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I hereby declare that this work has been done by me and has not been submitted elsewhere.

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Certified that the project work entitled (Analysis of Factors Determining the Performance of Micro Enterprises: The case of Kemisie Town on Vocational and Technical office) submitted by Ahmed Motuma Assen is his own work and has been redone in the light of evaluator's comment's under my supervision.

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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The micro and small business sector is recognized as an integral component of economic development and a crucial element in the effort to enhance countries out of poverty (Wolfenson, 2007:28-39). The dynamic role of micro and small enterprises (MSEs) in developing countries as engines through which the growth objectives of developing countries can be achieved has long been recognized. It is estimated that MSEs employ 22% of the adult population in developing countries (Fisseha, 2006:43). In developing countries, MSEs by virtue of their size, capital investment and their capacity to generate greater employment, have demonstrated their powerful propellant effect for rapid economic growth. The MSE sector has also been instrumental in bringing about economic transition by providing goods and services, which are of adequate quality and are reasonably priced, to a large number of people, and by effectively using the skills and talents of a large number of people without requiring high-level training, large sums of capital or sophisticated technology (ILO, 2008:56). Similarly, Lara and Simeon (2009:1453– 1464) found that the MSE sector generates substantial employment and economic output in many countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production. The sector has potential to provide the ideal environment for enabling entrepreneurs to optimally exercise their talents and to attain their personal and professional goals (MoTI, 1997:9). In all successful economies, MSEs are seen as an essential springboard for growth, job creation and social progress. The small business sector is also seen as an important force to generate employment and more equitable income distribution, activate competition, exploit niche markets, and enhance productivity and technical change and, through the combination of all of these measures, to stimulate economic development. This is not denying the importance of large industries and other enterprises for the growth of the Ethiopian economy, there is ample evidence to suggest that the labor absorptive capacity of the MSE sector is high, the average capital cost per job

created is usually lower than in big business, and its role in technical and other innovative activities is vital for many of the challenges facing Ethiopia (MoTI, 1997:9). In Ethiopia, MSEs sector is the second largest employment-generating sector following agriculture (CSA, 2005:34-35). A national survey conducted by Ethiopian Central Statistical Authority (CSA) in 2007 in 48 major towns indicates that nearly 967,000 and 4,060 operators engaged in micro and small scale manufacturing industries respectively, which absorb about 740,000 labor forces. Accordingly, the whole labor force engaged in the micro enterprises and small scale manufacturing industries is more than eight folds (740,000 persons) to that of the medium and large scale manufacturing industries (90,000 persons). This is a contribution of 3.4% to GDP, 33% of the industrial sector's contribution and 52% of the manufacturing sector's contribution to the GDP of the year 2001 (CSA, 2005:34-35). According to Mulhern (1995:2-92), MSEs exert a strong influence on the economies of all countries, particularly in the developing countries. He reported that the MSEs have been a major engine in the economic growth, innovation and technological progress. In addition Carrier (2008:11-23) stated that: *the MSEs* are more fertile than their larger [macro enterprises] in terms of innovation and development. The MSE sector is characterized by highly diversified activities which can create job opportunities for a substantial segment of the population. This indicates that the sector is a quick remedy for unemployment problem. To curb unemployment and facilitate the environment for new job seekers and self-employment a direct intervention and support of the government is crucial.

Due to the similarity of their characteristics, informal sector activities and micro enterprises are often lumped together. Assistance and support to strengthen these enterprises can lead to higher profits and employment levels which in turn can contribute to a bottom-up transition out of poverty for entrepreneurs and workers (Sievers& Vandenberg, 2007:1341). It is further believed that:

The micro enterprise (ME) activities can contribute to increasing tax-incomes for the government and enable the government in the long run to invest the money. In order to strengthen the position of micro enterprises (MEs) the access to financial and nonfinancial services plays a pivotal role in the performance and expansion of these enterprises. The strengthening and the expansion of existing micro enterprises (MEs) and the support of new

enterprises can contribute to fulfill social objectives, attract considerable foreign reserves into a country and have a clear importance in providing employment, meaning they are the backbone of the private sectors in developing countries (Mead & Liedholm, 1998:61). The aim of micro enterprise (ME) development and the provision of micro enterprise (ME) services are to enable the entrepreneurs to take advantage of market opportunities and improve the access to skill development opportunities that strengthen entrepreneurial capabilities (UNIDO, 2002:36). Micro enterprise (ME) in Ethiopia are, however, confronted with several factors that affect the performance of micro enterprise (ME). The major factors include financial problems, lack of qualified employees, lack of Proper financial records, marketing problems and lack of work premises, etc. Besides, environmental factor affects the business which includes social, economic, cultural, political, legal and technological factors. In addition there are also personal attitudes or internal factors that affect the performance of ME, which are related to the person's individual attitude, training and technical know-how (Werotew, 2010:226-37). Generally, there are external (contextual) and internal factors which are still affecting the very performance of MEs.

