POLICY IMPACT AND REGULATORY CHALLENGES OF MICRO AND SMALL ENTERPRISES (MSEs) IN ETHIOPIA

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Abstract

This paper gives some detailed evidence on the background of the MSE operators/MSEs and presents a systematic analysis of the policy and regulatory changes, their impact on development of the MSE sector in Ethiopia and the constraints. It is based on primary data collected from 974 MSE operators using a structured questionnaire prepared for the purpose. Although there have been serious attempts by the government to liberalize and improve the policy and regulatory environment of the MSE sector, which resulted in increase in investment and competition and improvement in the licensing procedures, information from the survey data indicates that there is divergence between policies and directives issued and their actual implementation on the ground. The results show that capital shortage, inadequate business premise, inadequate/uncertain market and high taxes as the major constraints to expand MSEs in Ethiopia. Moreover, the MSE operators revealed that the policy predictability is quite low which implies that a lot remains to be done to create an enabling policy environment for the MSE sector. Concrete and coordinated regulatory and institutional support (infrastructure facilities like business premises, water and power; financial services; extension services; assistance in the transfer of technologies; promotion of marketing facilities; and provision of training on sustainable basis) has yet to be provided by the government.

[1] * The study was conducted for the Ethiopian Development Research Institute (EDRI). We are grateful to the EDRI for allowing us to use the data for this paper. The views expressed in this paper do not necessarily represent those of EDRI or the organizations to which the authors are affiliated.

1. INTRODUCTION

The GDP share of industry in Ethiopia remained stagnant, at about 11 per cent, in the last decade. Within industry, the share of large & medium scale manufacturing also stagnated at 40 per cent while that of small-scale industry and handicrafts stayed at 18 per cent between 1991/92 and 2001/2002. Per capita manufacturing value added and exports in 1998 were 7.9 USD and 0.8 USD, respectively. The former contrasts with the 36.6 USD for Kenya, 15.8 USD for Tanzania, 24.3 USD for Uganda and 326.1 USD for Egypt. Similarly, the country's per capita manufacturing export contrasts with the 28.3 USD for Kenya, 2.9 USD for Tanzania, 0.9 USD for Uganda, and 36.5 USD for Egypt (World Bank, 2002).

In Ethiopia, about half of the urban workforce is engaged in the *informal* sector (defined as "home based or individual establishments operated by the owner with few or no employees"). The nationwide urban informal sector survey by the CSA, conducted in January 2003, indicated that there were 997,380 persons engaged in 799,358 establishments (1.3 persons per establishment), of which 60 percent were female. About 43.3 percent were involved in manufacturing and about 37.8 per cent in trade, hotels & restaurants.

The survey also revealed that about 74.7 per cent of the informal sector operators started their operation with initial capital of up to Birr 250. The main source of capital included own savings, loans from friends/relatives, and assistance/grant from friends/relatives. According to the survey, the informal operators indicated lack of capital, inadequate skill and lack of premises as the major problems they faced in starting their business. Market and health problems were also identified as the major difficulties in running their day-to-day activities.

The 2002 nationwide survey of the CSA identified 974,676 cottage/handicraft manufacturing establishments engaging 1,306,865 people (1.34 persons per establishment) compared to the 98,136 industrial workers employed in the Large and Medium Scale enterprises in 2002. Of these, 616,696 (63 per cent) were in urban areas while the remaining 357,979 (36.7 per cent) were located in rural areas. Among the persons engaged in the industry, about 94 per cent were active owners, partners or family workers while 4.3 per cent were employees. Women constituted about 74 per cent of the workforce.

In terms of start-up capital, more than 87 per cent of the cottage/handicraft manufacturing industries started their operation with a total capital of less than 250 Birr while 12 per cent had initial capital ranging from 251 to 5,000 Birr (the remaining

0.4 per cent had capital ranging from 5,001-10,000 Birr) (CSA 2003). The 2002 CSA survey also indicated that own saving (37.2 per cent), and assistance from friends & relatives (27 per cent) were the major sources of initial capital.

Regarding problems, about 41 per cent of the cottage/handicraft manufacturing establishments in the 2002 CSA survey indicated lack of capital as the major problem of the industry followed by the absence of adequate skills (6 per cent). Moreover, the respondents revealed absence of market demand, shortage of supply of raw materials and lack of working capital as the main reasons for not fully using their capacity.

The 2002 CSA Small Scale Manufacturing Survey shows that there were 31,863 small scale manufacturing industries in Ethiopia, of which 19,996 (63 per cent) were located in urban areas (CSA 2003). Grain milling establishments account for 85.5 per cent of the small scale manufacturing industries in the country and 100 percent of those in the rural areas.

The survey (CSA 2003) also indicated that out of the total persons engaged in the small scale manufacturing (97,782), about 91 per cent were male while a significant proportion (74.5 percent) were literate (of which 44 percent have completed grades 7-12 – 38 per cent of the male and 6 per cent of the female operators). About 47 per cent of the male and 29 percent of the female operators had completed primary level of education.

The major problems facing small scale manufacturing establishments, as identified in the survey, include absence of market demand followed by lack of supply of spare parts and shortage of raw materials (CSA 2003). Among the problems of regulation that hinder starting operation, getting license and obtaining working premises were the major ones.

While the CSA surveys provide useful general information on business enterprises in Ethiopia, the available data is patchy in terms of detail, especially regarding micro and small enterprises (despite their importance in terms of number and persons engaged). So, to partially fill this gap, EDRI conducted a survey of micro and small enterprises (MSEs) in six major towns May-June 2003.

Sampling method

The population of the study does not include street vending and “gulits” as well as some businesses that are likely to be in the MSE category according to the number-of-workers criteria but are capital-intensive (e.g. goldsmiths, jewellery shops). The sampling method involved the following steps. First, six major cities in Ethiopia, namely Addis Ababa, Nazret, Awassa, Baher Dar, Jimma and Mekele, were selected based on population densities, extent of micro and small enterprise activities, and regional representation (the number of towns covered being dictated by resource availability). Secondly, the major micro and small enterprise activities were identified on the basis of previous surveys, reconnaissance survey conducted by the principal researchers, and a pilot survey (in which the coordinator, supervisors and some of the enumerators were also involved). Then, the number of MSEs from each category of activities and the proportion of micro and small enterprises for each city were identified based on the objectives of the study. Finally, 1000 micro and small enterprises (250 from Addis and 150 from each of the other towns) were randomly selected. Data was obtained from 974 MSEs (551 micro and 423 small enterprises), including 226 women-operated MSEs, in which 3,651 persons (excluding apprentices) are engaged.

Method of data collection

Data collection was carried out using 20 enumerators, 4 supervisors and one field survey coordinator. The would-be enumerators and supervisors were trained intensively on each question of the structured questionnaire prepared for the purpose, after which the best were selected. They were then involved in the pilot testing. The questionnaire was refined and finalized based on inputs from the pilot survey, which was then administered to the sample MSEs. Completed questionnaires were checked for errors and inconsistencies at two levels: first, supervisors in each cite were made to thoroughly check every questionnaire immediately after completion and those with errors returned to the enumerators for correction. The second check involved a data analyst.

Unlike previous MSE studies and surveys in Ethiopia (including the CSA surveys cited above), the present study included highly detailed questions related to various aspects of MSEs, thereby generating data that permits an in-depth analysis of many MSE related issues. The survey instrument (structured questionnaire) included questions related to background of the owner and history of the enterprise; finance; marketing; business development services (BDS); rules/regulations; and infrastructure issues; as well as relationships with suppliers and clients.

In what follows, we provide an analysis of the policy and regulatory changes, their impact on development of the MSE sector in Ethiopia and the constraints based on this data set. The rest of this paper is organised as follows. Section 2 summarises the background of MSE operators/MSEs (in terms of start-up capital, gender, age, education, prior business experience, reason for engaging in the business, etc.) while section 3 discusses the policy changes, effectiveness in implementation, and their impact on MSE development. The regulations/rules related constraints facing the sector as well as *perceived* predictability of laws & policies, government's adherence to its policies and policy credibility among MSE operators are discussed in section 4. Section 5 concludes.

