

## Barriers to Growth of Medium and Small Enterprises in Developing Country: Case Study Ethiopia

Amentie C\*, Negash E and Kumera L

Department of Management, Jimma University, Ethiopia

### Abstract

Entrepreneurship is important for achieving economic growth in contemporary economies is widely recognized, both by policy makers and scholars. So the main objective of this study is to determine the barriers to growth of small and medium enterprises in Ethiopia. For research design; cross-sectional, descriptive and inferential designs study were used in the study. The study used both primary and secondary data. Pertaining to data analysis the researchers used quantitative data analysis techniques mainly descriptive analysis using percentages, tables and mean were employed. Accordingly, this study identified that strong competition in the markets, high level of interest rates on loans, poor infrastructure, speed of debt payment by customers, unavailability of an appropriate property, state of the country's economy, low market demand for firms' products/service, pricing of competitor products, in availability of raw materials, attitude of banks and low availability of finance from lenders were rated as high barriers for small and medium business growth. While, specially strong competition in the markets, high level of interest rates on loans, and poor infrastructure were as the highest barriers for small and medium business growth in developing country.

**Keywords:** Small enterprises; Entrepreneurship; Ethiopia

### Introduction

#### Background of the study

The role of small firms and entrepreneurship in stimulating economic growth is complex, because various intermediate variables are at play. Examples of such variables are entry and exit of firms (competition), innovation and variety of supply. Economists have started to build theoretical frameworks which try to capture the role of the intermediate variables.

The entrepreneurship development process is affected by (1) macro-level environmental factors, (2) characteristic of entrepreneurial opportunities and (3) individual motivations [1]. Differences in factors may help us explain why "some people and not others discover and exploit entrepreneurial opportunities". Indeed, according to the European Commission, "The challenge for the entrepreneurship sustainable development is absence of identifying the key factors for building a climate in which entrepreneurial initiative and business activities can thrive [2]. Therefore our study focuses to determine the barriers to growth of small and medium enterprises in Ethiopia

Medium and Small businesses are strategically important for entrepreneurship development because they curb the monopolistic power of large enterprises and increase the competitiveness of the market. They also act as the seed beds for entrepreneurial skill development. The contribution of these businesses to innovation, economic growth, and job creation in most parts of the world is well documented. Thus, providing support to small businesses is a prudent approach to create new employment opportunities.

Despite the mentioned fact above, the growth of SMEs faces a number of constraints that hinders its rapid growth and development, which ultimately reduce the weight of its potential contribution to the national economy. Such factors are entrepreneurial characteristics, absence of BDS, social linkages, marketing problems, and absences of proper business plan due to knowledge or other reasons [3]. In addition, Werotew [4] also noted that 'environmental factors such as social, economic, cultural, political, legal and technologies along with, internal (personal) factors like individual attitudes, training and

technical know-how are all the constraints that are challenging the success of Ethiopian SMEs.

#### Statement of the problem

Entrepreneurship, which is recognized to be a change agent and the fourth factor of production that brings together land, labor and capital, makes a significant contribution to the pace of nation's economic development. However, this important factor of production is not being utilized properly in Ethiopia [5].

The challenges of youth entrepreneurs globally are remarkably similar; and this necessitates investigation into the financial and non-financial support required to enable their success. Solomon [6] argues that there exist five key constraints and barriers to entrepreneurship development in general: social and cultural attitude towards entrepreneurship, entrepreneurship education, access to finance/start-up financing, administrative and regulatory framework, and business assistance and support. Llisterri et al. also note that lack of experience and resources causes early failure of business. Similarly, Ethiopian entrepreneurs have largely the same combination of difficulties, in the main access to capital for starting or scaling up projects, lack of business and technical skills, unavailability of operational space, non-existence of mentors and limited access to markets.