1.2 Statement of the Problem

In most developing countries, MEs face constraints both at start up phases and after their establishment. In Africa, for example, the failure rate of MSEs is 85% out of 100 enterprises due to **lack of skills and access to capital** (Fedahunsi, 1997:170-186). It is typical of MSEs in Africa to be lacking in business skills and collateral to meet the existing lending criteria of financial institutions (World Bank, 2004:29). This, according to World Bank, has created finance gap in most markets. The MEs are able to source and obtain finance mostly from informal sectors like friends and relatives while medium or large enterprises obtain funds from banks. This unequal access to finance by MEs and medium and large enterprises has undermined the role of MEs in the economic development in African countries (World Bank, 2004:29). The study conducted by Ethiopian CSA discloses that, the contribution of micro enterprises in creating job opportunities and in the development of our economy is vital (FMSEDA, 2006:13). However, their contribution is very low in compared with that of other countries due to **financial problem, lack of qualified employees, lack of proper financial records, marketing problems, lack of working premises and raw materials. Lack of**

information about market opportunities and standards and regulations is one of the underlying factors that hinder their performance (MuluGebreeyesus, 2009:10-13). According to ZelekeWorku (2009:1-9) **lack of integration between the vocational curriculum taught at academic institutions and skills required at the workplace in micro businesses and enterprises** is a major obstacle to the growth and development of MEs. The same author continued stating:the performance of the ME sector in Ethiopia is poor in comparison with similar sectors in other ... African countries such as South Africa, Kenya, Uganda and Tanzania. Micro businesses and enterprises in Ethiopia are generally characterized by an acute **shortage of finance, lack of technical skills, lack of training opportunities and raw materials, poor infrastructure and over-tax.**

Devereux and Sharp (2006 cited in ZelekeWorku, 2009:1-9) identified that lack of access to finance is the most influential factor from among all adverse factors hindering the growth and development of the MSE sector in Ethiopia. In Kemsie town administration, micro enterprises (MEs) have a problem of **finance when establishing the business.** Most individual sources of finance come from personal savings and loans acquired from relatives, friends and money lenders with high amount of interests (MoTI, 2005:13-14). After the business goes operational, the probability of becoming **profitable and paying back debts along with accrued interest is less.** Besides, MSEs do not conduct market research and develop/design a product or service as per the need of customers (ZelekeWorku, 2009:2-9). For micro enterprises (MEs), **lack of shed is unquestionably** a serious problem in the town. Most informal operators do not get access to suitable locations where they can get easy access to markets (HLCLEP, 2006:17). Further, the **problem of technical procedures and appropriate technology** used by the firm are another factor associated with high technology of equipment and use of new technologies.. In view of the above problems, the **central question** of this study is: **what are the factors that mostly affect the performance of micro enterprises (MEs) in Kemsie town administration?** Specifically, the following sub-questions are raised:

- ❖ What are the sources of finance or funds available to the micro enterprises (MEs)?

- ❖ What are the various contextual factors that impeded the performance of the micro enterprises (MEs)?
- ❖ What are the internal factors that affect the performance of micro enterprises (MEs)?
- ❖ How can the problems of micro enterprises (MEs) in *Kemisie* town administration be minimized?

1.3 Objectives of the Study

1.3.1 General Objective

The main objective of the study is to assess factors that affecting the performance of micro enterprises (MEs) in Kemissie town administration.

1.3.2 Specific Objectives

The specific objectives are:

- To examine the sources of finance or funds for the start-up and expansion of micro enterprises (MEs).
- To investigate the internal and external parametric factors that determines the performance of micro enterprises (MEs).
- To recommend possible solution to alleviate the problem of micro enterprises (MEs).

1.4 Significance of the Study

The findings of this study will be useful to the stakeholders including:

i. Academics/Researchers

Findings from this study will assist academicians in broadening of the prospectus with respect to this study hence providing a deeper understanding of the critical factors that affect the performance of micro enterprises (MEs).

ii. Micro Enterprises

The findings of this study will help micro enterprises (MEs) in *Kemisie* and others, within an insight into the benefits of using different factors studied in this research to predict the factors that affect the performance of micro enterprises (MEs).

iii. Governmental Policy Makers

The government can use the findings of this study to assist in policy formulation and development for a framework for critical finance, marketing, work premises and other factors that affect the performance of micro enterprises (MEs). Moreover, the findings of this study will help the policy makers and financial institutions how to encourage establishing or expanding micro enterprises (MEs). It also enables them to know what kind(s) of policies should be framed

1.5 Limitations and Delimitation of the Study

1.5.1 Limitations of the Study

The study will cover only enterprises found in *kemisie*. To conduct the researcher expects the limitation of real information from youth group, managers, leaders and customers. Similarly they will challenge by constraints of finance to collect data and shortage of time to collect data and analyze. Since this study employs cross sectional survey design, it will not check the situation through longitudinal survey. However, in Ethiopia, there is lack of sufficient research conducted on this study. Thus, it is difficult to obtain adequate data from leaders and youths concerning the public sector, working in the area and their status.

1.5.2 Delimitation of the Study

The study assessed factors affecting the performance of (MEs) in *Kemisie* town administration. Although, there are different issues that can be researched in relation to micro enterprises (MSEs), this study is delimited to the politico-legal, working premises, technological, infrastructural, marketing, financial, management and entrepreneurial factors.

Besides, the scope of this study was spread across micro enterprises (MEs) especially in the business sector of metal and wood work and service enterprises.

1.6 Organization of the Thesis

The thesis will have 5 chapters: like chapter one introduction of the study, chapter two review of related literature, chapter three research methodology of the study, chapter four data analysis and discussion and chapter five will be conclusion and recommendation of the study.

1.7 Operational Definitions of Terms

Cooperatives: association of at least 10 individuals who are from the same area.

Enterprise: It refers to a unit of economic organization or activity whether public or private engaged in to the service and manufacturing of goods.

Factors: A factor is a contributory aspect such as politico-legal, working premises, technologies, infrastructures, marketing, financial, management and entrepreneurial influences that affect performance of micro enterprises.