2. BACKGROUND OF MSE OPERATORS/MSES

The survey results indicate that sole proprietorship is the single dominant form of ownership among the sample firms, accounting for 94 per cent. It is usually argued that *micro* and *small* enterprises are different in that the former tend to operate on informal basis or as sole proprietorship, thereby making separation between finances of the owner's household and that of the enterprise difficult. In our case, however, disaggregating the data by *size* indicates that this cannot be taken as a distinguishing characteristic since the proportions of sole proprietorships are comparable: 91 per cent for small enterprises compared to 96 per cent for micro. Legal status, strictly speaking, refers to legally established formal enterprises while we were also interested to know to what extent capital *pooling* (i.e. joint ownership) is practiced among MSE operators. Accordingly, we asked about the number of owners involved. About 93 per cent have single-owners, indicating that the practice of pooling of capital by a group of individuals as way of overcoming the problem of start-up capital has yet to develop in Ethiopia.

In terms of gender, male-owned MSEs dominate: 74 per cent of the sample firms are male-only enterprises compared to 23.2 per cent for female; the rest have mixed ownership (i.e. male-female partnerships). The situation does not change when we split the sample into micro and small categories: that is, male-operators dominate in both, accounting for 74 per cent. These contrasts with the situation in other countries: for example, in Liedholm and Mead (1999), which is based on survey data from 12 countries[2], it is reported that "the majority of MSEs in most countries are owned and operated by women". About 80 per cent are registered (72 per cent of the micro compared to 90 per cent of small) while about 75 per cent have operating license (66 per cent of the micro compared to 88 per cent of small enterprises).

[2] These were surveys undertaken as part of the USAID-funded GEMINI project in Botswana, Kenya, Malawi, Swaziland, Zimbabwe, Dominican Republic, Guinea, Jamaica, Lesotho, Niger, Nigeria, and South Africa covering more than 65,000 MSEs.

Most MSEs are young, the median[3] age being 5 years. It appears that a significant proportion of the MSEs are firms that emerged taking advantage of opportunities created by the reform: 79 per cent of the sample MSEs were established in 1993 or after (and 45 per cent established in 1999 or after), compared to only 15.5 per cent during the entire Derg period. Disaggregating by size, the survey data reveals that 47.7 per cent of the micro enterprises were established before 1999 (i.e. are older than 5 years) while 21.4 per cent were established before 1993 (meaning they have been in business for more than 10 years). The latter is striking since it shows that so many of them remained micro (i.e. did not grow) for such a long time.

They are also owned/run by relatively young operators, the mean age being 36 years (but have a relatively large household size, averaging 5.8 persons). Although most operators were born outside the town in which they are operating, they have long-residence (17 years on the average). In terms of the micro vs small category, *micro* operators tend to be younger (mean age being 34 years compared to 40 for small enterprise operators) and have smaller household size (5.2 compared to 6.7 persons).

A good proportion (about 42 per cent) of the operators had at least some high school education (grade 9-12) while close to 12 per cent had education above grade 12 (including university degree) when starting their business (see Table 1). However, their education status does not seem to have changed much over the years since then as the proportions of those with these levels of education at the time of the survey are 44.6 per cent and 14.3 per cent, respectively. Most (87 per cent) did not have vocational or technical training. Nor did they receive such education after wards.

[3] Throughout the report, we use the median instead of the arithmetic mean whenever the distribution of a variable is skewed.

Table 1: Distribution of MSE owners by level of education at time of business start

Level of education	%
None	8.8
Grade 1- 4	19.2
Grade 5-8	24.2
Grade 9-12*	41.6
Above high school 12**	12.0

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

* This category includes those who reached grades 9 – 12, 10+1 and technical school diploma; ** includes those who attended (but not necessarily complete) 12+1, 12+2, 12+3, college diploma, and university degree programs.

There are two approaches to the emergence and expansion of MSEs and the increase in the number of people engaged in such activities. One approach perceives this as an outcome of *improved opportunities* for people (including the poor and disadvantaged) to participate in "ways that empower and nourish" them. According to the second approach, on the other hand, it is an indication of *failure* of an economy to provide productive jobs, forcing people to "take refuge in activities that provide only minimal subsistence support" (see Liedholm and Mead, 1999). While it may not be easy to sort this out (and there is probably some truth in both), in this survey, we attempted to get some information that may throw some light on the issue in the Ethiopian context. Accordingly, we asked respondents as to why they got into their respective specific business activities (summarised in Table 2).

Table 2: Reasons for getting into the specific business (%)

Reasons	micro	small	Male-owned	Female-owned	Total
Skilled in this activity	35.2	42.6	41.3	29.6	38.4
Parents/relatives in this business	16.2	17.0	15.2	19.0	16.5
Thought would be profitable	39.9	48.5	46.8	32.7	43.6
Capital requirement matched what I had	15.2	17.0	16.5	15.5	16.0
Little/no regulatory restrictions	6.0	5.4	4.6	9.3	5.7
I had no alternative	38.3	24.6	30.9	38.1	32.3

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

The four most frequent responses obtained are: (i) "I thought it would be profitable" (43.6 per cent); (ii) "I am skilled in this activity" (38.4 per cent); (iii) "this is the only thing I was able to do, I had no alternative" (32.3 per cent); and (iv) "parents/relatives are/were in this business" (16.5 per cent)[4]. We can see from the responses that the situation is more complex than could be explained by one or the other of the above approaches. Reasons (i) and (ii) suggest that many MSEs were picked by operators with options that exercised *choice* in picking their respective businesses based on consideration of expected *profitability* or comparative advantage in *skill*. On the other hand, from the third reason, a good number of MSEs were taken as *activities of last resort* by individuals searching for ways to sustain themselves. This is in congruence with the fact that 14.2 per cent of the MSE operators were retrenched/laid-off from a public sector job (i.e. retrenched/laid-off former civil servants, employees of State Owned Enterprises (SOEs), and demobilised soldiers/fighters). That many operators regard MSEs as activities of last resort seems to suggest, among other things, the need for measures to cultivate positive attitude, especially among the educated urban youth, such that they regard MSEs as respectable business activities worth being engaged in.

Looking at the same issue by size, about 38% of the micro enterprises cited lack of alternative as the reason for getting into their respective specific business activity compared to 25 per cent for small enterprises while profitability and skill factors were cited as the reasons by about 49 per cent and 43 per cent of the small enterprises (compared to 40 and 35 per cent for micro enterprises).

In terms of gender, the proportions reporting to have been attracted by expected profit and skill considerations are higher for male-owned than female-owned enterprises. A higher proportion of the female-owned enterprises cited lack of other alternative as the reason for getting into the business under consideration, indicating that resort to MSEs as a *sustenance mechanism* is more common among female operators. It is not clear what explains this, though.

Most MSE operators had some prior business experience: 42.3 per cent did apprenticeship in similar business (for more than a year on the average) while 75.5 per cent also reported having several years of experience in business in general. Respondents were also asked what they were doing immediately before starting their business and whether their experience (if any) was useful to the current business. More than 57 per cent were working in businesses (of same or different type as their current business) either as owners, employees or apprentices while 6.4 per cent were working in the public sector (18.5 per cent were in school and 6.7 per cent had never been employed). This seems to be consistent with the hypothesis, stated in the TOR, that 'workers, having developed their skills at a work place and gaining exposure to

[4] Note that percent figures do not add up to 100% since respondents were allowed to give multiple responses.

market conditions, abandon their employment and start their own businesses'. About 79 per cent reported that they found their previous business experience to be very helpful in their current business.

More than 87 per cent of the MSEs started by their current operators from scratch using relatively small start-up capital (median of Birr 2,077). They were mainly financed out of the owner's personal savings (accounting for 57.5 per cent on the average) followed by grant money from relatives/friends[5] (16.7 per cent), savings from other owned business (10.2 per cent), and borrowing from relatives/friends (4.7 per cent)[6]. The importance of Iqub/Iddir as source of start-up capital is not as high as is usually believed to be: only 22 and 9 firms respectively (partially or fully) financed their start-up capital using cash from Iqub/Iddir and borrowing from Iqub/Iddir. An early study (Fasika and Daniel, 1997) had found the sources of start-up capital for MSEs to be (a) personal savings; (b) borrowing from friends and relatives; (c) inheritance; and (d) bank and suppliers loans. They indicate that 68 per cent of the enterprises reported that personal savings were the main sources of finance to start new business, followed by borrowings from friends and relatives (17.5 per cent) and inheritance (7.3 per cent). Bank loans accounted for an insignificant proportion (1.9 per cent).

