



**THE DEVELOPMENT CHALLENGES OF MICRO AND SMALL-SCALE MANUFACTURING ENTERPRISES IN ARBAMINCH CITY ADMINISTRATION, IN THE CASE OF SHECHA SUB-CITY, SOUTHERN ETHIOPIA**

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**ABSTRACT**

This study was conducted to determine factors affecting the development of micro and small-scale manufacturing enterprises in Shecha sub city of Arbaminch town administration. Data were collected from 154 operators of MSEs. The data were analyzed using descriptive statics. lack of land/lack of operating or working space, lack of access to markets, lack of entrepreneurship skills and expertise, lack of equipment to carry out businesses and lack of credit for start-up capital or expanding are identified as the main factors affecting the development of micro and small scale manufacturing enterprises in the study area. The study result indicated that, most of MSEs have registered increase in employment and increase in total capital or assets during the entire duration of their business. Similarly, most of MSEs failed to formulate and adopt deliberate business development strategies. Sex, education status and source of skill to start business are found internal factor and association with level of enterprise development. So that, providing adequate working and marketing premise, provision of capacity building trainings on business development, management, marketing skills to owners and targeted action to control the import of cheap counterfeits must be made. Furthermore, measures need to be taken to promote the consumption of domestic goods so as to build a tradition of consuming Ethiopian-made products and thus expand the market for local articles, equipment and the provision “lease financing” should be strengthened.

**Keywords:** Micro enterprises, Manufacturing Sector, Enterprise, capital

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## I. INTRODUCTION

Micro and small-scale enterprises (MSEs) have been acknowledged as key sectors that play an important contribution to the economy of a nation. It has pervasive functions in increasing employment, income generation, reducing poverty and creating job opportunities to citizens. The development of the MSE sector long drew the attention of governments, policy makers, analysts, donors and other key development sector actors. Ethiopia adopted its first MSE development strategy in 2005 and it emphasized on the poor and less skilled people to form cooperatives and create their own jobs. The second new MSE Strategy was developed in 2011 and it included the university graduates as MSE target groups during its implementation. On top of providing job opportunities to the population other than the owners, they are hoped to bring about the technological transfer and new corporate management skills to the nation. Small scale businesses in Ethiopia are divided into five sectors: these are the manufacturing sector, the service sector, construction sector, the urban agriculture sector and the retail sector. These sectors are expected to substitute imports or are categorized in the manufacturing sector (MoUDC 2013, MoFED 2010). The Ethiopian Growth and Transformation Plan (GTP) recognize MSEs as ways to enhance wealth creation and expansion of employment opportunities. The plan specified the MSE subsector creates employment opportunities for the mass of the population and thereby contributes towards poverty reduction (MoFED, 2010). The development of MSEs is therefore the key components of Ethiopia's industrial policy direction that will contribute to the economic transformation in Ethiopia (MoFED, 2010).

According to the new MSE Strategy (2011), MSEs in Ethiopia are divided into five sectors and are expected to substitution of import products and provide job opportunities to the population other than the owners. They are also hoped to bring about the technological transfer and new corporate management skills to the nation. Although the development of MSEs has been well recognized by the different policy documents their success rate in terms of creating job opportunities and serving as a link in technological transfer is still seriously problematic in Ethiopia. According to the Survey conducted by MoUDC (2013) on Micro and Small Enterprises (MSEs) in Selected Major Cities of Ethiopia, the employment opportunities created in the sector were basically family based. It was observed that 34.4 % of the MSEs employed a single worker, followed by 33.8% and 24.1% which employed 3-6 Persons and 2 persons respectively.

