



## DETERRENENTS TO THE SUCCESS OF MICRO AND SMALL ENTERPRISES IN ETHIOPIA: THE CASE OF AMHARA REGION MSEs

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### ABSTRACT

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In Ethiopia, MSEs have become the favorite of policy makers as they are believed to play a critical role in addressing both poverty reduction and economic growth goals. Over the years, while some MSEs have grown extremely large and profitable, many others have failed or have not been as successful as they might have been. This study seeks to identify the factors that hamper the success of Micro and Small Enterprises in Amhara region of Ethiopia since studies aimed at assessing the same are virtually missing. This study employed a quantitative research approach using a descriptive survey design. The data was drawn from a survey of 316 MSEs in Amhara region, Ethiopia. Statistical models including One Way Analysis of Variance (ANOVA) and T-test are used to analyze the data apart from other descriptive statistics such as percentages and mean. The study has revealed that working premises, marketing and financial factors are the three most serious factors that hamper the success of MSEs. We suggest that since the real challenges of MSEs change over time, the challenges of MSEs must be studied at some periodic interval to identify the real challenges of MSEs of the time and take appropriate action timely.

**Contribution/Originality:** The study contributes to the existing literature by revealing the critical factors that hamper the success of MSEs and may help the local government to devise ways to support these enterprises in efforts to eradicate poverty and achieve sustainable development by 2030.

### 1. INTRODUCTION

Domestic private investment is an essential element for economic development and in the effort to lift countries out of poverty (Wolfensohn, 2001). In many countries, micro and small enterprises have been the major instruments of growth in employment and output over the last two decades (UNIDO and OECD, 2004). Similarly, Nichter and Goldmark (2009) also assert that the MSE sector generates substantial employment and economic output in numerous countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production (Tybout, 2000). In addition, the sector has the potential to provide the ideal environment for enabling entrepreneurs to optimally exercise their talents and to attain their personal and professional goals (Federal Democratic Republic of Ethiopia (FDRE) Ministry of Trade and Industry (MoTI), 1997 cited in Kosa *et al.* (2018)).

In respect of the role of MSE sector in generating substantial employment and economic output, studies in five African countries (Botswana, Kenya, Malawi, Swaziland, and Zimbabwe) found that MSEs generate nearly twice the level of employment that registered, large-scale enterprises and the public sector do (Mead and Liedholm, 1998). In

many Latin American countries, micro and small enterprises employ over half the working population. International Labour Organization (2003) found that they generated 58% of total employment in Paraguay, 54% in Mexico, and 53% in Bolivia. With regard to economic output, the contribution of the MSE sector varies considerably across countries; MSEs contribute approximately 31% of overall GDP in the Dominican Republic, 13% in Kenya, and 11% in Pakistan (Inter-American Development Bank, 1998; Daniels, 1999; Small and Medium Enterprise Development Authority of Pakistan (SMEDA), 2002).

In Africa a key issue for policy development surrounding micro and small enterprises (MSE) is what factors hamper the success of MSEs? Evidence from developing countries points to the fact that while entrepreneurs are generally not in short supply in most African countries, only a small fraction of new enterprises “graduated” from birth to become small enterprise (Mead and Liedholm, 1998). While some of the MSEs have grown extremely large and profitable but on the other hand, many others have failed or have not been as successful as they might have been. Although failure is not the sole reason for enterprises to leave the business, many enterprises do fail each year (Abebe, 2011). Consequently, a critical issue for policy making is to understand the critical challenges of MSEs that hamper the success of the business. The literature on MSEs in Ethiopia is confined to the capital city (i.e. Addis Ababa) or a specific sub-city within Addis Ababa. The challenges of MSEs could vary from one area to another due to differences in administration capability, pressure from residents to make government offices more responsible and accountable and level of development in various respects including infrastructure, electrification etc.. This idea is in line with Mead and Liedholm (1998). In their review, they identified that location matters in determining MSE’s chances of survival. Thus, the main objective of this study was to identify the factors that hamper the success of MSEs in Ethiopia with particular reference to Amhara region MSEs. More specifically, this study tried to examine the current challenges which deter MSEs’ success; rank the severity of the challenges of MSEs and examine whether the challenges of MSEs vary by sector.

