Employment growth and challenges in small and micro enterprises Woldiya, North East Amhara region, Ethiopia

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Due to the increasing unemployment problem, Ethiopia is moving forward to combat unemployment by injecting small and micro enterprises. The objective of this study is, therefore, to assess the employment growth across years and bottlenecks in the expansion of small and micro enterprises. Primary data were collected using interview schedule and focus group discussion with 140 enterprise owners that were selected randomly from the enterprises. Data were analyzed using descriptive statistics and compound annual growth rate. The compound annual growth rate of small and micro enterprises in employment aggregately were 3.86% and the enterprises add annually 0.18 workers on average. When looking separately, the mean annual compound growth rate of small scale and micro enterprises were 2.4 and 4% on average respectively. Small enterprises add 0.19 workers per firm and micro enterprises add 0.14 workers per firm annually. Shortage of working capital and working space are the most important problems. It was recommended that employment growth in small and micro enterprises were low and emphasis should be given for enterprises to create more jobs rather than promoting to have large number of one man stood enterprises.

Key words: Compound annual growth rate, employment, small, micro.

INTRODUCTION

Small and micro enterprises

There are different ways of defining the term small and micro enterprises in different countries. The base for defining is deepened on the number of employees hired, the capital invested and the total balance sheet (asset, liability and capital). So, according to European Union, small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EURO 10 million. A micro enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EURO 2 million (kayanula et al., 2000). According to the micro and small enterprises development strategy (1997), micro enterprises are those business enterprises with a paid up capital of not exceeding Birr 20,000 (about $ 1176) and excluding high tech consultancy enterprises and other high-tech establishments, whereas small enterprises are those business enterprises with a paid up capital above Birr 20,000 and not exceeding Birr 500,000 (about $ 29,411), and excluding high-tech consultancy enterprises and other high-tech establishments.

Background

Poverty in Ethiopia is widespread and remains a major challenge of sustainable development and stability. It is estimated that close to half of the population in urban and rural areas of the country live in absolute poverty due to lack of economic opportunities, governance crisis,
inadequate basic household income and poor means of survival (Mammo, 2008; Serneels, 2004). Although, a growing number of researchers have suggested that the prospect of development in the agricultural sector tends to increase along with development in the small and micro enterprises (SMEs) sector, until recently, SMEs have not been a major area of focus in Ethiopia (Alemeayehu, 2006) but the existing government has issued a national SMEs development strategy for the promotion of SMEs in 1997 and established a well concerned institution for the sector by the Council of Ministers of Ethiopian Regulation No 33/1998 on April 3, 1998. In developing countries, the informal sector that mainly constitutes micro enterprises is the major source of employment and income for the urban population. According to ILO (2002) estimations, the share of informal employment (outside agriculture) to the total non-agricultural employment accounts for nearly half or more in all regions of the developing world and about 72% in sub-Saharan Africa (SSA). They are also very important part of the developing world economy. For example, in SSA, the contribution of the informal sector in non-agriculture GDP is about 41%. Hence, their efficiency matters in determining overall economic performance and poverty reduction.

The Ethiopian government has long recognized the important contribution that small and micro enterprises can make in poverty reduction, employment creation and private sector development. Micro and small enterprises offer both a safety valve for the survival of workers that is available to find steady wage employment and opportunity for the poor entrepreneurs to raise their capital and income. These enterprises also offer a vehicle for acquiring and applying skills to raise productivity and private sector growth, providing better wage earning opportunities for the poor, while raising national income. Due to these reasons and based on the government strategy of capacity building in public and private sectors, donors as well as national governments have attempted to promote micro and small enterprises through support for financial and non-financial services appropriate for them (Solomon, 2007).

