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Micro and Small Enterprises (MSE) Development in Ethiopia: Strategy, Regulatory Changes and Remaining Constraints[1]

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Abstract

This paper gives some detailed information on the profile of the MSE operators/MSEs and examines the current business environment for the MSE sector. It is based on primary data collected by the authors through a survey of 974 MSE operators using a structured questionnaire. Although there have been attempts by the government to liberalize and improve the policy, regulatory and institutional support environment for MSEs, 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 stated policies & directives and the outcome on the ground. Capital shortage, inadequate business premise, inadequate/uncertain market and high taxes still remain major constraints to expand MSEs. Moreover, the data revealed that policy predictability is quite low. Much more remains to be done to create an enabling business environment. 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 and other stakeholders.

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1. Introduction

In Ethiopia, according to the nationwide urban informal sector survey by the CSA (2003b), there were 799,358 establishments employing 997,380 persons (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. On the other hand, the survey of Small Scale Manufacturing Industries (CSA 2003c) indicated that it engages 97,782 persons, about 91 per cent of which were male. The 2002 nationwide survey of cottage/handicraft manufacturing establishments by the CSA (2002a) identified 974,676 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, 74 per cent were women; about 94 per cent were active owners, partners or family workers while 4.3 per cent were employees. 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 (CSA 2003a).

The employment figures indicated above contrast with only 98,136 industrial workers employed by large and medium scale enterprises during the same period.

The importance of the micro and small enterprises sector in Ethiopia, particularly for the low-income, poor and women groups, is evident from their relatively large presence, share in employment and small capital requirement. These are sufficient reason for governments and other stakeholders in development to be interested in micro and small enterprises. However, in the context of many developing countries, countries in transition in particular including Ethiopia, MSEs are also seen as an emerging private sector, forming the basis for private-sector-led growth. In Ethiopia, at the level of strategy and policy, these roles of MSEs have received recognition. They are seen as means of providing employment, alleviating poverty, ensuring food security, and private sector development. For example, see ADLI (MoFED 2003), the Poverty Reduction Strategy (MoFED 2002), the Industrial Development Strategy (Ministry of Information 2003, Amharic), the Micro and Small Enterprises Development Strategy (Ministry of Trade and Industry 1997), and the Food Security Strategy (FDRE, 2002). Reflecting this, numerous initiatives and interventions, by government and donors alike, have been underway. Yet, the sector has not been studied adequately. While the CSA surveys referred to above provide useful information, comprehensive surveys such as these, covering both urban and rural areas, naturally face a limit as to the extent of details they could reasonably be expected to handle. Besides, they cover manufacturing industries only. So, detailed MSE related studies are very scarce to say the least. The result is that the available data is patchy in terms of detail, especially on issues of supplier finance (or trade credit), marketing, institutions & infrastructure, etc. and, in particular, impact of enacted policies and rules/regulations, issues of predictability of rules/regulations, and remaining policy/regulatory constraints. It was to partially fill this information gap that EDRI conducted a comprehensive survey of MSEs in six major towns during May-June 2003.

Sampling method

The official definition of micro and small enterprises (i.e. having 10 workers or less) was adopted, but excluded street vending and "gulits". The sampling method involved the following steps. First, six major cities in Ethiopia with high population density and MSE concentration, namely Addis Ababa, Nazret, Awassa, Baher Dar, Jimma and Mekele, were covered (the number of towns covered being dictated by resource availability). Secondly, the major micro and small enterprise activities were identified on the basis of information from 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, a sample of 1000 micro and small enterprises was selected which, in the absence of MSE list by town, was distributed non-proportionately across the six cities as follows: 250 from Addis and 150 from each of the other towns. The firms were then selected randomly. Data was obtained from 974 MSEs: 551 micro (with less than 5 workers) and 423 small (having 5-10 workers) enterprises, including 226 women-operated MSEs, in which 3,651 persons (excluding apprentices) are engaged.

Method of data collection

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 in-depth analysis of many MSE related issues so as to under-pin evidence-based policy making. The survey instrument (structured questionnaire) included questions related to background of the owner and history of the enterprise; finance; marketing; business development services (BDS); product improvement/change; rules/regulations; and infrastructure issues; as well as relationships with suppliers and clients.

