

AN ASSESSMENT OF CHALLENGE FACED BY SAMALL AND MEDIUM  
ENTERPRISE IN ACCESSING FINANCE; IN CASE OF WOLKITE TOWN



WOLKITE UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

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## DECLARATION OF ORIGINALITY OF THE PAPER

I here declare that this senior essay entitled Assessment of challenge faced by small and medium enterprises in accessing finance Wolkite town. Submitted in partial fulfillment of the requirement for a bachelor's or degree in accounting and finance at Wolkite University through the Department of Accounting and Finance is my original work.

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## ABSTRACT

*Small and medium scale enterprise has become an important contributor to Ethiopia economy. The sector contributes to national objective of creating employment opportunities, training entrepreneur, generating income and providing a source of livelihood for the majority of the low-income households in the country, accounting for material amount of GDP. The research entitled challenges faced by SMEs in accessing finance in wolkite town. The main objective of the study is accessing challenges faced by SMEs in accessing finance from formal financial institutions in wolkite town. For this used stratified random sampling techniques used in the study and out of 244 SMEs operating in wolkite town a sample of 71 SMEs taken as a sample and collected data analyzed by using descriptive statistics like percentage and the result is presented using tables. The finding of the study shows that; there is institution such as bank and non-banks institution that are willing to provide funds to SMEs in wolkite town but the town SMEs is not able to meet the requirement of this financial institution. Chief among these requirements is the issue of collateral which most SMEs cannot provide. Aside this other issue is small equity base of these SMEs among others. Secondly, those who are able to access credit are faced with high interest rate and short repayment period making it very difficult to embark on any developmental or expansion projects. Finally the based on the finding of the study the researchers recommended for National bank of Ethiopia to endorse policy measure at moderating collateral requirement and to set the interest rate as minimum as possible and for the SMEs to seek another financial institutions like micro finances on the periods of high interest rate and to prepare proper financial statement as it helps to facilitate the process of accessing credit.*

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## List of acronyms

EEA - Ethiopia Economy Association

FF and CBAs - Family friends and Close Business Associations

GDP- Growth Domestic Product

GTP-Growth Transformation plan

GTZ- German Technical Cooperation

MOTI - Ministry of Trade and Industry

MSME- Micro, Small and Medium Enterprise

NBE- National Bank of Ethiopia

SMEs-small and medium enterprises

SSA-sub-Saharan Africa

USA -United Stated America

VCs- Venture Capitalists

# CHAPTER ONE

## 1. Introduction

### 1.1 Background of the study

Small and medium Enterprise (SMEs) usually been perceived as a dynamic force for sustained economic growth and job creation in developing countries. They play a multi faced role such as boosting competition, innovation, as well as development of human capital and creation of financial system. With increased urban population dynamics of Sub Saharan Africa (SSA) the importance of SMEs is grown. In cities and town of Ethiopia, SMEs and the informal sector are the predominant income generating and they have significant contribution to local economic development and used, as the basic means survival (Geber-egizabher and Demeke, 2004).

The small and medium enterprise sector in Ethiopia is taken as an instrument in bringing about economic transition by effectively using skill and talent of the people particularly women and youth without demanding high level training, much capital and sophisticated technology. The small and medium enterprise in formal and small manufacturing enterprise sector (SMEs) contributed value added of birr 8.3 million in 1996. Based on 2002/03 data, this figure constitutes 3.4% of GDP, 33% of the industrial sector contribution and 52% of the manufacturing sector contribution to the GDP of the same year. Although the five-year growth and transformation plan (GTP) of Ethiopia envisages to create a total of 3million SMEs at the end of plan period (NBE, 2011) citing the source from the brief noted that a total of (70,500) new SMEs were established in 2011/12 employing 806,300) people across the country. The performance is below the target set in GTP (EEA, 2015).

The financial of small and medium enterprise (SMEs) has been a topic of Keen interest recent year, because of the key role that SMEs plays in economic development and their potentially important contribution to economic diversification and employment. Numerous studies have discussed that SMEs are financially more constrained than large firms in both developed and developing countries (Ayyagari et.al. 2007).

A crucial element in development of SMEs sector is access to finance particularly to bank

financing given relative importance of the banking sector in serving this segment.

