Small and Medium Enterprises

IJSMEs VOL 5 NO 1 (2022) P-ISSN 2576-7712 E-ISSN 2576-7720

Available online at https://www.cribfb.com
Journal homepage: https://www.cribfb.com/journal/index.php/ijsmes
Published by CRIBFB, USA

MICRO, SMALL AND MEDIUM ENTERPRISES ACCESS TO FINANCE CHALLENGES IN SUPPLY SIDE PERSPECTIVE IN ETHIOPIA

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ARTICLE INFO

Article History:

Received: 30th August 2022
Accepted: 10th October 2022
Online Publication: 15th October 2022

Keywords:

Bank and Micro Finance Institutions financing, Access to Finance, Supply Side Challenges, Micro, Small and Medium Enterprises, Ethiopia

JEL Classification Codes:

G21, G23, G32

ABSTRACT

Empirical evidence shows that the contribution of Micro, Small and Medium Enterprises Empirical evidence shows that the contribution of Micro, Small and Medium Enterprises (MSMEs) to gross domestic product growth, job creation, and poverty alleviation is high. Because of limited access to finance and other factors, a significant number of MSMEs, particularly in developing countries, cannot realize their full potential. The study investigates the micro, small, and medium enterprises' access to finance challenges from the supply-side perspective in Ethiopia. The study employed descriptive analysis using survey data collected from purposely selected 11 banks and 9 micro-finance institutions (MFI). The results show that the lack of collateral, unavailability of financial records, poor pre-loan savings, low loan repayment rate, business feasibility problems, credit information asymmetry, attitudinal problems of the MSMEs, and diversion of the loan are demand-side constraints. From the financial institution's perspective, the result shows that the liquidity problem, the influence of unfair competition from government banks, the lack of competent human resources, political leaders' intervention, especially in MFI, corruption, the COVID-19 pandemic, political instability, and inadequate capital are major obstacles. Macroeconomic conditions related to challenges such as foreign exchange shortages, inflation, and trade imbalances are also mentioned as major obstacles. According to the findings of this study, designing and implementing business skill development in mindset, business planning, business bookkeeping, and financial reports can help MSMEs access loans. For financial institutions, the study suggests cash flow-based lending products, applying psychometric testing for credit scoring, improving the governance of the government-affiliated MFIs, and automating the MFIs.

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INTRODUCTION

Micro, small and medium enterprises (MSMEs) are strong drivers of economic development and employment. For instance, MSMEs in OECD countries such as the UK and Greece account for 53% and 86% of total employment, respectively. In developing countries such as Peru, MSMEs contribute to 42% of GDP and 60% of employment. Similarly, in Cambodia and Kenya, MSMEs account for about 50% and 80% of employment (Liu, 2018). According to Lessidrenska (2019), 4 out of 5 new positions in the formal sector were created by MSMEs, which is about 90% of total employment.

For all the high significance of MSMEs to job creation and the mitigation of servile destitution, large numbers of MSMEs can't exhaust their maximum capacity because of the access to finance and different variables that hinder their development and execution, for the most part, in developing nations. According to the International Finance Corporation (2017), MSMEs in high-income countries are less compelled to access finance. Those nations with high incomes have the most elevated extent of access to finance unconstrained MSMEs, which is 81% of total MSMEs and has just 19% of compelled MSMEs. In contrast, low-income countries have the greatest number of completely or partially financially obligated MSMEs; 67% (3 million MSMEs) of money-compelled or constrained MSMEs were discovered. Additionally, 26% of MSMEs in the upper-middle income nations and 15% of MSMEs in lower middle-income nations are completely finance constrained, and 9% and 33% of enterprises, respectively, are somewhat finance constrained. In emerging

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https://doi.org/10.46281/ijsmes.v5i1.1808

To cite this article: Wajebo, T. W. (2022). MICRO, SMALL AND MEDIUM ENTERPRISES ACCESS TO FINANCE CHALLENGES IN SUPPLY SIDE PERSPECTIVE IN ETHIOPIA. *International Journal of Small and Medium Enterprises*, *5*(1), 23-31. https://doi.org/10.46281/ijsmes.v5i1.1808

economies, including Sub-Saharan Africa, SMEs are commonly more credit-obligated than large firms, seriously influencing their conceivable outcomes (Ayyagari et al., 2008; Beck et al., 2008; Ayyagari et al., 2012).