Gullit: A petty trading activity usually undertaken at road sides and sometimes at designated places.

Idir: A widely prevalent sort of funeral grouping in Ethiopia, where resources are mobilized and pooled to get emotional and material support up on a death of the member himself, his dependants or relatives.

Informal sector: in this paper the concept of informal sector is used alternatively with micro enterprises, because it is consistently and widely accepted, and comparative data are available for Ethiopia. **Initial paid-up capital:** is that part of the issued capital of an establishment that has been paid by the owners to start the operation.

Iqub: A voluntary, informal, and indigenous form of rotating saving and credit scheme, where each member contributes a mutually agreed amount of money on weekly or monthly basis. **Manufacture of food products:** includes manufacture of vegetable, preparing, *baltina*' products and manufacture of bakery products.

Manufacture of metal products: are an enterprises sector engaged in manufacture of fabricated metal products, except machinery and equipment; manufacture of parts and accessories for motor vehicles and their engines.

Manufacture of wood and wood products includes manufacturing of furniture, joinery and modern beehives.

Micro enterprise: In old definition micro enterprise means commercial enterprise whose capital is not exceeding birr 20,000 other than high technology and consultancy services. In a new definition micro enterprise defined by separating industry ..and Service as indicating by table below.

Sector	Human power	Total asset
Industry	≤ 5	≤ 100000
Service	≤ 5	$\leq 50,000$

Performance: in this paper performance defined in terms of profitability of the micro enterprises (MEs).

Partnership: involves two or more individuals who have a partnership agreement to operate a business and share the earnings and liabilities of the venture.

Respondent: respondents are those individuals who are owner managers or operators of an enterprise.

Small enterprise: In old definition Small enterprise means a business engaged in commercial activities whose capital is exceeding birr 20,000 and not exceeding 50,000 birr, other than high technology and consultancy services.

Sector	Human power	Total asset
Industry	6-30	\leq birr 1.5 million
Services	6-30	\leq birr 500,000

In a new definition Small enterprise defined by separating industry and Service as indicating by table below.

1.8 Brief Expression of Study Area

Kemissie city administration is one of the city administrations established by the Amhara national regional state urban centers establishment, organization and definition of their powers and duties based on revised proclamation No.91/2003. The city is organized in seven kebeles which are sub divided into urban and surrounding rural kebeles. Kemissie city administration is the administrative centre of the Oromo nationality zone administration which is one of the three nationality zones in Amhara region.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews works on micro enterprises (MEs) in Ethiopia and other countries in general and Addis Ababa in particular. Works on performance and determinants of performance were also reviewed. This is of help to understand the state of micro enterprises (MEs) and its determinants of the performance. This chapter comprises of six sections. These are definitions of MEs, the role of MEs in poverty reduction, the ME sector in Ethiopia, the concept of business performance, empirical studies and the conceptual framework.

2.2 Definition of Micro Enterprises

The ME sector everywhere is characterized by highly diversified activities which can create employment opportunities for a substantial segment of the population. This implies that the sector is a quick remedy for unemployment and poverty problem. The realization of a modest standard of living through curbing unemployment and facilitating the environment for new job seekers and self-employment requires a direct intervention and support of the government and other concerned stakeholders (Mulugeta, 2011:13). Hence, in order to channel all necessary support and facilities to this diversified sector, a definition is needed to categorize the sector accordingly. However, there is no single and universally acceptable definition of a micro enterprise (Kayanula and Quartey, 2000:35). This is so because the criteria and ways of categorizing enterprises as micro and small from institution to institution and from country to country depending essentially on the country's level of development. Even within the same country, definitions also change overtime due to changes in price levels, advances in technology or other considerations (Emma I. et al., 2009:1-9). Firms differ in their levels of capitalization, sales and employment. Hence, definitions that employ measures of size (number of employees, turnover, profitability, net worth, etc.) when applied to one sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to a different result. The absence of such uniform definition of

micro enterprises (MEs) has created a difficulty. In line with this, Tegegne and Meheret (2010:11) argued that the absence of a single or globally applicable definition has made the task of counting the number of micro enterprises (MEs) and assessing their impact extremely difficult across countries, though the rationale for most governments to make such definition and categorization is mainly for functional and promotional purposes to achieve the desired levels of development of the sector. United Nations Industrial Development Organizations (UNIDO) gives alternative definition for developing countries. Accordingly, it defines micro enterprises as the business firms with less than 5 employees (UNIDO, 2002:53). The United States of America, the Small Business Act issued in 1953 stated that, small business is one which is independently owned and operated and not dominant in its field of operation. The act also further stated that, number of employees and sales volume as guideline in defining small business (Major L. C. & Radwan N. S., 2010:2-19). In the same country, a committee for economic development (CED) has explained that small business is characterized by at least two of the key features: management is independent (usually the managers are owners), capital is supplied and an individual or small group holds ownership and the area of operation is mainly local (workers and owners are in one home country). According to Kayanula and Quartey (2000:16) in Malawi, the official definition of enterprise sizes is based on three criteria namely the level of capital investment, number of employees and turnover. An enterprise is defined as small scale if it satisfies any two of the three criteria, that is, it has a capital investment of USD 2,000 - USD 55,000, employing 5-20 people and with a turnover of up to USD 110,000 (using 1992 official exchange rate). The same authors narrated that some of the key characteristics of small enterprises are mobilizing funds which otherwise would have been idle; being a seed-bed for indigenous entrepreneurship; their labor intensiveness; employing more labor per unit of capital than large enterprises; promoting indigenous technological know-how; using mainly local resources, thus have less foreign exchange requirements; catering for the needs of the poor and; adapting easily to customer requirements (flexible specialization). In Kenya, by referring the 1999 MSE National Baseline Survey, MSEs defined as those non-primary enterprises (excluding agricultural production, animal husbandry, fishing, hunting, gathering and forestry), whether in the formal or informal sector which employ 1-50 people (Ronge et al., 2002 cited in Mulugeta, 2011:15). More specifically, according to them, micro enterprises are those that employ 10 or