The rest of this paper is organised as follows. A brief conceptual framework is given in section 2. Section 3 presents summary discussion on past and present MSE policy and strategy in Ethiopia. Section 4 gives profile of MSEs/operators in terms of personal characteristics (gender, age, education, prior business experience, etc.), ownership, legal status, acquisition & financing, reason for engaging in the business, etc. Section 5 looks at the impact of policy changes and the current ‘business environment’ as MSE operators perceive it: regulations/rules related constraints facing the sector as well as *perceived* predictability of laws & policies, government adherence to its policies and credibility of policies are discussed. Section 6 concludes.

2. Conceptual framework

Traditional approaches to MSE development relied on direct and subsidized provision of financial and non-financial services. The disappointing outcome necessitated a search for more effective ways. The new approach, takes individuals’ “creativity, drive and commitment”, rather than government actions, as the key in setting up, operating and developing businesses. It also recognises that the wider social, economic and institutional context, over which government has control affect the conditions that enable and/or constrain entrepreneurship. It emphasises three areas: business environment, financial services, and business development services (BDS). Some aspects of the required environment are common for all firms, small and large alike. These include: stable macro-economy, openness in trade and investment, competitive financial sector, developed physical (transport, warehousing, port facility, communication) and social (education and health) infrastructure" (Hallberg 1999). Others aspects are specific to MSEs". These may include: entry barriers and non-competitive behaviour in MSE markets; expensive and cumbersome regulatory requirements (including registration, licensing and land/premise allocation procedures); levies; tax structures that are discriminatory and distort incentives; laws related to business protection and intellectual property (discouraging innovation); government procurement procedures that discourage MSE participation; and rigidities in the labor market that not only make hiring & firing difficult & costly but also limit labor flexibility and mobility (ibid).

The approach gives emphasis to the creation of an enabling environment for MSE competitiveness and developing markets for MSE-relevant services (rather than substitute them). There is a move away from subsidy and public provision of services, instead directing government action toward completing markets to correct their failures and eliminating policy biases. In order to widen the coverage and impact of government programs, it (i) uses the private sector to deliver services, and (ii) focuses allocation of public resources on "facilitating market transactions and investing in public goods...that open market access and build enterprise competitiveness" (e.g. infrastructure, education, technology) (Hallberg, 1999).

3. MSE policy and strategy in Ethiopia

Designing and implementing appropriate economic policies, strategies, and legal and regulatory framework are *prerequisites* for creating an enabling environment to promote MSEs. In Ethiopia it could be argued that deliberate effort to promote MSEs is relatively recent. In line with its ideology, policies and regulations of the Derg regime 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 state/parastatal organizations in availing foreign exchange and bank loans, limits on single borrower loans[3], restrictions on license and investments, absolute priority given to the public sector in access to trained qualified manpower, etc. 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

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

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 regime change in 1992, drastic measures, intended to transform the command economy to a market-led one, many of which are bound to affect MSEs, were taken. 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; 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. There are also MSE-focussed measures including the issuance of the National Micro and Small Enterprises Strategy (1997[4]) and establishment of the Federal Micro and Small Enterprises Development Agency.

The strategy stresses that "various policy, structural and institutional related problems and bottlenecks" have constrained the role of the MSE sector in and contribution to the national economy. It thus primarily aims at creating enabling legal, institutional and other supportive environments for the development of MSEs. The specific objectives of the strategy include: facilitating economic growth and bring about equitable development; creating long-term jobs; strengthening cooperation between MSEs; providing the basis for medium and large scale enterprises; promoting exports; and balancing preferential treatment between MSE and bigger enterprises. The intended MSE support include creating legal framework; improving access to finance; introducing different incentive schemes; encouraging partnerships; providing training in entrepreneurship, skills, and management; improving access to appropriate technology, information, advice and markets; and developing infrastructure. The strategy also states its intention to strengthen private sector

[4] Based on the national strategy, regional governments have developed their own regional MSE development strategies.

associations and chambers. A number of institutions are expected to be involved in providing support to the MSEs[5].

