critical problems the economy has been suffering from. This attention and the continued supports for the development of the sector would make the prospects of the SMEs brighter for growth.

These prospects can be manifested by:

- increasing trends in the graduation of SMEs into medium scale enterprises and high share of manufacturing SMEs would further strengthen the various linkages in the economy;
- Increasing supply of working and selling premises is another factor which boosts the sector's prospect for growth as it would help SMEs station themselves in permanent market location;
- learning from weaknesses of existing incentives and supports, further improving of supports would boost the prospect for growth as enterprises require higher support on a higher scale, and
- the presence of a large domestic market, especially for the large low income segment of the population, would serve as an incentive for further expansion of production by SMEs.

4. Policy Recommendations

The key recommendations include:-

- Problem of detailed time series data is rampant and has constrained the undertaking of an in-depth study on SMEs, which, in turn, would help inform decision making. Therefore, Federal and regional MSEDAs should collect detailed time series data and make it available for researchers and other users.
- Industrial clusters help small firms overcome constraints associated with size, promote technological development, and enhance their ability to compete in local and global markets and provides both soft (such as building trust) and hard elements (physical infrastructure, common facility centers) to MSEs. Therefore; cluster development has to be further promoted;
- SMEs should not remain micro and small for ever; therefore, the various growth constraining factors have to be addressed and further incentives have to be identified and provided so as to speed-up their graduation to medium scale industries;
- SMEs linkages with medium and large scale manufacturing industries are critical; therefore, both forward and backward linkages with the economy at large and the manufacturing industry in particular have to be strengthened; and
- Last but not least, building the technical and management capacity of business operators, improving the productivity and competitiveness of small businesses would play critical role for ensuring the survival and graduation of SMEs to the next scale.