fewer workers and small-scale enterprises are those that employ 11-50 workers. The same study argued that the above definitions are based on one of the three criteria mainly used in literature to define MSEs-number of employees. The second criterion relies solely on the degree of legal formality and is mainly used to distinguish between the formal and informal sectors. According to this criterion, MSEs are those enterprises that are not registered and do not comply with the legal obligations concerning safety, taxes and labor laws. The last criterion defines MSEs by their limited amounts of capital and skills per worker. The above indicated writers emphasized highlighted that the degree of informality and size of employment have perhaps been the two most readily accepted criteria on which classification of MSEs is based; and lastly they claimed that the term MSE incorporates firms in both the formal and informal sectors. Similarly, in Ethiopia there is no uniform definition at the national level to have a common understanding of the MSE sector. The old (1998) definition was based on paid capital only (see table below). An enterprise is categorized as micro if its paid up capital is less than or equal to 20,000 ETB. Similarly, an enterprise is considered small when its paid up capital is less than or equal to 500,000 ETB.

Table 1: Old Definition of MSE in Ethiopia

Sector	Manpower	Paid up capital
Micro enterprise	-----	≤ 20,000 ETB
Small enterprise	_____	≤ 500,000 ETB

The limitation of this definition is that it does not provide information on job creation, size and asset base. This is because employment and asset ownership are not part of the definition. Secondly, the definition does not differentiate between manufacturing (industry) and services.

The New (2010/2011) definition considers human capital and asset as the main measures (see table below). The new definition addresses the limitations of the old definition. Minimum asset requirement for services and industry is different as shown in table 2 below.

Table 2: New (Current) Definition of MSEs in Ethiopia

Level of the enterprise	Sector	Human power	Total asset
Micro enterprise	Industry	≤ 5	≤ 100000
	Service	≤ 5	$\leq 50,000$
Small enterprise	Industry	6-30	\leq birr 1.5 million
	Service	6-30	\leq birr 500,000

The CSA conducts survey on small scale industries. It has conducted surveys for the years 2001/2, 2005/6 and 2007/8. However, CSA adopts its own definition which is not well aligned with the MSE policy and the new definition. Hence, the data it collects is less useful in terms of analyzing the MSE policy. CSA's definition is based on the size of employment and extent of automation. Hence, according to CSA,

- Large and medium scale manufacturing enterprises have been classified as establishments with more than ten employees using automated machinery.
- Small and medium enterprises are establishments that engage less than 10 persons using power driven machinery.
- Cottage/handicrafts are household type enterprises located in households or workshops normally using own or family labour and mostly manual rather than automated/mechanical machinery

The limitations of the CSA definition are, it ignores the size of capital and the sectors outside manufacturing.

2.3 The Role of Micro Enterprise in Poverty Reduction

Poverty in Ethiopia is widespread and remains a major challenge of sustainable development and stability (Lutheran World Federation of Ethiopia, 2006 cited in Eshetu & Mammo, (2009:2). By now, it is clear and agreeable that poverty, both in urban and/ or rural areas, is all about lack of basic needs, low or inadequate level of income and consumption, poor

command over resources, and high level of social exclusion, inequality and vulnerability. The role played by micro enterprises (MEs), through the various socioeconomic benefits emanating from the sector was found to be eminent in the overall development effort and process of nations. In other words, by generating larger volumes of employment as well as higher levels of income, the micro enterprises (MSEs) will not only have contributed towards poverty reduction, but they will also have enhanced the welfare and standard of living of the many in the society (Mukras,2003:58-69). Current international thinking is in tune with a view that acknowledges micro enterprises (MEs) as a tool to fight poverty in the long run. The UNIDO approach to this is worth mentioning here: Poverty reduction is simply not going to happen by government fiat but only through private sector dynamism. The evidence directly linking MEs and poverty reduction is considerably less robust than that linking them to economic vitality, even in the most developed economies. There are suggestions of greater employment opportunities for poor, low skilled workers, increased skills development and broader social impacts. The movement to support ME development internationally reflects a return to promoting poverty reduction by investing in private sector-driven strategies by all of the major multilateral agencies. Poverty Reduction Strategies (PRSs) currently being formulated in many developing countries places a more pronounced emphasis on the contribution that the private sector will have to make – compared to the over-reliance on the social agenda that characterized earlier PRSs (Perumal K. & Prasad, n.d:2-29)). In conformity with the above view advanced by UNIDO and as an organization concerned to the condition of labor, the ILO's approach to poverty reduction is through small enterprise development. This strategy focuses on the needs of poor people who are part of the MSE economy, as owners/operators and workers, as their dependents, as the unemployed who may benefit from job creation and as customers. While further strengthening the above shown approach, Vandenberg (2006:18) suggests that: the ILO's existing strategy for poverty reduction through smallest enterprises must emphasize the fact that small enterprises make a positive contribution to poverty reduction when they provide employment, adequate levels of job quality, and low-cost goods and services used by the poor; entrepreneurship, combined with productivity increase, is a key ingredient for poverty reduction through small enterprise development; and vibrant enterprises, competitive markets and a fair globalization can make a significant impact on poverty reduction. Drawing on a study conducted in the urban centers