Of those who started their business from scratch, 58 per cent reported that they chose to start own business because they prefer to work for themselves while expectation of better income from engagement in small business activity and inability to find wage employment, respectively, were the reasons for 14.8 per cent and 12.7 per cent. The other two ways through which MSE operators acquired their business were inheritance and purchase, accounting for 8.8 per cent and 3.5 per cent, respectively. Acquisition through inheritance is relatively rare, contrary to expectations. One plausible explanation is that the small size of the private sector itself (due to the nationalisation and subsequent suppression of the private sector by the Derg) which meant that many of those reaching old age did not own enterprises that they could transfer to their off springs through inheritance. That most of the MSEs and their owners, as discussed above, are young seems consistent with this.

Regarding business premises, a significant proportion (71 per cent) started in rented premises, paying median monthly rent of Birr 200 (which reached Birr 273 at the time of the survey - a 36.5 per cent increase), 12.5 per cent were using own premises

[5] MSE operators may receive loans from their relatives/friends who charge them interest. For our purposes such lenders are considered as moneylenders.
[6] The rest being covered by cash from liquidation of other business (2%), support from NGO/government institutions (1.6%), bank loans (1.5%), cash from Iqub/Iddir (1.5%), etc.

while 4 per cent bought it[7]. For those who had to purchase a premise, the median price amounted to Birr 40,000 (*4 times* their average start-up capital). Most (about 84 per cent) of the MSEs are still operating in the very premises where they started: only about 16 per cent relocated, mainly due to better location, lower rent or acquisition of own house (56.8 per cent); expulsion by the landlord (20.3 per cent) or need for larger space resulting from expansion of the business (16.3 per cent). The proportion of MSEs operating from the home (i.e. using residences which also *double* as business premises) is 16 per cent.

People starting micro and small businesses are generally believed to face numerous difficulties. So, we asked MSE operators to identify and rank the three most important problems they faced in *starting* their business. Capital constraints (82.1 per cent), inadequate premise (43.5 per cent), shortage of demand (31.9 per cent) and inadequate skill (28.2 per cent) were identified to be among the top three problems. They also singled out capital constraints (37.9 per cent), inadequate skill (9.2 per cent) and inadequate premise (8 per cent) as the *primary* problems.

Only about 17 per cent of the sample MSEs are one-person enterprises operated by their proprietors. So, self-employment does not appear to be a central characteristic of these enterprises. The average number of workers (excluding apprentices), at the time of the survey, is 3.7 implying that, on the average, each enterprise provides employment to 2.7 persons (other than the owner).

Contrary to the common belief that MSE operators do not use delegation system, a big proportion (84.4 per cent) of the sample MSE operators normally delegate someone to run the business in their absence. However, most (68.9 per cent) seem to use ‘kinship’ (which may be a measure of trust) rather than *competence* as selection criteria for delegation. For those that do not delegate, the main reasons are that they work alone, hence have no one to delegate (37 per cent), lack of reliable person (29.4 per cent), no need to delegate since they are always present (13.3 per cent), and lack of skilled labour (11.9 per cent).

In terms of composition, family labour (composed of working owners plus unpaid family members with active involvement in the enterprise) constitutes a significant proportion of the MSE labour force: the mean ratio of family labour to total workers (working owners plus paid and unpaid workers plus trainees/apprentices) is 59%. The share of hired labour, which comprises 39% on the average, is high while the share of

[7] The rest either used building/premises acquired through inheritance or lease, or operated on a road-side.

trainees/apprentices is negligible (averaging 1.7 per cent): this contrasts with the situation in West Africa as reported in Liedholm and Mead (1999[8]).

It is interesting that the number of child workers (aged 14 or below) working in MSEs is small, contrary to expectations: out of the total 3,259 workforce, there were only 39 children engaged as paid or unpaid workers or apprentices at the time of the survey.

3. POLICY IMPACT

The Micro and Small Enterprises Development Strategy, which draws heavily on the 1995/96 Micro and Small Enterprises Survey (conducted by the CSA), stresses that the role of the MSE sector in and contribution to the national economy has been constrained by "various policy, structural and institutional related problems and bottlenecks". Some seven years since the survey that informed the strategy was conducted, and years since the strategy, whose primary objective is to create an enabling legal, institutional and other supportive services, has been adopted, it will be in order, to see whether and the extent to which the environment has changed for MSE operators.

3.1 Policy and institutional changes affecting MSE development

Designing and implementing appropriate economic policies, strategies, and legal and regulatory framework are *prerequisites* for creating an enabling environment to promote MSEs. A study conducted by the ECA (2001), indicates that, although the regulatory and policy environment for MSEs vary across Africa, countries such as Cameron, Ethiopia, Gabon, Nigeria, Senegal and Uganda have shown that the policy environment in which MSEs operate proves to be a major handicap for their expansion and growth. The same study reveals that the complexity of the customs system and the many forms and declarations required have had a negative impact on the general business climate, diverting entrepreneurs' efforts from more productive tasks. The tax levied on imported *raw materials* is often higher than that on imported *finished products* that use the same raw materials. This substantially increases the

[8] Based on survey data, Liedholm and Mead (1999) found that 'only in a few countries do hired workers comprise as much as 20% of the MSE labor force. Botswana and the Dominican Republic stand out in this regard: in those countries, over a third of the labor force is made up of hired workers. Trainees and apprentices add a significant share of workers in some locations, particularly in West Africa; in Southern Africa, as in other parts of the Third World, the survey results indicate that apprentices comprise less than 10% of the MSE labor force" (Liedholm and Mead 1999, p. 4).

production cost of MSE operators that require highly taxed imported inputs, thereby limiting their competitiveness. In Ethiopia, on top of the disabling regulatory framework, the infrastructure was evaluated as particularly disabling.

Policies and regulations during the Derg era were openly aimed at curtailing (if not eliminating) the private sector. Restrictive policies such as fixing a ceiling on industrial capital, introducing one man–one license rule, favouring the state and parastatal organizations in availing foreign exchange and bank loans, limits on single borrower loans[9], restrictions on license and investments, absolute priority given to the public sector in access to trained qualified manpower, etc. (which discouraged the participation of the private sector in the economy) were in place. In general, the legal requirements to obtain licenses during the Derg were bureaucratic which discouraged the participation of micro and small enterprise operators. The tight foreign exchange control and heavy import restrictions (both inputs and other commodities) had created scarcity of imported commodities and corrupt and rent seeking business community (see Gebrehiwot 1997 for more discussion on this).

Following the fall of the Derg, drastic measures were taken to transform the command economy to a market-led one, which are bound to affect MSEs. The main macro economic reforms and restructuring that, directly or indirectly, affect the development of MSEs include: adoption of market economic policy; deregulation of domestic prices; devaluation of the local currency; privatisation of public enterprises; decentralization and devolution of power and the formation of regional states; issuance of the National Micro and Small Enterprises Strategy (1997); establishment of the Federal Micro and Small Enterprises Development Agency; formulation of a new labour law; financial sector reforms including the opening of private banks, insurance companies and microfinance institutions. The reforms also included the monetary management and liberalization of interest rates and foreign exchange market; fiscal policy reform including tax reform, budgetary restructuring and reduction of government deficits; introduction of investment laws to encourage private (both domestic and foreign) investment; liberalization and promotion of foreign trade; and promotion of favourable economic environment and bilateral, regional and multilateral international relations.

As discussed above, improving the regulatory and policy environment in Ethiopia is a key factor for the growth and development of the MSE sector. According to Asmelash

[9] These were set at maximum of birr 500,00 in case of AIDB (now DBE), and birr 1 million in case of CBE.

Beyene (2002), in order to support MSE development, government needs to take the following measures:

(a) undertake a thorough review of the policy and regulatory environment with the aim of determining their weaknesses and learning from best practices within and outside Africa and revamp their laws, regulations and procedures in a manner that will stimulate the growth of MSEs;
(b) regularly review policies to determine their effectiveness;
(c) continued effort to harmonize laws, regulations and procedures at national and regional levels;
(d) facilitate the participation of MSEs in government procurement by simplifying tendering procedures;
(e) encouragement and support to MSEs in the traditional sectors; and
(f) formulation of MSE sector and apex associations (where they do not exist) and strengthening them where they exist since they could play an important advocacy role.

The industrial development strategy of the federal government of Ethiopia, issued in 2003[10], explicitly recognises the private sector to be the *engine* of industrial development. It also indicates that promoting MSEs is one of the important instruments to create productive private sector and entrepreneurship and that the government will give due emphasis and priority to promote this sector. The strategy also stresses that every effort will be made to support this sector by providing infrastructure (working premises and land), financial facilities, supply of raw materials, training, etc. Federal and regional governments are expected to coordinate the support services through the already established MSE Development Agencies at federal and regional levels.

