

## **Determinants of Micro and Small Scale Enterprises Advancement into Medium scale Enterprises: The case of Nifas Silk Lafto Sub-city, Addis Ababa**

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### ***Abstract***

*The purpose of this study is to examine the determinants of micro and small scale enterprises advancement into medium scale enterprises. The study used explanatory research design and the total population of the study was 1180 MSEs. Stratified random sampling procedure was used for the selection of 299 MSEs from Nifas Silk Lafto Sub-city. Data were collected by using structured questionnaire from the selected respondents and analyzed by using regression technique. The study shows that the major source of finance for MSE is personal saving. The study shows most of the MSEs are legally sole proprietorship and majority of them complained for insufficient loan to run their businesses. The findings of the study revealed that credit access; marketing and administrative factors affected positively the advancement of small scale microfinance to medium scale enterprises at 5% level of significance. Based on the findings the researcher recommends that locality based approach for solving problems of MSEs through prioritizing the challenges as per their severity; enhancing capacity of the MSE development agency through provision of skill and business training; improving local business environment through provision of sufficient work premises at appropriate location & facilitating access to credit from financial institutions are the major issues.*

**Keywords:** *Micro and Small Enterprises, Advancement, Determinants, Nifas Silk Lafto Sub-city, Addis Ababa*

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## **1. INTRODUCTION**

### **1.1. Background of the Study**

From global point of view, Micro and small scale enterprises (MSEs) play a vital role in economic development, as they have been the primary sources of Job/employment creation, output growth and the central focus of the industrial development strategy, not only in less developed countries (LDCs) but also in developed countries. A study conducted by Syed and Mohammed (2009) showed that the MSEs play a vital role in the progress of the economy of the developed nation due to the fact that it reduces the unemployment problems by using lower capital per employment, avoid extra costs for development of industrial infrastructure, reducing the risk of the investments, check imbalance between different sections of the economy and maximize the use of locally available resources.

According to the study of Boaten (2012), the dynamic role of MSEs in developing countries as “necessary engines for achieving national development goals such as economic growth, poverty alleviation, employment and wealth creation, leading to a more equitable distribution of income and increased productivity is widely recognized.” In an attempt to accelerate growth rates in low-income countries, particularly in Africa, many development partners and donors have made the promotion and development of MSEs a major concern. This shows that MSEs are seen as essential facilitator for economic growth, job creation, industrial development and poverty alleviation, equitable distribution of income both in developed and developing countries. Micro and small scale enterprises are the main source of employment in developed and developing countries comprising of over 90% of African business operations and contributing to over 50% of African employment and GDP (Okafor, 2006).

Micro and small scale enterprises are important both to the individual and to the nation. To the individual they provide employment and raise the standard of living of both employers and employees. To the nation, they complement large scale modern sector enterprises, they utilize agricultural and other raw materials that would have gone to serve limited or closed markets that warrant only small scale production, and they mobilize resources. Left out of the mainstream formal mobilization channels and they provide the necessary platform for take-off into large scale modern production (Bwisa, 2011). While the contributions of small businesses to development are generally acknowledged, Micro and small scale enterprises face many obstacles that limit their long term survival and development. Research on small business development has shown that the rate of failure in developing countries is higher than in the developed world (Arinaitwe, 2002). Past statistics indicate that three out of five businesses fail within the first few months of operation (National Statics Bureau of Ethiopia, 2007).

In Ethiopia until 1997, there were no organized policy and support systems catering to the development of the MSEs sector, so structural, institutional, and policy barriers were not being addressed. Premises, markets, finance, supply arrangements, regulatory barriers and legitimization of entrepreneurial activity are among the most urgent (ILO, 2005). Recognizing the significance of this sector, the Ethiopian Government issued the National Micro and Small Enterprises Strategy in 1997 and established the Federal Micro and Small Enterprises Development Agency in 1998. The country's industrial policy in 2003 and the poverty reduction strategy in 2006 have singled out MSEs as major instruments to create a productive and vibrant private sector and reduce poverty among Rural and urban dwellers.

The Micro and Small Enterprises Sectors contribute to the economy of nations“ by creating employment opportunities, production of goods and services and other value added activities. The five year Growth and Transformation Plan envisages ensuring faster and sustained development of the industrial sector and enabling the sector to gradually play a key role in the economy. To this end, particular emphasis is given to the promotion of micro and small enterprises as well as supporting the development of medium and large scale industries. In Ethiopia, especially in Oromia Regional states, small businesses increasingly face competition not only from their peers but also from large corporations participating in niche markets once regarded as a preserve for small businesses (Ntakobajira, 2013). According to Amyx (2005), one of the most significant challenges is the negative perception towards SMEs. Potential clients perceive small businesses as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously. Lack of planning, improper financing and poor management have been cited as the main causes of failure of small enterprises (Longenecker, 2006). The advancement of small scale to medium scale enterprises, changes overtime in their employment and output shares, market orientation and location are usually thought to be related to many factors, including the level of economic development, changes in real income per capita, population growth, and progress in technology. Given this thought, the most important question which to address in this paper would be assessing the determinant factors that limit the advancement of Small Scale to medium scale enterprise in Nifas Silk Lafto Sub-City.