of four Western African countries namely Benin, Burkina Faso, Niger and Togo to identify key factors shaping the micro enterprise sector, explores the needs, characteristics, motivations, and success factors for micro entrepreneurship in the region, together with some of the impediments to the growth and success of micro enterprise ventures (Roy and Wheeler, 2006:452- 464). Roy and Wheeler indicated that MSE provide a substantial source of employment, thereby contributing to get rid of poverty to the urban poor. According to them, the main reason for the urban poor to be absorbed in the ME is due to the fact that the formal sector does not have the capacity to absorb this growing demand for jobs, and for this reason many have had to look for alternative means to generate a livelihood. Hence, participation in the informal sector is often the only option available as a source of income, and so the sector has absorbed many of the unemployed who have been neglected by the formal sector in the region. They pointed that the income generated from being engaged in MEs primarily used to satisfy the poor's own physiological needs and those of their family, and then to provide a home and security for the household. They specifically claimed that MEs help the urban poor by making them financially secure which in turn limits or reduces the misery, vulnerability and material and non-material hardships that come with poverty.

2.3.1 Micro Enterprise for Economic Growth: 'Pro' and 'Contra' Arguments

There are two polarized thoughts, according to (Agyapong, 2010:196-205; Anderson et al., 1994:129-133 and Staley & Morse, 1965:31) the role and contribution of MSE to economic growth and poverty reduction: *'Pro' and 'Contra' Arguments*. Their works often classified as the classical and modern theories on MSEs' development. The contra argument predict that advantages of MSEs will diminish over time and large enterprises (LEs) will eventually predominate in the course of economic development marked by the increase in income. In line with these shortcomings and pessimism Admassie and Matambalya (2002:1-29), for instance, concluded that high level of technical inefficiency, which reduce their potential output levels significantly. Research carried out by Biggs (2002 cited in Tegegne and Meheret, 2010:14) strongly question the role played by MSEs to minimize the incidence of high level poverty in most developing economies through employment creation, income generation and multiplier effects on other sectors of the economy. While, the pro argument views based on experiences from many countries showing the „contra“ arguments seem to

get less supports as many international aid agencies, including the World Bank (2004:41). The World Bank gives three core arguments in supporting MSEs in LDCs, which in line with the arguments of the „modern“ (pro) paradigm on the importance of MSEs in the economy (World Bank, 2002 and 2004 cited in Tulus T., 2006:5). First, MSEs enhance competition and entrepreneurship and hence have external benefits on economy wide efficiency, innovation and aggregate productivity growth. Second, MSEs are generally more productive than LEs but financial market and other institutional failures and not conducive macroeconomic environment impede MSE development. Third, MSEs expansion boosts employment more than LEs growth because MSEs are more labor intensive. In other words, the World Bank believes that direct government support for MSEs in LDCs help these countries exploit the social benefits from their greater competition and entrepreneurship, and their MSEs can boost economic growth and development. The above arguments do not mean, however, that LEs are not important, or MSEs can fully substitute the role of LEs in the economy. Even, there are skeptical views from many authors about this World Bank’s pro-MSE policy. Some authors stress the advantages of LEs and challenge the assumptions underlying this pro-MSE policy. Specifically, LEs may exploit economies of scale and more easily undertake the fixed costs associated with research and development (R and D) with positive productivity effects (Tulus Tabunan, 2006:5).

2.4 The Micro Enterprise Sector in Ethiopia

The five-year Growth and Transformation Plan (GTP) has given particular attention to the expansion and strengthening of micro-scale enterprises (MoWUD, 2007:17-28). 19 Table: 2.1 Numbers, Amount of Credit and Jobs Created through MEs **2008/09 2009/10**

	2008/09	2009/10	Percentage change
No. of MSEs	73,062	176,543	141.6
No. of total employment	530,417	666,192	25.6
Amount of credit (in millions of Birr)	662.7	814.1	22.8

Source: (MoWUD, 2007:17-28) According to MoWUD (2007:17-28) The sector is believed to be the major source of employment and income generation for a wider group of the society. The major objective of this program, which is creating and promoting MSEs in urban areas, envisages reducing urban unemployment rate. A total of 176,543 MSEs were established in 2009/10 employing 666,192 people. The number of established and total employment created went up 141.6 and 25.6 percent, respectively, compared to a year ago. The total amount of loan

received from micro finance institutions was Birr 814.1 million under the review period, 22.8 % higher than last fiscal year.

2.4.1 Micro Enterprise Development Strategy

Enterprise promotion efforts in Ethiopia have traditionally focused on urban based and MSEs. In the 1960s and early 1970s, a department within the Ministry of Industry and Tourism was responsible for coordinating promotion activities which basically consisted of providing training on business management (United Nations, 2002:101-103). As stated by United Nations report (2002:101-103): In 1977, the Handicraft and Small Scale Industries Development Agency (HASIDA) was established to provide training mainly in management and technical skills and to serve as coordinating agency for Government policy on small enterprises. Shortage of funds and unfavorable government policy toward the private sector in the 1980s made it extremely difficult for HASIDA to have an impact on the development of local small enterprises. Since mid-1999, the government has revisited the whole issue of small and medium enterprise promotion in Ethiopia but with more focus on micro and small enterprises. A major study was conducted with the support of a donor agency which resulted in the preparation of a National Micro and Small Enterprises Development Promotion Strategy (NMSEDPS). The Ethiopian government released the country's first MSEs development strategy in November 1997 E.C. The primary objective of the national strategy framework is to create an enabling environment for MSEs. In addition to this basic objective of the national MSE strategy framework, the MoTI has developed a specific objective which includes, facilitating economic growth and bring about equitable development, creating long-term jobs, strengthening cooperation between MSEs, providing the basis for medium and large scale enterprises, promoting export, and balancing preferential treatment between MSEs and bigger enterprises (MoTI, 1997:8-27). The strategy outlines the policy framework and the institutional environment for promoting and fostering the development of MSEs and stimulating the entrepreneurial drive in the country.