The strategy is based on the new approach to MSE development. As stated in the strategy, the fundamental principles guiding interventions by stakeholders (government, private sector, NGOs, Associations, Chambers and others) include: that support to the MSE operators will be based on private sector development; that all support to the MSE sector should be designed to be all-round; that support services should, as much as possible, be based on fees; that addressing marketing problems of MSE operators will be given due consideration; that emphasis will be given to the advancement of women; that supporting institutions should provide solid services to the MSE operators using adequately skilled and trained staff; that the private sector will be involved in the supply of commercial BDS to MSE operators; and that cooperative ventures should be facilitated.

The industrial development strategy, issued in 2003[6], recognises the promotion of MSEs as an important instrument to create productive private sector and entrepreneurship, hence accords it due emphasis and priority. It promises to make every effort to support this sector through provision of infrastructure (working premises and land), financial facilities, supply of raw materials, training, etc. Federal and regional governments are expected to coordinate the support services.

Taken at face value, it would appear that these measures would go a long way in promoting MSEs in the country. However, a study by the ECA (2001) concluded that 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. The result is a substantial increase in the production cost of MSE operators that require highly taxed

[5] 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.
[6] Currently, there are attempts to revise the current National Micro and Small Enterprises Strategy of Ethiopia issued in 1997.

imported inputs, thereby limiting their competitiveness. In Ethiopia, the infrastructure was also evaluated as particularly disabling.

As argued in Asmelash (2002), among the measures needed to support MSE development are:

(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; and
(c) Continued effort to harmonize laws, regulations and procedures at national and regional levels;

Considering that it has been years since the MSE strategy was adopted and the time lapsed is sufficient for the policies & measures to be implemented and the intended support be delivered through the system, it is time to take stock. In light of the importance the strategy gave to improving and simplifying the business environment, having a close look at whether and the extent to which the promised improvements have materialised, regulatory constraints relaxed and intended institutional supports delivered is in order. This was one of the motivations for the 2003 MSE survey. While the survey generated a large data set with detailed information on various aspects of MSEs, in what follows, we analyse the data on ownership, nature of acquisition & financing; policy/regulatory changes and their impact on development of the MSE sector as well as remaining regulatory constraints as perceived by MSE operators.

4. Profile of sample MSEs/MSE operators

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 to over come 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 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[7], 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).

Most MSEs are young, the median[8] 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 48 per cent of the micro enterprises were established before 1999 (i.e. are older than 5 years) while 21 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

[7] 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.
[8] Throughout the report, we use the median instead of the arithmetic mean whenever the distribution of a variable is skewed.

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 4.1). 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.

Table 4.1: 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 4.2).

The four most frequent responses obtained are: (i) "I thought it would be profitable" (44 per cent); (ii) "I am skilled in this activity" (38 per cent); (iii) "this is the only thing I was able to do, I had no alternative" (32 per cent); and (iv) "parents/relatives are/were in this business" (17 per cent)[9]. 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 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.

Table 4.2: 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

Looking at the same issue by size, about 38 per cent 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.

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

Most MSE operators had some prior business experience: 42 per cent did apprenticeship in similar business (for more than a year on the average) while 76 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 per cent were working in the public sector (19 per cent were in school and 7 per cent had never been employed). This seems to be consistent with the hypothesis that 'workers, having developed their skills at a work place and gaining exposure to 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 their current operations from scratch with relatively small start-up capital (median of Birr 2,077). They were mainly financed out of the owner's personal savings (accounting for 58 per cent on the average) followed by grant money from relatives/friends[10] (17 per cent), savings from other own business (10 per cent), and borrowing from relatives/friends (5 per cent)[11]. The importance of Iqub/Iddir as source of start-up capital is not as high as usually believed: 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 (18 per cent) and inheritance (7 per cent). Bank loans accounted for an insignificant proportion (2 per cent).

Of those who started their business from scratch, 58 per cent did so 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 15 per cent and 13 per cent. The other two ways through which MSE operators acquired their business were inheritance and purchase, accounting for 9 per cent and 4 per cent,

[10] MSE operators may receive loans from their relatives/friends who charge them interest. For our purposes such lenders are considered as moneylenders.