## **1.2 Statement of the problem**

Starting a business is like bringing up a child. As a child needs proper nurture and nourish to grow, the same analogy is true in starting and growing a

business. It's clear that in the initial stage the economic development of small scale business is very slow, as results of this entrepreneur tend to have less initiative and drive to the desired target. Gradually, in visualizing the development pace they become more innovative and enthusiastic (Siva, 2012). Hence, developing a business requires ample trial time, strong commitment and awareness of the opportunity that the environment provides so as to achieve the intended goal. The Ethiopian government adopted the national Micro and Small Enterprise Development Strategy for the first time in November 1997 E.C. The policy identified a number of constraints hampering the development of MSEs. The policy serves as guideline to all stakeholders to stimulate the establishment of new enterprises and enabling the existing ones to grow and become more competitive. This policy identified unfavorable legal and regulatory frameworks, underdeveloped infrastructure, poor business development services, limited access to finance, ineffective and poorly coordinated institutional support as the key constraints that hinders the development of the sector (Federal Democratic Republic of MSEs Development Strategy, 1997).

In addition, the reviewed empirical studies with regard to the sector focused on socio-economic determining factors of MSEs Success and its major challenges and constraints (Solomon, 2004). Most studies, in academic and non-academic institution, focus on factors that hinder the growth of MSEs and the outcome of the program in aggregate forms. Regarding the role of micro and small enterprises in the process of industrial development, empirical studies fail to investigate the transitional development of small scale enterprise to medium scale enterprises. For instance, the research conducted by Solomon (2004) also tried to analyze growth determinants of MSEs and found that product diversification is a major determinant factor for the growth of small enterprises in Addis Ababa. The finding revealed that business

experience is associated with new start-ups calls for the promotion of the culture of apprenticeship and intern experience sharing for the young as a possible area of intervention in employment generation schemes to minimize the extent of unemployment. The researcher holdup to see MSEs contribution in the development of medium scale enterprise by solving their challenges and using their opportunities. From the above mentioned studies, it is possible to learn that factors which determine advancement of Small Scale to medium scale enterprise which are not studied in depth. Therefore, this study tries to assess factors affecting advancement of Small Scale to medium scale enterprise in Nifas Silk Lafto Sub-City and also tries to identify challenges and prospects for the sector and come up with policy recommendations which will be relevant for MSEs advancement from small to medium scale enterprise.

## **2. LITERATURE REVIEW**

### **2.1. Determinants of Growth of SMEs**

In spite of the major role, the significance and contributions of the small-scale enterprises to the national economy, this set of enterprises are still battling with many problems and certain constraints that exist in promoting their development and growth. For instance, (International Labor Organization, 1994) study shows that inadequate entrepreneurial talent affects the development of small-scale manufacturing and processing industries. While large-scale industries are established with expatriate capital, small-scale industries need to have a domestic entrepreneurial and industrial base. Other problems that hinder the advancement of small-scale enterprises are the persistent low level of technology, the shortage inadequate entrepreneurial skills of operators and the absence of an effective management technique. Small-scale enterprises tend to concentrate on traditional industries where low

entry barriers, low minimum production scales, and relatively large labor force are the potential advantages.

However, the traditional industries have not been immune to the recent technological revolution taking place in the field (Adubifa, 1990). Hanshom (1992) and McCormick (1998) stated that African small enterprises are found to be unorganized in production activities. Low capital investment on capital goods and lack of division of labor in production makes these enterprises remained weak. It is a clear fact that many micro, small and medium-scale enterprises are dying out owing to lack of financial support from the government and other citizens. Mills (1990) stated that the major pre-occupation of all developing countries these days is simply how to improve social, economic and political status of the people. According to Uma (1974), it involves the improvement of the living standards of the mass of the low income population and making the process self-sustaining. Improving the living standard of the people involves the setting of priorities in the mobilization and the use of resources available. In some rural areas, the working and living conditions of women for instance, have not been able to be ameliorated by many recent programs designed to improve their economic status. Many writers have pointed out the detrimental effects on women of technological and socio-economic changes in the process of development (Dey, 1975; Zeidenstein, 1975; Palmer, 1978; Whitehead 1985; Stevens 1985). There has not been a total consideration and enough provisions for some rural entrepreneurs in the development process. Many of these entrepreneurs are left out in the provisions of the government toward the advancement of their enterprises. SMEs globally face difficulty in accessing finance from conventional financial institution. However, International Finance Corporation and World Bank efforts at improving their financial problems reveal contextual finance problems requiring homegrown strategies

to manage and overcome this predicament. Most SMEs have difficulty accessing loans from banks; most credit officers lack an in-depth understanding of SMEs business cycles, and are averse to lending to them (Du & Banwo, 2015).

