

Critical Success Factors of Micro & Small Enterprises in Ethiopia: A Review

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Abstract: *The study raises the issues pertaining to Micro and Small Enterprises operating in Tigray Regional Zonal Cities. This paper investigates what are the critical success factors that can help MSEs to be sustainable and achieve positive growth so as to limit the high business failure rate in Ethiopia. These issues are termed as Critical Success Factors for example the Entrepreneurial Characteristics, Firm Characteristics, Contextual Factors like the operating environment of a firm, which affects the performance and success of a firm. These factors affects the policies and strategies of a firm. The proposed conceptual model in the paper depicts that the success of the firm largely depends on entrepreneurial characteristics, firm characteristics, and contextual factors. This study is an honest attempt to draws the attention of researchers, academicians, professional, policy-makers and consultants to enhance the effectiveness and sustainability of micro and small business enterprises in context of Ethiopia in general.*

Keywords: Micro & Small Enterprises, Critical Success Factors, Entrepreneurs

1. Introduction

Economic Scenario: The economy of Ethiopia has registered a remarkable growth i.e. real GDP expanded by 10.3 percent in 2013/14, compared to the Growth & Transformation Plan target of 11.2 percent for 2013/14 (World Economic Outlook Update, July 2014). This outstanding growth is mainly attributed to service sector (51.7%), agricultural sector (21.9%) and industrial sector (26.4%). The economic growth of Ethiopia has been accompanied by a rapidly growing population and a lack of sufficient employment opportunities. With a population of 87 million in 2013/14, Ethiopia is the second most populous country in Sub Saharan Africa after Nigeria. According to the report of PHE Ethiopia Consortium; Ethiopia's population is very young i.e. 45% of Ethiopians are less than 15 years old and each year an additional 1.2 million people will join the national workforce. The five-year Growth and Transformation Plan envisages creating 3 million employment opportunities in micro and small enterprises (MSEs) at the end of the plan period. The development of this sector is generally believed to be the major source of employment and income generation for a wider group of the society in general and urban youth in particular.

2. Definition of MSEs in Ethiopian Context:

According to Micro and Small Enterprises (MSEs) Development Strategy of Ethiopia (2011), as it is designed in conformance to Growth and Transformation Plans of Ethiopia, the objective is to ensure the sustainability of the development in all economic sectors of the country. The main focus of the government is to create Job opportunities through MSEs development, in order to reduce unemployment and alleviate poverty and promote industrial development by considering the MSEs as a base. According to Development Strategy the improved definition of small enterprises is as follows: **a) Industrial sectors** (manufacturing, construction and mining): It operates with

6-30 persons and/or with a paid up capital of total asset Birr 100,000 and not exceeding Birr 1.5 million. **b) Service sector** (retailer, transport, hotel and Tourism, ICT and maintenance service): It operates with 6-30 persons or/and total asset, or a paid up capital is with Birr 50,001 and not exceeding Birr 500,000. The improved definition of MSE is presented in the following table for the ease of our reader.

Table 1: Classification of Micro & Small Enterprises in Ethiopia

| Level of the Enterprise | Sector | Human Power | Total Assets |
|-------------------------|----------|-------------|--------------------------------------|
| Micro enterprise | Industry | ≤5 | ≤100000(\$6000 or E4500) |
| | Service | ≤5 | ≤50,000(\$3000 or E2200) |
| Small enterprise | Industry | 6-30 | ≤birr 1.5 million (\$9000 or E70000) |
| | Service | 6-30 | ≤birr 500,000(\$30000 or E 23000) |

Source: Micro and Small Enterprise Development Strategy, provision framework and methods of Implementation. www.mse.org.et/documents/strategy.doc Retrieved on 01/10/2015.

For further details on MSEs can be found at the source given above. The detailed report will be referred for further information like legal framework for MSEs, sectors and sub sectors, provision of support based on the development level of MSEs, major problems, challenges and solutions etc.

3. Overview of Micro & Small Enterprises in Ethiopia

According to the Federal Micro and Small Scale Enterprise Development Agency (FeMESDA) and annual report (2013/14) of National Bank of Ethiopia, a total 200,319 new MSEs were established during the fiscal year 2013/14 against 77,415 during previous year i.e. 2012/13. The total no. of employment generated during 2013/14 was 2.4 million as compared to 1.2 million during 2012/13. Out of total newly established of MSEs in Ethiopia, Oromia region

took the leading share (70,259 MSEs i.e. 35.1%) followed by Amhara (64,135 MSEs - 32%), Tigray (32,726 MSEs - 16.3%) SNNPR (22,632 MSEs - 11.3%) and Addis Ababa (7,392 MSEs - 3.7%).