As per Beck et al. (2008), small firms consistently report more financing needs than medium-sized and large firms. The likelihood that a small firm references access to finance as an essential limitation is 39%, compared with 36% for medium-sized firms and 32% for large firms. Various studies have also revealed that MSMEs in Ethiopia have extremely limited access to finance from formal financial institutions (Weltbank, 2015; Nega & Hussein, 2016). A review directed by the Weltbank (2015) on SME finance in Ethiopia showed that just 3% of small enterprises and 23% of loan facilities.

MSMEs in Ethiopia access finance from formal, semi-formal, and informal institutions. The formal financial institutions are managed establishments that include banks, insurance companies, microfinance institutions, and capital goods and leasing companies. The semi-conventional ones are institutions that are not controlled by the NBE yet have another administrative office and which incorporate saving and credit cooperatives (SACCOs), rural/saving and credit cooperatives (Ru/SACCOs), and village saving and lending associations (VSLAs). Furthermore, the informal ones are unregulated financial sources, which include Iqub and Idir.

As one of the key areas of the formal financial framework, banking in Ethiopia began in 1905 with the foundation of the Bank of Abyssinia, which was possessed by the Ethiopian government in association with the National Bank of Egypt. As indicated by the report of the national bank before the end of 2019/20, the quantity of banks has arrived at 18 (16 private and 2 public). These banks have a total of 6,511 branches across the country as of 2019/2020.

On the other hand, microfinance institutions were initially begun in the 1980's by professor Mohammed Yenus in Bangladesh as another optional financial industry. In Ethiopia, the government provided its first microfinance enactment in 1996 (proclamation 40/96), fully intent on giving microfinance service to the poor by deposit taking. The principal objective of these organisations is to convey advances, miniature saving, miniature protection, cash movement, and renting to the huge number of the barred populace in the country in a savvy and practical way. As indicated by the national bank report, as of 2019/20, the quantity of microfinance establishments (MFIs) came to 41. Their all-out capital and all-out resources arrived at Birr 19.4 billion and Birr 92.2 billion, separately. The five biggest MFIs are comprised of Amhara, Dedebit, Oromiya, Omo and Addis Credit and Savings establishments, which accounted for 82.6% of the total capital, 90.1% of the investment funds, 85.9% of the credit, and 86.3% of the absolute resources of MFIs starting in 2019/20.

In spite of incredible endeavours by the Ethiopian government to further develop MSMEs' access to finance from formal financial institutions, the credit market was somewhat immature in Ethiopia compared with other adjoining nations. So, MSMEs are experiencing restricted access to finance, which is choking the area's ability to contribute towards the country's financial turn of events and business. So far as the author knows, intensive study at the national level wasn't conducted from the supply side perspective to offer policy insight, particularly regarding the criteria used by financial institutions to assess loan requests from MSMEs. Subsequently, the researcher mainly attempted to identify the factors constraining access to finance for MSMEs from a supply-side perspective. Specifically, the study seeks to identify the key constraints of MSMEs' access to finance, assess the criteria used by banks and MFI for loan processing, and assess the legal landscape of the financial sector (banks and MF). Finally, the study helps to highlight the policies and legal frameworks that need improvement.

LITERATURE REVIEW

Definitions and categorization of enterprises differ from country to country. Depending on contexts and development scenarios, countries choose one or more thresholds to define and categorise enterprises. Some of the factors used for defining and setting boundaries across enterprises include investment size, number of employees, annual sales turnover, net asset value, and legal status.

The global experience of categorizing enterprises also varies in general categorization and use of terminologies. Some countries and organisations generally use the category of micro and small enterprises (MSE), while others use small and medium-sized enterprises (SMEs). There are international development organisations and experts who combine both MSEs and SMEs into one and create the term "micro, small and medium enterprises" (MSMEs). The term MSME covers a wide range of definitions across countries and multilateral organisations. For example, the Interpretation Note on Small and Medium Enterprises and Environmental and Social Risk Management prepared by the International Finance Group (2012) and the European Commission Guide (2016) for SME Definition used the number of employees, total net assets, and total annual sales as criteria for categorization of MSMEs.

However, due to its ease of collection, some of the most commonly used criteria are total employees, total assets, and total annual sales amount, even though the numbers vary across countries. According to the OECD (2005), in developing countries, micro-enterprises have at most 10 or, in some cases, 5 workers; small enterprises are generally those with fewer than 50 employees; and the most frequent upper limit designated for medium enterprises is 250 employees.

The definition and terminology of SMEs and MSEs have evolved over time in Ethiopia as well. According to the Ethiopia Micro and Small Enterprises Development Strategy of 2011, the working definition of MSEs in Ethiopia is based on capital, number of employees, and type of services. See the details in Table 1 below.