Limited access to finance faced by SMEs has drawn considerable attention from both academics and practitioners for many decades. Literature on this subject suggests that better financial access for SMEs contributes to economic growth, reduced income inequality and reduced poverty (World Bank, 2008). Small enterprises and most of the poor population in Sub-Saharan Africa have very limited access to deposit and credit facilities and other financial services provided by formal financial institutions. For example, in Ghana and Tanzania, only about 5–6 percent of the population has access to the banking sector (Basu *et al.*, 2004). Other studies have in developing economies have found funding as the major problem of SMEs. These studies have made varying recommendations, but SMEs continue to be constrained by funding as suggested by the empirical studies cited earlier on. Whereas some countries have set up small business equity markets to help raise equity capital, others have set up state grants and develop a list of business angels to assist small businesses. Park *et al.* (2008) further argued that SMEs face financing gaps probably because of a combination of reasons originating from both the supply and demand sides. The supply side refers to providers of finance (financial institutions and investors), while the demand side is composed of SMEs who require financing from financial institutions and other providers of finance. The financing gap for SMEs is most prominent in capital market financing. Most countries, including the developed ones, have problems in SME financing through capital markets (Park *et al.*, 200).



Women face startup difficulties such as lack of a source of initial capital. Many women find their initial financing by way of borrowing from formal sources. However, the major difficulty for entrepreneurs, especially for women, is accessing credit due to collateral requirements of the banks. Even if they can access financial credit, the money borrowed is rarely sufficient to address the financial gap or expand their businesses (Wasihun & Paul, 2010). Entrepreneurship is recognized as an important driver of economic growth, productivity, innovation, and employment. Entrepreneurship is related to the functional role of entrepreneurs and includes coordination, innovation, uncertainty bearing, capital supply, decision-making, ownership, and resource allocation in their organization (Munyori & Ngugi, 2014). Most of the prevalent areas in which MSE faces a problem are sales or marketing, human resource management, and general marketing research and training (Kefale & Chinnan, 2012).

Marketing problem has been widely acknowledged as being the most important of all activities and critical for the survival and growth of MSEs. However, many studies found owner/managers of MSEs as having a very limited understanding of the marketing concept generally to be little more than advertising and public relations and lacking adequate marketing skills. Specifically, MSEs frequently encountered problems in promotion and marketing research. These problems include the selection of promotional media, low purchasing power of customers, advertising, content design and format of the promotional materials, market size, location and addresses of potential customers (Kefale & Chinnan, 2012). According to Useem (2001: 297), it is essential to support and guide small business enterprises in the early stage of establishment by providing them with supervisory and skills-related support and supervision. White (2005: 41-42) has found that small and medium-sized enterprises often experience costly bureaucratic and

administrative challenges. In South Africa, small and medium-sized enterprises are set up with minimal support and guidance from the national Government although the duty of the national Government is to create an enabling economic environment. The study was conducted against the background of the need to obtain vital information that explains why more than half of all newly established small and medium-sized enterprises fail in the first three years of their establishment. The legal and regulatory system that calls for complex registration and licensing requirements demands tedious and costly reporting practices imposing heavy costs on MSEs and hence reduce their profitability of the business. Unpredictable government policies coupled with grand corruption, high taxation pose great threat to growth of MSEs. They are disincentive to increasing the size of business operations (Nganwa, 2013).

Many African countries do not have a legal and regulatory framework that supports growth of MSE sector. Unpredictable government policies coupled with grand corruption, high taxation pose great threat to growth of MSEs. They are disincentive to increasing the size of business operations. In the case of Uganda, an extensive number of outdated and cumbersome laws and regulations had increased the transaction costs of MSEs, thereby hampering their economic performance and growth. In Ethiopia, the complexity of the customs system and the many forms and declarations required had a negative impact on the general business climate, diverting entrepreneurs' efforts from more productive tasks (Nganwa, 2013). Small and micro enterprises face problems of policy and regulatory frameworks, and structural and institutional indiscretions, lack of smooth supply of raw materials and lack of working premises, lack of sufficient capital, and marketing problems. These problems call for government intervention by recognizing and paying due attention to the promotion and development of MSEs. It is also important to formulate

strategies in a way to address the challenges of unemployment, economic growth and equity, and overall poverty in the country. Numerous studies have shown persistence of poverty and the unparalleled level of unemployment that characterizes Ethiopia in general and urban areas in particular.