The remaining sections are organized as follows: Section two presents a review of the literature on factors that deter the success of MSEs; section three discusses the research methodology including the research design, sampling and sampling technique and method of data collection and analysis. The last two sections, section four and five, presents the results and discussions and implications respectively.

## 2. RELATED LITERATURE REVIEW

Several studies have examined the challenges and other related issues of micro and small enterprises (Hall, 1992; Mead and Liedholm, 1998; Roy and Wheeler, 2006; Katwalo and Madichie, 2008; Firasew, 2011; Abera, 2012). The literature suggests that, although internal factors were the main cause of failure, external factors also contributed to approximately one third of small business failures (Peterson *et al.*, 1983). In this regard, Roy and Wheeler (2006) 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 MSEs 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 (Abera, 2012). A study by Hall (1992) has also identified two primary causes of small business failure – weaknesses in operational management and inadequate capital.

Although the argument that small businesses in Africa are crucial in employment creation and their contribution to economic growth is not new, the journey of the MSE entrepreneur in many instances is short-lived – there is high failure rate in Africa (Katwalo, 2010). A research in Tanzania, surveying 160 micro enterprises, has identified that high tax rates and corruption are found to be critical constraints to business operations of micro enterprises (Fjeldstad *et al.*, 2006 cited in Firasew (2011)). Other reasons for MSE’s failure include intense

competition with replication of micro-businesses (Manning and Mashego, 1994) unavailability of funding (World Bank, 1996) and manager characteristics including lack of skills and experience (Katwalo and Madichie (2008) and Ray (1993) cited in Katwalo (2010). In their review, Mead and Liedholm (1998) also identified that MSE survival rates vary significantly by sector, location and gender of the entrepreneur, among others. Similarly, Bekele and Worku (2008) examined the factors that affect the long-term survival and viability of micro, small and medium enterprises (MSMEs) in five regions of Ethiopia. The findings of this research indicated that the factors that affect the long term survival of MSMEs in Ethiopia are gender of the entrepreneur, adequacy of finance, level of education, level of managerial skills, level of technical skills, and ability to convert part of their profit to investment.

Firasew (2011) identifies the challenges of MSEs as market-related problems, which includes poor market linkage and poor promotional efforts; institution-related problems such as bureaucratic bottlenecks, weak institutional capacity, 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 among the MSEs and finally society-related problems including distorted attitude about the operators themselves and their products. In his research, Lemma (2008) investigated the nature, characteristics, economic performance, opportunities and challenges of MSEs in the construction sector and identifies the main constraints of the MSEs to be shortage of capital, lack of raw materials, absence of government support, lack of market, lack of credit facilities and high interest rate. Abera (2012) also examined the factors affecting the performance of MSEs with a special emphasizes on textile and garment, food processing and wood and metal work sectors in Arada and Lideta sub-cities, Addis Ababa. The findings revealed that the challenges which affect performance of MSEs include inadequate finance, lack of working premises, marketing problems, inadequate infrastructures, poor management practices, and technological, entrepreneurial and politico-legal problems including bureaucratic bottlenecks system. The empirical finding also indicated that lack of capital, lack of market and bureaucratic requirements and procedures are among constraints faced by MSEs in *Kolfe Keraneo* sub-city of Addis Ababa (Tasisa, 2014).

In summary, literature on MSEs in Ethiopia is confined to the capital city (i.e. Addis Ababa) or a specific sub-city within Addis Ababa. The challenges of MSEs could vary from one area to another due to differences in administration capability, pressure from residents to make government offices more responsible and accountable and level of development in various respects including infrastructure, electrification etc.. This idea is in line with Mead and Liedholm (1998) in their review, they identified that location matters in determining MSE's chances of survival. Thus, this study aimed at identifying the challenges of MSEs in Ethiopia with particular reference to Amhara region MSEs.