The existing MSE strategy primarily aims at creating enabling legal, institutional and other supportive environments for the development of MSEs. The specific objectives include: facilitate economic growth and bring about equitable development; create long-term jobs; strengthen cooperation between MSEs; provide the basis for medium and large scale enterprises; promote exports; and balance preferential treatment between MSE and bigger enterprises. The fundamental principles that guide interventions by stakeholders (government, private sector, NGOs, Associations, Chambers and others), as stated in the strategy include: support to the MSE operators will be based on the Agricultural Development Led Industrialization (ADLI) and private sector development; all support to the MSE sector should be designed to be all-round; support services should, as much as possible, be based on fees;

[10] Currently, there are attempts to revise the current National Micro and Small Enterprises Strategy of Ethiopia issued in 1997.

addressing marketing problems of MSE operators will be given due consideration; emphasis will be given to the advancement of women; the staff of the support institutions should be adequately skilled and trained; supporting institutions (the Ministry of Trade and Industry, Federal Micro and Small Enterprise Agency, Regional Micro and Small Enterprise Agencies, NGOs and Chambers) should provide solid services to the MSE operators; the private sector will be involved in the supply of commercial BDS to MSE operators; and facilitate cooperative ventures.

The intended supports to promote the MSE sector include creating legal framework; improve access to finance; introduce different incentive schemes; encourage partnerships; provide training in entrepreneurship, skills, and management; improve access to appropriate technology, information, advice and markets; and develop infrastructure. Due attention is also given in the strategy to strengthen private sector associations and chambers. Based on the national strategy, regional governments have developed their own regional MSE development strategies. A number of institutions are expected to be involved in providing support to the MSEs[11]. But, to what extent are these institutions delivering these on the ground?

International donor communities such as ILO, GTZ, etc provided very limited financial and technical support to the MSE sector. According to Zewdie and Associates (2002), the Regional Trade, Industry, and Tourism Bureaus, in addition to their regulatory role, are involved in the provision of business development services: they provided limited training on business, based on the ILO training packages, and delivered some marketing services by organising trade fair and providing market price information. The Ministries of Education and Labour and Social Affairs, which have regional structures throughout the country, are also involved in delivering short-term skill training and long-term vocational and technical training to potential MSE operators.

However, data from the present survey shows that availability of such services is far from satisfactory. Since 1991, there has been recognition of the role of the MSE sector in employment creation and economic growth (as opposed to being viewed as marginal and unproductive, tax evader, and with limited contribution to economic growth). Yet, more than 95 percent of the MSE operators surveyed indicated that they did not receive any support, whatsoever, to promote their activities (Table 3). In spite of the serious attempts to liberalize and improve the policy and regulatory environment, the survey data indicates that there is divergence between policies and directives issued and their actual implementation on the ground. Concrete and

[11] These include government and other public sector agencies at both national and local levels (such as various ministries, Federal and regional MSE agencies, banks, etc), NGOs, donors, and private business associations.

coordinated institutional support (infrastructure facilities like business premises, water and power; financial services; extension services; assistance in the transfer of technologies; promotion of marketing facilities; and provision of training on sustainable basis) has yet to be provided. The establishment of the MSE Development Council (composed of the federal government, local governments, private sector representatives, and MSE operators) at the Prime Minster Office and Regional Government Administration levels may be one option to surmount the coordination difficulties in the MSE sector. The Council's mandate and modus operandi should promote an effective consultative and participative process in policy formulation and implementation.

Table 3: Institutions that supported MSE

Did you receive support from:	Yes		No	
	No.	%	No.	%
Donors	1	0.2	972	99.8
International NGOs	7	0.7	967	99.3
Local NGOs	4	0.4	970	99.6
Governments projects/institutions	24	2.5	950	97.5
Training providers	7	0.7	967	99.3
Banks	45	4.6	929	95.4
Microfinance institutions	27	2.8	947	97.2
Cooperatives	3	0.3	971	99.7
Business associations	20	2.1	954	97.9
Other institutions	28	2.9	946	97.1

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

3.2 Impact of the policy reform on MSE development

Generally, policy reform and liberalization are expected to have a positive impact on competition, production and productivity of MSEs. However, putting an enabling policy environment in place by itself may not be sufficient to ensure optimal results. The response to the new opportunities opened-up by the reform is likely to depend on, among other things, the degree to which MSE operators can access resources such as skill, technologies, finance, infrastructure, markets, etc. In the present survey, we investigated whether or not the policy environment, as perceived by the MSEs in our sample that existed before[12] 1993, has improved following the 1993 policy reform and looked at MSEs' ratings, on 5-points scale (1 = 'increased a lot'; 5 = 'no change'), of changes in investment, competition, infrastructure availability, access to finance,

[12] Limiting it to this group of MSEs is appropriate because they operated under both the pre-reform and post-reform policy environments, hence are in a better position to compare the two.

tax, market and prices. We also investigated whether there has been an improvement in the licensing procedure over the past decade. The results are summarised in Tables 4 to 8.

Table 4: The post-reform policy environment as perceived by MSE operators

Improved after 1993?	Micro enterprises		Small enterprises		Total	
	No.	%	No.	%	No.	%
Yes	43	28.7	58	37.7	101	33.2
No	86	57.3	84	54.5	170	55.9
Do not know	21	14.0	12	7.8	33	10.9
Total	150	100	154	100	304	100

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

The results show that a lot remains to be done to create an enabling policy environment for the MSE sector. We observe from Table 4 that about 56 percent of the MSE operators that were in existence before 1993 reported that the policy environment has not improved for the MSE sector after the reform: only about 33 percent reported an improvement in the environment. Disaggregated by size, the proportion is higher for small enterprises: It appears that the improvement in policy environment had relatively higher positive impact on small enterprise operators compared to micro.

Table 5: Improvement in the licensing procedure in the last ten years

Responses	Micro enterprises		Small enterprises		Total	
	No.	%	No.	%	No.	%
Yes	285	63.33	265	73.2	550	67.7
No	50	11.1	40	11.0	90	11.1
Do not know	115	25.6	57	15.7	172	21.2
Total	450	100	362	100	812	100

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

As Table 5 reveals, the licensing procedure in the MSE sector has improved over the past decade: about 73 percent of the small and 63 percent of the micro enterprise operators reported so. However, a good number of MSEs (about 11 percent) failed to notice any improvement suggesting the need for more effort in this respect.

The reform process is expected to increase private investment and competition in the economy. Potentially, MSEs in Ethiopia face competition from three main sources: (a) imports; (b) large-scale enterprises; and (c) other MSEs. Market liberalization, trade liberalization in particular, enables importers to bring in goods that undercut the market for local MSE products; that is, MSEs face stiff competition from imported goods which may be of relatively higher *quality* and lower *prices*. Although this may encourage healthy competition and improve quality of MSE products, it could also constrain development of the MSE sector.

The survey data summarised in Tables 4, 5 and 6 indicate that investment and competition have increased after the market liberalization process. About 76 percent of the MSE operators reported increase in investment (Table 4). The reform appears to have helped the market for MSE products to expand: about 59 percent reported increases in the size of the market after the reform. So has competition: Competition from other MSEs and from imports were reported to have increased by about 91 percent and 51 percent, respectively. Regarding infrastructure and delivery of financial services, about 79 percent and 47 percent of the MSE operators, respectively, indicated an increase after the reform.

Rises in tax rates and tax administration/enforcement after the reform have been reported by about 68 percent and 54 percent of the MSE operators, respectively. Both prices of inputs and products of MSEs have also increased after liberalization. What is not clear however is what explains the simultaneous increase in competition and output prices. The reported rise in taxes and/or better tax enforcement over former evaders may be at least part of the reasons.

Disaggregated by size, the data (Tables 5 and 6) shows similar pattern for both micro and small enterprises. Both reported that investment, competition among MSEs and with imported goods, infrastructure, access to finance, tax rate, tax administration, size of output market, as well as product and input prices have increased after the reform. However, the percentage increases were relatively higher for small enterprises compared to micro.