### Statement of the problem

Due to the ever increasing unemployment in Ethiopia, the FDRE has undertaken different measures starting promulgation of laws to establishment of executives starting from federal to grass root level to enhance the strength and competence of SMEs and also different micro finance enterprises are providing credit for these enterprises. The factors that forced the government of Ethiopia to undertake this program is, a number of joblessness in the country which increases to 1.1 million. A study by the Ministry of Finance and Economic Development indicates that 37% of the urban population is below poverty line (Endalkachew, 2008). According to the census result (2006), the urban unemployment stands at 25%. Recently, with around 50% of the urban men between age 15 and 30 unemployed. Ethiopia has one of the highest unemployment rates worldwide (Serneels, 2004). The policy for SMEs promulgated in 1998 serves as a guideline to all partners to stimulate the establishment of new enterprises enable the existing one to grow and become more competitive.

The policy identified number of constraints hampering the development of this sector and unfavorable legal and regulatory frameworks, underdeveloped infrastructure, poor business development service, limited access to finance, ineffective and poorly coordinated institutional support as the key drawbacks (Endalkachew, 2008). Small and micro enterprises (SMEs) have a tremendous potential to generate employment for the majority of the urban labor force. They are also important sources of income not only for those people who could not find employment in other sectors but also provide cushion to falling incomes of low wage earners. Hence, in the study area, SMEs are operating in manufacturing, service, dairy, fattening, poultry, construction, agriculture, wholesale, retailer and other activities.

The Wolviya city administration has undertaken SMEs program by organizing the youth into group and solely to reduce unemployment. Currently, there is an information gap in exploring the challenges of SMEs in employment creation and regarding to what extent these sectors create jobs at startup and the growth in employment across periods. So the paper has an objective to assess the employment growth of SMEs across periods, at startup and helps to explore the most important problems in the expansion of SMEs to absorb more labor in the market.

### LITERATURE REVIEW

#### Theories on growth of SMEs

Various theoretical models have been developed which describe the growth of small businesses. One class of theoretical models focus on the learning process, either active or passive, and the other models refer to the stochastic and deterministic approaches. In the passive learning model, a firm enters a market without knowing its own potential growth. Only after entry does the firm start to learn about the distribution of its own profitability based on information from realized profits. By continually updating such learning, the firm decides to expand, contract or to exit. This learning model states that firms and managers of firms learn about their efficiency once they are established in the industry. Firms expand their activities when managers observe that their estimation of managerial efficiency has understated actual levels of efficiency. As a firm ages increase, the owner’s

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1 The name of the study area
estimation of efficiency becomes more accurate, decreasing the probability that the output will widely differ from one year to another. The implication of this theoretical model is that smaller and younger firms should have higher and more viable growth rates (Goedhuys, 2002). In the active learning model, a firm explores its economic environment actively and invests to enhance its growth under competitive pressure from both within and outside the firm. The potential and actual growth changes overtime in response to the outcomes of the firm’s own investment, and those of other actors in the same market. According to this model of learning, owners or managers could raise their efficiency through formal education and training that increases their endowments. Entrepreneurs or managers with higher formal education, work experience and training would therefore be expected to grow faster. The firm grows if successful, closes if unsuccessful (Goedhuys and Hardi, 2002). The other set of growth theories of firms include the ‘stochastic’ and ‘deterministic approaches’. The stochastic model which is also known as the Gibrat’s law argues that all changes in size are due to chance. Thus, the size and age of firms has no effect on the growth of small enterprises.

According to empirical tests of the law has indicated that it only considers size and age as potential variables which may significantly affect firm growth by neglecting other explanatory variables which may significantly affect firm growth. The deterministic approach assumes, on the contrary, that differences in the rates of growth across firms depend on a set of observable industry and firm specific characteristics (Pier, 2002).