## **2.2. Empirical Literature**

Eshetu and Zeleke (2008) conducted a longitudinal study to assess factors that affect the long-term survival and viability of 25 enterprises by using a random sample of 500 MSEs from 5 major cities in Ethiopia. The findings of the study revealed that businesses that failed 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%). Mulugeta (2011) also identified the critical problems of MSEs as market-related problems, institution-related problems, operator-related shortcomings, MSE-related challenges and finally society-related problems. In addition to the above study, Workeneh (2007) in his study in Addis Ababa identified lack of adequate training, unfavorable regulatory policy of the government institutions, problem of premise, and inadequate training in the area of marketing and bookkeeping affect the performance and contribution of the sector. Abebe (2011) analyzed the relation between personal related success factors and business related factors on the performance of MSEs in Addis Ababa. He analyzed the data using descriptive and inferential statistics. The ANOVA result indicated there is no significance variation in the performance of MSEs in relation to the variations to each of the eight independent variables of the study.

Goshu (2015) examined the determinants of MSE growth in terms of profitability of MSE business in Nekemte town. The study showed that the major source of finance for MSE is personal saving. The study showed that

MFI loan term is too short to run the business. Most of the MSEs that are operating in government-owned shades complained for its sufficiency and suitability of the locations for running business. The result of regression analysis showed that sources of finance for MSE operators, loan term that MSEs borrowed from MFI, previous business experience of the operators, marketing skill of members of the business, source of raw materials of the MSE, and major customers of the product or services of MSEs affects positively the growth of profitability of MSEs business significantly at 1% level of significance. Tefera *et al.* (2013) investigated the growth determinants of MSEs based on a survey covering 178 randomly selected MSEs from Mekelle city. They adopted logistic regression to identify factors that significantly affect the growth of MSEs using change in employment size since startup as a measure of firm growth. The binary choice logit model result showed that there is a significant gender difference on the growth of MSEs with male owner growing faster than those owned by female. In addition, the initial investment on the firm, the location and the sector in which the MSEs operates matter a lot for the growth of these enterprises.

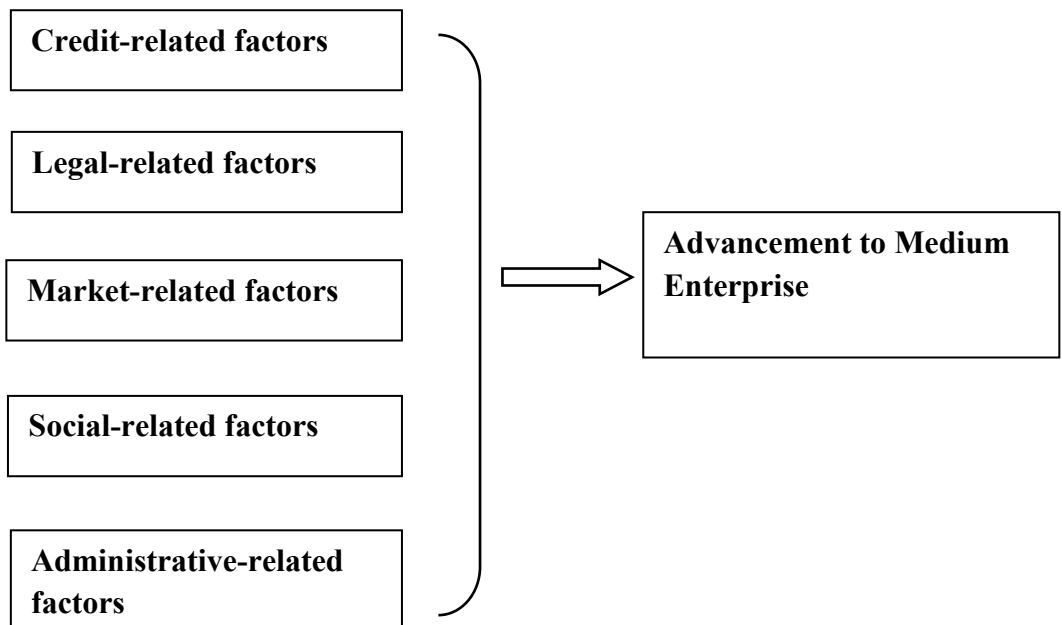
Gebreeyesus (2007) investigated the determinants of success among micro-enterprises in six major towns in Ethiopia. Firm's initial size and age are inversely related with growth providing evidence that smaller and younger firms grow faster than larger and older firms and consistent with the learning hypothesis but contrary to the Gibrat's law.