These impressive facts indicate the rapid growth of MSEs and their role in employment generation. Studies have suggested that there is huge potential for employment and income generation by establishing MSEs and consequently, this will lead to poverty reduction in Ethiopia (Bekele, & Worku, 2008; Tadesse, 2014). Although the MSEs sector contributes significantly to the national economy, but the high failure rate of MSEs is a major concern (Mead & Liedholm, 1998; Rogerson, 2000). Therefore, the aim of this paper is to understand the existing phenomena of growing MSEs in Ethiopia. Further, this study will identify Critical Success Factors (CSFs) of MSEs in Ethiopia.

Thus, we can say That Micro and Small firms are major drivers of industrial growth and economical encroachment. In developed countries, entrepreneurial small firms play critical roles in introducing new products and new techniques into the market through technological innovations (Pavitt et al. 1987; Acs & Audretsch 1990; Coad & Tamvada, 2012). Micro and small sized enterprises are one of the significant employment generators in an economy (Mwega, 1991; Carree & Klomp, 1996; Okpara & Wynn, 2007). One of the major reasons why micro and small firms exist in developing countries is that they offer individuals a livelihood and a source of income. In many cases, new small businesses are found as a last resort rather than as a first choice (Beck et al. 2005). The nature of the work is labor-intensive but with low productivity (Little, 1987). Although the vast majority of firms in developing countries are micro and small enterprises and merely few will ever think of expansion or spread their wings to larger canvas of the market.

The existing phenomena indicate that large chunk of MSMEs in Ethiopia are established with government support. This includes loan disbursement by various financial institutions like public and private banks and micro finance institutions etc. According to annual report 2013/14 of NBE Annual Resource Mobilization of ETB 111.4 billion & Disbursing Activities of Commercial Banks and Development Bank of Ethiopia (Specialized Bank) ETB 59,965.4 million was recorded as at June 30, 2014. The point here is to be noted that outstanding credit amount (Includes government borrowing in the form of bonds and treasury bills from commercial banks, DBE and other sectors other than NBE) is very high i.e. ETB 181,327.4 million. To recover the loans, these financial institution are usually depended on MSEs upto certain extent, in that case these MSEs are supposed to record growth in coming years. But, the previous studies indicate that enterprises managed by women have lower expected growth rates (Coad & Tamvada, 2012). In a study for women owned SMEs, it is observed that Women in Ethiopia represent up to 30 percent of all SMEs owners and have a 78 percent failure rate. (Bekele, & Worku, 2008; Kipnis, 2013).

Moreover, the literature suggests that journey of the MSE entrepreneur in many instances is short-lived, with the

statistic of MSE failure rate in Africa being put at 99 per cent (Mead & Liedholm, 1998; Rogerson, 2000). Scholars have endeavored to identify the a range of reasons for these failures in this area, which include lack of supportive policies for MSEs development, cut throat competition with imitation of micro and small businesses, shortage of funding, lack of managerial characteristics like skills, experience and culture (Katwalo and Madichie 2008; Ray, 1993); marketing techniques used including quality of service and markets served (Blankson et al, 2006).

4. Conceptual Framework

Critical Success Factors (CSFs)

The definition of CSFs has been well documented in literature by various academicians. The concept of success factors was developed by D. Ronald Daniel at McKinsey & Co. during 1960s and further explored by John F. Rockart in an article published in Harvard Business Review, march-april 1979. Rockart (1978) defined CSFs as "for any business, the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization. They are the few key areas where "things must go right" for the business to flourish. If results in these areas are not adequate, the organization's efforts for the period will be less than desired." The researcher identified four prime sources of CSFs as industry structure, firm's competitive strategy, environmental factors, and temporal factors. The CSF has attracted considerable attention as a means of supporting both MIS planning and requirements analysis (Rockart, 1978; Boynton, & Zmud, 1984).