Challenges for employment creation

SMEs are working in this open and competitive environment as a result SMEs are affected by factors within their boundary. Organizational problems grouped into five areas which are human relations, accounting, marketing; internal management and external management. Although, they have generally concluded that the most prevalent areas in which SME have problems are sales or marketing, human resource management, and general management; they specifically reported promotion, marketing research and training as the most frequently encountered problems. Marketing problem has been widely acknowledged as being the most important of all activities and critical for the survival and growth of SMEs. However, many studies found owner/managers of SMEs as having a very limited understanding of the marketing concept generally to be little more than advertising and public relations and lacking adequate marketing skills. Specifically, problems in promotion and marketing research were frequently encountered by SMEs. These problems include the selection of promotional media (local news paper or radio, direct mails, outdoors, etc), difficulty in getting customers to pay, low purchasing power of customers, advertising, content design and format of the promotional materials, market size, location and addresses of potential customers (Solomon, 2007). Manufacturing enterprises are more likely to have problems in operations and production management. Wholesalers and retailers are found to have more problems with internal financial management. Specifically, cash flow and debt management were identified as the two most frequently occurring problems.

Researchers grouped problems of SMEs into five -finance, government, marketing, equipment and infrastructure and labor and finally found that finance was the most crucial problem. Poor banking services, with high interest rates, high cost of premises and tax, difficulty in obtaining loans for startups, all were cited but stringent loan repayment terms was mentioned as jeopardizing the viability of SMEs. Ivy also found government bureaucracy and perceived corruption as major problems. Monk (2000) also found that lack of working capital, poor market selection and rapidly changing external market conditions the major reasons for failures in SMEs.

METHODOLOGY

Small and micro enterprises in the study area

The study area, Woldiya is one of the cities in the Amhara National Regional State, Ethiopia. The city has urban and rural kebeles dwelling that are participating in agriculture, manufacturing, poultry, waste disposal, service delivery, trading and off farm activities. The total number of small and micro enterprises that are registered legally and functioning in the study area is 2483.

Sampling technique

The North Wollo zone has 9 rural and 3 urban districts and Woldiya district is one of the districts in the zone. Due to large number of SMEs, accessibility to information and detailed knowledge, the area is selected purposely. The number of enterprises participating in the district legally are 2483 in number. In order to identify irregular short-term tendencies and to allow for a reliable estimation of employment performances, the time period enterprises started business at least 5 years (Yunggui, 2000) that were 140 selected with random sampling techniques. For the purpose of focus group discussion, 12 participants were participated from government staffs, elderly people, owners of the enterprises and employees of the SMEs.

Methods and sources of data collection

Primary sources of data

A primary source of data was collected through semi structured interview schedule and focus group discussion. The interview schedule was first pre-tested and modified before the execution of the survey.

2 The lowest government political strata
RESULTS AND DISCUSSION

The general characteristics of the enterprises

Table 1 showed that the type and number of small and micro enterprises, 102 enterprises (72.9%) are micro enterprises and 38 enterprises (27.1) are small enterprises. The average startup capital for small and micro enterprises is 53155.45 and 7431.00 Birr respectively. This study showed 72.9% of small and micro enterprises started their businesses with a capital less than 20000.00 Birr; the average startup employees were found 7.5 and 5 for small and micro enterprises respectively. According to Table 2, the CAGR, AAGR and AG of jobs in SMEs annually is 3.86, 6.5 and 0.18% respectively. The annual change in job per enterprise were 0.18 means on average each enterprises increased 0.18 individuals in terms of employment annually. The annual compound growth rate and average annual growth rate since start up indicated that overall growth performance is low compared to other developing countries by using the same measurement. For instance, the CAGR of small and micro enterprises in Botswana, Swaziland and Zimbabwe were 6.3, 4.1 and 5.6% respectively. The AAGR of Botswana, Swaziland and Zimbabwe were 8.4, 6.6 and 7.4% respectively (Table 3).