[11] 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.

respectively. Contrary to expectations, acquisition through inheritance is relatively rare. 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) 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 are recently established young firms 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 37 per cent increase), 13 per cent were using own premises while 4 per cent bought it[12]. 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 (57 per cent); expulsion by the landlord (20 per cent) or need for larger space resulting from expansion of the business (16 per cent). The proportion of MSEs operating from home (i.e. using their residences which also *double* as business premises) is 16 per cent.

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 (85 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 per cent), no need to delegate since they are always present (13 per cent), and lack of skilled labour (12 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

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

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 per cent. The share of hired labour, which comprises 39 per cent on the average, is high while the share of trainees/apprentices is negligible (averaging 1.7 per cent): this contrasts with the situation in West Africa as reported in Liedholm and Mead (1999[13]). 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.

5. MSE business environment: the evidence

5.1 Policy changes and impact

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 per cent of the MSE operators surveyed indicated that they did not receive any support, whatsoever, to promote their activities (Table 5.1). In spite of the attempts to liberalise and improve the policy and regulatory environment, the survey data indicates that there is divergence between policies and directives issued and the *actual practice* on the ground. Concrete and coordinated

[13] 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).

institutional support such as 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 have 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 5.1: Per cent of MSEs receiving institutional support

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.

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[14] 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,

[14] 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 5.2 to 5.6. The results show that a lot remains to be done to create an enabling policy environment for the MSE sector.

We observe from Table 5.2 that about 56 per cent 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 per cent reported an improvement in the environment. Disaggregated by size, the proportion is higher for small enterprises: It appears that the change in policy had relatively higher positive impact on small enterprise operators compared to micro. As Table 5.3 reveals, the licensing procedure in the MSE sector has improved over the past decade: about 73 per cent of the small and 63 per cent of the micro enterprise operators reported so. However, a good number of MSEs (about 11 per cent) failed to notice any improvement suggesting the need for more work in this respect.

Table 5.2: 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

Table 5.3: 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

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.

Taken together, the data summarised in Tables 5.2, 5.3 and 5.4 indicate that investment and competition have increased after the market liberalization process. About 76 per cent of the MSE operators reported increase in investment (Table 5.2). The reform appears to have helped the market for MSE products to expand: about 59 per cent 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 per cent and 51 per cent, respectively. Regarding infrastructure and delivery of financial services, about 79 per cent and 47 per cent 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 per cent and 54 per cent 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 explanation.

Disaggregated by size, the data (Tables 5.3 and 5.4) 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. The percentage increases were relatively higher for small enterprises compared to micro.

About 28 per cent (25 per cent of the micro and 32 per cent of small enterprise operators) reported increased government support to the MSE sector. However, almost as many (about 25 per cent – 45 per cent 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 (bout 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 per cent) or not changed much (31.3 per cent). The basic conclusion from Tables 5.2, 5.3 and 5.4 is that although market liberalization appears to encourage MSE operators, there is a long way to go by way of improving support to the sector.

Table 5.4: 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

5.2. Current policy/regulatory constraints

A host of rules/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 sever 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'[15] 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

[15] 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.

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 sever 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 per cent), high collateral requirement (47 per cent), inefficient/arbitrary tax administration (44 per cent), lack of/inadequate business premise (42 per cent), lack of business support services (41 per cent), and lack of/inadequate access to credit (39 per cent) figure out prominently. Other factors rated as major or very sever problem by a good number of MSEs include: bureaucratic requirements (red tape and paper work) (23 per cent); penalties (including kickbacks to officials) for operating without license, if and when detected (20 per cent); weak legal enforcement (19 per cent); crime and theft (19 per cent); competition (16 per cent); entry regulation (15 per cent); and inability to use the institutional enforcement mechanism (legal & judicial system and police) (15 per cent). This contrasts clearly with the situation in Kenya, where issues of tax, business premise, and bureaucratic requirements/regulation/harassment do not appear as major problems (See GEMINI 1995).

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 too 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[16]? 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.

[16] 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.