### 3. RESEARCH METHODOLOGY

#### 3.1. Research Design

Research design is the blueprint for fulfilling research objectives and answering research questions (Adams *et al.*, 2007). In other words, it is a master plan specifying the methods and procedures for collecting and analyzing the required information. The same authors discuss three types of research design, namely exploratory, descriptive and explanatory. The type of research design employed under this study was descriptive research. Moreover, the study utilized cross-sectional data in the sense that all relevant data were collected at a single point in time. Here are obvious reasons for choosing cross-section data which include the difficulties encountered in surveying large samples of the same respondents over time due to new entry and exit in the market and the unavailability of such record in our country.

### 3.2. Data and Sampling

According to Kothari (2004) depending on the sources and techniques one uses for gathering data, data can be divided into primary and secondary data. They also state that primary data are data collected by using techniques like observations, interviews, questionnaires and experiments, among others. On the other hand secondary data refer to documents that have been organized before. In this study, primary data was employed. The primary data were collected using questionnaire.

The layout of the questionnaire was kept very simple to encourage meaningful participation by the respondents. The questions were kept as concise as possible with care taken to the actual wording and phrasing of the questions. The reason for the appearance and layout of the questionnaire are of great importance in any survey where the questionnaire is to be completed by the respondent (Adams *et al.*, 2007). The items in the questionnaire are adapted mainly from Abera (2012). The questions that were used in the questionnaire were multiple-choice questions and five-point Likert scale type questions.

For the purpose of this research the population from which samples were drawn was all MSEs in Amhara region which are 99,752 MSEs in number. A total of seven hundred fifty questionnaires were distributed to respondents using convenience and judgmental sampling. Out of these, 348 questionnaires were returned. However, 32 of these were incomplete and for analysis we used 316 usable responses. Attempts are made to include different MSEs operating in different sectors to be part of the sample of our study.

### 3.3. Method of Data Analysis

In order to analyze the research data, statistical models such as One Way ANOVA and T-test were employed apart from other descriptive statistics such as percentages and mean. The One Way ANOVA test was used for comparing three or more means. It was used when there are more than two categories. The T-test was used for variables having two categories to check whether results differ between categories.

## 4. RESULTS AND DISCUSSIONS

### 4.1. Background Information

In regard to gender of the respondents, 48% of them were male and 52% were female. So, we can say that the study has considered both male and female MSE entrepreneurs in a fair manner. Regarding sector of the sample MSEs, most of them are engaged in trade (31%) followed by textile and garment (19%), food and related (14%), service (13%), hand craft (9%), wood and metal work (7%) and others (7%). This classification of MSEs by sector type was believed to be helpful to study whether the challenges differ by sector. This is because firms in different sectors of the economy could face different types of problems and hence, the degree of severity of critical factors may differ from sector to sector. Starting own business requires a start-up capital besides project ideas. To capture information regarding the relative importance of the various sources of finance, enterprises were asked their source of finance. The study has revealed that family (39%) is the most common source of finance, followed by personal saving (27%), micro finance institutions (12%), *iqub/idir* (6%), friends/relatives (6%), NGOs (4%), banks (2%) and others (3%). This shows that the main source of finance for MSEs in Amhara region is family. Personal saving and Microfinance institutions are the next important source of finance.

### 4.2. Challenges of Micro and Small Enterprises

Respondents were asked different questions regarding the challenges faced by MSEs in Amhara region. There are a number of challenges that affect performance of MSEs involved in different sectors. Eight potential factors were considered including politico-legal factors, working premises, technological, infrastructural, marketing, financial, management and entrepreneurial related factors. The following paragraphs discusses about the specific challenges faced by MSEs in the context of those factors.

Table-1. Politico-legal Factors.