According to the study report by Ministry of Urban Development and Construction (2013), small Scale businesses are divided into five sectors: these are the manufacturing sector, the service sector, construction sector, the urban agriculture sector and the retail sector. However, a large proportion of MSEs were in the retail sector i.e. involved in the buying and selling of commodities. Despite the fact that the major national documents give emphasis to the manufacturing sector to produce essential commodities and create conducive environment in technological transfer, insignificant proportions of the MSEs have been involved in the manufacturing sector. The MSE in manufacturing sector are also characterized by low level of technological innovativeness which is supposed to be vital for the growth and development of MSEs (MoUDC, 2013)

The preliminary discussion with the sub-city MSE Office revealed that those MSEs that are particularly engaged in manufacturing sector are adversely affected by the frequent interruption of electric power and less market access for their products even by the government institutions in Arbaminch City administration. During the period the power shortage had been serious, MSEs in manufacturing sector were completely cut off in power use and during the less serious periods, they were put in rationing of Power. As result of the frequent and unplanned power interruption, manufacturing sector MSEs are forced to operate within their limited production capacity, reduced their operating hours, suffer from losing substantial raw materials in process, experience damage to machinery and equipment as well as incurred additional cost for fuel and transportation (MoUDC, 2013).

The manufacturing sector MSEs are generally characterized by low productivity and stagnation followed by less market accesses, capital, limited access to financial services, lack of business plan and strategy, lack of partnership and networking, absence of technical and business skills. In addition to this, the limited demand and purchasing power of the local people and even the government institutions, limited export and, poor business environment and networking are some of the problems in the sector irrespective of the supporting packages aided by different proclamations in for the sector (GFDRE, 2011).

In view of the problems, the study tried to address the following research questions: What are the internal and external factors that mostly affect the development of manufacturing Sector MSEs in Shecha sub-city of Arbaminch City Administration? What has been done by the Government to support manufacturing sector MSEs and how can

the problems of manufacturing sector MSEs in Shecha sub-city be minimized? What kind of support from the side of relevant stakeholders is being made to address these challenges in the sub-City? What are the development challenges of SMEs of manufacturing sectors in Shecha sub-city?

## II. LITERATURE REVIEW

Entrepreneurs put their faith in common sense, overestimate their managerial skills, or believe that hard work alone can ensure success. If a small business manager does not know how to make decisions and does not understand the basic management principals, there, he is likely to face managerial challenges in the long run if not failure to progress with business activities (Griffin & Ebert, 2006). Small businesses managers need to have experience in the field they want to enter. The experience will provide practical understanding as well as knowledge about the nature of the business, which will spell out the difference between failure and success (Scarborough & Zimmerer, 2008).

Effective control system keeps the business in track and alert managers of any potential danger. If any control does not signal any impending problems you may seriously be troubled, then such controls are ineffective (Griffin & Ebert, 2006). Scarborough and Zimmerer (2008) argue that; the largest investment a small business makes is in inventory yet inventory control is one of the most neglected managerial responsibilities. Insufficient inventory levels result in shortages and stock outs causing customers to become disillusioned and leave. More common situation is that the manager has too much inventory, but also too much of the wrong type of inventory. Many small businesses that fail due to poor inventory control, have excessive amounts of cash tied up in an accumulated useless inventory.

Many small businesses do not realize the importance of planning to their firms' success. Often managers of small businesses neglect the process of planning because they think that it is something that benefits only large companies. Failure to plan a firm's future will have a devastating effect on the firm existence. This often manifests itself in two ways; Lack of strategic plans (Strategic plan plots the overall direction of the business and identifies the ways of maximizing its strengths and overcoming its weaknesses) and unplanned expansion (Growth is natural, healthy and desirable part of any business. But it must be planned carefully. Expansion should be financed by the retained earnings or capital contributions from owners, but most small businesses wind up borrowing at least a portion of their capital investment). As the business increases in size and complexity, problems tend to increase in proportion and the managers must learn how to deal with it. Sometimes entrepreneurs encourage that eventually the business outstrips their ability to manage (Griffin & Ebert, 2006).

For many small businesses choosing the location is partly a science. Too often business locations are chosen without proper study and planning. Location is much too critical to be left to chance. Some beginning owners choose a particular location just because they have seen a vacant place or building (Scarborough & Zimmerer, 2008; Lambing & Kuhl, 2007). Entrepreneurs need to establish prices that will earn necessary profits by first understanding what it costs them to make, market, and deliver their products and services. Small businesses owners often underprice their goods and services resulting to losses that ultimately cause their failure (Tootelin & Gaedeke, 2002).