Prior research documented that SMEs play a significant role in the economy of a country. Consequently, the performance of the SME sector is closely associated with the performance of the nation. There has been more written about small business growth in recent years than any other aspect of management. One of the main reasons is the

\*Corresponding author: Amentie C, Department of management, Jimma University, Ethiopia, Tel: +251 47 111 1458; E-mail: [chalchissa@yahoo.com](mailto:chalchissa@yahoo.com)

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contribution of expanding enterprises to economic development and unemployment reduction, which generally has attracted the attention of researchers and policy makers in many countries [7]. However, access to finance and managerial skill are problem becomes a challenge to Small and Medium Enterprises in developing country [5].

But as finding of Beyene, internal attributers (personal and business related) and external attributers (governmental, access to market, infrastructure) factors were affected the success of the small and medium enterprises. In addition, SMEs in Ethiopia are constrained and failed to succeed by a number of factors [3,8] such as unfavorable legal and regulation condition, lack of access to market, poor access to quality business infrastructure, problems of raw materials and lack of working capital are among many factors

Even though scholars note that, the safe way is to have comprehensive measures of success than relying on a single indicator in dealing with the growth of small and medium enterprises, studies [6,9] conducted so far in line with this issue give more emphasis to *single measurement criteria of growth as methodology*. And even special focus is given to the determinants of performance of manufacturing enterprise, but such assessment do not guarantee to conclude about determinant factors of growth/success of SMEs in whole sector. In addition, though there are some studies which directly or indirectly assessed the growth determinants of SMEs, they have reached to different conclusions for similar research issue for example concerning the effect of education of the business owner [10,11] which is necessitated to have further study. It implies that the studies conducted in other specific area do not guarantee to conclude about the picture of the rest parts of the world, especially at country level. So those, this study contribute to fill the gap of past researches in barriers to growth of small and medium enterprises in Ethiopia.

Based on the samples 386 which were selected by simple random from all selected sample of enterprises, this study would investigate:

1. What are the factors which have been the barriers to the growth of small and medium enterprises in Ethiopia in general?
2. Where are the position of each of the factors in ranking order based on mean values for significant affect ratings?

## Literature Review

### Barriers to small enterprises' growth

Institutional factors can also be categorized as barriers to growth. Even though these factors vary across different industry sectors, some broad categories of external burdens on small businesses can be easily identified. Heinonen, Nummela, and Pukkinen [12], all suggest that government regulations affect the financial standing of small businesses. Andersson et al. and Arinaitwe cited in Kodicara [13] point to several African nations where the governments encourage banks to assist small and medium businesses through financial incentives such as tax breaks.

Chilton [14], however, commenting on the barriers to growth of small and medium businesses in the USA, concluded that the government can have a positive influence on small and medium business growth by doing as little as possible to small and medium businesses rather than doing as much as possible. The Task Force appointed by the government of Ethiopia to develop a national strategy to support the growth of SMEs adopted the stance proposed by Chilton [14] and proposed a policy formula based on the principle "maximum support but minimum interventions" [10].

The impact of government legislation on the growth of small business has been extensively investigated in past research. Restrictive social and industrial legislation and paperwork overload were found to have a negative effect that retards the growth of small businesses [13,15]. The other regulatory burdens identified in past research are excessive business rates, licensing fees, and insurance premiums [16].

Macro-economic conditions that vary from region to region may also have an influence on the growth of a small and medium business [12]. The infrastructure development within a region such as the status of roads, telecommunications, transport and electricity have an impact on the growth of small businesses. The main barriers to growth of small businesses in Ethiopia are high cost of electricity, poor communication facilities, lack of market information, the procurement processes for financial loans and grants, inadequate business services and high interest rates [10]. The loss of staff time and the compliance costs that arise out of some of the above are significant barriers to small and medium business growth.

In most countries, including Ethiopian, government and private sector financial institutions, banks and other lending institutions use availability of collateral as a criterion when evaluating applications for financial assistance. Adoption of this collateral-based lending approach erodes the supply of finance to small businesses. It discriminates against those entrepreneurs and small businesses that have the potential to be successful but lack adequate collateral and securities (World Bank report).