2.5 Empirical Study

According to Mead & Liedholm (1998:69) and Swierczek and Ha (2003:46-58), the main factors that affect the performance of MEs in developing countries is not their small size but their isolation, which hinders access to markets, as well as to information, finance and institutional support. The argument that small businesses in Africa are crucial in the role they play in employment creation and general contribution to economic growth is not new. Although this may be true, the vast majority of new enterprises tend to be one-person establishments (Mwega, 1991:33-36). This has tended to ensure that the journey of the ME entrepreneur in many instances is short-lived, with the statistic of ME failure rate in Africa being put at 99 per cent (Rogerson, 2000:41). Various reasons for these failures have been proposed by scholars including lack of supportive policies for ME development (McCormick 1998:26-27), intense competition with replication of micro-businesses (Manning & Mashego, 1993:59-61); manager characteristics including lack of skills and experience (Katwalo & Madichie, 2008:337-348 and Verhees, F. M., & Meulenbergh, M. G., 2004:134-154). A study by Hall (1992:237-250) has identified two primary causes of small business failure appear to be a lack of appropriate management skills and inadequate capital (both at start-up and on a continuing basis). The research undertaken in Tanzania by surveying 160 micro enterprises showed that high tax rates, corruption, and regulation in the form of licenses and permits, are found to be the most important constraints to business operations of micro enterprises (Fjeldstad et al, 2006 cited in Mulugeta, 2011: 22). A view expressed by Fredland and Morris (2009:8) argued that the causes of failure cannot be isolated and that „any attempt to do so is, at bottom, a futile exercise“. However, they suggested that: The issue of causation is clarified somewhat by classifying causes as endogenous (internal to the firm and presumably within its control) and exogenous (external to the firm and beyond its control). Such a classification has the merit of providing a somewhat better policy handle since if causes are endogenous, appropriate policy „helps firms help themselves“; if exogenous, appropriate policy may seek to change the economic environment. Previous evidence suggests that, although endogenous factors were the main cause of failure, exogenous factors had a significant effect in approximately one third of small business failures (Peterson et al., 1983:15-19). Roy and Wheeler (2006:452-464) identified that the level of training of micro entrepreneurs (both

formal and informal); experience and number of years in operation; knowledge of the market; level of differentiation (in terms of price, quality or other) and diversification of products; access to the necessary resources and/or technologies; level of planning; vision for the future; and the entrepreneur's level of poverty are among the factors contributing to success of MEs while lack of market knowledge and training, limited access to capital, and lack of co-operation among possible business partners are some of the factors inhibiting the growth and development of the micro enterprise sector.

2.6. Previous Studies on Ethiopian Micro Enterprises

Eshetu and Zeleke (2008:2-9) conducted a longitudinal study to assess the impact of influential factors that affect the long-term survival and viability of small enterprises by using a random sample of 500 MSMEs from 5 major cities in Ethiopia. According to this research, that lasted from 1996-2001, the factors that affect the long term survival of MSMEs in Ethiopia are found to be adequacy of finance, level of education, level of managerial skills, level of technical skills, and ability to convert part of their profit to investment. This is so because the findings of the study revealed that businesses that failed, during the study period were characterized by inadequate finance (61%), low level of education (55%), poor managerial skills (54%), shortage of technical skills (49%), and inability to convert part of their profit to investment (46%). The study further indicated that participation in social capital and networking schemes such as *Iqub3* was critically helpful for long-term survival of the enterprises. Businesses that did not participate in *Iqub* schemes regularly were found to be 3.25 times more likely to fail in comparison with businesses that did, according to the study. In their study, based on the survey covering 123 businesses units in four *Kebeles* of *Nifas Silk- Lafto* and *Kirkos* sub-cities of Addis Ababa, and aimed to investigate the constraints and key determinants of growth, particularly in employment expansion, Paul and Rahel (2010:89-92) found out that the studied enterprises registered 25% increment in the number of total employment they created since their establishment with an average annual employment rate of 11.72%. With regard to the sources of initial capital of the studied enterprises, the study indicated that, the main ones were loan from MFI (66.7%), personal savings/*Iqub* (17.5%), and loan from family/friends (17.1%). Moreover, the concrete problems that the targeted MSEs faced at their startup were lack of capital (52.8%), skills