Table 6: Changes observed in the micro and small enterprise sector after the reform

Changes	Increased a lot		Increased slightly		Decreased a lot		Decreased slightly		No change		Do not know		Total	
	No.	%	No.	%	No	%	No.	%	No.	%	No.	%	No.	%
Investment	169	24.4	356	51.3	20	2.9	27	3.9	62	8.9	60	8.6	694	100
Competition (imports)	107	22.2	139	28.8	15	3.1	8	1.7	79	16.4	135	28.0	483	100
Competition (domestic)	330	47.6	301	43.4	17	2.4	9	1.3	17	2.4	20	2.9	694	100
Infrastructure	158	22.8	390	56.3	45	6.5	15	2.2	60	8.7	25	3.6	693	100
Support of government	40	6.0	149	22.2	96	14.3	40	6.0	290	43.2	57	8.5	672	100
Access to finance	80	11.9	239	35.7	45	6.7	16	2.4	183	27.3	107	16.0	670	100
Tax rate	255	38.7	194	29.4	22	3.3	38	5.8	42	6.4	108	16.4	659	100
Tax administration	151	22.9	204	30.9	76	11.5	65	9.8	49	7.4	115	17.4	66	100
Size of the market	173	24.9	240	34.5	83	11.9	155	22.3	31	4.5	14	2.0	696	100
Price of your product	126	18.3	326	47.7	39	5.7	77	11.2	105	15.2	14	2.0	690	100
Price of input	175	25.6	334	48.8	38	5.6	63	9.2	58	8.5	16	2.3	684	100

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

About 28 percent (25 percent of the micro and 32 percent of small enterprise operators) reported increased government support to the MSE sector. However, almost as many (about 25 percent – 45 percent of the micro and 14 per cent of the small) MSEs indicated that there was no change. Even more worrying is that a good percentage (about 20 percent) reported *deterioration* in government support after liberalization.

A good number of MSEs reported that access to non-labour physical inputs has either become more difficult (16%) or not changed much (31.3%). The basic conclusion reached from Tables 4, 5 and 6 is that market liberalization appears to encourage MSE operators in Ethiopia. However, there is a need to improve the support of the government to the sector.

Table 7: Changes observed by micro enterprise operators after the reform

	Increased a lot		Increased slightly		Decreased a lot		Decreased slightly		No change		Do not know		Total	
	No.	**%**	**No.**	**%**	**No**	**%**	**No.**	**%**	**No.**	**%**	**No.**	**%**	**No.**	**%**
Investment	74	19.4	204	53.4	11	2.9	15	3.9	34	8.9	44	11.5	382	100
Competition (imports)	55	20.4	64	23.8	9	3.3	3	1.1	48	17.8	90	33.5	269	100
Competition (domestic)	160	42.0	176	46.2	9	2.4	6	1.6	13	3.4	17	4.5	381	100
Infrastructure	73	19.2	217	57.0	23	6.0	10	2.6	38	10.0	20	5.2	381	100
Support of government	15	4.0	79	21.2	50	13.4	24	6.5	166	44.6	38	10.2	372	100
Access to finance	28	7.5	122	32.8	24	6.5	6	1.6	117	31.5	75	20.2	372	100
Tax rate	112	31.8	100	28.4	12	3.4	11	3.1	32	9.1	85	24.1	352	100
Tax administration	64	18.1	111	31.4	34	9.6	18	5.1	37	1.5	89	25.2	353	100
Size of the market	78	20.5	144	37.8	49	12.9	80	21.0	19	5.0	11	2.9	381	100
Price of your product	51	13.5	186	49.1	23	6.1	48	12.7	60	15.8	11	2.9	379	100
Price of input	70	18.7	191	51.1	19	5.1	40	10.7	43	11.5	11	2.9	374	100

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

Table 8: Changes observed by small enterprise operators after the reform

Changes	Increased a lot		Increased slightly		Decreased a lot		Decreased slightly		No change		Do not know		Total	
	No.	%	No.	%	No	%	No.	%	No.	%	No.	%	No.	%
Investment	95	30.4	152	48.7	9	2.9	12	3.8	28	9.0	16	5.1	312	100
Competition (imports)	52	24.3	75	35.0	6	2.8	5	2.3	31	14.5	45	21.0	214	100
Competition (domestic)	170	54.3	125	39.9	8	2.6	3	1.0	4	1.3	3	1.0	313	100
Infrastructure	85	27.2	173	55.4	22	7.1	5	1.6	22	7.1	5	1.6	312	100
Support of government	25	8.3	70	23.3	46	15.3	16	5.3	124	14.3	19	6.3	300	100
Access to finance	52	17.4	117	39.3	21	7.0	10	3.4	66	22.1	32	10.7	298	100
Tax rate	143	46.6	94	30.6	10	3.3	27	8.8	10	3.3	23	7.5	307	100
Tax administration	87	28.3	93	30.3	42	13.7	47	15.3	12	3.9	26	8.5	307	100
Size of the market	95	30.2	96	30.5	34	10.6	75	23.8	12	3.8	3	1.0	315	100
Price of your product	75	24.1	143	46.0	16	5.1	29	9.3	45	14.5	3	1.0	311	100
Price of input	105	33.9	143	46.1	19	6.1	23	7.4	15	4.8	5	1.6	310	100

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

4. REGULATORY CONSTRAINTS IN THE MICRO AND SMALL ENTERPRISE SECTOR

A host of rules and regulations related questions (ranging from *entry* barriers to taxes, environment protection, consumer protection and quality control, workers' welfare, finance, enforcement mechanisms, and competition) were included in the survey instrument to capture respondents' assessment of them as they impinge on their businesses. For instance, respondents were given a long list of factors and asked to rank, on a four-point scale (0 = 'not a problem' to 4 = 'very severe problem'), the severity of each as a constraint to their business. They were also given lists of (a) 'rules/regulations' related and (b) 'market-related'[13] obstacles and, in each case, asked to identify, in order of importance, what the three most important hindrances *were* to the growth/expansion of their business in the *past*. Elsewhere, they were also asked to identify, in order of importance, what the three most important obstacles *will be* (be they rule/regulation-related or market-related) if they were to expand their business *now*. In this case, we deliberately refrained from providing a list of possible factors/obstacles, letting respondents to identify them instead, partly in order to check the consistency in respondents' identification and rating of problems/obstacles and partly to see if the factors have changed over time. We also asked about their perceptions and expectations related to changes in policy/rules/regulations and implementation. The results are summarised below.

Of the factors rated as very severe problem, the top five are high taxes, inefficient/arbitrary tax administration, high collateral requirement, lack of/inadequate business premise and lack of business support services in that order. Considering factors that are rated as major problem or higher, we have high taxes (51.2%), high collateral requirement (47.1%), inefficient/arbitrary tax administration (43.8%), lack of/inadequate business premise (41.6%), lack of business support services (40.8%), and lack of/inadequate access to credit (38.5%) figure out prominently. Other factors rated as major or very severe problem by a good number of MSEs include: bureaucratic requirements (red tape and paper work) (23.1%); penalties (including kickbacks to officials) for operating without license, if and when detected (19.7%); weak legal enforcement (19.3%); crime and theft (18.5%); competition (15.5%); entry regulation (15.1%); and inability to use the institutional enforcement mechanism (legal & judicial system and police) (14.8%). This contrasts clearly with the situation in Kenya, where issues of tax, business premise, and bureaucratic

[13] We would like to note, however, that this classification involves some degree of arbitrariness since some factors do not neatly fall into one or the other category.

requirements/regulation/harassment do not appear as major problems (See GEMINI 1995).

Of course, it is possible that the complaint about taxes being too high may partly reflect stricter enforcement of tax collection now compared to the past: for those who were not paying taxes before (due to evasion or otherwise) even a modest tax may be regarded as high. But, could it also be that MSEs, not fully aware of the taxes they are required to pay, end up paying more as it happened in Tanzania[14]? There could be yet another explanation once we recognize that, in the absence of book accounts, small businesses pay taxes as assessed by tax officers: tax officers may deliberately *overestimate* MSEs' tax obligations (taxable income) in order to force them to give kickbacks in return for underestimating their taxable income. Results of the Ethiopia Firm Survey (EDRI/World Bank (2003) also indicate that high taxes are among the major problems facing medium and large enterprises in Ethiopia. Considering the wide spread complaints (by MSEs as well as medium and large firms alike) about taxes being too high (despite the fact that the marginal business tax is 30%) and the alternative explanations, it may be worthwhile to do a case study that would help us understand what exactly the problem is. It is also striking that about 14% of the MSEs reported being robbed in the past 2 years, which is on the high side considering that the firms surveyed are in major urban towns.

A vast majority of respondents did not regard rules/regulations related to the welfare of workers (i.e. rules on free hiring and firing, minimum wages and fringe benefits, protection to unions and union pressure) and skill inadequacy as problems. The former may be either because they are not subject to the labor law or they evade it with relative ease. Interestingly, regulations related to environment protection and consumer protection and quality control did not rank high either, probably reflecting that such regulations do not exist or that MSEs manage to evade them. We looked at the issue by splitting the data into the licensed and unlicensed MSE sub-samples to see whether being licensed or not make difference. We did not find any noticeable difference: licensed and unlicensed MSEs alike do not consider these factors as posing serious problems.