Further, CSFs are defined as "events, circumstances, conditions, or activities that require special attention because of their significance. They can be internal or external and can influence success either positively or negatively" (Dickinson, 1984). Literature indicates that CSFs are inherent and considered as strategic requirement or constraint for a firm. CSFs have roots in the firm's long range planning to develop new capabilities (Dickinson, 1984). Theory suggests that most businesses are established with few general statements like vision, mission and objectives. In emerging firms with more specific business, strategies are the actions necessary to achieve the company's objectives or goals. They are necessary to provide direction and performance expectations for the functional areas of the company. Working with the guidance from the company strategies, each functional area of the business, prepares its own objectives and functional strategies and tactics. Here, the interaction among strategic plans, business plans, and program plans are based on critical success factors, as managers gets inputs from all the areas of business (Crandall & Crandall, 2008). Therefore, CSFs must be planned at all hierarchy levels of a firm as CSFs are a valuable tool that can help management to achieve superior performance and successfully implement a system to manage a firm. In addition, management of a firm can use CSFs to improve individual goals and job performance (Howell, 2010).

The present study is a systematic approach to understand the critical success factors, which require the attention of entrepreneurs for decision making. Micro and small firms

usually do not spend time, energy and money to define the assumption on which strategy rests. CSFs can be used in selecting "partners" to help in the development of new entities from nothing. CSFs should also be used in selecting members of a management board. CSFs analysis can help entrepreneurs to spot the potential voids so that corrective measures can be taken on time. Moreover, CSFs can isolate deficiencies of the firm and suggest areas for improvement. Thus, the indispensable character of CSFs is to identify the warning system to avoid unpleasant events or missed opportunities (Dickinson, 1984). Therefore, the general objective of the study is to investigate critical success factors related to Micro & Small Enterprises in Ethiopia.

CSFs of Firms

Over the decades, the critical success factors of a firm or determinants have been studied in diverse disciplines, such as psychology, behavioural science, economics, strategy, and innovation. However, it is observed that knowledge of a firm's growth is very inadequate (Davidsson & Wiklund, 2000; Wiklund, Patzelt & Shepherd, 2007). We peep into the highly fragmented existing literature. For example, research from a psychological and behavioural science perspective emphasizes on the behavioural aspects of an entrepreneur (Begley & Boyd, 1987); literature from strategic management point of view focuses on the linkages among environment, business strategy and growth (McDougall, Robinson & DeNisi, 1992); on the other hand research in economics area explores the linkages between firm size and growth (Almus, & Nerlinger, 2000; Audretsch, Klomp, Santarelli & Thurik, 2004). Thus, we can observe that there exist different views, with none of them explaining the CSFs of firm growth in a holistic manner.

Entrepreneurial Characteristics

Nichter & Goldmark (2009) explored various factors which contribute for the development of micro and small enterprises in developing countries. These include individual entrepreneur characteristics; firm characteristics; relational factors (such as social networks or value chains); and contextual factors (such as the business environment). Gagoitsope & Pansiri (2012) found that entrepreneurial motives have a positive effect on an entrepreneur's motivation, managerial innovation, and ability to take opportunities, self-sufficiency, and developing business linkages. One of the hurdles for MSEs is lack of access to capital and inability of entrepreneurs to meet the requirements financial institutions. This may include, for example, proposals of business plan, documentation of financial requirements and other liability issues. It is therefore necessary to look at CSFs. Therefore, CSFs can also be defined in terms of components of a strategy in which the organisation must excel to outperform the competition. These are interlinked by core competencies in specific activities or in managing linkages between activities. The question therefore is to what extent the Ethiopian MSEs can identify and exploit CSFs in terms of building their capabilities (Katwalo, 2010).

Firm Characteristics

Yusuf (1995) identified the factors, which were perceived as critical for success in small business. These factors were divided into broad headings like goal management, government support. Marketing factors, overseas exposure, education, training, personal qualities, prior experience and political affiliations. Chittithaworn, et. al. (2011) examined eight factors that influence the SMEs business success. These factors are: SMEs characteristic, management and know-how, products and services, Customer and Market, the way of doing business and cooperation, resources and finance, Strategy, and external environment. Gadenne, D. (1998) conducted a study on managerial practice, type of industry and found that in service industry, the firm's success could depend on individual 'worth' of all employees directly dealing with customers, in manufacturing industry, the success of the firm may depend on maintaining a competitive advantage.

Contextual Factors

Many CSFs entail information external or contextual to the organization for example -information with regard to market structure, customer perceptions, or future trends of the relent market (Rockart, 1978). Nichter & Goldmark (2009) explored various factors and one of them is contextual factors, which are usually external to the organization and can be classified as business environment. Further, studies suggest that contextual factors or the operating environment of a MSEs/firm affects the performance of the micro and small enterprise (McDougall, Robinson & DeNisi, 1992; Gadenne, 1998; Nichter & Goldmark, 2009; Chittithaworn, et. al., 2011).