Firm level data collected by World Bank show that access to finance is perceived as one of the main obstacles in doing the business. A number of studies shown that financing is a greater obstacle for SMEs than large firms, particularly in the developing countries, and that of large companies (Demirglic-Kunt and Maksimoric, 2005)

Ethiopia SMEs have little access to finance, which hinders their emergence and eventual growth. The main source of capital are their retained earnings and informal saving and loan association, which are unpredictable, not very secure and have little Scope for risk sharing because of their regional or sectorial focus. Access to finance is poor because of high risk of default, among SMEs, and due to inadequate financial facilities. Small business in Ethiopia can rarely meet the condition set by financial institutions, which see SMEs as a risk because of poor guarantees and high interest rate. The effect of higher interest rate on credit to reduce the expected future profits and their strength of SMEs on the business area, although service and inadequate access to credit, inadequate access of finance, absence of linkage, and absence of proper business plan due to knowledge, where among the major problem for SMEs and to attention their promotion and development to the challenge of SMEs and to alleviate the problem and promotion growth of SMEs (Negash and Kumera (2016).

## **1.2 Statement of Problem**

Small and medium enterprises have become an important contributor to Ethiopia economy. The sector contributes to the national objective of creating employment opportunity, training entrepreneur, generating income, and providing a source of livelihood for majority of the low-income households in the country, accounting for the material amount of GDP (Eshetu and Mamo, 2009).

There are numbers of constraining factor obstacle on the development of SMEs in Ethiopia, the basic and the one that seek attention is access to finance. And also, they are many problems which affects long term survival and business performance of small and medium enterprise due to lack of financial resources, weakness management experience, poor location and shortage of availability of raw materials. Yet astringent collateral requirements to get access credit from financial institution are the major problems for majority of SMEs. Improving the availability of

finance facilities to this sector is one the incentive that has been proposed for stimulating its growth and the realization of its potential contributions to the Ethiopia economy. But, the need of SMEs for finance becomes higher and complicated as compared to large firms. Despite this emphasis, the effect of existing institutional problem, especially the lending term and condition on access to credit facilities, have not been addressed yet in the country. In addition, there is no empirical study indicating the potential role of improved lending policies by the financial institution in alleviating problem of access to finance (GTZ, Access to finance in Ethiopia, 2006).

For instance, (Tsega, 2007) studied the challenges and prospect of women operated micro and small enterprise in Axum city, (Woldegebrel, 2012) studied the challenge and prospect of SMEs in case of Addis Ababa city. But don't conduct on the challenge faced by SMEs related with accessing finance from financial institution. Also, the study is limited to identify and analyze the challenge and constraint of SMEs which emerges from the policy and regulatory framework, source and access to finance, and lack of appropriate support services. Then the researcher would study at current data and on new place to fill this gap specifically in Wolkite town.

### **1.3 Research Questions**

In order to investigate or assess the problem associated with, accessing their finance, the researchers developed the following research question's

1. Does SMEs have challenge in accessing finance?
2. To what extent has this challenge affect their operation?
3. To what extent interest rate affect SMEs in accessing finance?

### **1.4 Objective of the study**

#### **1.4.1 General objective**

The overall purpose of this study is to assess the challenge faced by small and medium enterprise in accessing finance in the Case of Wolkite town.

#### **1.4.2 Specific objective**

Specifically, the study would focus

1. To investigate the challenge for SMEs in accessing finance.
2. To evaluate the extent that this challenge affects their operation.
3. To examine the effect of interest rate in accessing finance.

### **1.5 Significance of the study**

The researchers believed that the result of this research would have the following significance. Firstly, for SMEs help's in prompting their ability and potential for address their problems. Secondly, the government and other concerned bodies involved in the promotion of the development of SMEs may use the finding of this research as additional information to address uncovered problem. Thirdly, as SMEs are the largest contributions for the national economy development their growth in ability and potential is essential for the whole society. Lastly, it will be used as a reference for other researchers who are interested to conducted study on related problem.

### **1.6 Scope of the study**

The study would focus on the small and medium enterprise in Wolkite town and challenge faced in the process of accessing finance. The reason for focus on this title is the problem of many small and medium enterprises is accessing finance. Because of some constraint like budget and unable to cover many SMEs, the study would have limited in Wolkite town.

### **1.7 Limitation of the study**

One of the basic limitations that the researchers faced is the recklessness of SMEs managers in responding to the questions in the questionnaire, and time being are the main problems. The other limitation is respondent's perception about the research project they consider it as the researchers would have conducted for some other reason behind the main objective of the research.