We also examined the issue by disaggregating the data by size and gender (see figures 2 and 3). High tax rates (59%), inefficient/discretionary tax administration (55%) and high collateral requirement (46%) are the three main constrains for small enterprises, which are somewhat reversed for micro enterprises (as high collateral

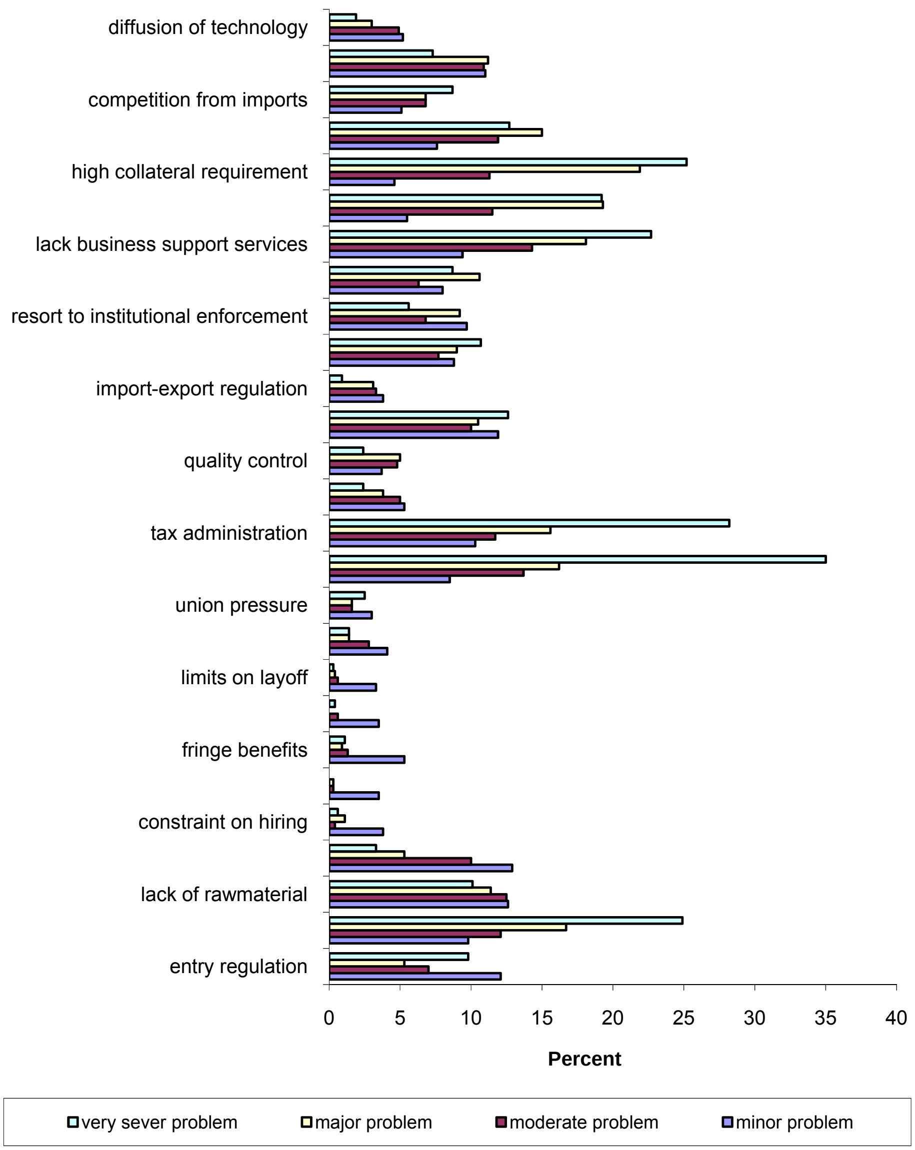
[14] Bagachwa (1993) reported that in Tanzania, although sales tax was imposed on final products only, inputs to be used in processing being exempted, small firms, lacking proper information were unaware of this and ended up paying sales taxes on inputs and outputs.

requirement (48%), high tax rates (44.3%), and lack of/inadequate business premise (43.6%)). A much higher proportion of small enterprises rated high tax rates, inefficient/discretionary tax administration and bureaucratic burden as major or very severe problems compared to micro enterprises. Could this difference be due to the higher possibility for tax evasion among micro enterprises, partly because they are outside the regulatory system due to their informal nature[15] and/or many micro enterprises not being required to pay tax. In terms of gender, it is interesting to note that there is a noticeable difference between the proportion of male- and female-owned enterprises that rated high tax rates and inefficient/discretionary tax administration as major or very sever constraints in that it is higher for the former (for which we have no obvious explanation) while the proportion that gave similar rating to credit-access constraint are about the same.

Perceived predictability of laws and policies and credibility are believed to be important for business decisions. Perceptions and expectations influence business decision: It is not whether they are *right* or *wrong* that matters, but *how strongly* they are held by economic agents. In order to asses these, we included in the survey questions designed to capture respondents' perceptions of the predictability of changes in laws/rules and policies relevant to their respective businesses; their expectations of government's *adherence* to its *announced* policies and laws and *effectiveness* in implementing them; as well as *perceptions* regarding the extent of *participation* of the business sector in the process of designing new rules and regulations. The results are summarised in figures 4 and 5. In this respect, the proportion of MSE operators who reported that they have to cope, on regular basis, with "unexpected changes in rules, laws or polices which materially affect their enterprise" is high: about 36% for the whole sample, 42% for small and 32% for micro enterprises. Disaggregated by gender of owner, the figures are 38% for male-owned as opposed to 29% for female-owned enterprises.

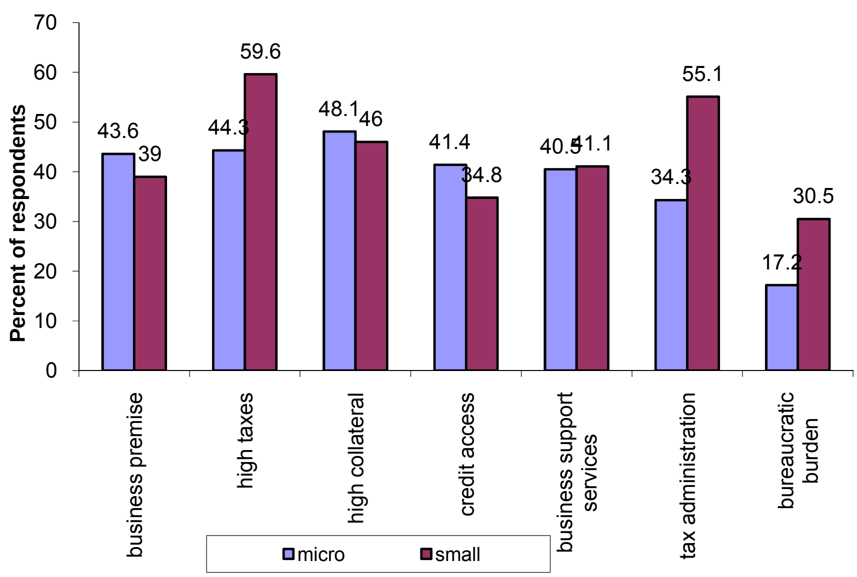
[15] In fact, according to one approach, mainly advocated by Hernando de Soto, being informal is the result of a *rational* decision by economic units that decide to "stay totally or partially outside the legal system by weighing the *costs* of being legal against its *benefits* and by considering the firm's individual restrictions, such as financial capital availability" in a situation where *regulations* are *excessive* and the system of *monitoring* [and enforcing] compliance is *inefficient and/or corrupt* (Braun, and Loayza, 1994). The *effective* burden of regulation on business (and the potential for corruption, hence the incentive to become informal and remain informal) depends not only on *the rules* but also on the *extent of discretion* of officials in interpreting and implementing them (see Johnson, Kaufmann and Zoido-Lobaton, 1998).

Figure 1: Main constraints of MSE operators



The perceived policy predictability is quite low among the sample MSEs: only about 34% feel some degree of predictability (ranging from completely predictable to fairly predictable) of changes in laws, rules and policies. The figures are very similar for the micro- and small-samples: about 32.8% for the former and 36% for the latter. Moreover, there appears to be a wide spread *credibility* problem: as high as 40% (41% for micro and 39% for small) do not believe that the government adheres to its announced policies and rules. Taken at their face value, the figures suggest that the prevailing perceptions and expectations (regardless of whether they are right or wrong) are not likely to encourage MSE operators to expand their businesses.