Lack of funds could lead to excessive borrowing and consequently business becomes bankrupt because their liabilities are higher than their assets. According to Dwivedi (2005), the role of financial institution is to facilitate the flow of funds from individual surplus spending units to deficit spending units. The whole of this process is called money market. And according to this author, the money market reaches its equilibrium where demand for money equals supply of money. The author adds that, to business firms or enterprises, money is the producer's good much as machinery or inventories, thus in order to attain growth of any business, especially small sized ones, the business enterprise should acquire additional capital through the capital market in order to maximize their returns. Longenecker et al. (1997) stated that economies of scale virtually prohibit small businesses from always although frequently and sometimes using other sources of finance such as public stock issues. Government regulations like taxation are regularly well intended and they benefit without question. However, their costs to small businesses are relatively higher as a result small businesses normally do shift the burden of those costs to customers. Government regulations have been accused of distorting free markets by impending competition (Susman, 2007).

During the early stages of starting business many owners commit themselves to taking any sources of finance they have available to them. This can be disastrous as high interest rates and unfavorable payment schedules are overlooked due to pressure of financing their business. For the entrepreneurs taking high risk borrowing is simply a choice between starting a business and never starting the business. The best source of finance to small business can often be family and friends contributions but pay back in time. Small businesses are particularly vulnerable in

periods of high interest rates because they rarely depend heavily on financial institutions for seasonal borrowing (Susman, 2007; Lambing & Kuhl, 2007).

Micro & small enterprise considered as a vital component of the socio-economic development of both developed and developing countries, usually some of these enterprise collapse with in the 1<sup>st</sup> few years of their start-up of those operating, some grow rapidly, while others grow slowly. So it is important to identify the causative factors of success because it helps new entrants of the sector to consider the factors & use for their future in the business. The success of a firm is motivated by external opportunities, such as promising demand prospects for the firm's produce, and /or internal inducements, such as a shift to a more efficient utilization of existing resources of the firm. On the other hand, external & internal factors may also function as obstacles to growth & success. As far as external success determinants are concerned, demand for the firm's products is the major factors. Second, the market actions of the competitors, the supply of production factors and the features of the local business environment are typically external to a small firm. Internal success determinants include the features of the firm itself and attributes of the business owners of the firm enterprises. In this research the internal success factors of the enterprises are under consideration.

### **III. RESEARCH DESIGN AND METHODOLOGY**

The study was conducted in Shecha sub-city of Arbaminch City Administration. It is one of the four sub-cities of Arbaminch city Administration. It is located 505 kilo meters and 260 kilo meters away from the capital of Ethiopia and the region respectively. It is also located to the southern part of the city of Arbaminch. The sub-city hosts many of the zonal, city and woreda administration offices. It also hosts different government and private banks, insurance companies and educational institutions including the Chamo campus of Arbaminch University.

The study was descriptive in its nature and employed both qualitative and quantitative approach so as to describe and critically assess the problems encountering the development of manufacturing sector MSEs in study area. This was because a mixed approach or triangulation is assumed to be effective in observing diverse aspects of variables of the study. The variables were measured both quantitatively and qualitatively after operationalization (Creswell, 2003). The rationale for selecting a mixed approach for this study was that the nature of the research problem requires both qualitative and quantitative data sets.

Primary data were obtained from sample respondents through distribution of questionnaire on the objectives of the research. For supplementary data from in-depth interviews and focus group discussions were also conducted using guides and checklists and Secondary data were collected from relevant books, internet sources, journal articles, unpublished materials, conference reports, proceedings and office documents including government policies, legislations and other published and un-published documents prepared by different governmental and non-governmental organizations regarding the development of the manufacturing sector MSEs. The researcher also employed an in depth interview guide for purposively selected city and sub-city micro and small scale enterprise development office personnel.