### **1.8 Organization of the paper**

This research paper was organized in to five chapters. The first chapter deals about the introduction parts of the study which includes background of the study, statement of the problem, objective of the study (general and specific), significance of the study, and scope of study. The second chapter deals about review of literature (both theoretical and empirical). The third chapter

deals about research methodology which including research approach, research design, target population, sampling technique, sample size, source data and method of data collection, data analysis and presentation and ethical consideration. The fourth chapter deals with data analysis and interpretation. The last chapter deals about conclusion and recommendations.

## CHAPTER TWO

### 2. Review related literatures

The literature review describes object connected to the study of an assessment of challenge faced by the SMEs in accessing finance in the Case of Wolkite town, therefore it is a particular layout. First some definition and characteristics of the Ethiopia SMEs. This will be the ways for the discussion of their contribution to the economic development growth and also looked at literature on the barriers of accessing finance. Attention will be focus on the type of financing available to these SMEs without forgetting to also look at the source of credit finance for these SMEs and at last the empirical literature review is highlighted.

#### 2.1 Theoretical Definition

##### 2.1.1 Definition of SMEs

There is no universally accepted definition of SMEs because in each economic system every country has its own classification to their industrial regulations. The categorization of SMEs depends on quantitative judgment such as number of paid up employees, size of enterprise and amount of capital employed. In Britain and USA small and medium enterprise classified based on gross revenue and number of workers they employ. In Britain small scale business classified based on paid up employees don't exceed 200 and annual gross revenue of 2 million pound. Japan classified SMEs as manufacturing enterprise with total capital not exceeding 100 million yen with 300 employees. In the whole sale trade the classification capital not exceed 30 million yen and less than 100 employees. In retail and service trade SMEs classified based the total capital not exceeding 10 million yen and 50 employees. (Ekpenyong and Nynog, 1992, 94).

##### 2.1.2 Definition of Ethiopia SMEs

According to the Ethiopia ministry of trade and industry (MOTI) defined SMEs as follows micro enterprise, are small business with total capital investment not exceeding birr 20,000 and excluding this enterprise with high technical consultancy and other high technology establishment. Small enterprise; are business with a total investment between birr 20,000 up to birr 50,000 and don't include these enterprises with advance technology and high technical consultancy.

Therefore, MOTI classifies SMES in Ethiopia based on capital investment and on the basis of establishment. This is important because the sector accounts for large business throughout the country so that proper definition and classification is of the essence for policy makers in their dealing with SMEs.

### **2.1.3 SMEs contribution to economic development and growth**

The private sector is that engine of growth of the economy, there for they must be given the necessary tools to increase their growth (Aniyama -Ackah,2006) economic development is a process of economic transition involving the structural transformation of an economy through industrialization ,raising GNP and income per head .Economic growth on the other hand contribute to more goods and service by increasing investment, increase in labor forces, efficient use of inputs to expand output and growth will benefit from improvement in the living standard especially of the government can as sister and fiscal policies (Pass et.al.,1993).

### **2.1.4 Barriers of accessing finance**

Understanding only that actual use of financial service, not complete by itself but access across its different dimension is important to collecting indicators of and barriers to access and comparing them to usage and other country characteristics will enable researchers and policy makers close the gap. The quality and quantity of access is important. Barriers identified as main by (Haft metal, 2009) as Ethiopia SMEs access to finance are religion problem of forming group, high interest rate and the willingness to receive loan from financial institution (owners manager's are pessimist) are basic.

The other basic barrier is lack of documentation most developing country like Ethiopia to have a bank account .An individual is required to have at least three documents, identify cards/passport, wage slip, recommendation letter proof of domicile given high degree of information in these developing countries, only small degree of information in these developing countries, only small population can produce most of these document (Beek, Remirgu –Kunt and Martinez Peria, 2007).

In addition to the above-mentioned barriers affordability barriers one that need emphasize. The study indicates that in most developing countries 'the cost of giving checking account which is above to average precipitate. The lack of appropriate product and service for SMEs are in another important barrier to access financial service, as per the world banks report (2008).