Abera (2012) investigated 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 empirical study elicited inadequate finance, lack of working premises, marketing problems, inadequate infrastructures, poor management practices,

and technological, entrepreneurial and politico-legal problems including bureaucratic bottlenecks system as determinants of performances. Hamu (2017) also identified factors determining the financial performance of MSEs with a special attention to manufacturing, service, construction and trade sectors in Asella Town. The findings revealed that MSEs lacked financial support, technological, customer relationship and marketing skills in order for them to be competitive and well performed.

### **2.3. Conceptual Framework**

Following the information available in the literature the following conceptual model was developed.



**Source:** Researcher's own construction

### **3. RESEARCH METHODOLOGY**

#### **3.1. Research Approach and Design**

A mixed method approach is used to answer the research questions because this type of research design blends elements of qualitative and quantitative research approaches to provide a broader and/or deeper understanding of a central phenomenon. This process was accomplished by collecting and analyzing qualitative and quantitative data at specified phases within a single study. The core premise of this methodological design was that use of a combination of qualitative and quantitative approaches had resulted in a more complete understanding of the research topics understudy than either approach would in isolation (Creswell & Plano Clark, 2011; Greene *et al.*, 1989). Furthermore, explanatory research design was employed to answer the stated research questions.

#### **3.2. Source of Data and Data Collection Methods**

The study was conducted by collecting data from both primary and secondary sources. Primary data were collected from the respondents based on a structurally designed questionnaire. It was included both closed ended and open-ended questions. Secondary data were collected from different related document. Questionnaire was employed for selected enterprises. The structured interview is used to get information from officials and leaders in the enterprises. Therefore, the data collection instruments employed to this study was structured questionnaires. The *Nifas silk Lafto* sub-city was purposely chosen among the 10 sub-cities of Addis Ababa purposively for its proximity and convenience to collect data in short time. Although there are different sectors in which the MSE operators have been engaged in, the sectors selected for this research are manufacturing (metal work, wood work, pottery, and weavers), construction and service, urban agriculture, and trade

sector because of large concentration of MSEs compared to other sectors in the sub-city. In addition, it is difficult to reach the operators/or owners managers of other sectors such as municipality service, parking and etcetera which will make data collection infeasible. A five point Likert scale 1(Strongly disagree) to 5 (Strongly agree) was developed.

### **3.3. Sampling Design and Sampling Procedure**

The study employed stratified random sampling method to select the intended institutions. This is because the population for the study does not have a homogenous group. Kothari (2004) pointed out that stratified random sampling is commonly used probability sampling method if the population from which a sample is to be drawn does not have a homogenous group. The population was stratified into a number of non-overlapping sub population (strata) and sample items are selected from each stratum. With this technique the strata's were sectors of MSEs such as manufacturing (metal work, wood work, pottery, and weavers), construction, and service, urban agriculture, and trade. Sampling frame was formally acquired from registered MSEs until April 2017 by Nifas Silk Lafto Sub-City Micro and Small scale Enterprises Development office. The total population of the study constitutes 1180 from which (180) medium scale enterprises and (1000) micro and small scale enterprises. Following Yemane (1996) sample size determination formula, it was possible to determine the sample size at 95 % confidence level and 5% precision levels. Thus, the sample size was determined to be 299. This total sample size is proportionally distributed to each stratum. Therefore, 46 SMEs out of 180 and 253 MSEs out of 1000 were selected.

### 3.4. Data Analysis Technique

The data collected were analyzed using descriptive statistics (measures of central tendency and measures of variations) and logistic regression econometric tool. In this study MSEs are assumed to be either advanced or not advanced. Hence, the binary choice logistic regression model that assumes dichotomous dependent variable which takes either 1 or 0 value depending on  $Y^*$  is used. The logit model based on cumulative logistic probability function is used in this study since it is believed to offer better explanation on underlying relationship between firm growth and the factors affecting on it. The dependent variable in this case is dummy variable since Micro and small scale enterprises are assumed to be either advanced or not. The binary logistic regression model can mathematically be specified as follows:

$$P_i = E(Y=1|X_i) = \beta_0 + \beta_i X_i$$

Where  $Y_i$  represents growth of a firm

$X_i$  is a vector of independent variables

$\beta_0$  is the constant and  $\beta_i$ ,  $i = 1, 2, \dots, n$  are the coefficients of the independent variables to be estimated.