Accordingly, simple random sampling was used to obtain information from 154 respondents randomly selected from the total of 256 manufacturing enterprise owning individuals or cooperative members the sample thus becomes 154 respondents.

### **IV. DATA PRESENTATION, ANALYSIS AND INTERPRETATION**

From the total population for the study which constitutes 174 questionnaires were distributed and of that 154 were filled and returned the questionnaire. Therefore, the analysis will be based on the data.

Regarding to marital status of the respondents, of the total participants of the survey 78 (50.65%) were single. 51 (33.12%) of the respondents were married. 20 (12.98%) of the respondents were divorced. And finally 5 (3.25%) of the respondents were separated.

Enterprises are created by having different legal ownership status such as sole owner ship, joint ownership, family business, Cooperatives and others. Hence, in this respect the response obtained from the respondents has shown that 68 (44.2%) had sole ownership legal status. 5 (3.25%) of the respondents pointed that they had a joint ownership legal status. 61 (39.61%) out of the total respondents stated that they had family ownership legal status. The rest 20 (12.98%) of the respondent participants revealed that they had cooperative ownership legal status. Therefore, from

the above analysis we can conclude that the majority of the enterprises were legally organized on sole and family basis. For this the respondents who owned the firms solely were asked as to why they prefer to start their own business and the respondents believe that sole ownership “brings high income”. The respondents also mentioned “family custom or traditional belief” as their main reason to prefer sole ownership of the business.

**Table 1: Background and characteristics of Respondents**

Parameter	Frequency	%
Age		
18-24	48	31.2
25-30	64	41.6
30+	42	27.2
Total	154	100.0
Sex		
Male	102	66.24
Female	52	33.76
Total	154	100.0
Level of education		
Can't read and write	0	0
Read and write	15	9.74
Grades 5-10	21	13.6
10+1	40	25.97
10+2	30	19.48
10+3 /diploma	40	25.97
BA/BSC and above	8	5.1
Total	154	100.0
Marital status		
Single	78	50.65
Married	51	33.12
Divorced	20	12.98
separated (Widowed)	5	3.25
Total	154	100.0

*Source: Field Survey*

**Table 2: The legal ownership status of the firms.**

	Frequency	%
What is the legal ownership of the business?		
Sole ownership	68	44.2
Joint ownership	5	3.25
Family business	61	39.61
Cooperative	20	12.98
Total	154	100.0
Reasons for sole ownership status		
Family tradition	66	42.86
To be self-employed	48	31.2
Brings high income	50	32.46
Total	154	100.0

*Source: Field Survey*

#### IV.I. MAJOR CHALLENGES OF SMALL AND MICRO ENTERPRISES AT ARBAMINCH CITY, SOUTHERN ETHIOPIA

**Table 3: Percentage Access to Land and Working Premise**

Is the land/working place occupied by your enterprise owned or rented/leased?	Frequency	Percentage
Rented or leased by your firm	52	33.8
Micro institution	152	66.2
Total	154	100.0
Did your enterprise submit an application to obtain a land for expansion?		
Yes	137	89.2
No	14	9.2
Don't know	3	1.5
Total	154	100.0
To what extent is access to land an obstacle to the current operations of your enterprise?		
Minor obstacle	14	9.2
Moderate obstacle	64	41.5
Major obstacle	71	46.2
Don't know	5	3.1
Total	154	100.0

Source: Field Survey

#### IV.II. AVAILABILITY OF BUSINESS STRATEGY

Respondents were asked whether they have formulated business development strategy or not. According to the data obtained from the respondents, 116 (75.1%) of the respondents fail to have effective business growth strategies. While the rest 38 (24.67%) out of the total respondents do have business plans. The majority of the respondents that stated that they have no business strategy or plan told the researcher that they have no awareness and skill of developing business growth strategies/ plans and limited exposure to formal business management skills. The discussion with the respondents revealed that, respondents depend on instinctive techniques actually different from deliberately designed long-term strategies& plans. Their actions are unplanned and accidental used to cope with the needs of the market, customers and so on. On the other hand, the respondents also revealed that most of them have very limited numbers of full time workers in their business enterprises both at starting period and currently except creating jobs at family and household basis. The enterprise development office personnel also stated during the interview session that the way the enterprises get support on developing business strategies and plans was not effective because of turnover of professionals in the sector in the sub city.