problem (17.9%) and lack of working space (17.1%). Moreover, Daniel (2007:49), identified that lack of raw material, stiff competition and shortage of working capital. Mainly relying on a sample survey of 557 operators and 200 MSEs chosen from four A voluntary, informal, and indigenous form of rotating saving and credit scheme, where each member contributes a mutually agreed amount of money on weekly or monthly basis. In such schemes, each member is entitled to receive the collected lump sum once as per his contribution. Major cities of Ethiopia namely *Adama*, *Hawassa*, *Bahirdar* and *Mekelle*, Tegegne and Meheret's research (2010:40-72) was conducted with the intention of assessing the contribution of the MSE strategy to poverty reduction, job creation and business development. The raised causes for this gloomy prospect of business were not growing (33%), lack of finance (13%), lack of market (11%), and lack of working space (4%). The major constraints identified by various studies on MSEs in Ethiopia are associated with market and finance problems. The causes of market-related problems of MSEs engaged in metal and wood work are shortage or absence of marketing skills, poor quality of products, absence of marketing research, shortage of market information, shortage of selling places, and absence of sub-contracting (FMSEDA, 2006:34). The product line of MSE activities in Ethiopia is relatively similar (Assegedech Woldelul, 2004:1). Accordingly she states that: lack of product diversity, however, is prevalent and as a result similar products are over-crowding the market. Some micro enterprises shift from one product to another, and in doing so, capture better market opportunities. Nevertheless, as soon as the market has established itself, a multitude of further micro enterprises start off in the same business and this causes the selling price to fall immediately. According to Assegedech Woldelul (2004:7): Shortage of funds discourages the smooth operation and development of MSEs. Even if there are credit facilities, some of the MSEs do not use the money for the intended purpose. They rather divert it for other unintended and non-productive expenditures. Consequently, the enterprises fail to return the money back to the lender on time. This can result in a loss of credibility to get repeated loans when needed. According to Assegedech Woldelul (2004:4), competition is also another problem that hinders the performance of MSE. She explained it:

As is mostly the case and common recognition, "Competition is Cruel", which implies that some larger companies in relation to MSEs have advantages due to: selling at reduced price without reducing product quality using economies of scale, customer targeting capacity,

proper and intensified product/service advertising capacity, good personal contacts and networks, sound industry reputation and sufficient information regarding existing market and capacity to exploit more market *opportunities*. In his research, Dereje (2008:47) studied the nature, characteristics, economic performance, opportunities and challenges of MSEs in the construction sector based on 125 sample enterprises. The results of the study revealed that the main constraints of the MSEs were shortage of capital, lack of raw materials, absence of government support, lack of market, lack of credit facilities and high interest rate. Studies were also conducted specifically with a purpose of identifying the problems that MSEs encounter. For instance, Workneh's (2007:51) research undertaken in *Kolfe Keraneo* sub-city of Addis Ababa indicated that lack of capital, lack of market, unfavorable policy, and inadequate infrastructure, absence of adequate and relevant training, bureaucratic structure and procedures are among constraints faced by MSEs. Similarly, Adil's (2007:63) research carried out in Addis Ababa shows that inappropriate government intervention, shortage of capital, location disadvantage, lack of market and lack of display room are the major challenges that obstruct MSEs. According to HLCLEP (2006:17), there is lack of entrepreneurial and managerial skills, which in turn leads to problems in production due to the unfamiliarity of workers with rapid changing technology, lack of coordination of production process and inability to troubleshoot failures on machinery and/or equipment's is a critical problem that MSEs are facing since they cannot afford to employ specialists in the fields of planning, finance and administration, quality control and those with technical knowledge. Mulugeta (2011:72-77) has identified and categorized the critical problems of MSEs in to market-related problems, which are caused by poor market linkage and poor promotional efforts; institution-related problems including bureaucratic bottlenecks, weak institutional capacity, lack of awareness, failure to abide policies, regulations, rules, directives, absence of training to executives, and poor monitoring and follow-up; operator-related shortcomings like developing a dependency tradition, extravagant and wasting behavior, and lack of vision and commitment from the side of the operators; MSE-related challenges including lack of selling place, weak accounting and record keeping, lack of experience sharing, and lack of cooperation within and among the MSEs and finally society-related problems such as its distorted attitude about the operators themselves and their products. In reality, literature on MSEs in Ethiopia is scanty and most of the available studies

were not conducted in line with performance aspects of micro enterprises. However, this research tried to assess factors affecting the performance of MSEs in a holistic way by targeting and deeply investigating those operators engaged in service, metal and wood work activities in Kemisie town administration.

2.7 The Conceptual Framework

Conceptual framework means that concepts that relate to one another were used to explain the research problem. Since business performance is influenced by both internal and contextual factors, operators need to understand what influences businesses to reach peak performance. The **contextual** factors include politico-legal, working premises, technological, infrastructural, marketing and financial factors. The influence of these factors to the firm performance is very important but it is noteworthy that the management has no (little) control over them (Wanjiku, 2009:81-82). Nevertheless, the factors must be closely monitored to ensure that stringent measures are taken within the best time to either take advantage of the opportunities or combat the threats found in the external environment. The **internal** factors that influence the firm's performance can be classified as management and entrepreneurial factors. To align the conceptual framework with the research objectives, business performance is the dependent variable whereas politico-legal, working premises, technological, infrastructural, marketing, financial, management and entrepreneurial factors are all independent variables.

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1. Research Approach and Design

3.1.1. Research Approach

Mixed research approach will be employed in order to investigate factors determining the Performance of micro –enterprises in Kemissie town. According to Dawson (2002) qualitative research explores attitudes, behavior and experiences through such methods as interviews or focus groups. It attempts to get an in-depth opinion from participants. As it is attitudes, behavior and experiences which are important, fewer people take part in the research, but the contact with these people tends to last a lot longer. Thus, both qualitative and quantitative approach is the most appropriate method to investigate the analysis of factors determining the performance of micro -enterprises.