### **2.2.5 Types of finance available to SMEs**

Boom et.al, 1983 and Longenecker et.al, 1994 like most writers on the subject of SMEs financing describe two basic types of financing namely debit and equity (Hizrich and Peters, 1995) and (Anderson Dunkelberg, 1993) debit as funds borrowed to be paid on at agreed time schedule. The payments of interests are supposed to be done regardless of whether the firms and whose return is primary based on the profit. This implies that if a firm fail to make a profit it's owner don't get return. Generally, equity funds as long-term funds but debit may be short to medium or long term, (His rich and Peter, 1995) mention another basic classification on a fund. Internal and external funds, internally generated funds come from a number of sources within a company and are more frequently employed. They include operational and investment are profit, sales of assets, extended payment term, reduction in working capital and account receivable another important source of internally generated funds expanding the collection of receivable accounts. They is release for the firms use source that are external to a firm include owner's friends and relatives, commercial banks, suppliers and distributors, government and non-government agencies. It is very important to carefully evaluate the reason for the choice of one form of funding against another or particular mix. A number of factors must consider and they include the following, purpose of fund, leverage and owners' equity and riskiness. The choice of the type of financing that is whether to use equity or debit depends on several factors and one such important factor is the intended purpose of the fund. Wert Henderson (1979) note that the suitability of fund obtained and project for which funds are obtained is very important? Long term funds as long-term debt may not be suitable for short term projects. This will burden the firm with the cost servicing an unnecessary debt. Similarly, short term debt is not appropriate for the financing long term projects since the loan may have to be repaid before the end of the projects. Wert and Henderson (1979) concluded that a more flexible short-term debt is more suitable for short term projects where as long term funds such as long-term debt or equity are more suitable for long term financing such as acquisition of equipment or the construction of a new plant.

Borrowing created financial leverage since payment of interest adds to financing costs. Thus, a percentage of increase in the earnings before interest and tax of interest and tax of the s firm. Consequently, the value of the owners' equity will appreciate.

Similarly, a percentage decrease in net earnings before interest and tax will lead to a greater percentage reduction in net earnings, and consequently. The depreciation of owners' equity therefore the use of debt results in higher earnings volatility and increase the risk to owners' equity. Equity capital does not result in financial leverage (Brealley and Myers, 1996), Wert, and Henderson, 1979).

A part from the increased risk to earning and owners' equity, debt financing poses another risk. When a firm has with to honors its debt obligation with difficulty or unable to honor the obligation at all, then it is said to be in the financial distress. The probability of the financial distress increases as the firm's debt to equity ratio increases, so to avoid financial distress a firm must guard against excessive financial distress in the future in to consideration in the revaluation of firms.

The attitude of suppliers toward a firm may change when a firm becomes financial distress. Also, valuable management time will be lost to the firm financial distress may result in bankruptcy. Filing for bankruptcy involves heavy legal fees, which comes from the remaining value of the firm's assets. So, costs of financial distress and bankruptcy must be considered carefully (Wert and Henderson, 1979).

### **2.1.6 The source of finance to SMEs**

As indicated by (Tracy, 2009) for SMEs source initial or additional capital needed to conduct business can be;

1. Family, friends and close business associations (FF&CBAs) have been one of the primary capital sources to launch new business concept since the Beginning of time and will most likely two continue to fill this rate in the future. This is the main source of finance in Ethiopia and any other developing countries (Geberhiwot and Wolday, 2006) the range of capital rising opinion from FF and CBAs stretches from the founder of a business taping their own credit worthiness or resources (saving, home equity or credit card) to mom or dad or a trusted business associated stepping up with the needed seed money to launch the company. Generally, this type of capital tends to be for lower dollar amount, geared towards equity as opposed to debit, and provides to closely hold and for family operated business.

2. As indicated by (Eracy, 2009) in the business world a large number of private sector capital

sources are available and included such as venture capitalists (VCs), investment bankers, or White knight and similar types of private investment groups. Private capital source come in a variety shapes, size and forms, but all tends to gravity toward a common set of criteria. The dollar size of the capital commitment is generally much larger and these groups trend to be more risk-based capital source and look for higher returns from equity driven transaction.