No.	Politico –Legal Factors	1*	2*	3*	4*	5*
1.	The tax levied on my business is not reasonable	17%	19%	10%	29%	25%
2.	Bureaucracy in company registration and licensing	16%	25%	22%	22%	16%
3.	Lack of government support	11%	18%	17%	32%	22%
4.	Unnecessary political intervention	21%	26%	21%	18%	14%
5.	Lack of accessible information on government regulation that are relevant to my business	14%	24%	22%	23%	17%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

Regarding politico-legal factors, as indicated in Table 1, the majority of the respondents believe that the tax levied on their business is not reasonable (54%) and there is lack of government support (54%). However, even though a significant proportion of respondents believe that there is bureaucracy in company registration and licensing (38%) and unnecessary political intervention (32%), a greater proportion of respondents believe to the contrary. The views “tax levied on their business is not reasonable and there is lack of government support” have been prevalent in all different sectors ( $F= 0.64$ ,  $\text{Prob} > F= 0.7212$ , and  $F= 0.65$ ,  $\text{Prob} > F=0.7135$  respectively). The survey was made before the recent tax reform and thus, the view on tax may not hold true now as the reform might have mitigated the problem. As to working place related factors, the results have revealed that absence of own premises is the most severe challenge from the three working place factors considered as 58% of the respondents rated this factor at least 4 on a 5-point Likert scale. Please see Table 2 for the results.

Table-2. Working place Factors.

No.	Working place Factors	1*	2*	3*	4*	5*
1.	Absence of own premises	18%	20%	5%	25%	33%
2.	Current working place is not convenient	14%	22%	16%	29%	18%
3.	The rent of house is too high	16%	26%	9%	26%	23%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

A significant proportion of the respondents also believe that the rent of house is too high (49%) and current working place is not convenient (47%). The view that rent of house is high was more prevalent among MSEs engaged in hand craft at 5 percent level of significance ( $F= 2.12$ ,  $\text{Prob} > F= 0.0412$ ). Those views on absence of own premises and working place inconvenience were prevalent among all sectors ( $F= 1.07$ ,  $\text{Prob} > F= 0.3818$  and  $F= 0.79$ ,  $\text{Prob} > F=0.5994$  respectively). The other potential factors were technological factors.

Table-3. Technological Factors.

No.	Technological Factors	1*	2*	3*	4*	5*
1.	Lack of appropriate machinery and equipment	11%	24%	18%	28%	19%
2.	Lack of skill to handle new technology	11%	20%	21%	31%	18%
3.	Lack of money to acquire new technology	9%	12%	13%	38%	28%
4.	Unable to select proper technology	13%	20%	24%	27%	16%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

As shown in Table 3, four items make up this scale. From this four items, the third item- lack of money to acquire new technology- is perceived to be the most serious challenge faced by MSEs and this view was shared by all sectors ( $F= 1.53$ ,  $\text{Prob} > F= 0.1561$ ). A substantial proportion of respondents also believed that there is lack of skill to handle new technology (49%), there is lack of appropriate machinery and equipment (47%), and they are unable to select proper technology (43%). In regard to infrastructural factors, power interruption is the most severe challenge (69%) followed by lack of appropriate dry waste and sewerage system (54%) and insufficient and interrupted water supply (54%). These views were also prevalent among all sectors ( $F=1.51$ ,  $\text{Prob} > F= 0.1638$ ;  $F= 0.80$ ,  $\text{Prob} > F= 0.5918$  and  $F= 1.32$ ,  $\text{Prob} > F= 0.2382$  respectively). However, the view on road infrastructure and transportation service was positive. Although a significant proportion of respondents also believe that road infrastructure (40%) and transportation service (42%) are problems which affect their performance, a greater

proportion believed to the contrary. See Table 4 for the results.