Table 1. MSMEs Categorization in Ethiopia

Type of Enterprises	Sector	Man power	Size of capital (ETB)
Micro Enterprise	Industry	≤ 5	< 100,000
	Service	≤ 5	< 50,000
Small Enterprise	Industry	$6 \leq 30$	100,001- 1.5 million

	Service	6 ≤30	50,001- 500,000
Medium Enterprise	Manufacturing Industry	31≤100	1.5 – 20 million

Source: Computed from own survey

In Ethiopia, financial institutions including MFIs, Commercial Banks and Leasing Companies categorise enterprises differently. Micro enterprises are not common in the definition and segmentation made by commercial banks as well as Development Bank of Ethiopia (DBE), particularly while segmenting credit customers. Banks commonly mention Small and Medium Enterprises (SMEs) in their financial service mix. Indeed, there are only a few banks which try to approach SMEs differently with their credit services by making them visible in their structures and product mixes. However, the definition and segmentation used by banks do not strictly follow the profile of enterprises, such as size of employment and capital. Rather, the major basis of categorization is the size of loan availed to each type of enterprise. This has made tracking the data about the amount of loan extended to SMEs more difficult since the size of loan does not necessarily correspond with the size of enterprises, because larger companies can also take smaller sized loans.

On the other hand, MFIs have traditionally been set up to serve microenterprises, although they later included small and medium enterprises. And in most cases, MFIs use a government definition and categorization of enterprises.

The Development Bank of Ethiopia (DBE) has its own definition of SMEs. For DBE, the definition of small and medium enterprises (SMEs) covers all enterprises that operate with over 6 employees and have a total capital of 500,000 to Birr 7.5 million. The Bank does not provide lease financing services to micro and small enterprises whose total capital is less than Birr 500,000.

MATERIALS AND METHODS

According to Saunders et al. (2009), mixing qualitative and quantitative approaches gives the potential to cover each method's weaknesses with strengths from the other method. Thus, both qualitative and quantitative approaches to research will be employed to undertake the study.

A descriptive research design was used in this research. These descriptive statistics were applied to generate descriptive information on parameters under consideration or investigation. The time dimension of the study is cross-sectional. Respondents were asked once or at a point in time about issues under investigation.

The data for the study was obtained from both primary and secondary sources. Primary data was collected from banks and microfinance institutions. Since the research is going to approach the supply side subject matter, banks and MFIs were considered as the research population. Thus, all the 18 banks and 41 MFIs were used as research populations. On the other hand, secondary data was collected from the administrative publications, annual and inventory reports, previous studies, and other related literature. Data was collected from loan and customer relations managers of banks and MFIs using self-administered questionnaires and structured interview questions. Key informant interviews were conducted with appropriate leaders of the financial institutions. Additionally, managers working for selected financial institutions were interviewed.

A non-probabilistic method of sampling techniques, namely a purposive sampling method, was employed to draw respondents from the total population. Eleven (11) banks, which are shown in Table 4 below, whose combined market share is 95.8 % in terms of branch network and 94.7 % in terms of capital based on the 2019/20 report of national banks are included in the sample. The remaining banks will not be considered because of their very low branch network and share of capital.

Besides banks, Micro Finance Institutions (MFIs) are instrumental in providing financial services (both lending and deposit services), particularly to micro, small and medium enterprises (micro, SMEs) in Ethiopia. Currently, there are 41 MFIs serving millions of people in the lower income quintile throughout the country.

However, the market is dominated by a few MFIs. According to the National Bank of Ethiopia's annual report of 2019/2020, the five largest MFIs, namely Amhara Credit and Saving Institutions S.C (ACSI), Debit Credit and Saving Institutions S.C (DECSI), Oromia Credit and Saving S.C (OCSSCO), Omo Microfinance S.C and Addis Credit and Saving Institution (ADCSI), accounted for 82.6 percent of the total capital, 90.1 percent of the savings, 85.9 percent of the credit and 86.3 percent of the total assets of MFIs. So that except the Dedebit credit and saving institutions because of the security issue, the entire top four and four other MFIs, namely Diredawa Microfinance S.C, Harari Microfinance S.C, Gembelaa Microfinance S.C, Bussaa Gonofaa Microfinance Institution S.C and Specialized Financial and Promotional Institution (SFPI) are included in the sample selection. This is due to their large number of active borrowers in comparison to the remaining borrowers. Therefore, first-hand information was collected from financial institutions, as shown in Table 2 below.