3. Debit capital source including banks leasing companies, government backed programs (micro finance in our country context), assets-based lenders are readily available in the market. this group similar to private source tend to look for a common set of characteristics when extending capital in the form of debit .Security of some sort of assets or personal guarantee for example must be presented and debit provides tend to look for more stable business environment where a company has been in business for an extended period of time and has provide track record. The general idea is to provide this capital to organization that will use it in the best interest of the general public ( Tracy,2009) in to day business world where customers credit own other types of credit being offered by banking sector in developed countries, it's amusing to see the small and medium enterprise ,change agent suffers from lack of access to finance in this country .As known an important roles of banks to provide relationships leading service that help resolve problems in providing external finance to in from nationally obscure ( Berger and Udell ,1994) however ,a number of factor may affect the banking system ability to provide credit to SMEs. It is important to clarify from outset that the researcher will focus ,here on the rest majority of SMEs firms whose access to external finance is institution handling the micro and small business sector ( Camilleric,2005).this are a firm with very high growth potential access the banks and other financial institution for early phase financing. Because this high risk firms generally require large injection of external funding relative to insider financing, have little in the way of tangible assets that may be pledged as a collateral, and are subject to significant moral hazard opportunities to change projects they are in suited for banks financing and thus tend to have low level of leverage (Barge and Udell, 20011).

## **2.2 Empirical review**

Woldegebreil (20012) studied the challenged and prospect of micro and small enterprise in case Addis Ababa city. The objective of the study is to identify the nature of small and medium enterprise to identify and analyze the specific relationship between the success of small and

medium enterprise and some selected factor, to identify the impact of selected constraint. The researchers used both primary and secondary source of data. Primary data is obtained from questionnaires and un structured interviews, and from secondary data is collected in written books or document. The researchers also will use stratified random sampling techniques from the study areas. On the base of the finding, the major problem facing micro and small enterprise in Addis Ababa are lack of business plan, lack of formal and informal association, and lack of favorable business environment, high cost and shortage of raw material, lack of proper institutional support, lack of proper marketing practice, poor financing and staff competition among micro and small enterprise in the same business line. The study recommended that enterprise should train by professional how to develop business plan, the culture of corporation and formal and association should be improved the work of successful enterprise. As examples enterprise must develop sufficient marketing skills and diversified their product, enterprise should form a supply chain management and support each other to minimize their raw material related problems. Tsega (2007), studied the challenge and prospect of women operated micro and small enterprise in Axum city. The objective of analysis whether women owned micro and small enterprise bringing and change through considering the socio-economic development, find up out the business startup and current constraint faced feature prospect to transform toward medium scale enterprise and based on the finding of the study, to reward the future possible ways. To undertake this research the researchers used both primary and secondary source of data. The finding reveal that the major challenges hinder human operated micro and small enterprise are the lack of work place, limited started capital (credit selling) and the business arrangement in that hinder wholesaler involvement in retailing activity which hinder enterprise to be vibrant and competitive. The study recommended that trade and industry seriously follow up the operator of micro and small enterprise, a fair competition and health market arrangement should be established, the micro finance institution should revisit its policy to easy the credit access and there should be provide credit without group formation if the customer has an equivalent asset for collateral. Responsible bodies should act to tackle the lack of attitudinal changes and knowledge or any motivational mechanism of officers by providing training and motivational mechanism.

### **2.3 Conclusion and Knowledge Gap**

To sum up this chapter covers the theoretical and empirical literature review. In the theoretical

literature review some concept related to the research problem presented and discussed. Those concepts are definition of small and medium enterprise by Ethiopia, future of small and medium business enterprise, types small business, challenges and prospect of small and medium enterprise some of the previous studies related to the research problem are presented under the empirical literature review. How to relate and conduct the gap between the previous researcher study and finding are presented under this topic. Generally, most the previous study related to the research or focused on the employment and income generation of small and medium enterprise, do not conducted on the challenges and prospect of small and medium enterprise. Because of this the researcher are motivated to fill this gap and in this problem in the best way.

## **2.4 Conceptual framework**

The research addressed various types of SME constraints such as inadequate access to finance lack of collateral, institutional quality, access to productive resources, access to training, competition, marketing and management related factors. Thus, the theoretical consideration on the link between SME constraints and the growth potential or performance of SMEs can be viewed from different angles. Business constraints may, on the one hand, limit physical capital accumulation.

## **CHAPTER THREE**

### **3. Research Methodology**

This chapter is aimed at describing and explaining the method that were used in collecting and analyzing data. It comprises research approach which includes quantitative and qualitative research approach, research design, sample design, target population, sampling techniques; source of data and instrument used data analysis and presentation.

#### **3.1 Research approach**

The researchers used both quantitative and qualitative research approach. Quantitative research approach is to describe variable, to examine relationship among variables and to determine the cause and effect of different issues. Qualitative research approach is concerned with subjective of attitudes, opinions and behavior. It involves the generation of data in qualitative form which cannot subject to rigorous quantitative analysis (Kothari, 2004).