3.1.2. Research Design

The research design/strategy that will be employed will be case study research design. According to Gerring (2007) Case study research design to research is most usefully defined as an intensive study of a single unit or a small number of units (the cases), for the purpose of understanding a larger class of similar units (a population of cases).

The case study is a way of organizing economic data for the purpose of viewing economic and social reality. It examines a socio-economic unit as a whole. The unit may be a person, a family, a social group, a social institution, or a community. The case study probes deeply and analyses interactions between the factors that explain present status or that influence change or growth (Best and Kahn, 2003).

Creswell (2003) referring to (Stake, 1995) suggests that case studies are research strategies , in which the researcher explores in depth a program, and event, and activity, a process, or one or more individuals. The cases are bounded by time and activity, and researchers collect detailed information using a variety of data collection procedures over a sustained period of

time. Furthermore, as a research strategy, the case study is used in many situations to contribute to our knowledge of individual, group, organizational, social, political and related phenomena in different fields of study like political science, business and community planning (Yin, 2003).

Therefore, Case studies help us to connect the actions of individual people to the large scale socioeconomic structures and processes. The logic of case study is to demonstrate a casual argument about how general social force shape and produce results in particular settings. As a result, the issues of analysis of factors determining the performance of micro –enterprises will be investigated through the application of case study research design.

3.2. Data Sources

In this study, both primary and secondary data sources will be employed. The primary data sources will be questionnaire, key informants interviewees and focus group discussants whereas secondary data sources will be books, articles and journals.

Primary data source

The study will use well-designed questionnaire as best instrument and face-to-face interviews with the MSEs operators/and the relevant owner managers who heads the enterprises in the selected sectors.

Secondary data Sources

Secondary data from files, pamphlets, office manuals, circulars and policy papers will be used to provide additional information which is appropriate. Besides, variety of books, published and/or unpublished government documents, websites, reports, journals and newsletters were reviewed to make the study fruitful.

3.3. Sampling Technique

Stratified random sampling will be used to get information from different sizes of the MSEs. This technique is preferred because it is used to assist in minimizing bias when dealing with the population. With this technique, the sampling frame can be organized into relatively

homogeneous groups (strata) before selecting elements for the sample. According to Janet (2006:94), this step increases the probability that the final sample will be representative in terms of the stratified groups. The strata's are sectors including: metal work, food processing and wood work. According to Catherine Dawson (2009:54), the correct sample size in a study is dependent on the nature of the population and the purpose of the study. Although there are no general rules, the sample size usually depends on the population to be sampled. In this study to decide sample size, list of the population formally registered until October 2016 by Kemisie town Administration office of Micro and small enterprises. The researcher will use 62 samples among the population which are 124 micro enterprises. From the total population of the enterprise the sample size will be selected randomly from the strata.

3.4. Methods of Data Collection

a. Questionnaire

The questions that will be used in the questionnaire will be multiple-choice questions and five-point likert scale type questions. The type of scales used to measure the items on the instrument is continuous scales (strongly agree to strongly disagree).

b. Semi-structured Interview

Semi-structured interviews will be employed for qualitative data collection. Semi-structured interviews incorporate elements of both quantifiable, fixed-choice responding and the facility to explore, and probe in more depth, certain areas of interest. Thus, this type of interview has the advantages of easiness to analyze, quantify and compare data and allows interviewees to explain their responses and to provide more in-depth information where necessary (Brewerton & Millward, 2001). Hence, semi-structured interviewing is perhaps the most common type of interview used in qualitative social research (Dawson, 2002). Semi-structured interview will be held with prominent personalities in the town who could know deeply the factors determining the performance of micro enterprises. As a result, a total of 10 participants or interviews from managers, religious leaders, and zonal leaders of the town will be selected through availability sampling technique.

c. Focus Group Discussions

In this study, FGD will be one of the data collection tool to supplement, confirm and check the validity of information that will be generated in semi-structured interviews and in-depth interviews with key informants. Gillham (2000) states that Focus Group Discussion (FGD) using semi structured questions allows researchers to look more deeply into the research issues and develop new lines of inquiry that arise during interviews. Likewise, Krueger (1994) argues that group discussion compared with formal questionnaire interviews allow sensitive issues to be more freely discussed in groups when individual would not wish to discuss them alone with a stranger. Hesse-Biber and Leavy (2004) also delineates Focus Group as a distinct method of qualitative and quantitative interviewing in that multiple participants are interviewed in the context of a group. It is often used to give voice for group participants.

d. Key Informants Interview

Attempts to explore facts on the ground makes it a rational approach to include key informant interviews by involving selected group of individuals who are likely to provide needed information, ideas, and insights on the proposed research. Accordingly, interviews will be conducted among key informants that will allow the researcher collecting data on relevant and well-informed sources about determinants of micro enterprises. According to Kumar (1989) key informant interviews involve interviewing of knowledgeable individuals who are likely to provide the required information, ideas and insights on a particular subject. Such individuals must be identified carefully and in this study key informants will be selected from each user group.

A total of 15 key informants will be selected purposely as key informants to support data that will be obtained from interviewees and discussants. Key informant interviews will be conducted using a check list of open ended questions prepared for FGD. The time and place for key informant interviews will be decided by key informants themselves and the majority of interviews will be held at their home/office.

3.5 Method of Data Analysis

The data gathered from questionnaires, interviews and discussants will be analyzed carefully to keep their accuracy and validity. In analyzing the data both quantitative and qualitative analysis techniques will be used. Hence, it will be analyzed and explained using tabular and descriptive data analysis techniques.

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