$$P_i = E(Y = 1|X_i) = \frac{1}{1 + e^{-(\beta_0 + \beta_i X_i)}}$$

$$P_i = \frac{1}{1 + e^{-Z_i}} = \frac{e^{Z_i}}{1 + e^{Z_i}}$$

$$\text{Where } Z_i = \beta_0 + \beta_i X_i$$

If  $P_i$  is the probability of being surviving and  $(1-P_i)$ , the probability of growth of a firm



$$1 - P_i = \frac{1}{1 + e^{Z_i}}$$

Therefore, we can re-write this equation as:

$$\frac{P_i}{1 - P_i} = \frac{1 + e^{Z_i}}{1 + e^{-Z_i}} = e^{Z_i}$$

Later  $\frac{P_i}{1 - P_i}$  is the odds ratio of growth of enterprise with the ratio of the probability that a given firm grow to the probability that a firm grow. Then, if we take the natural logarithm of equation (e) we obtain:

$$L_i = \ln\left(\frac{P(i)}{1 - P(i)}\right) = \ln\left(e^{\beta_0 + \sum_{i=1}^m \beta_i X_i}\right) = Z_{(i)c}$$

If the disturbance term  $U_i$  is taken in to account the logit model becomes

$$L_i = Z(i) = \beta_0 + \sum \beta_i X_i + U_i$$

Consequently,  $L_i$ , which is the log of odds ratio, is called logit or logit model (Gujarati, 2004). Hence, the above Logit Model is employed to estimate the effect of the hypothesized explanatory variables on advancement of enterprises.

## 4. RESULT AND DISCUSSION

### 4.1. Results of Descriptive Statistics

With a response rate of 93.65% 280 questionnaires were completed and collected back successfully. The analysis was done on the basis of 280 responses.

**1) Employment and Legal Ownership of the Enterprises:** The legal ownership statuses of the establishment were classified in to five Sole ownership, Joint ownership, Family business and Cooperative. 44.29 percent of the enterprises were established as sole ownership, 17.14 of them were join ownership, and 29.64 percent of the sample enterprises were established as cooperative, 2.14 was established as family business. Overall the sampled enterprises were created a job opportunities for 2134 employees; likewise, 29.64 percent of the enterprises create a job opportunity for 1 to 5 employees, 57.5 percent of the enterprises create a job opportunity for 6 to 10 employees 10.71 percent of the enterprises create a job opportunity for 11 to 15 employees and the rest 2.14 percent of the enterprises were created a job opportunity for more than 15 individuals. In addition to these, out of the total enterprises 86.07 percent of them were small scale enterprises and the rest 13.93 were medium scale enterprises. Micro enterprise, according to the strategy in use, consist of employees (including the owner or family) not greater than 5 and while small scale enterprise is an enterprise which has 6-30 employees (Federal Democratic Republic of Ethiopia, 2011).

Initially, 52.86 percent of the respondents start their business with their own personal saving, 17.14 percent of them initially funded by family, 13.57 percent of the sample enterprises were funded by microfinance institutions; the rest were starts their business through borrowing from relatives and friend. The constraint of finance for MSE affects their advancement directly or indirectly. There are studies which support this finding. Lack of financial resources is often reported as the major obstacle and limiting factor that is experienced by SMEs in developing countries. Therefore, funding is a problem (Millicent & Reginald, 2014:61). Moreover financial institutions find it difficult to provide funding to SMEs because most small businesses do not

have assets to secure collateral securities (Moaisi, 2005). However, according to Wiese (2014), the ultimate source of finance was gained through sole ownership, spouse/partner salary, income from another job, cooperative and family business contributions.

**2) Credit-related Factors:** Accordingly, more than 48 percent of the respondents replied that they were not satisfied with the financial access given by microfinances and other lending institutions. More than half of the respondents also confirmed that the amount of loan size borrowed from MFIs and other lending institutions were not sufficient to operate their business. In conformity with the finding of Terfasa *et al.* (2016) the problem of access to finance is more severe for MSEs as the loan requirement of microfinance institutions (MFIs) is complicated. A large proportion of both micro and small enterprises do not apply for a loan or credit due to cumbersome bureaucracy, limited working premises, and high collateral requirement.

There are studies which support this finding. Lack of financial resources is often reported as the major obstacle and limiting factor that is experienced by SMEs in developing countries. Therefore, funding is a problem (Millicent & Reginald, 2014). Moreover financial institutions find it difficult to provide funding to SMEs because most small businesses do not have assets to secure collateral securities (Moaisi, 2005). Likely, 66 percent of the sampled respondents said that they didn't have the opportunity to get machinery and equipments. The mean score of this variable was 2.48 which approach to disagree level, which suggests that the enterprises are challenged by credit and loan related problems.

**2) Market-related Factors:** Around 54 percent of the respondents mentioned that they had access to different business trainings. Around 65 percent of the

respondents also responded that they didn't have access to information to exploit business opportunities. More than 68 percent of the respondents replied that there is no fair competition in the market. Moreover, more than 66 percent of the respondents replied that there is no adequate infrastructure such as power and water supply which helps to operate their business.