Problems SMEs faced to create job opportunities

As it is indicated in previous chapters, unemployment is a dynamic phenomena caused by complex interactions of economic and institutional factors. Accordingly, an attempt was made to assess major problems challenging the small and micro enterprises. This section, thus, presented major problems of the sample enterprises from the survey as well as from focus group discussion. The Federal Government of Ethiopia has issued a national strategy for the promotion and development of micro and small enterprises which aimed to create more jobs. Even though, there is a general positive environment for the development of SME in service delivery, reasonable tax, infrastructure development, there were still problems that hinder the employment growth of the SMEs. The major problems encountered by SME operators in the process of increasing more temporarily or permanent workers were described as follow: In the survey, the owner or the manager of the enterprise was asked to point out the most constraining factors to which they actually constitute an obstacle to increase more workers in their enterprise. The question was subjective and open. In Table 4, it can be seen that marketing problem, working space and working capital were the most constraining factor to increase employees. The small and micro scale enterprises have limited access to formal credit and depended on the informal financial markets which were bounded by limited financial capacity and high interest. Small and micro enterprises usually have no asset that are worth to be pledged for collateral requirements for the financial institutions especially banks. As the terms and conditions of the conventional financial bodies are not suitable to the SME operators and because there are no adequate special financial institutions to cater for the sector, the problem of credit gets so profound. Thus, SMEs depend mainly on internally generated funds (Solomon, 2007). The other deterministic problems that hindered employment growths stated by the respondents are lack of work space which is a very serious problem. SMEs were working under high house rent. Seasonality

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Table 1. Distribution of small and micro enterprises.

<table>
<thead>
<tr>
<th>No.</th>
<th>Enterprises</th>
<th>Frequency</th>
<th>Average startup capital</th>
<th>Average startup employees</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Micro</td>
<td>102</td>
<td>7431</td>
<td>5</td>
<td>72.90</td>
</tr>
<tr>
<td>2</td>
<td>Small</td>
<td>38</td>
<td>53155.45</td>
<td>7.5</td>
<td>27.10</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>140</td>
<td></td>
<td></td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Own survey results (2009).

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3Ethiopian currency
Table 2. Employment growth in SMEs in general.

<table>
<thead>
<tr>
<th>No.</th>
<th>Employment growth</th>
<th>Mean</th>
<th>Max</th>
<th>Min</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Compound annual growth rate (percent)</td>
<td>3.86</td>
<td>-23</td>
<td>32</td>
</tr>
<tr>
<td>2</td>
<td>Average annual growth rate (percent)</td>
<td>6.5</td>
<td>-12</td>
<td>86</td>
</tr>
<tr>
<td>3</td>
<td>Annual growth (change of jobs per enterprise)</td>
<td>0.18</td>
<td>-012</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: Own survey result (2009). As indicated below Table 4, the CAGR, AAGR and AG of jobs in small enterprises were found as 2.4, 4.7 and 0.14 respectively in addition, CAGR, AAGR and AG of jobs for micro enterprises were 4, 7.4 and 0.19 respectively.

Table 3. Employment growth of small and micro enterprises separately.

<table>
<thead>
<tr>
<th>No.</th>
<th>Employment growth</th>
<th>Small Mean</th>
<th>Small Max</th>
<th>Small Min</th>
<th>Micro Mean</th>
<th>Micro Max</th>
<th>Micro Min</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Compound annual growth rate (%)</td>
<td>2.4</td>
<td>19</td>
<td>-23</td>
<td>4</td>
<td>0.32</td>
<td>-0.15</td>
</tr>
<tr>
<td>2</td>
<td>Average annual growth rate (%)</td>
<td>4.7</td>
<td>38</td>
<td>-12</td>
<td>7.4</td>
<td>0.86</td>
<td>-0.11</td>
</tr>
<tr>
<td>3</td>
<td>Annual growth (change of jobs per enterprise)</td>
<td>0.14</td>
<td>1.2</td>
<td>-.71</td>
<td>0.19</td>
<td>1.4</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

Source: Own survey result (2009).

Table 4. Constraints that hindered employment growth.