Table 2. Financial Institution Include in the Purposively Selected Sample

Category	**List**	**Location**
MFIs	Amhara Credit and Saving Institute (ACSI)	Bahir Dar
	Addis Ababa Credit and Saving Institute	Addis Ababa
	Oromia Credit and Saving Sh. C (OCSSCO)	Addis Ababa
	Omo micro-finance	SNNPRS
	Dire credit and saving institution	Dire Dewa
	Gambella credit and saving institution	Gembella
	Harari credit and saving institution	Harari
	Specialised Financial and Promotional Inst.	Addis Ababa
	Gona Bussa Credit and saving institution	Addis Ababa

Commercial Banks	Awash Bank	Addis Ababa
	Oromia International Bank	Addis Ababa
	Commercial Bank of Ethiopia (CBE)	Addis Ababa
	Abay Bank	Addis Ababa
	Nib international bank	Addis Ababa
	United bank	Addis Ababa
	Dashen bank	Addis Ababa
	Bank of Abyssinia	Addis Ababa
	Abay Bank	Addis Ababa
	Cooperative l Bank of Oromia	Addis Ababa
	Wegagen Bank	Addis Ababa

Source: Computed from own survey

Descriptive method of analysis was used to conduct the analysis. Tables, charts and summary statistics are used to summarise information. Content analysis was also employed to analyse the qualitative data.

RESULT AND DISCUSSION

The Time Duration Needed for Loan Process

Different elements add to the time it takes to deal with a single loan and to pass a decision. Among the deciding variables, the time taken to gather the required reports, the investigation both at the branch and the supporting organ, and the liquidity status of the bank can be recorded as examples. Thus, the processing procedure, straightforwardness or transparency, and time span are a portion of the variables deciding the comfort of loaning offices, which adds to the development and enduring customer-bank relationship. Remembering this inquiry was raised with regards to the time stretch for processing single credits and passing a decision, 66% of the respondents answered that under about fourteen days is needed to finish the interaction. While 27.8% and the remaining 5.6% of respondents said it takes between two weeks to a month and more than a month to make a decision, as shown in Table 3 below.

Table 3. The Time Interval a Single Loan Process Takes

		Frequency	Percent	Valid Percent
Valid	Below 15	12	66.7	66.7
	15-30 days	5	27.8	27.8
	Greater than 30 days	1	5.6	5.6
	Total	18	100.0	100.0

Source: Computed from own survey

Borrowers Assessment Criteria of Financial Institutions

In the study, financial establishments were approached to rate the significance level of the criteria set in case they were applied for assessing MSMES borrowers. They were approached to rate the level of the significance of the components on a scale going from 1 to 4 (1-not important, 2-less important, 3-importantly, and 4-very-significantly). Table 4 depicted the reaction of financial institutions. The result shows that 89.5% of the respondents agree that the accessibility of guarantee and the reimbursement of past loans are the most important criteria for loan processing. While the remaining 10.5% of respondents indicated that the presence of security and prior credit history (reimbursement) are important criteria. This infers that access to finance was exceptionally restricted by severe security needs and the reimbursement of past credit. Moreover, the appropriate response reflected by key sources supports this outcome. They were using a conventional security-based lending approach, which was not helpful for MSMEs. From the interest side, the vast majority of them were saying that the absence of a sufficient guarantee was considered as a critical boundary that influenced them to get a loan facility.

Likewise, respondents were approached to label the importance of analyzing the borrower's risk exposure by inquiring business plan. 63.2% of the respondents, followed by 36.8% of the total respondents, agreed that business plan is the most important and important precondition for processing credit, respectively. Similarly, 68.4% of respondents, followed by the remaining 31.6%, believed that the firm's profitability is the most important and important precondition for credit handling separately.

The respondents were also approached to rate the importance label of experience of loan applicants in the loan appraisal process, 36.2% of the respondents replied that experience is very important, while 63.2% of the respondents concurred that experience of the manager is important for loan processing.

As it tends to be found in Table 4 beneath, 52.3% of respondents answered that the number of permanent employees is the least important criteria for loan processing. While from the leftover 47.7% of the respondents, 36.8% of the respondents, followed by 5.3% and 5.3% of the respondents, replied that the number of permanent employees in the MSMEs is an important, most important, and not important requirement for loan processing, respectively.