#### IV.III. ACCESS TO INFRASTRUCTURE

Cognizant of the fact that one of the major barriers and constraints to MSE growth is lack of adequate infrastructure, the survey measured MSEs' access to various infrastructures. The term infrastructure is related to adequate supply of electrical power, access to transport, water, land and business premises, and telecommunications. Appropriate access of infrastructure has positive effect of promoting MSEs by lowering the cost of doing business. The respondents were asked whether their business enterprise obtain an electrical connection or not. All 154 (100%) of the surveyed participants stated their enterprises have access to electric connection. The respondents were also asked if they have experienced power outages or not. 142 (92.2%) of the total respondents confirmed that their firm experienced power outage. The rest 12 (7.8%) of the respondents pointed that they never experienced power outage. The respondents were further asked whether their firm obtain a water connection or not. 114 out of 154 (73.8%) out of the surveyed respondents informed that their MSEs have access to water connection.

Whereas 20 (13%) out of the total respondents reported that they experienced insufficient water supply for production. Only 20 (13%) of the respondents informed that their enterprise does not use water for production. The government's efforts to expand mobile phone network and expansion of service have helped to improve telecommunication access. However, the use of modern technologies for communicating with clients or suppliers was low among the MSE sector. For instance, use of email access to communicate with clients or suppliers was

reported only by 15 (10%) of the respondents. Similarly, only 5 (3.1%) of the participants responded that they have their own website.

Different literatures revealed that in Ethiopia and elsewhere in other countries, one of the major factors which constrained the growth of MSEs is lack of access to land. To this end, the respondents were requested three questions related to access to land and working premise, whether they submitted an application to obtain a land for expansion and the level and degree of access to Land is an obstacle to their current operations of their enterprises or not. Nearly 52 respondents or (33.8%) affirmed that the land/working place occupied by their enterprises is rented, while the remaining 102 (66.2%) of the participant respondents reported that the land or the working premise is owned by micro institutions. Furthermore, nearly nine out of every ten respondents that is 137 (89.2%) reported that they have submitted an application to obtain a land for expansion of their enterprise business. On top of that, nearly nine out of every ten that is 135 (87.7%) of the respondents reported that access to land posed either moderate or major obstacle to their operations. Furthermore, the interview session with the office personnel revealed that land access problem is serious in the entire sub city. And they also stated that enterprises stay longer in one working place even though they reach good business status in capital. The enterprises who obtained land earlier do not want to graduate and shift and leave the land for the newly organized manufacturing enterprises. In this regard the city administration's failure to take actions based on the regulation and directives of enterprise graduation and shift to their own business is one major problem though the regulation commands an enterprise to stay 3-5 years in government support.

**Table 4: Percentage Access to Finance**

Parameter	Responses	
	No	%
Internal funds or retained earnings	7	4.5
Borrowed from non-bank financial institutions microfinance institutions,	140	90.8
Purchases on credit from suppliers	5	3.2
Other, moneylenders, friends, relatives, etc.	2	1.3
Total	154	100

Source: Field Survey

One of the greatest challenges that MSEs entrepreneurs facing in Ethiopia and in other places are problem of access to finance. As Araya and others stated shortage of finance and lack of access to financial institutions were the highest impediments facing MSE operators not to efficiently run as the required and expand their work (Araya, 2014, MoUDC 2013). Respondents were asked to name their finance sources to run their manufacturing enterprise as a working capital i.e. the funds available for day-to-day operations. Accordingly, nine out of every ten of the respondents that is 140 (90.8%) stated that their source of finance for their enterprises is borrowed from non-bank financial institutions i.e.-microfinance institutions while the rest 7 (4.5%) stated that their source of finance to run their enterprise is internal fund or retained earnings of fund. Purchase on credit from suppliers and borrowed from other money lenders as sources of their finance identified by 5 (3.3%) and 2 (1.3%) respectively. Therefore, from the above analysis we can understand that the major source of finance for entrepreneurs for running their enterprise is obtained from borrowing from non- bank financial institutions like microfinance institutions, the Omo microfinance institution in this case.