#### **3.2 Research design**

The study was conducted on assessment of challenge faced by SMES in accessing finance in Wolkite town. In order to achieve this study, the researchers would use descriptive type of research design. Because the major purpose of descriptive research design to describe the state of affairs as it exists at present (Kothari, 2004).

#### **3.3 Sample design**

Sample design is referring to the techniques used to select sample unit for measurement. It also a framework, or road map that serves as the basis for selection of survey sample and affect many other important aspects of a survey as well. (Leather, T. 2006).

##### **3.3 .1 Target population**

Target population is a population from which the sample will draw. Population can be defined as the total collection of individuals whom researchers seek to make inference on (Cooper& Schindler, 2014). Thus, the target population for this study is 244 Small and Medium Enterprises in the manufacturing, service, construction and trading sectors operating in Wolkite town.

##### **3.3.2 Sampling Techniques**

The researcher is used stratified random sampling techniques. Which is this stratified random

sampling being the process of dividing a set of sampling unit in to one or more subgroups. (Rosen, B.1997). The total population of the study areas is heterogeneous and it was stratified in to group and four sector of the enterprise such as construction, manufacturing, service, and trade.

### 3.4 Sample Size

From the total population of 244, the researchers select 71, enterprise by using 10% error term. According to the Yamane (1967) provide formula to calculate the sample size.

$$n = \frac{N}{1 + N(e)^2} \quad n = \frac{244}{1 + 244(0.1)^2} = 71$$

Where n=sample size

N=population

e =error term the formal,  $f = \frac{n(N)}{N}$ , where f=sample frame

N =total population

n =sample size

The total population of each stratum is construction (f1)68, manufacturing (f2)50, service (f3) 56, trade (f4)70. The sample size is 71 small and medium enterprises taken as.

$$F1 = \frac{71(68)}{244} = 20$$

$$F2 = \frac{71(50)}{244} = 15$$

$$F3 = \frac{71(56)}{244} = 16$$

$$F4 = \frac{71(70)}{244} = 20$$

### 3.5 Source and method of data collection

In order to conduct this research, the researcher use both primary and secondary data, from the primary data collection method the researchers would use questionnaires, and from the secondary data are the researchers use from published and unpublished sources, books and other written documents.

### 3.6 Data analysis and interpretation

After the data collection process is accomplished, next the data was arranged so as to make the

analysis and interpretation easy. The data is processed on the activity which involves editing, presenting and classifying the data through table and computation of percentage. To analyze and process the collected data, the researchers are using descriptive data analysis. The reason for the use of descriptive data analysis is present the data in the tables. Here tabulation, percentage and description were used to make the analysis and interpretation.

### **3.7 Ethical consideration**

Research is a public trust that must be ethically conducted, trustworthy, and socially responsible if the results are to be valuable (University of Minnesota, 2003: 6). Accordingly, before gathering information from the respondents, the aims and the objectives of the study were explained to respondents, and full consent of the informants was obtained. In relation to this, Creswell (2012: 149) states that “the researcher develops an informed consent form for the applicant to sign before they engage in the research.” It is also explained from the outset that the information collected was only used for academic purposes. They were also allowed to withdraw at any stage when they feel uncomfortable with the issue. Interview participants were also involved based on their full consent by filling protocol for their willingness to be asked and recorded during the interview. Their full right to self-determination and to withdraw at any stage of the interview was also respected. Moreover, private issues, which were unethical and culturally considered taboo, were avoided from the questionnaires.

## CHAPTER FOUR

### 4. Data Analysis and Interpretation

This study focuses on challenge faced by SMEs in Wolkite town. This part of study deal with analysis and interpretation of questionnaire distributed to the SMEs of Wolkite town. The result and discussion are presented below under appropriate heading. The researcher distributed a 71 questionnaires and 60 were filled and returned giving a response rate of 84.5%.

#### 4.1 Demographic profile

The background information of business respondents includes about sex, age and level of education of the respondents that was used in appropriately known the respondent's characteristics before going to the basic part of the study.