This demonstrates that the financial institutions were not arranging their clients based on firm size rather than loan size. Bank management information systems (MIS) were not intended to capture firm sizes (number of workers, and so on), regardless of whether they had the capacity to do as such. The loan size is absolutely reliant upon the size of security rather than really taking a look at business needs. Despite the fact that the entirety of the state banks and not many of the private banks opened the SME window, they didn't yet take on cash flow based lending approaches for making SME advances.

In addition, almost all of the respondents, as shown in Table 4 agreed that projected income, type of business activity or sector in which the MSMEs are operating, audit report, and profitability of the MSMEs are important requirements for loan appraisal.

From those financial institutions' experts who participated in the survey, 52.6%, 68.4%, 84.2%, and 47.4% agreed that the projected income, profitability of the enterprise, intended purpose of the loan, and audit report are the most important criteria in the loan processing, respectively. Nonetheless, this evidence shows that the financial institutions are predominantly worried about the target capacity of the MSME to repay the loan. In all actuality, access to finance was profoundly restricted by severe collateral prerequisites. As reflected by credit administration managers of the MFI and banks in the interview undertaken, there are factors that MFIs consider when they decide the qualification of MSE customers. The components they set at the bleeding edge were availability of collateral and financial reasonability of customers' business. They also mentioned accounting record keeping, such as tax clearance and financial records, as well as previous loan repayment history, as requirements for handling loan applications. The overall qualification standards set by banks to propel credit administration to various kinds of customers are pretty much comparable.

This result is contrary to the finding of the study conducted by Adedejebi (2019) to identify the determinants of lending to small and medium enterprises by deposit banks in Nigeria. He/she found that the ranking of criteria by bank staff showed that projected income, type of business facility, and existing profitability had the highest determinant factors in the loan process.

Table 4. Ranking of Criteria in Assessing MSMEs Borrowers

The importance level of the factors determines the credit processing or credit appraisal in financial institutions	**not important**	**less important**	**important**	**most important**
	Percent	**Percent**	**Percent**	**Percent**
Availability of collateral	0.0%	0.0%	10.5%	89.5%
Business plan	0.0%	0.0%	36.8%	63.2%
Intended purpose of the loan	0.0%	0.0%	15.8%	84.2%
Previous loan history (repayment)	0.0%	0.0%	10.5%	89.5%
Number of permanent employees	5.3%	52.6%	36.8%	5.3%
Sector in which business activity deployed	0.0%	5.3%	42.1%	52.6%
Profitability of the enterprise	0.0%	0.0%	31.6%	68.4%
Projected income in credit	0.0%	0.0%	47.4%	52.6%
Financial record keeping	0.0%	21.1%	21.1%	57.9%
Audit report	0.0%	15.8%	36.8%	47.4%
Experience of the manager	0.0%	0.0%	63.2%	36.8%
Length of time doing business with the bank	5.3%	10.5%	68.4%	15.8%
Public guaranty scheme	5.3%	36.8%	42.1%	15.8%

Source: Computed from own survey

Challenges for MSMEs Financing in Supply Side Perspectives

As indicated in the Table 5 below, about 90% of the respondents of financial institutions agreed that there are circumstances in which credit granting and monitoring process is overridden by directors and senior management influential staff. Similarly, about 21% of the respondents have shown disagreement on whether the process of credit administration is performed independently of individuals involved in the business organisation of credit. This fact gives the signal for somebody to understand that there is a transparency problem in the loan process in financial institutions.

Table 5. Factors Affecting the Credit Processing

Factors affect the credit processing/appraisal	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**
	%	%	%	%	%
There are circumstances in which credit granting and monitoring process is overridden by directors, senior management influential staffs	0.0%	0.0%	10.5%	63.2%	26.3%
The process of credit administration is performed independently of individual involved in the business organisation of credit	5.3%	15.8%	57.9%	15.8%	5.3%

Source: Computed from own survey

The open-ended question was posed for financial institution managers and experts to assess the major challenges of MSMEs' access to finance. The responses stated by respondents were broadly categorised as: enterprise specific challenges, challenges related to macro-economic conditions, factors related to the capability of the financial institutions themselves, factors related to integration among the key stakeholders and intermediate institutional capability. Under the last category of obstacles, corruption happening in public sectors in service delivery, lack of working premises for MSMEs, poor integration in credit facilitation and repayment, and lack of appropriate training on financial management were included.

As indicated in Table 6 below, inadequate or lack of collateral, unavailability of financial records, poor business skills and unprofitability, lack of pre-loan saving because of poor culture of saving, credit information asymmetry, poor/unsatisfactory/no business plan or misaligned business plan with the sector, low loan repayment rate, and diversion of the loan for unplanned purposes are mentioned as primary obstacles stemming from MSMEs. For further details, you can refer to Table 10 below.