Figure 2: Factors and percent of respondents rating them as major or very sever constraint to business



Both *accessing* the formal sector (i.e. becoming formal) and *staying* formal are costly to the operator. The former includes registration/license fees, required registration time (due to bureaucratic rules and inefficient public service) while the latter are of three broad types: taxes, regulations (e.g. related to welfare of workers, environment protection, consumer protection and quality standard, etc.), and bureaucratic requirements. Studies in other countries show that the costs of entry into the formal sector and staying formal could be significant (see Braun and Loayza, 1994). These are costs that can be avoided/evaded by being informal. So, in the survey, we asked enterprises a series of questions related to their registration and license status and reasons for not registering or being licensed, etc.

Figure 3: Factors and perccent of respondents rating them as major or very sever constraints

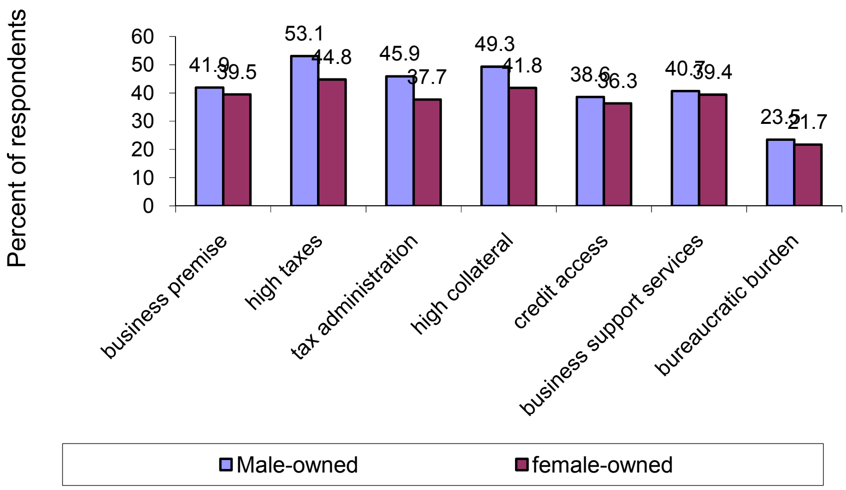


Figure 4: Pereceived degree of predictability of changes in laws, rules & policies

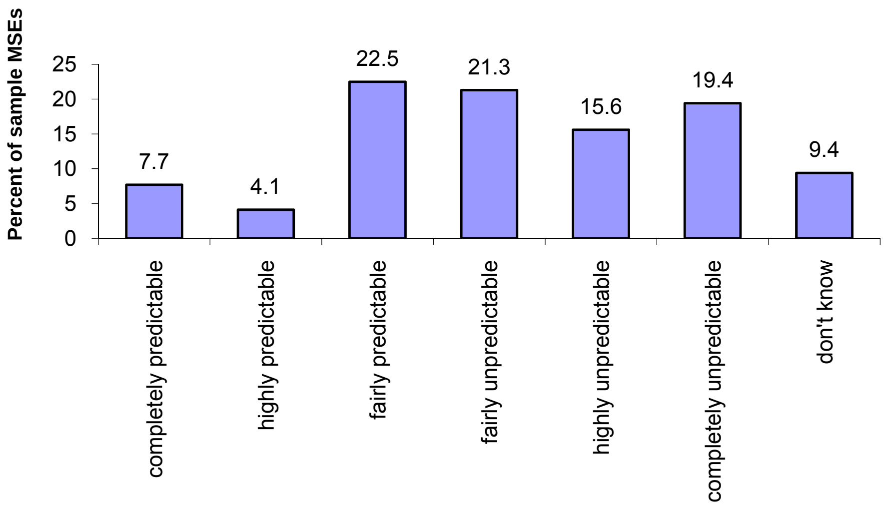
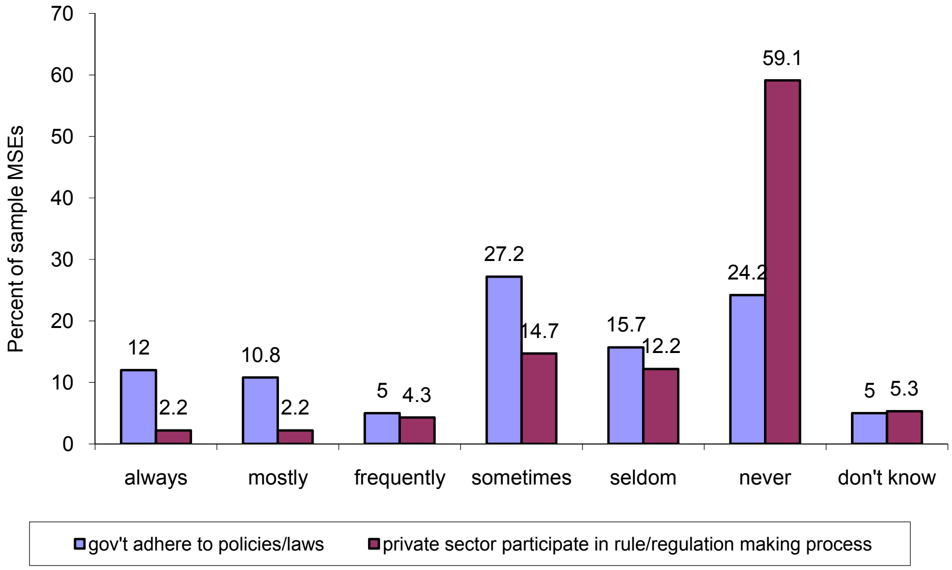


Figure 5: Expected government adherence to & implementation of policies/laws and degree of business sector participation in designing rules/regulations



The data shows that 80% of the sample MSEs are registered while about 3/4th have license (work permit). In terms of size category, only 72.4% of the micro enterprises are registered compared to 89.6% for small enterprises. Sample MSEs that are not registered or licensed were asked about the reason(s) for not doing so. For those not registered, the most common reasons are: that 'business is too small to need license' (51%); 'no benefits to registering' (20.3%); and 'taxes too high' (12.6%). Similarly, of those that have no license, 73% cited 'business too small' as the reason. Other reasons cited include: "I do not need a license, I can do without one" (8.7%); "cumbersome licensing procedure" (6.2%); and "licensing costs (initial and renewal) too expensive"(4.6%).

However, being informal is not without cost either: it involves costs in the form of penalties (or bribes to escape penalty) upon detection and forgone benefits of not being able to "take full advantage of government-provided goods" (Braun and Loayza, 1994). Accordingly, we asked MSEs about the *perceived* benefits (if any) of registering and having a license (without any attempt to quantify): while 36.4% and 24%, respectively, do not see any benefits in registering and being licensed, most of the remaining identified various kinds of benefits. Among the benefits cited are that: "I would not have to hide from/give bribe to government officials" (46.6%); "I will be able

to apply for credit" (16.5%); "I can apply for land/business premise" (10.2%[16]); "increased customers" (8.9%); and "I can buy raw materials in bulk" (6.8%).
It is also interesting to note that none of the sample MSEs resorted to the court system to resolve disputes (with suppliers as well as customers). This is despite the fact that 80% are registered, that more than 75% are licensed, and that many cases of contractual breach and robbery are reported: for example, failure on the part of suppliers to make timely delivery and to meet quality/standard were rated as major or very severe problems by 9% and 12% respectively. While that MSEs do not use the court system may not necessarily be bad, it is not clear whether it is due to their *preference* for out-of-court settlement or because they are *discouraged* by (perceived or otherwise) *inefficiency* and *corruption* in the legal and judicial system.

We asked MSE operators whether the growth/expansion of the business under consideration has been their important objective and, if so, to cite, separately, the three main (a) regulations-related, and (b) market-related constraints/obstacles. The first question was motivated by our anticipation that some may take up MSE activity only as *temporary*[17] engagement (until a 'better' alternative comes along) in which case growth/expansion may not be their overriding objective, rendering the issue of obstacles to growth less relevant for them. Results are summarised in Table 9. While, as one might expect, a significant proportion (85%) had growth as a primary objective, this was not the case for as many as 15% of the sample MSEs. While the reason for the latter is not clear, one possible explanation could be a '*survivalist*' attitude among operators (i.e. operators being concerned primarily about the survival of their business) causing reluctance to undertake potentially risky expansion.