Table 4.1 sex, age and educational background of the respondents

| Sex    | Number of respondents | Percentage |
|--------|-----------------------|------------|
| Male   | 36                    | 60%        |
| Female | 24                    | 40%        |
| Total  | 60                    | 100%       |

| Range | Number of respondents | Percentage |
|-------|-----------------------|------------|
| 18_30 | 26                    | 43.33%     |
| 31_41 | 15                    | 25%        |

|          |    |        |
|----------|----|--------|
| 41_50    | 12 | 20%    |
| 51_60    | 7  | 11.67% |
| Above 60 | 0  | 0      |
| Total    | 60 | 100%   |

| Educational background | Number of respondents | Percentage |
|------------------------|-----------------------|------------|
| Elementary school      | 20                    | 33.33%     |
| Secondary school       | 30                    | 50%        |
| Diploma                | 8                     | 13.33%     |
| Degree and above       | 2                     | 3.33%      |
| Total                  | 60                    | 100%       |

Source: survey 2015, E.C

From the above table of 60 respondents 36 or 60% were male, 24 or 40% were female. Therefore, from this the researchers understand most of SMEs managed and run both male and female at almost the same proportion, however their slightly more men than women, which would be attributed to the fact that most men run business, and also fact that most the business were inherited by men from the older generation most probably from their parents. Although 26 or 43.33%% among the 60 respondents are age between 18 up 30, 15 or 25% are age between 31 up 40, 12 or 20% were age between 41 up to 50, 7 or 11.67% were age Between 51 up to 60 and 0 or 0% were age above 60 from this most of the respondents are found between at active or working age, from this the researchers understand that more of the respondents were found at active age groups, therefore at active or working age group must participants on SMEs, so access to finance is very essential for creating a good business activities. Also, the number of respondents 20 or 33.33% were elementary school, 30 or 50% are secondary school, 8 or 13.33% were diploma and for 2 or 3.33% degree and above. This implies that most of participants on SMEs are work on the educational level of secondary school. Therefore the researchers

understand from this more of the environment in which they operates and decision making process.

## 4.2 Nature of business

Table 4.2 Nature of business of the respondents

| Types of business | Number of respondents | Percentage |
|-------------------|-----------------------|------------|
| Small             | 46                    | 76.67%     |
| Medium            | 14                    | 23.33%     |
| Total             | 60                    | 100%       |

Source: own survey, 2015 E.C

From the above table above 46 or 76.67% were small business, 14 or 23.33% were medium enterprise. This indicated that more of the respondents covered on high number of small enterprises, therefore from this the researchers understand most of them small enterprise they need finance in order to become expand their business activities.

## 4.3 Types of business organization

The types of business clearly defined based on its legal registration status in that there is sole proprietorship where the owner operator and has registered the business as sole owner, partnership where they own business jointly may with friend and limited company that have several owners each having a certain percentage of ownership,( Author, 2011). Therefore this types of business organization supported by the following table 4.3

Table 4.3 Frequency distribution of form of participants

| Ownership form          | Frequency | Percentage |
|-------------------------|-----------|------------|
| Private limited company | 0         | 0          |
| Public limited company  | 0         | 0          |

|                     |    |        |
|---------------------|----|--------|
| Partnership         | 26 | 43.33% |
| Sole proprietorship | 30 | 50%    |
| Family owned        | 4  | 6.67%  |
| Total               | 60 | 100%   |

Source: from research questionnaires, 2015 E.C

As can be seen from table 4.3 the bulk of the respondents of SMEs are registered in sole proprietorship. They accounted for 30 out of 60 respondents representing 50%. None of the respondents were public limited company, with 43.33% being partnership. The remaining 6.67% of the respondents were family owned business. This indicates that most of partnership less participants than sole proprietorship. As we know most of the partnership company does not have enough financial strength and they have small equity base they seek access to finance from financial institution. Therefore from this explanation most of the partnerships need to encourage their motivation on the business organization by supporting finance from any financial institution.

#### 4.4 Nature of business

Table 4.4 frequency distribution of the nature or kinds of participants of SMEs

| Nature of business | Frequency | Percentage |
|--------------------|-----------|------------|
| Manufacturing      | 10        | 16.67%     |
| Construction       | 13        | 21.67%     |
| Service            | 20        | 33.33%     |
| Trade              | 17        | 28.33%     |
| Total              | 60        | 100%       |

Source: questionnaires, 2015 E.C

Hence, the responses received were fairly spread across a wide range of the town economy with the most concentration centered on service and trade. These sectors accounted the total responses

respectively as can be seen from table 4.4, the manufacturing sector accounted for 10 representing 16.67%, and construction 13 representing 21.67%. Therefore, from this implication the majority of SMEs participating on service and trade business enterprise. So, on this explanation the researchers understand on SMEs in Wolkite town to cover the higher percentage on 33.33% and 28.33% respectively on service and trade business enterprise.