Table 6. Enterprise Specific Challenges to MSMES finance

S.No.	Enterprise Specific Challenges	Frequency (%)
1	Inadequate or lack of collateral	92
2	Poor business feasibility	72
3	Poor/ unsatisfactory/ no business plan	67.5
4	Low loan repayment rate	51
5	Lack of compulsory saving because of poor culture of saving	47
6	Credit information asymmetry	44
7	Diversion of the loan for unplanned purpose	41
8	Attitudinal problem of the MSMEs or youth	40
9	In availability of financial records specially MSEs	33.3
10	Lack of working premises for MSMEs	29
11	Disagreement among the MSMEs operators	28
12	Lack of experience and poor business skill in MSMEs side	27.8
13	Discomfort of MSMEs in interest rate	27
14	Requesting too high loan amount	22

Source: Computed from own survey

Macroeconomic conditions such as the liquidity problem, shortage of foreign exchange, rise in inflation and macroeconomic instability (trade imbalance) are factors perceived as macro-economic conditions related obstacles to MSMEs' financing by financial institutions. As indicated in Table 7 below, the majority of the financial institutions, which is about 91.1% and 90% of the financial institutions which were addressed in this assessment, reflected liquidity problems and foreign exchange shortages as one of the major challenges for the provision of loans to MSMEs.

Table 7. Macro-Economic Condition Related Factor Affecting MSMEs Financing

S.No.	Macro-economic condition related factors	Frequency
1	Liquidity problem	91.1
2	Foreign exchange shortage	90
2	Macroeconomic instability (trade imbalance)	88
3	Inflation rate	85

Source: Computed from own survey

It is known that the capacity of financial institutions is a very important factor that determines the MSMEs' access to finance. From the financial institutions' perspective, liquidity problems, influence of unfair competition from government banks, lack of competent human resources in the area, political leaders' intervention, corruption, mismatch between the demand and potential of the suppliers, and inadequate capital are stated as primary obstacles. Secondly, reduction of income due to the impact of the COVID-19 pandemic and political instability, shortage of reserve money, policies and regulations crafted by NBE, employee turnover, rigidity of loan procedures, and credit information asymmetry due to lack of a unique identification system were mentioned as challenges.

Despite efforts to define MSMEs in Ethiopia, during this diagnostic assessment of financial institutions (FIs), it was found that there is limited awareness among the FIs about existing government definitions. Government affiliated MFIs and leasing companies have a relatively better understanding of the definition and categorization of enterprises made by government agencies. However, MFIs either use their own definition and eligibility criteria to target MSMEs or follow and use definitions of different funding requirements and projects.

In the process of financing SMEs through MFIs, the eligibility criteria include capital size, greater than 100,000; and the number of employees of SMEs, greater than or equal to 7. Most MFIs mostly consider the number of employees or total asset value, while others focus on the loan size, business experience, business sector, and the like.

On the other hand, employees mentioned the difficulty of properly defining and differentiating enterprises by the size of employees and capital, since most of the enterprises lack proper registration and updating of their capital; and MSEs rarely prepare proper payrolls regularly due to employees' lack of interest in paying payroll taxes. For further details, see Table 8 below.

Table 8. Financial Institutions Specific Challenges for MSMES Financing

S.No	**Financial Institutions Specific Major Challenges**	**Frequency**
1	Liquidity problems	91%
2	Influence of unfair competition from government banks	68%
3	Lack of competent human resource in the area	48%
4	Political leaders' intervention specially MFI	48%

5	Corruption	43%
6	Mismatch between the demand and the potential of the supplier	43%
7	Inadequate capital	39%
8	The impact of covid-19 pandemic on economy	36%
9	Shortage of reserve money	32%
10	Policies and laws crafted by national bank of Ethiopia	29%
11	Employee turn-over	24.7%
12	Reduction of the income of the bank	17%
13	Credit information asymmetry due to lack of unique identification system	16%
13	Rigidity of the loan procedure	13%
14	Lack of valuation standard for properties for collateral	11.3%
15	Political Instability	11%

Source: Computed from own survey

Legal and Regulatory Framework of Bank and MFI

National bank laws crafted to oversee banks and MFIs have contrarily influenced the exhibition of financial establishments. Financial institutions report that a lack of liquidity and competition in the area are limiting MSMEs' access to finance. The National Bank of Ethiopia's (NBE) directive no. SBB/53/2012 confines business banks to loans with a limit of 25% of their capital for a single borrower and 15% of their all-out capital for a connected party. This high limit encourages large businesses to take advantage of more credit shares and may result in an unreasonable allocation of MSMEs' limited financing. The NBE directive number MFI/18/06 also limits MFIs to not exceeding 1% of their capital for individuals who can provide collateral and fewer than 4% of their capital for group guarantees. Microfinance institutions will also hope to deal with constant liquid assets equal to at least 20% of their total deposits. This causes the liquidity deficit issue, especially for private MFIs.