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 per cent) 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 per cent 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 manage to evade it with relative ease. Interestingly, regulations related to environment protection, consumer protection and quality control did not rank high either, probably reflecting that such regulations either do not exist or can be evaded. 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. No noticeable difference exists: 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 per cent), inefficient/discretionary tax administration (55 per cent) and high collateral requirement (46 per cent) are the three main constrains for small enterprises, which are somewhat reversed for micro enterprises (as high collateral requirement (48 per cent), high tax rates (44 per cent), and lack of/inadequate business premise (44 per cent)). A much higher proportion of small enterprises rated high tax rates, inefficient/discretionary tax administration and bureaucratic burden as major or very sever 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[17] 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

[17] 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).

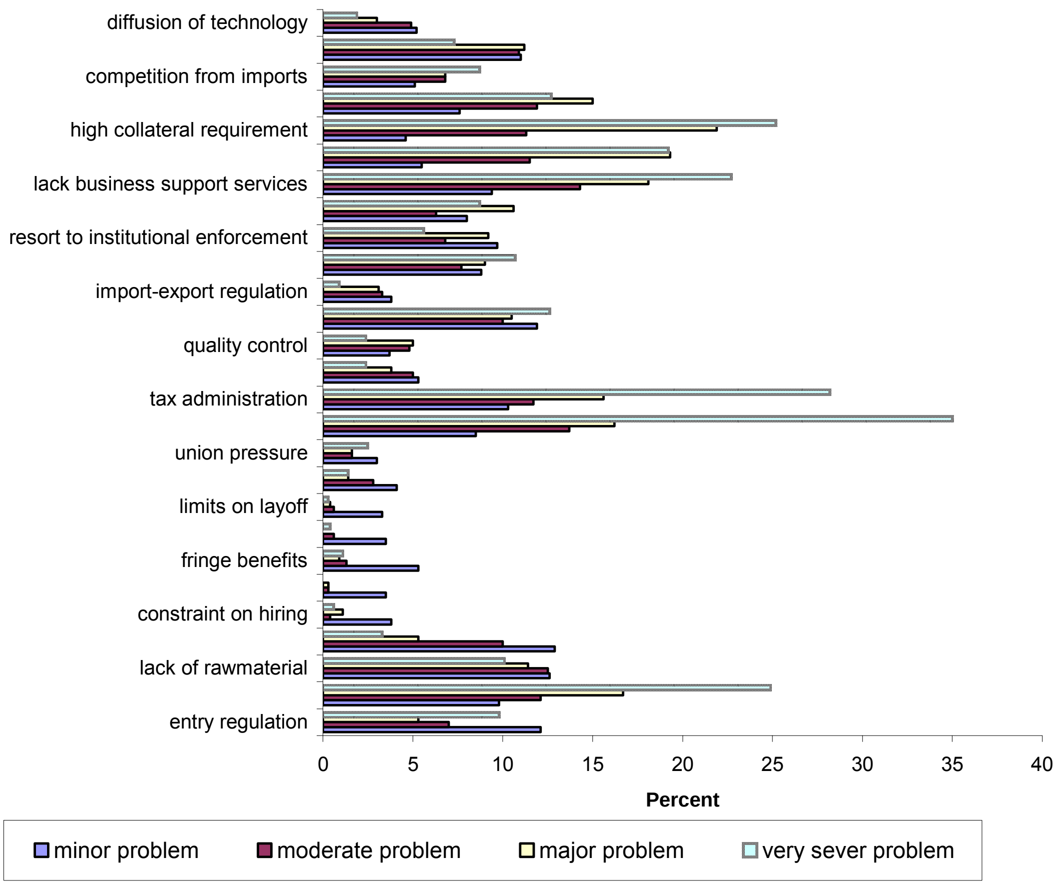
the proportion of male- and female-owned enterprises that rated high tax rates and inefficient/discretionary tax administration as major or very sever constraints in that it is higher for the former (for which we have no obvious explanation) while the proportion that gave similar rating to credit-access constraint are about the same.

One of the principles of good regulation is *consistency*[18] in the sense of being "predictable so that people know where they stand". *Perceived* predictability of laws and policies and credibility constitute an important part of the business environment, hence are crucial 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, a high proportion of MSE operators reported that they have to cope, on regular basis, with "unexpected changes in rules, laws or polices which materially affect their enterprise": about 36 per cent for the whole sample, 42 per cent for small and 32 per cent for micro enterprises. Disaggregated by gender of owner, the figures are 38 per cent for male-owned as opposed to 29 per cent for female-owned enterprises.