Some argue that male and female entrepreneurs have different goals regarding firm growth/expansion in that the latter are concerned about "income stability and economic security", hence "may be more prone to avoid taking the risks involved with firm expansion and hence may be more likely to diversify" rather than expand an existing enterprise (Downing, 2001). Female operators' "dual domestic and productive responsibilities may also hamper growth" and may also mean that business profits are more likely to be used to maintain household consumption (Berger 1989 as cited in Liedholm and Mead, 1999) rather than expansion. This does not, however, seem to be born out by our data. The proportion of male and female entrepreneurs that reported having growth/expansion of their business as a major goal are not very different: 86% for male entrepreneurs compared to 81% for female.

[16] Note that percent figures do not add up to 100 since multiple answers were allowed.
[17] which was *confirmed* by the data since, as discussed in section 3, about 32% of the MSE operators reported *lack of any other alternative* as the reason for getting into their respective current businesses.

However, there appears to be a noticeable difference between micro and small operators: 81% of the former reported having growth/expansion as an important objective relative to 90% for the latter. This is not consistent with our expectation: we expect intention/desire to grow to be more common among micro enterprises, partly because growth is likely to be easier for such enterprises: the higher one is on the size ladder, the more difficult growth becomes.

As for the rules/regulations related obstacles to growth/expansion, high taxes (56.8%), lack of/inadequate business premise (48.6%), power interruption (38%) and tax administration (37%) were cited among the top three (see Table 9a). To probe the issue a bit further, we looked at the factors singled out as primary. As Table 10 shows, lack of/inadequate business premise, high taxes, and power interruption come on top: being identified as primary by 32%, 26.4%, and 9.3% respectively.

On the other hand, the market-related constraints/obstacles identified to be among the top three are shortage of capital (87.3%), inadequate/uncertain market (57%), constrained access to credit (46.9%) and inadequate business support services (41.4%) in that order (see Table 9). More specifically, 74% singled out shortage of capital as the primary obstacle while 15% identified inadequate/uncertain market.

It will be in order to see whether the constraints and problems enterprises face differ across enterprises and if so how. Such an understanding is crucial, partly to identify the particular policy support needs of each group and design appropriate interventions accordingly. Therefore, we tried to examine whether the (rules/regulation-related and market-related) obstacles to growth/expansion identified and the ratings are different for micro vs small and male vs female-owned enterprises. As can be observed from Table 9b, the market-related factors identified as the three main obstacles and the order of importance basically remain unchanged when we disaggregate the data by enterprise size and by gender, although the percentage of firms identifying them differ. That is, micro and small enterprises as well as male and female entrepreneurs alike put *capital shortage*, inadequate/uncertain *market*, and *credit* access constraint, in that order, on top of the list. With respect to market-related factors singled out as primary constraints, again, as Table 9b indicates, capital shortage is the most critical for most MSEs in aggregate as well as for micro & small enterprises and male & female operators

Table 9: Rule/regulation related obstacles and percent of MSEs reporting them among the top three impediments to business

(a) Rule/regulation related obstacles and percent of MSEs reporting them among the top three					
Obstacle	**Micr o**	**Small**	**Male-owned**	**Female-owned**	**Total**
High tax rate	51.7	63.1	58.4	49.9	56.8
Lack of/inadequate business premise	53.9	42.7	50.7	44.4	48.6
Power interruption	31.1	45.2	37.5	38.2	38.0
Inefficient/discretionary tax administration	32.1	42.5	38.3	33.0	37.0
(b) Market-related obstacles and percent of MSEs reporting them among the top three					
Obstacle	**Micro**	**Small**	**Male-owned**	**Female-owned**	**Total**
Shortage of capital	90.3	83.3	86.5	90.5	87.3
Inadequate/uncertain market	55.7	58.9	59.2	51.6	57.1
Credit access	51.9	40.8	46.7	45.5	46.9
Inadequate business services	39.3	44.4	37.7	52.9	41.5
(c) Factors and percent of MSEs reporting them among the top three constraints to growth at present					
Obstacle	**Micro**	**Small**	**Male-owned**	**Female-owned**	**Total**
Shortage of capital	87.1	79.3	84.1	83.8	83.9
Inadequate/uncertain market	38.1	38.1	38.2	36.5	35.1
Inadequate business premise	46.4	43.2	46.4	44.2	44.9
High tax	22.8	32.1	27.7	25.4	26.9

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

It is also interesting to note that the market-related obstacles to business expansion have remained the same over time. Asked about the three main factors that pose hindrance if they were to expand their business now, MSE operators identified capital shortage (84%), inadequate business premise (45%), inadequate/uncertain market (35%) and high taxes (27%) in that order (Table 9c). In particular, shortage of capital was singled out as the primary constraint by 53.5% while inadequate/uncertain market is the primary factor for the other 11% (Table 10c), which were also reported (by 74% and 15% respectively) to have been the primary obstacles in the past. These results of the survey data suggest, among other things, that interventions designed to provide credit services that are appropriate in terms of type, magnitude, maturity, etc. for such enterprises in urban areas may go a long way in promoting growth of MSEs.

Table 10: Obstacles and percent of MSEs reporting them as *primary* constraints to growth/expansion

(a) Rule/regulation related obstacles and percent of MSEs reporting them as *primary*					
Obstacle	**Micro**	**Small**	**Male-owned**	**Female-owned**	**Total**
Lack of/inadequate business premise	34	28.9	32.4	31.5	31.8
High tax rate	21.8	32.3	26.1	25.9	26.4
Power interruption	7.1	12	8.9	10.2	9.3
Inefficient/discretionary tax administration	2.3	3.1	2.4	3.7	2.6
(b) Market-related obstacles and percent of MSEs reporting them as *primary* constraint in the *past*					
Obstacle	**Micro**	**Small**	**Male-owned**	**Female-owned**	**Total**
Shortage of capital	77.4	69.2	74	74.3	73.9
Inadequate/uncertain market	14.3	16.1	14.9	15.8	15.1
Inadequate business services	1.7	2.9	2.4	1.4	2.2
(c) Factors and percent of MSEs reporting them as the *current primary* constraints					
Obstacle	**Micro**	**Small**	**Male-owned**	**Female-owned**	**Total**
Shortage of capital	59.9	45.2	52.6	54.9	53.5
Inadequate/uncertain market	10.5	11.6	10.9	11.5	11.0
Inadequate business premise	8.2	12.1	10.4	8.8	9.9
High tax	4.0	8.7	5.8	7.5	6.1

Source: EDRI, Micro and Small Enterprises Survey (2003), Addis Ababa

5. CONCLUSION

The survey results indicate that investment, competition among MSEs and with imported goods, infrastructure, access to finance, tax rate, tax administration, size of output markets, product and input prices have increased after the reform process. About 76 percent of the MSE operators reported increase in investment after the market liberalization. Increased competition after the reform among MSEs was reported by about 91 percent while about 51 percent stated that competition with imported goods has increased. About 79 percent and 47 percent of the MSE operators, respectively, indicated that infrastructure and delivery of financial services have increased after the reform. Although about 28 percent of the respondents reported increased government support after the reform, almost as many (about 25 percent) indicated that there was no change in government support to the MSE sector. Actually, a good percentage (about 20 percent) revealed that government support has declined after the market liberalization.

The major regulatory constraints of the MSE sector include high taxes, inefficient/arbitrary tax administration, high collateral requirement, lack of/inadequate business premise and lack of business support services in that order. Considering factors that are rated as major problem or higher, we have high taxes, high collateral requirement, inefficient/arbitrary tax administration, lack of/inadequate business premise, lack of business support services, and lack of/inadequate access to credit figure out prominently. Other factors rated as major or very severe problem by a good number of MSEs include: bureaucratic requirements (red tape and paper work); penalties (including kickbacks to officials), if and when detected, for operating without license; weak legal enforcement; crime and theft; competition; entry regulation; and inability to use the institutional enforcement mechanism (legal and judicial system and police). The results of the survey also indicate that the perceived policy predictability is quite low among the sample MSEs: only about 34% feel some degree of predictability (ranging from completely predictable to fairly predictable) of changes in laws, rules and policies.

The government needs to improve the legal, regulatory and institutional framework within which MSEs operate. The federal and regional governments should implement national and regional legal and regulatory policies which balances legitimate controls and protection with the need for simplicity, impartiality and legal redress. This includes establishing and protecting property rights to enforce contracts and the setting and upholding of core labour standards and being environmentally responsible.

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