As raised by three leaders of different financial institutions, customers of banks and microfinance institutions face a challenge in foreclosing property for collateral due to the corrupted and bureaucratic service delivery by public institutions. Since MFI hadn't installed the digitised management data system, they didn’t start the core banking service. Thus, they supply credit information to the credit reference bureau manually.

Government and NGO synchronous activities are at present distorting the microfinance markets. Presently, youth are, to a great extent, seeing the credit provided through youth revolving funds and different channels as remuneration for not being employed. The government has been attempting to create job opportunities just by injecting finance like youth revolving funds into the market by political choice. Nonetheless, experts from financial institutions were blaming the political choice of the government because of the decision passed by disregarding the financial institutions' methodology. They said that a significant number of people or gatherings for which the money was dispensed didn't really need the finance for organizations and that they didn't screen and survey and uphold the financial institutions' measures. This made an off-base opinion on youth to imagine that the money dispensed was viewed as us social protection and it's not normal to reimburse.

In addition, donors are conveying uncollectible funds by violating the microfinance law and directives of NBE donors and NGOs, which actually blend loan and charity. Consequently, the availability of donors, subsidised and soft loans is eroding the moral value and virtue of society. It's also distorting the market because those individuals who benefited from the donation or subsidised loan were taking advantage of those who accessed loans in the conventional way. NGOs are expected to be involved in capacity building of the MFIs and clients by participating in training, supplying hardware and other facilities that reduce their overhead costs, and providing loan capital. Every fund and therefore the incentivised loans are expected to be channelled through financial institutions to mitigate the above risks.

The other important challenges of MFIs are the lack of a centralised database, which makes them unable to deliver integrated or core banking services for their clients. Weak management information systems have affected the efficiency of MFIs significantly. This is often aggravated by a scarcity of ordinary software, skilled manpower, and infrastructure to support a management data system network in remote areas.

CONCLUSIONS

Several studies show that MSMEs account for more than 40% of the gross domestic product and more than 70% of job creation in low-income nations. However, many components are compelled not to release their maximum capacity, especially in non-industrial nations like Ethiopia. Among those components, access to finance is one of the most basic limitations, as displayed in a few examinations already (Weltbank, 2015; World Bank, 2019; Nega & Hussein, 2016). As a result, this study investigates the micro, small and medium enterprises' access to finance challenges from the supply-side perspective in Ethiopia.

The caveats for MSMEs' access to finance found in this study were broadly categorised into macro-economic conditions-related challenges, MSMEs and financial institutions' specific challenges, and key stakeholders' and intermediate institutional capability-related challenges. The factors majorly constraining MSMEs' access to finance solely related to MSMEs were: inadequate or lack of collateral, unavailability of financial records, unprofitability of the business, low loan repayment rate, poor pre-loan saving, poor/unsatisfactory/no business plan or misaligned business plan with the sector they are operating the business, and diversion of the loan for unplanned purpose. Disagreement among the MSMEs' operators, attitudinal problems of the MSMEs or youth, and credit information asymmetry were also among those caveats.

Under the financial institution’s specific challenges, liquidity problems, the influence of unfair competition from government banks, lack of competent human resources in the area, political leaders’ intervention, corruption, mismatch between the demand and potential of the suppliers, and inadequate capital were raised as primary obstacles. Secondly, reduction of income due to the impact of the COVID-19 pandemic, political instability, shortage of liquidity, policies and regulations crafted by national bank, employee turnover, rigidity of loan procedures, and credit information asymmetry.

The macroeconomic conditions related challenges such as the liquidity problem, shortage of foreign exchange, inflation rise, and macroeconomic instability (trade imbalance) were also factors constraining MSMEs' access to finance. The poor integration among key stakeholders includes corruption, lack of working premises for MSMEs, poor credit facilitation and repayment, and a lack of appropriate training on financial management.