The perceived policy predictability is quite low among the sample MSEs: only about 34 per cent 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 33 per cent for the former and 36 per cent for the latter. Moreover, there appears to be a wide spread *credibility* problem: as high as 40 per cent (41 per cent for micro and 39 per cent 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.

[18] the others being transparency, accountability, proportionate to risk, and targeted or focused on the problem with minimal side effects (see Good Regulation Task Force, www.nao.gov.uk/publications/nao_reports/index.html#2001-2002).

Figure 1 Main constraints of MSE operators



Both *accessing* the formal sector (i.e. becoming formal) and *staying* formal are costly to the operator. Cost of access includes registration/license fees, required registration time (due to bureaucratic rules and inefficient public service) while the costs of staying formal 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). Note that 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 2: Factors and percent of respondents rating them as major or very sever constraint to business

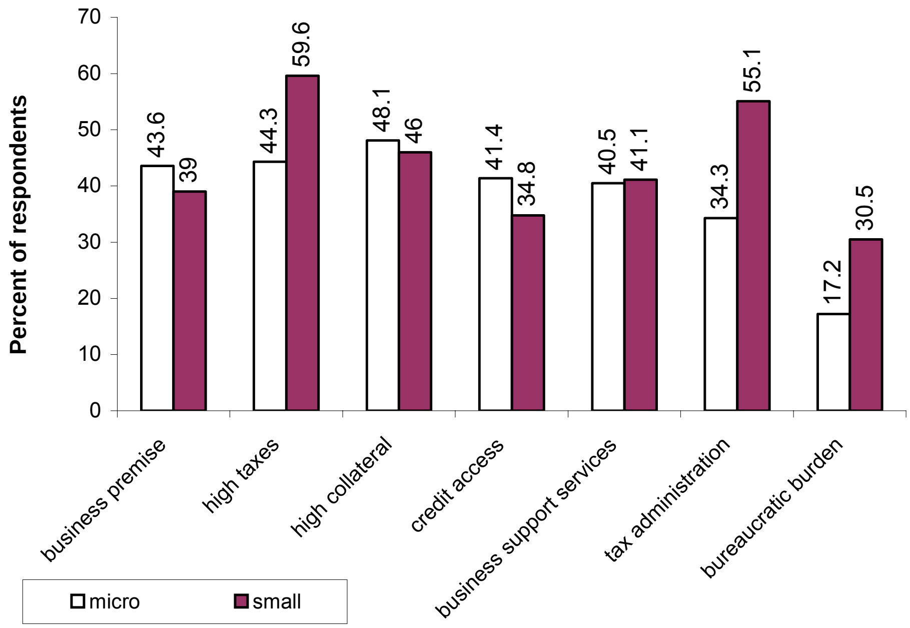


Figure 3: Factors and percent of respondents rating them as major or very sever constraints