**Table-4. Infrastructural Factors.**

No.	Infrastructural Factors	1*	2*	3*	4*	5*
1.	Power interruptions	13%	12%	7%	29%	40%
2.	Insufficient and interrupted water supply	15%	18%	13%	31%	23%
3.	Poor road infrastructure	16%	25%	19%	24%	16%
4.	Lack of sufficient and quick transportation service	16%	29%	13%	23%	19%
5.	Lack of appropriate dry waste and sewerage system	15%	20%	11%	25%	29%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

**Table-5. Marketing Factors.**

No.	Marketing Factors	1*	2*	3*	4*	5*
1.	Inadequate market for my product	13%	16%	15%	35%	21%
2.	Opportunity for new market is so difficult	9%	11%	12%	41%	27%
3.	Lack of demand forecasting	9%	17%	26%	25%	23%
4.	Lack of market information	8%	12%	19%	40%	22%
5.	Absence of relationship with an organization that conduct marketing research	6%	10%	14%	43%	27%
6.	Poor government support to create market network	12%	11%	11%	35%	31%
7.	Lack of promotion to attract potential customers	9%	15%	17%	40%	19%
8.	Poor customer relationship and handing	17%	36%	15%	18%	14%
9.	Poor government support to get production & sales premises	10%	9%	10%	35%	36%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

As shown in Table 5, from the nine marketing factors considered, poor government support to get production & sales premises, absence of relationship with an organization that conduct marketing research, poor opportunity for new market, and poor government support to create market network are the most severe challenges as more than 65% of the respondents rated those factors at least 4 on a 5-point Likert scale. One Way ANOVA result shows  $F = 1.28$ ,  $\text{Prob} > F = 0.2622$ ;  $F = 1.82$ ,  $\text{Prob} > F = 0.0824$ ;  $F = 2.04$ ,  $\text{Prob} > F = 0.0506$ ;  $F = 2.46$ ,  $\text{Prob} > F = 0.0183$  respectively indicating that while the views regarding the first and second factor were prevalent among all sectors, the views on the third factor were more prevalent among hand craft sector and the fourth factor more prevalent among textile and garment sector. Lack of market information, lack of promotion to attract potential customers and inadequate market for their product are the next most serious challenges with at least 50% of the respondents rating at least 4 on a 5-point Likert scale. Other factors including poor customer relationship and handing and lack of demand forecasting are factors that were relatively least serious problems to hinder the success of MSEs.

The study also revealed that from six financial factors considered, complex and monotonous procedures by banks and other lending institutions, shortage of working capital, high collateral requirement from banks and other lending institution, and high interest rate charged by banks and other lending institutions are the more serious factors affecting MSEs' performance. However, lack of cash management skills and inadequacy of credit institutions are less serious factors to hinder performance. So, we can say that it is not the inadequacy of credit institutions that is mattering but the complex and monotonous procedures by banks and other lending institutions, high collateral requirement from and high interest rate charged by financial institutions. See Table 6 for details.

**Table-6. Financial Factors.**

No.	Financial Factors	1*	2*	3*	4*	5*
1.	Inadequacy of credit institutions	16%	25%	13%	24%	22%
2.	Lack of cash management skills	15%	32%	12%	22%	18%
3.	Shortage of working capital	9%	12%	12%	40%	26%
4.	High collateral requirement from banks and other lending institutions	9%	11%	16%	32%	32%
5.	High interest rate charged by banks and other lending institutions	7%	14%	15%	37%	27%
6.	Complex and monotonous procedures by banks and other lending institutions	6%	11%	13%	41%	29%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

Table-7. Management Factors.

No.	Management Factors	1*	2*	3*	4*	5*
1.	Lack of clear division of duties and responsibility among employees	13%	23%	25%	23%	17%
2.	Poor organization and ineffective communication	9%	19%	23%	31%	17%
3.	Poor selection of associates in business	11%	25%	14%	31%	19%
4.	Lack of well trained and experienced employees	12%	23%	17%	28%	19%
5.	Lack of low cost and accessible training facilities	7%	14%	12%	40%	28%
6.	Lack of strategic business planning	12%	22%	14%	32%	21%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

In connection with management factors (See Table 7), lack of low cost and accessible training facilities is the most serious challenge affecting performance followed by lack of strategic business planning and poor selection of associates in business. Lack of clear division of duties and responsibility among employees, poor organization and ineffective communication and lack of well trained and experienced employees are least serious problems to hamper MSEs' success. Among the entrepreneurial factors, lack of entrepreneurship training and lack of experience sharing opportunity with similar successful firms are the two most serious factors that deter the success of MSEs followed by absence of initiative to assess ones strengths and weakness and lack of determination and courage to take responsibility for ones temporary failure. However, lack of tolerance to work hard and lack of motivation and drive were least serious problems to hinder MSEs' success. The results are presented in Table 8.