**3) Social-related Factors:** Social factors concerns how the entrepreneurs are interacting with the society and community. Accordingly, the majority (69%) feel that they are socially accepted entrepreneurs. Close to 57 percent of the respondents also mentioned that they had better contacts and networks with outsiders. Almost all (93%) of the respondents replied that the attitude of the societies towards their products and services was positive. Likewise, close to 85 percent of the respondents confirmed that they had access to clear division of duties and responsibility among employees and also they had a positive relationship with the workforce. The results of the mean score suggest that the businesses activities of the enterprises are accepted by the society, meaning that the communities are willing to buy and use their products. MSEs had got a special focus by the government. It comprised the largest share of total enterprises and employment in this sectors. In recognition of the important role MSEs have to play in generating income and creating job opportunities and reducing poverty, the government drafted its first Micro and Small Enterprise Development Strategy in 1997.

**4) Legal-related Factors:** Legal factors concerns about how the enterprises are connected with and supported by government. More than 75 percent of the respondents confirmed that they have never encountered political intervention from regulatory bodies. Furthermore, around 78 percent of the respondents said that they had accessible information regarding government regulations

that are relevant to their business, and also they were beneficiary of government incentives. About half of the respondents complain that the tax levied on their business was not reasonable and fair. This variable has got a mean score of 3.44 which fall in the range of neutral to agree. Although considerable number of respondents had reservation on legal services, in general terms the entrepreneurs were more or less comfortable with the current legal services of government offices. There is no doubt that there is a direct or indirect benefit of legitimate political participation (Huntington, 1968). Not only that, for the sake of the success of businesses, they must update with new policy and strategy made by both national and city administration government.

**5) Administrative-related Factors:** More than 55 percent of the respondents didn't agree that they had business support from government bodies. Around 56 percent of the respondents disagreed that they had encountered bureaucracies and red tapes. More than 75 percent of the respondents replied that they have benefited from government incentives. Around 53 percent of the respondents felt that they had never faced unfavorable working environments. The mean score of this variable was 3.31, which is closer to disagree level, which suggested that the enterprises are not getting good administrative services.

#### **4.2 Results of Regression Analysis on Factors Affecting Advancement of Micro Enterprises**

Before presenting and discussing the estimation results of the regression equation, it is worth to discuss the model performance and in terms of meeting assumptions.

**1) Multicolliniarity test:** Multicollinearity is a problem that happens when the explanatory variables have significant association. A VIF test was used to test the assumptions of multicollinearity. The result of the test indicates the highest VIF is 2.76 which indicate the model performed with no major multicollinearity problem among the explanatory variables (Table 1).

**Table 1: Multicollinearity Test Result**

Variable	VIF	1/VIF
Admin	2.76	0.362583
Marketing	2.42	0.413708
Social	1.89	0.528365
Legal	1.33	0.749693
Credit	1.11	0.903129
Mean VIF	1.90	

**Source:** Author's analysis result

**2) Heteroskedasticity Test:** The assumption of Heteroskedasticity states that the variance of each disturbance term  $u_i$  conditional on the chosen values of the explanatory variables should be some constant number (Gujarati 2003). In order to test the problem Breusch-Pagan test for was employed. Accordingly, the data is free from the problem of Heteroskedasticity since the p value is greater than 5% (Chi2 (1) = 4.47; Prob> chi2 = 0.344).

As projected in the theoretical sections, the key research question was to test how the anticipated variables affect the advancement of small scale enterprises to medium scale enterprises. Specifically, this study analyzes how credit and marketing factors, legal and administrative and social factors determine the advancement of small scale enterprises. Binary logistic

regression model was used to estimate. The coefficient of determination ( $R^2$ ) for the model was 0.52 showing that the model explained 52% and the overall model is statistically significant. The results of the econometric model estimation revealed that credit, marketing and administrative factors had significant effect on the advancement of small scale enterprises; whereas, social and legal factors didn't show significant relationship with dependent variable.

**Table 2: Estimation Results of the Logit Model**

Number of obs = 280		LR chi2(5) = 2.71			
Log likelihood = -111.67358		Prob> chi2 = 0.0341			
		Pseudo R2 = 0.5241			
<b>Variables</b>	Coef.	Std. Err.	Z	P>z	Odds ratio
Constant	0.65	0.98	0.66	0.51	0.52
Credit-related factors	0.05	0.08	0.57	0.04	1.05
Market-related factors	0.01	0.06	0.19	0.05	0.99
Social-related factors	0.05	0.05	0.96	0.34	0.95
Legal-related	0.07	0.09	0.78	0.44	.094
Administrative-related factors	0.05	0.08	0.59	0.045	1.05

**Source:** Author's analysis result

Accordingly, the variable credit had positively and significantly associated with the advancement of small to medium scale enterprises. Furthermore, given all the other variables in the model held constant, odds ratio greater than one suggested that, credit factor more likely contribute for the advancement of small scale enterprises to medium scale enterprises, which means increasing

the access of credit for microenterprises and increases the probability of small scale enterprises advancement to medium scale enterprises. Since the odds ratio of this variable is greater than one it is the indication of this variable plays very significant role to advance microenterprises to medium scale. In line with this study, Hadiyati (2010) also mentioned that related to the development of micro and small enterprises difficulties in marketing and the tight competition are the main challenges of their development. One can understand from the stated literatures the marketing and credit facilities are the critical factor for the success of micro and small enterprises.