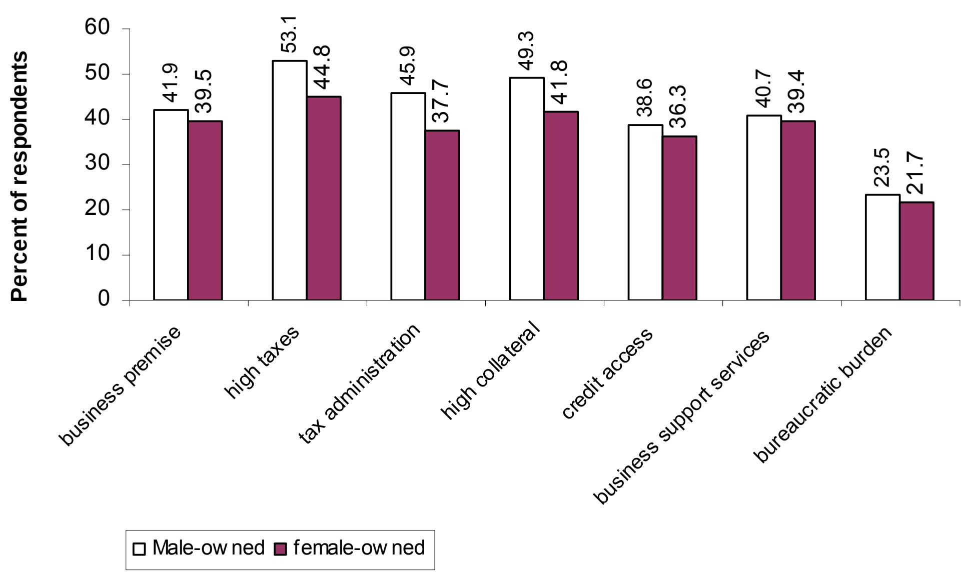


Figure 4: Perceived degree of predictability of changes in laws, rules & policies

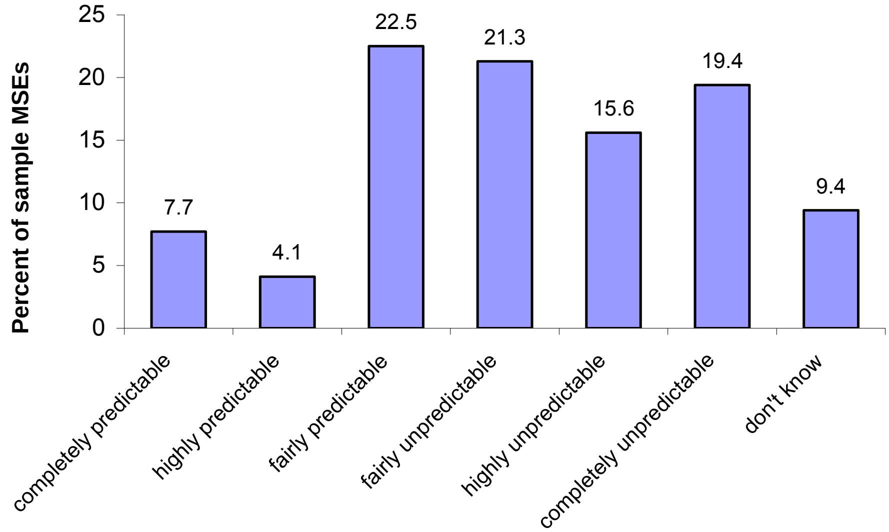
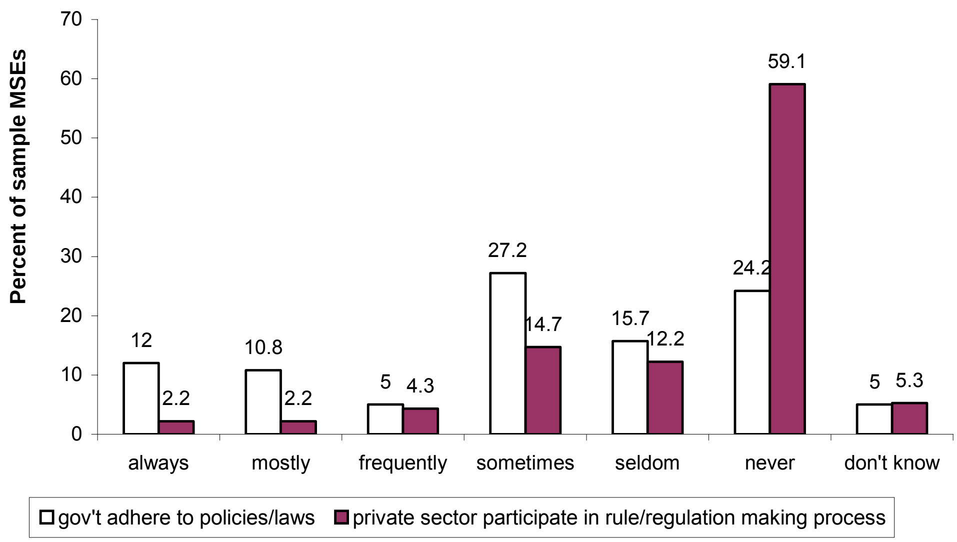