Table-8. Entrepreneurial Factors.

No.	Entrepreneurial Factors	1*	2*	3*	4*	5*
1.	Lack of motivation and drive	16%	33%	14%	24%	14%
2.	Lack of tolerance to work hard	19%	34%	11%	23%	14%
3.	Lack of determination and courage to take responsibility for ones temporary failure	11%	25%	24%	26%	15%
4.	Absence of initiative to assess ones strengths and weakness	10%	26%	16%	29%	20%
5.	Lack of entrepreneurship training	9%	13%	6%	41%	31%
6.	Lack of experience sharing opportunity with similar successful firms	9%	16%	8%	40%	27%

\*5= strongly agree, 4= agree, 3= undecided, 2= disagree and 1= strongly disagree.

#### 4.3. Comparison of Factors

Though the results suggest that some items from politico-legal, infrastructure, working premises, technology, marketing, financial, management and entrepreneurial factors affect the performance of MSEs, this does not necessarily mean that all factors have equal impact. In this regard, the respondents were asked to rate the severity of the factors using five point Likert scale. Table 9 compares the impact of the eight factors by using mean value.

The results have revealed that working premises, marketing factors and financial factors are the three most severe problems affecting the performance of MSEs. Technological factors and entrepreneurial factors are the next serious factors followed by management factors and politico-legal factors. However, infrastructural factors are the least serious factors to hamper MSE success.

Table-9. Comparison of the Factors.

No.	Factors	Mean	Rank of Severity	T-test Pr(T > t)
1	Politico-legal factors	3.24	7 <sup>th</sup>	0.0005
2	Working premises factors	3.69	1 <sup>st</sup>	0.0000
3	Technological factors	3.41	4 <sup>th</sup>	0.0000
4	Infrastructural factors	3.15	8 <sup>th</sup>	0.0151
5	Marketing factors	3.56	2 <sup>nd</sup>	0.0000
6	Financial factors	3.46	3 <sup>rd</sup>	0.0000
7	Management factors	3.28	6 <sup>th</sup>	0.0000
8	Entrepreneurial factors	3.38	5 <sup>th</sup>	0.0000

The results are statistically significant at 1% level of significance except for infrastructural factors which is significant at 5% indicating that the results didn't happen by chance and the factors considered are real challenges of MSEs. On the basis of the results, we can, therefore, say that working premises, marketing factors and financial factors are the three most important factors that do largely hamper the success of MSEs.

## 5. IMPLICATIONS

This study tried to identify the factors that hamper the success of micro and small enterprises in Ethiopia, specifically Amhara region. The study has revealed that marketing factors are found as one of the most serious problems faced by MSEs. Therefore, it is necessary to solve this problem using different approaches including: (1) Linking the MSEs with other private firms through vertical integration working within or around Amhara region so that the operators are able to secure market opportunity. (2) Changing the perception of the general public through extensive awareness creation mechanisms to buy local products, since families and individuals are the main buyers of the products manufactured by MSEs and (3) Allowing MSEs located and operating in Amhara region to supply their products to government institutions through affirmative actions, among others. Financial problem is also one of the most important factors affecting MSEs' performance. This requires government bodies to communicate with banks and other credit institutions to relax their requirements and reduce interest rates, among other things, so that MSEs would have growth opportunities. To make MSEs competitive and profitable, increasing the capacity and skill of the operators through continuous trainings, experience sharing with successful enterprises, and provision of advice and consultancy are crucial. Moreover, improved provision of necessary infrastructure like uninterrupted electric power is basic to effective performance of these enterprises. Finally, since there are changes over time, the challenges of MSEs must be studied at some periodic interval to identify the real challenges of MSEs of the time and take appropriate action timely.

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