The other significant variable that influences the advancement of microenterprises is the access of organized market. The analysis shows that, the marketing factor influences positively and significantly the advancement of microenterprises. Given all other variables constant, increasing the access of marketing for microenterprises increases the probability of microenterprise advancement; furthermore, odds ratio less than one indicated that even if the variable marketing influences the advancement of microenterprises however, the extent of the influence is small as related to credit facility. Munizu, (2016) also mentioned that marketing is the critical success factor of micro and small scale enterprises. Financial problems, lack of managerial skills, workplace and marketing problems are among the problems the development of small and micro enterprises face (Gebremariam, 2017).

The regression result revealed that administrative-related variable was also positively and significantly associated with small scale enterprises advancement. Given all the other variables in the model held constant, an odd ratio greater than one suggested that administrative factors are more likely determines the advancement of small scale enterprises to medium scale enterprises. The other variables which were hypothesized are the social factor. On the other case all the other variables in the model held constant, an odd



ratio less than one suggested that legal and social factors are less likely determines the advancement of small scale enterprises to medium scale enterprises. In line with this study Abeiy (2017) concluded that business startup environment and registration process found to be simple and easy, but still there is confusion on the administrative issues among MSE operators regarding VAT registration, getting TIN identification number and Certification of competency application. Enterprises considered these issues as challenging tasks that makes business start up in the sector very tough. Majority of MSE operators rated infrastructure access has not been improved and hugely affecting their performance; getting working premises is still a time consuming and challenging task for them (Abeiy, 2017). The other two variables legal and social factors didn't show a significant association with microfinance advancement.

## **5. CONCLUSION AND RECOMMENDATION**

This research was carried out to investigate the determinants of small scale enterprises advancement to medium scale enterprises. Explanatory research design and logistic regression was used to analyze the data. The descriptive analysis suggested that there was a problem of sufficient loan, business related trainings, fair competition in the market place and in adequate infrastructure such as power and water supply. Apparently, the enterprises are boarding from government offices bureaucratic services and unreasonable taxes. Furthermore, the regression analysis suggested that credit access; marketing and administrative factors are the main determinant factor for the advancement of micro and small enterprises to medium scale enterprises. On the other hand, results also reveal, MSEs that comes to business with higher initial investment shows better growth than those MSEs that started business with lower initial investment. Previous researches in the country made the

same conclusion, finance as one of the main factors that affect starting, success, performance and growth of MSEs (Habtamu, 200; Admasu, 2012; Berhane, 201; Mulugeta, 2011). MSEs do not have enough access to loan to start and they need to have pre- credit compulsory saving before acquiring business loan. Supporting this, the major source of startup finance and working capital is own saving, family and friends followed by microfinance and *equb* (Selamawit *et al.*, 2014).

The finding shows that majority of MSEs operators in the study area do not have convenient working places. Because of this, the MSEs operators do not perform their business related activities effectively and efficiently. And also, the location of the working premises is not suitable for attracting new customers. This means the working places restricts access to market. Finally, the research clearly illustrates that, even if the degree of those critical factors are not uniform across the enterprise, most of the factors are considerably common for all enterprise. It has been noted that the factors that are prevalent to the financial performance of businesses such as credit, administrative, and marketing factors had very high effect on the determinant of small scale enterprise advancement into medium scale enterprise in the research area.

The nature of determinants of MSE advancement identified in the study varies in their complexity and severity. Majority of the problems can be solved by the collaborative effort of support institutions and other stakeholders. A major recommendation that the researcher suggest to minimize severity of determinant factors that affects the advancement of MSE is described as follows.

- MSE support program should have to be based on the identified critical factors. Major problems like insufficiency loan and financial access, access

to different business trainings about demand forecasting, creating market access and value chain and relate and lack of working capital.

- MSE development agency and municipal services should undertake detailed study on the suitability of the location and the sufficiency of work premise size along with nature and type of business before constructing the premises for MSE.
- MFI institution are member of MSE support institution and has to provide credit service for organized MSE through adjusting loan term based on the nature of the business and its capacity of revenue generation.
- Sufficient managerial and marketing skill training has to be provided for MSE to change the traditional way of operating and marketing business in to the modern types of production and marketing.

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