The ability of a business to overcome the impediments to growth by securing support such as financial assistance, advice and training determines the success or failure of the business [10]. The most frequently mentioned barrier to the growth of small business is the difficulty of acquiring finance [12], after an analysis of a large Australian database, reported that the financial requirements of the small business sector are not homogeneous, with different businesses having different needs. This author proposed that policy makers support easier access to funds through mechanisms such as bank overdrafts and trade credit that are frequently used by successful small and medium businesses.

The non-availability of funding is a crucial factor that hinders the growth of entrepreneurial businesses regardless of their size, location, industry and the economic condition of the market [17]. Gilbey [18] states that even though London is one of the most competitive financial markets in the world, many small and medium business owner-managers there are still not able to access the money they need to start and grow their businesses. Past researchers have found this to be one of the greatest problems that inhibit the growth and expansion of small and medium business [13,19].

Banks have been criticised by many for insisting on collateral from small businesses which they cannot provide and for imposing crippling interest rates. In charging such high interest rates, banks appear to be eager to collect whatever money they can get now from small businesses while being oblivious to the future earnings they could gain as businesses grow by providing the initial financial support required. Shuster [16] proposed that this situation could be improved by developing closer relationships between banks and small businesses [12] found the direct intervention policy followed by some governments appropriate, as it assists small businesses to overcome disadvantages related to their size such as the access to funds.

## Research Methodology

### Research design

The cross-sectional was used in the study. Furthermore, to achieve

the objective, the study manipulated both descriptive and inferential statistics were employed.

### Sampling method and sampling size

To select the sample of respondents, the combination of non-probability (convenience) and probability (stratified) sampling methods was employed one after the other. Five industrial zones (towns) were selected as samples of population by convenience sampling method. The sample selected zones were: Mojo, Sebata, Gelan, Adama and DireDawa are taken.

Then after, researchers had taken stratified random sampling technique. The criterion for creation of strata was type of sectors respondents. Three strata namely workers in manufacturing, service and trade sectors in selected area in Ethiopia was used as respondents. All respondents from all stratum were chosen using simple random sampling method.

Sample size determination formula:

Description:

$$n = \frac{z^2 pq}{E^2} = \frac{(1.96)^2 (.50)(.50)}{(0.05)^2} = 386$$

Where

n=required sample size,

z=confidence level at 95% (standard value of 1.96),

E=margin of error (maximum error tolerable) to within 0.05,

p=population proportion at which the sample size is maximum (at p=0.5 and q=0.5, p\*q=0.25),

q=1-p,

Hence, to identify the necessary information, more than or equal 386 samples of respondents must be selected. Since, 386 samples were selected by simple random from all selected sample of enterprises. A well-structured questionnaire for survey was used as tools of data collections from selected respondents.

### Result and Discussion

To identify the barriers to growth of small and medium enterprise in Ethiopia, the open-ended question was used and finding was analyzed as follow in Table 1 below. Institutional factors can also be categorized as barriers to growth. Even though these factors vary across different industry sectors, some broad categories of external burdens on small businesses can be easily identified. In the following Table 1 the degree significance of the twelve factors (barriers) that may hinder the performance of firms' growth were rated by respondents.

In descending order of the mean values the twelve factors were rated by respondents in table below. Due to marginal difference in the mean values they were ranked as high (mean ratings of 4.00 and above), middle (mean ratings under 4.00 and over 3.5) and low (mean ratings of 3.5 and below).