<table>
<thead>
<tr>
<th>No.</th>
<th>List of problems</th>
<th>Frequency</th>
<th>Percent (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Working capital problem</td>
<td>51</td>
<td>20.56</td>
</tr>
<tr>
<td>2</td>
<td>Market problem</td>
<td>54</td>
<td>21.77</td>
</tr>
<tr>
<td>3</td>
<td>Skilled personnel</td>
<td>9</td>
<td>3.6</td>
</tr>
<tr>
<td>4</td>
<td>Seasonal work</td>
<td>12</td>
<td>4.83</td>
</tr>
<tr>
<td>5</td>
<td>Lack of training</td>
<td>9</td>
<td>3.6</td>
</tr>
<tr>
<td>6</td>
<td>Utilities expense</td>
<td>4</td>
<td>1.6</td>
</tr>
<tr>
<td>7</td>
<td>Unfair competition</td>
<td>9</td>
<td>3.6</td>
</tr>
<tr>
<td>8</td>
<td>Working place</td>
<td>42</td>
<td>16.93</td>
</tr>
<tr>
<td>9</td>
<td>Saturation (to hire)</td>
<td>9</td>
<td>3.6</td>
</tr>
<tr>
<td>10</td>
<td>Input supply problem</td>
<td>16</td>
<td>6.45</td>
</tr>
<tr>
<td>11</td>
<td>High house rent</td>
<td>6</td>
<td>2.4</td>
</tr>
<tr>
<td>12</td>
<td>Input price</td>
<td>7</td>
<td>2.8</td>
</tr>
<tr>
<td>13</td>
<td>Lack of improved variety (agriculture)</td>
<td>5</td>
<td>2.00</td>
</tr>
<tr>
<td>14</td>
<td>High tax</td>
<td>6</td>
<td>2.41</td>
</tr>
</tbody>
</table>

Source: Own survey results (2009).

work, input supply problem, power fluctuation, lack of skilled manpower, high rent, high input price, unfair competition and utilities expense are also major problems encountered by small and micro enterprises. This indicated the fact that market problem, working capital problem and lack of working place coupled with other factors stated as follows has negative impact on the employment growth in small and micro enterprises. Similarly, key informants and group focus discussion held to identify major constraints that hindered employment growth in small and micro enterprises. This realized that the factors stated by enterprise owners reflected by key informants also. The difference is that key informants described that the perception of the people and the entrepreneurs towards SMEs have problem. They do not think that poverty will be reduced by small and micro enterprises. Assume only for waiting until other jobs become secured or found.

CONCLUSION AND RECOMMENDATIONS

The employment growth in small and micro enterprises were analyzed by compound annual growth rate and the result showed a positive, negative and zero employment
growth rate with average growth of 3.86%, but weak as compared to other African countries and these enterprises add annually 0.18 workers on average. The mean annual compound growth rate of small and micro enterprises found 2.4 and 4% on average respectively. Small enterprises add 0.19 workers per firm and micro enterprises add 0.14 workers per firm annually. Working capital problem, market problem and working space constraint are the leading important factors on reducing employment growth on small and micro enterprises. The key informants also realized that lack of awareness about small and micro enterprises on employment creation and poverty reduction, lack of determination and endurance by owners and inability to implement the trainings given by the government are the major factors that hinder employment growth of small and micro enterprises.

In order to solve working capital problem for SMEs, banks and micro finances need to allocate sufficient amount of funds for the expansion of SMEs for employment and economic growth. Working premise and market problem should be solved in collaboration with the city administrators:

1) People assume that SMEs were essential until decent or secured job were found, so the concerned bodies should work by organizing trainings, workshops and seminars to reduce the negative perception on these sectors.

2) The employment growth in SMEs is low as compared to other countries, so emphasis should be given for enterprises to create more jobs rather than promoting to have large number of one man stood enterprises.

REFERENCES