Regarding loan processing criteria, the result reveals that the availability of collateral, previous loan history, intended purpose of the loan, profitability of the enterprise, business plan, financial record keeping, projected income, sector in which business activity is deployed, audit report, experience of the manager, and length of time doing business with the bank are the most important criteria's in their order. Although this evidence shows that financial institutions are primarily concerned with the capacity of MSMEs to repay loans, security requirements have severely restricted access to finance.

The other fascinating finding of this study is that the financial institutions were not prioritizing their customers based on firm size but, mostly, dependent on credit size, in which knowing the level of a MSMEs portfolio is impossible. Financial institutions' management information systems (MIS) were not designed to capture firm sizes (number of employees, for example) even if they could do so. The loan size is absolutely reliant upon the size of security inclusion rather than really looking at the expected pay capacity. Although the state banks and a few of the private banks opened the SME window, they didn't yet embrace cash flow-based lending approaches for providing SME loans.

The private commercial banks and MFIs are blaming the laws declared by the national banks. They reflected that the liquidity needs and challenges inside the space are impacting the MSMEs' access to finance. The national bank of Ethiopia directive no. SBB/53/2012 limits commercial banks to advance a restriction of 25% of their capital for a single borrower and 15% of their full-scale capital for an associated party. This high threshold favours the large enterprises to take advantage of more credit share. This might cause irrational assignment of the limited finance for MSMEs. Likewise, the directive number MFI/18/06 limits MFIs to not transcend 1% of their capital for people who can provide security and under 4% of their capital for group security. In directive number MFI/15/202, microfinance institutions will moreover expect to manage at unsurpassed liquid assets, essentially agreeable to 20% of their total deposits. This causing the liquidity inadequacy issue, particularly private MFI.

Recommendations

The following are recommendations derived from the finding of this study.

- Design and implement MSMEs capacity and business skills development programmes (financial literacy and the use of Fintech). Many MSMEs need to adopt a more business-like mind-set, feasible business plan, proper business bookkeeping, effective financial reports and other which help for loan process.
- Improve governance and increase independence of government affiliated MFIs by including shareholders and board members from the private sector. This will help to reduce the Politicisation of microfinance service, political intervention and improve the efficiency of the service
- Establish public credit guarantee scheme: Since loan service in financial institutions is highly constrained with collateral, it is advisable to establish the public credit guarantee scheme to mitigate the collateral constraints for MSMEs.
- Determine the optimal share of MSMEs loan from total loan portfolio for both MFIs and Commercial bank
- Improve access to finance for MSMEs through enabling policy and regulatory environment,
- Apply alternate credit scoring methods such as psychometric testing for a more efficient loan process. It enables us to evaluate personal characteristics like honesty, ethics, drive, motivation, optimism, intelligence, and business skills (Beck & Cull, 2014).
- Expand loan products that meet MSMEs' needs. Implement movable collateral registries to cover their perceived risks of lending. Expand supply chain finance, where small businesses are financed through the relationships they have with their major suppliers or customers. And introduce cash flow-based lending products rather than being dependent on traditional collateral-based appraisal techniques.
- Automate and Strengthen MFIs accounting standards: - this helps the accessibility and efficiency of the service and enable to interconnect the head office with their branches digitally and to provide core banking service for clients

Author Contributions: Conceptualization, T.W.W.; Methodology, T.W.W.; Software, T.W.W.; Validation, T.W.W.; Formal Analysis, T.W.W.; Investigation, T.W.W.; Resources, T.W.W.; Data Curation, T.W.W.; Writing – Original Draft Preparation, T.W.W.; Writing – Review & Editing, T.W.W.; Visualization, T.W.W.; Supervision, T.W.W.; Project Administration, T.W.W.; Funding Acquisition, T.W.W. Authors have read and agreed to the published version of the manuscript.

Institutional Review Board Statement: This study did not require ethical review or clearance because it does not include vulnerable populations or delicate subjects.

Funding: This study was financially supported by Federal Job Creation Commission (27,000 USD) in data collection process.

Acknowledgements: I would like to show my warm thanks to the management of Federal Job Creation Commission for the financial support and to the members of Policy and Strategy Analytics Directorate for their contribution in data collection processes. The views and opinions expressed in this article are mine and do not reflect the views of their institution.

Informed Consent Statement: This manuscript does not include details, images, or videos relating to individual participants.

Data Availability Statement: The data used in this study are available on request from the corresponding author. The data are not publicly available due to restrictions.

Conflicts of Interest: The author ensures that there are no conflicts of interests concerning the publication of this article.

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