Figure 5: Expected government adherence to & implementation of policies/laws and degree of business sector participation in designing rules/ regulations



The data shows that 80 per cent of the sample MSEs are registered while about 3/4th have license (work permit). In terms of size category, only 72 per cent of the micro enterprises are registered compared to 90 per cent 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 per cent); 'no benefits to registering' (20 per cent); and 'taxes too high' (13 per cent). Similarly, of those that have no license, 73 per cent cited 'business too small' as the reason. Other reasons cited include: "I do not need a license, I can do without one" (9 per cent); "cumbersome licensing procedure" (6 per cent); and "licensing costs (initial and renewal) too expensive"(5 per cent).

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 per cent and 24 per cent, 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" (47 per cent); "I will be able to apply for credit" (17 per cent); "I can apply for land/business premise" (10 per cent[19]); "increased customers" (9 per cent); and "I can buy raw materials in bulk" (7 per cent).

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 per cent 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 sever problems by 9 and 12 per cent 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

[19] Note that percent figures do not add up to 100 since multiple answers were allowed.

first question was motivated by our anticipation that some may take up MSE activity only as *temporary*[20] 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 5.5. While, as one might expect, a significant proportion (85 per cent) had growth as a primary objective, this was not the case for as many as 15 per cent 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 per cent for male entrepreneurs compared to 81 per cent for female. However, there appears to be a noticeable difference between micro and small operators: 81 per cent of the former reported having growth/expansion as an important objective relative to 90 per cent 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 (57 per cent), lack of/inadequate business premise (49 per cent), power interruption (38 per cent) and tax administration (37 per cent) were cited among the top three (see Table 5.5a). To probe the issue a bit further, we looked at the factors singled out as primary. As Table 5.6 shows, lack of/inadequate business premise, high taxes, and power interruption come on top: being identified as primary by 32, 26, and 9 per cent respectively.

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[20] 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.

On the other hand, the market-related constraints/obstacles identified to be among the top

Table 5.5: 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	Micro	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

three are shortage of capital (87 per cent), inadequate/uncertain market (57 per cent), constrained access to credit (47 per cent) and inadequate business support services (41 per cent) in that order (see Table 5.5). More specifically, 74 per cent singled out shortage of capital as the primary obstacle while 15 per cent 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 5.5b, 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 5.5b indicates, capital shortage is the most critical for most MSEs in aggregate as well as for micro & small enterprises and male & female operators.

Table 5.6: 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

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 per cent), inadequate business premise (45 per cent), inadequate/uncertain market (35 per cent) and high taxes (27 per cent) in that order (Table 5.5c). In particular, shortage of capital was singled out as the primary constraint by 54 per cent while inadequate/uncertain market is the primary factor for the other 11 per cent (Table 5.6c), which were also reported (by 74 and 15 per cent 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.

6. 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 per cent of the MSE operators reported increase in investment after the market liberalization. Increased competition after the reform among MSEs was reported by about 91 per cent while about 51 per cent stated that competition with imported goods has increased. About 79 per cent and 47 per cent of the MSE operators, respectively, indicated that infrastructure and delivery of financial services have increased after the reform. Although about 28 per cent of the respondents reported increased government support after the reform, almost as many (about 25 per cent) indicated that there was no change in government support to the MSE sector. Actually, a good percentage (bout 20 per cent) revealed that government support has declined after the market liberalization, which is contrary to the common rhetoric of high and wide ranging support.

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 sever 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). Perceived policy predictability is a serious problem: only about 34 per cent feel some degree of predictability (ranging from completely predictable to fairly predictable) of changes in laws, rules and policies.

The problems of policy unpredictability in the form of "unexpected changes in rules, laws or polices that materially affect" MSEs and failure to adhere to policies as identified by respondents hardly indicate presence of enabling business environment, with implication on MSE development. The findings clearly imply a need to revisit the legal, regulatory and institutional framework in the country within which MSEs operate. National and regional legal & regulatory policies that balance legitimate controls and protection with the need for simplicity, impartiality and legal redress are required. These include avoiding frequent changes of policies, rules & regulations; adherence to adopted rules/regulations; protecting property rights to enforce contracts and the setting and upholding of core labour standards.

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