As result in Table 1 indicates, strong competition in the markets (mean 4.41), high level of interest rates on loans (mean 4.31) and poor infrastructure (4.31) were as rated high barriers for small and medium business growth. In addition, the high mean values given to, speed of debt payment by customers (4.29), inavailability of an appropriate property (4.25), state of the country's economy (4.24), low market

Rank	Factor	Mean	Std. Deviation
High	Strong competition in the markets	4.41	0.7406
High	Poor infrastructure	4.31	0.51191
High	High level of interest rates on loans	4.31	0.5095
High	Speed of debt payment by customers	4.29	0.5446
High	unavailability of an appropriate property	4.25	0.57143
High	State of the country's economy	4.24	0.7124
High	Low Market demand for your products/service	4.2	0.65424
High	Pricing of competitor products	4.2	0.54069
High	In availability of raw materials	4.16	0.63029
High	Attitude of banks	4.07	0.67829
High	Low availability of finance from lenders	4.07	0.61198
Medium	Lack of skilled labor	3.89	0.79875

n=322, Mean Ratings: 5=Extremely Significantly.  
1=Extremely Insignificant.

**Table 1:** Barriers to growth of small and medium firms-rank order based on mean values for significant affect ratings.

demand for firms' products/service (4.20), pricing of competitor products (4.20), in availability of raw materials (4.16), attitude of banks (4.07) and low availability of finance from lenders (4.07) were rated as high barriers for small and medium business growth. While, lack of skilled labor (3.89) was rated as not high barrier for growth of small and medium firms.

In the output presented above some variables were discussed below. As per current finding, strong competition in the markets was high barrier for the growth of small and medium business. This finding is consistent with the assertion made by Porter [20] identified in five forces in the external environment: threat of new entrants, threat of substitutes, power of buyers, power of suppliers, and competitive rivalry among existing players, as determinants of the attractiveness of an industry. Higher intensity of these forces increases the competitiveness of the markets and reduces the growth opportunities to businesses entering them. Other studies also have confirmed the significant impact of competitive dynamics on the growth of small businesses [12].

High level of interest rates on loans was rated as the second high barrier of small and medium business. This finding similar with the finding stated by [12], the most frequently mentioned barrier to the growth of small business is the difficulty of acquiring finance and interest rates on loans after an analysis of a large Australian database, reported that the financial requirements of the small business sector are not homogeneous, with different businesses having different needs. This author proposed that policy makers support easier access to funds through mechanisms such as bank overdrafts and trade credit that are frequently used by successful small and medium businesses.

Here we can conclude as non-availability of funding and high interest rate is a crucial factor that hinders the growth of entrepreneurial businesses regardless of their size, location, industry and the economic condition of the market.

Poor infrastructure also the other variable was rated as the second high barrier of small and medium business. This result consistent with the finding of [12] was stated macro-economic conditions that vary from region to region have an influence on the growth of a small and medium business. In similar way, the main barriers to growth of small businesses in Ethiopia are high cost of electricity, poor communication facilities, lack of market information, the procurement processes for financial loans and grants, inadequate business services and high interest rates [10].

Therefore, we can conclude as the infrastructure development

within a region such as the status of roads, telecommunications, transport and electricity have an impact on the growth of small and medium businesses.

## Conclusion

The main objective of this study was determine the barriers to growth small and medium enterprise growth in Ethiopia. Accordingly, study identified as; strong competition in the markets, high level of interest rates on loans, poor infrastructure, speed of debt payment by customers, unavailability of an appropriate property, state of the country's economy, low market demand for firms' products/service, pricing of competitor products, in availability of raw materials, attitude of banks and low availability of finance from lenders were rated as high barriers for small and medium business growth. While, specially strong competition in the markets, high level of interest rates on loans, and poor infrastructure were as the highest barriers for small and medium business growth in developing country.

## Limitations and Further Research

Barriers influencing small and medium enterprises growth are multidimensional. The influence of some of these barriers on small and medium business growth could be either independent or interdependent. For further study it is possible to study the correlation of different variables but this did not test the correlation variables.

The data was collected from different sites as well as from different types of business sectors. This is difficult to specifically determine the factors of affect the growth of each sectors and one site. Further studies in this area will provide specific variable affects the growth of each sectors.

Due to resource constraints, the cross-sectional study conducted did not examine the variables that impact the growth small and medium businesses as they move from one stage to another. To see change growth or live cycle of the small and medium business longitudinal studies is needed.

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