(Very) small and growing businesses in Ethiopia - Preliminary findings

In terms of growth, micro, small and medium enterprises are considered a crucial tool for Ethiopia to meet its development goals. This article presents the main findings of a recent study to take a closer look at the potential of MSMEs and their needs of financial services in the country.

Micro, small and medium enterprises in Ethiopia are seen as a crucial tool in helping the country achieve its mission to become a low middle income country by 2025. These businesses are perceived to accelerate economic growth in urban and rural areas, create employment opportunities, ensure a fairer distribution of wealth and increase household income. Under Ethiopia’s first MSE development strategy implemented between 2011 and 2015, MFIs extended 4.29 billion Birr (186.7M USD) to Micro and Small Enterprises (MSEs). Within the framework of the revised MSE development strategy, developed as part of the second Growth and Transformation Plan (GTP II – 2015/16 – 2019/20), MFIs have been given the responsibility of extending 21 billion Birr (934.2M USD) to the same target group – a 400% increase on the previous period (cf article by Wolday Amha).

In light of the strategic importance of the microfinance sector to boost access to finance to MSMEs in Ethiopia, ADA commissioned a study to take a closer look at existing urban MSMEs in three MFI portfolios to find out what can be learned from entrepreneurs whose businesses started out micro but can now be classified as small and even medium growing businesses. A sample of 45 MSMEs1 (15 per MFI) in Addis Ababa evenly spread across the service (51%) and industry (49%) sectors was established and each one was targeted with in-depth, face to face interviews in order to gain insight into the SMEs performance, their growth trajectory and the obstacles faced during this process.

The preliminary findings of this qualitative research shows that:

- **Personal characteristics**: 86% of business owners that have graduated their businesses from micro to small or medium are men. 50% of the business owners attended college or university and have an overall average of 7 years prior business experience (7.6 years for men; 3.3 years for women – all primarily as employees in the same sector of activity). Most respondents only run a single business (67%) and none of the respondents manage more than two businesses. Finally, only 1 business had a manager that was not the same person as the owner.
- **Business characteristics**: The businesses have been operating on average for 7 years and the average time taken to grow the business from micro to small is a little under 4 years. Almost all of these businesses (91%) were launched with the owners’ savings or a combination of savings with family financial support and/or lqub’s (a form of ROSCA). All of them without exception are formally registered, either for ensuring better access to clients and suppliers or from fear of reprisals by the authorities.
- **Employment creation**: The businesses were launched with an average of 3 employees and on average have multiplied their workforce by a factor of 6. Out of the total 769 job opportunities created by these businesses, 44% were created by the service sector, 38% by manufacturing, 9% by construction and 8% by trade. Most importantly, 93% of the total number of jobs created are for non-family workers indicating that these businesses have demonstrated the will and capacity of managing these employees and are also capable of assuming the associated costs and risks. Finally, the majority of these jobs are occupied by underemployed or unemployed youth whose salaries are primarily determined by their level of experience.

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1 Sampling framework established by targeting MSMEs that have at least 5 years of operations and started out micro (defined in terms of number of employees and/or a proxy criteria such as loan or capital size) but graduated to small/medium businesses
2 Includes trade (20%) and services (31%)
3 Includes manufacturing (36%) and construction (13%)
Use of financial services:

- MFIs: The average first loan amount for the businesses amounted to 4,700 EUR (4,000 EUR for services; 5,600 EUR for industry) for an average term of 20 months. This indicates that many of these businesses had already managed to grow their businesses through personal savings and external support prior to accessing their first loan through a financial institution. Between the first and last loans, the average number of loans per business is 4 over a 5 year period although there are variations between the service sector (4-6 times on average) - where turnover is quicker and cash based transactions are more common – and the industry sector (1 to 3 times on average). These loan amounts have grown progressively over time and the average amount for the last loan for the service sector is 10,400 EUR and 14,200 EUR for the industry sector. With the exception of a single business, all of the respondents used all of the loan to finance the business. With regard to loan purpose, the loans are used for working capital (67%), a combination of working capital and asset finance (18%) or just for asset finance (15%). Finally, 42% of the businesses have had loan requests denied by MFIs primarily due to lack of collateral (90% of respondents) and the inability to meet the 20% pre-loan compulsory savings requirements.

- Banks: Perhaps one of the more surprising findings is that all of the businesses use non-credit services provided by banks. 89% of respondents have at least a savings account at the bank whilst 98% have a current account, use transfer services and have a debit card for access to ATMs. The preference for using a savings account at a bank instead of an MFI is due to ease of access and better service. These findings confirm that as these businesses grow, they tend to move away from cash based transactions, particularly with suppliers, and prefer to keep the cash available in current accounts which can be easily accessed through debit cards and ATMs. These services are clearly essential to business development but cannot be provided by MFIs. In that sense, this leads to questioning how far MFIs should upscale given that their competitive advantage decreases as businesses grow in size.

Use of business support services: Most businesses outsource their accounting to paid accountants (78%) and keep electronic records. Given this availability of formal financial records, financial institutions should be encouraged to finance the SME sector. With regard to other support services, 41% of businesses in the industry sector have used One Stop Shops (OSS) - and plan to do so in the future - whereas none of the businesses in the service sector have availed of these services. This can be explained by the fact that manufacturing SMEs commonly seek the use of subsidized working space and access to machinery provided by the government in “industrial shades” or incubator parks. Finally, according to 58% of respondents, there is a clear need for support in areas covering technical training/coaching, accessing or expanding premises and market linkages but the supply, from both a public and private perspective, is still underdeveloped (only 24% of respondents have benefited from technical trainings).

Growth and perspectives: All of the businesses interviewed plan on growing their business, hereby understood as both plans to either increase number of employees and turnover. The main challenges to achieving these objectives are access to finance (according to 69% of respondents) and other factors such as family and government support, know-how and experience (according to 31% of respondents). All of the respondents clearly stated that in addition to finance, the most critical factor for continued growth was resilience, hard work and adaptability.

Building on these initial findings, the study will formulate general recommendations for stakeholders (including financial institutions, business development service providers, professional association, local and international support organisations etc.) that wish to identify, support the growth or deepen the financial inclusion of Ethiopian MSMEs.
Findings and recommendations will be presented during the African Microfinance Week scheduled in Addis Ababa from the 9th until the 13th October 2017.

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