Table 2: Study Variables (Critical Success Factors)

| Variables (CSFs) | Sources |
|--|--|
| Entrepreneurial Characteristics <ul style="list-style-type: none"> • Age & gender • Education Level • Experience • Behavioural aspects–motivation | (Begley & Boyd, 1987; Yusuf, 1995; Gadenne, 1998; Nichter & Goldmark, 2009; Gagoitsope & Pansiri, 2012). |
| Firm Characteristics <ul style="list-style-type: none"> • Age, • Size • Management • Structure | (Yusuf, 1995; Gadenne, 1998; Almus, & Nerlinger, 2000; Audretsch, Klomp, Santarelli & Thurik, 2004; Chittithaworn, et. al., 2011). |
| Contextual Factors <ul style="list-style-type: none"> • Operating Environment | (Rockart, 1978; McDougall, Robinson & DeNisi, 1992; Gadenne, 1998; Nichter & Goldmark, 2009; Chittithaworn, et. al., 2011). |

The above mentioned literature revealed that the major critical success factors which affect the success of micro and small firms are entrepreneurial characteristics which include the behavioural aspects of an entrepreneur (Begley & Boyd, 1987; Yusuf, 1995; Gadenne, 1998; Nichter & Goldmark, 2009; Gagoitsope & Pansiri, 2012); firm characteristics like firm size and growth (Yusuf, 1995; Gadenne, 1998; Almus, & Nerlinger, 2000; Audretsch, Klomp, Santarelli & Thurik,

2004; Chittithaworn, et. al., 2011); contextual factors which includes the operating environment of MSEs (McDougall, Robinson & DeNisi, 1992; Gadenne, 1998; Nichter & Goldmark, 2009; Chittithaworn, et. al., 2011).

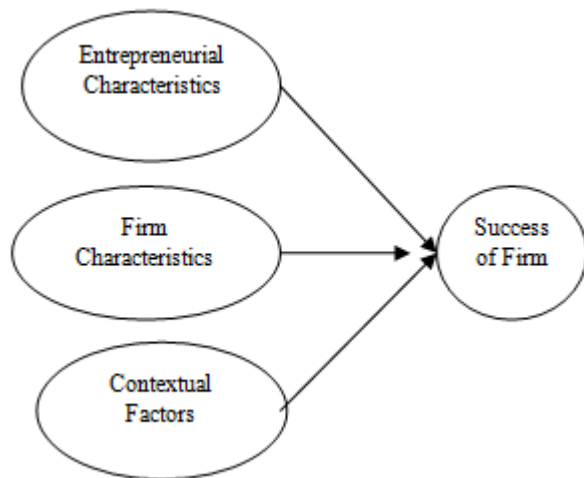


Figure 1: Conceptual Model

The above conceptual model will be empirically tested. The research problem of this study emanates from the high failure rate of micro and small business. This research investigates what are the critical success factors that can help these MSEs to be sustainable and achieve positive growth so as to limit the high business failure rate in Ethiopia.

5. Conclusion

First, in a world of globalization, economies are facing challenges in terms of employment creation, keeping the stable growth rate, to maintain balance in the economic indicators and many more. Under such highly volatile business environment there is a strong need to identify the critical success factors of micro and small business management in a non-western context. It may help in terms of assistance with regard to finance, training & development, marketing management, production, logistics & distribution, and technology. Second, as stated earlier with facts, the economy of Ethiopia is growing rapidly; scholars and practitioners should understand the CSFs of micro and small business management as it plays a significant role in providing auxiliary services to multinational corporations. Third, it is crucial to verify whether micro and small business management practices and policies developed in the western context are valid in a non-western context particularly in Ethiopia with due consideration of the relationships between the predictor, moderator, and criterion variables are similar in both contexts (Zoogah, 2008). Fourth, from an academic perspective this study will provide inputs to the future research on CSFs. Given the importance of small business to a nation's economic growth, and also the role that small business plays in poverty reduction, we postulate that an understanding of the problems, which negatively affect small businesses in Ethiopia, is a vital step in managing and avoiding the massive failure of micro and small businesses. Finally, the study endeavors to draw the attention of researchers, academicians, professional, policy-makers and consultants to enhance the effectiveness and

sustainability of micro and small business enterprises in context of Ethiopia in general.

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