## V. CONCLUSIONS

This study was conducted to determine factors affecting the development of micro and small scale manufacturing enterprises in Shecha sub city of Arbaminch town administration. Hence, the following major conclusions were drawn from the analysis of the respondents' response. According to the results of the analysis of the study, the performance of manufacturing MSE enterprises were influenced by interlinked factors. The most important ones include access to inputs particularly to raw materials, access to market for products and access to premise (land) to run business. Moreover, access to business training and financial access were also pointed out as important factors affecting enterprises' development and performance. On the other hand, it was also concluded that the support of Ethiopian government on small & micro enterprise manufacturing industries created a good opportunity for MSEs through, providing credit facilities, constructing shades and providing assistance for them to be organized in group to bring their knowledge and labor together for common benefit & try to develop the market network & occasional bazaars to make them sell their product is encouraging. However, the manufacturing MSEs were functioning with

serious challenges. Lack of land/lack of operating or working place, lack of access to markets, lack of entrepreneurship skills and expertise, lack of equipment to carry out businesses and lack of credit or restriction of loan (availability of ceiling) for start-up capital or expanding enterprise businesses are the most persistent challenges facing manufacturing MSEs in the study area. The manufacturing MSEs have failed to formulate and adopt deliberate business development strategies. Their actions were unplanned and accidental which are used to cope with the needs of the market and customer. Furthermore, poorness of utilities particularly that of electric power shortage, increased cost of procurement (inflation) of raw material and transportation were identified as a bottleneck problems of Small and micro manufacturing enterprises in the study area.

Based on the above conclusions of the major findings of the study, the following recommendations were made in order to tackle the challenges of manufacturing sector MSEs of Arbaminch city administration other than Shecha sub city:- Since most of the manufacturing MSEs Operators lack technical and managerial skills and skills to develop business strategies, the TVETs and other educational institutions should collaborate with City administration MSE office to provide on job training and mentorship for the short term and in the long run entrepreneurship courses must be mainstreamed into the TVET curriculums as appropriate as possible. The MSE coordination office at different levels starting from the city to down the sub city and kebele levels should enhance the capacity and skill of the operators through trainings, experience sharing from successful enterprises, and provision of advice on how to develop promotion and developing marketing strategy. Manufacturing MSEs are value adding enterprises as opposed to retail and business MSEs. Hence, Regional bureau of industry, MSE Agency, and the City administration of Arbaminch should work in a coordinated manner to alleviate their major challenges. In this regards, adequate working and marketing premise to the most strategic and growing manufacturing enterprises should be given due emphasis. Furthermore, improving electricity and water supply as well as transportation services would help to catalyze the growth of manufacturing sector MSEs: As the MSEs are developing, their financial requirements are exceeding the ceiling provided by the microfinance institution should be amended or other modalities of financing and best practices from other countries like “lease financing” must be available to manufacturing MSEs for purchase of equipment that can expand production and productivity levels of enterprises. Hence in this respect the government should develop guidelines to institutionalize “lease financing” in the region as well as in Ethiopia. Targeted action to control the import of cheap counterfeits should be put in place and measures need to be taken to promote the consumption of domestic goods especially manufactured by local enterprises so as to build a tradition of consuming Ethiopian-made products and thus expansion of the market for local enterprise made goods. The Federal MSE Agency as well as the regional bureau of industry and enterprise development agency should work for changing the inconsistent attitude of the public towards MSE products through extensive awareness creation efforts such as trainings, workshops, symposiums, frequent bazaars etc.

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