#### 4.5 Monthly sales turnover

Table 4.5 frequency distribution of average monthly turnover of respondents of SMEs

| Amount (birr)      | Frequency | Percentage |
|--------------------|-----------|------------|
| Less than Br 15000 | 18        | 30%        |
| Br 15000 _Br 25000 | 26        | 43.33%     |
| Br 25000 _Br 35000 | 11        | 18.33%     |
| Above 35000        | 5         | 8.33%      |
| Total              | 60        | 100%       |

Source: questionnaires, 2015 E.C

From the table 4.5 above, which represent the average monthly turnover for 60 respondents 26 of recorded an average turnover of Br 15000\_25000, this gave as interim of percentage 43.33% of the total responses which happen to be SMEs from service, trade and manufacturing of the economy. A turnover of less than birr 15000, is 30%, 18.33% fell within birr 25000\_35000 and just 8.33% of 5 respondents recorded a monthly turnover of above birr 35000. From this the researchers understand on further more it was observed that the one is large turn over are the one which have large accessing to financial credit, as they keep building assets and income flow in turn make the goodwill for accessing credit facility, and expand their business volume and operation at Wolkite town.

#### 4.6 Small and medium enterprise constraint

SMES known all over the world are faced with lots challenge in their operation and this was not deferent from the responses received from our target respondents. SMEs operators who took part

in the study were however asked to the rank for the major constraints they faced in operating and growing their business. Lack or inadequate accesses to finance were considered to be the constraints as its recorded 71.67%. This means that among all the problems faced by SMEs in their operating ranging from competition, high utility tariff, infrastructure among other the participants of SMEs saw the lack of credit facility as the major constraints.

Table 4.6 major constraints to the growth of SMEs

| Constraints              | Frequency | Percentage |
|--------------------------|-----------|------------|
| Lack of finance          | 43        | 71.67%     |
| Tax                      | 7         | 11.67%     |
| Competition              | 3         | 5%         |
| High tariff on utilities | 3         | 5%         |
| Infrastructure           | 4         | 6.66%      |
| Total                    | 60        | 100%       |

Source: questionnaire, 2015 E.C

The above table shows participants ranking of the major constraints facing the growth of their business in order on importance, 43 or 71.67% of the participants ranked lack of finance as the major constraints to the growth of their business followed by taxes which recorded 11.67% and infrastructure ranked as the 3rd major constraints to the growth of SMEs with just 6.66%. This show that as the major constraints for the growth of SMEs in Wolkite town is the lack of finance. From this the researchers understand among the entire problem faced by SMEs in the operation, the participants in this study viewed lack of credit facility as the major factor. In the table 4.6 shows that various challenges faced by SMEs in Wolkite town. Therefore SMEs don't fear high tax rate, but lack of finance for capital building for running business enterprise.

#### **4.7 Factor contributing to SMEs constraints**

The inability of SMEs in Wolkite town to readily have access to finance from financial institution can be attributed to a lot of factors, perceived risk nature of these SMEs, small portfolio of this business and the high transaction cost that banks go through in performing credit

appraisal on them before granting credit to these SMEs.

Table 4.7 total number of participant SMEs granted or denied access credit

| Credit status  | Frequency | Percentage |
|----------------|-----------|------------|
| Granted credit | 16        | 26.67%     |
| Denied credit  | 44        | 73.33%     |
| Total          | 60        | 100%       |

Source: questionnaire, 2015 E.C

The above table shows a number of participant SMEs who in way other has been granted or denied access to credit from financial institution from the table above, 73.33% of the total respondents say they have been denied access to credit, while 26.67% of them responded have been access to credit. As we seen from the data collected there is a minimum or limited access of finance from the credit institutions and a minimum enterprise are beneficial from the credit access. From this the researchers understand more of the higher percentage covered on denied access to credit from the financial institution.

#### 4.8 Constraints of access to finance

Table 4.8 frequency distribution of factor that hinder participants SMEs access to credit

| Factor                        | Frequency | Percentage |
|-------------------------------|-----------|------------|
| Default on previous loan      | 4         | 6.67%      |
| No security or collateral     | 35        | 58.33%     |
| Small equity base             | 12        | 20%        |
| Lack of experience management | 6         | 10%        |

|       |    |      |
|-------|----|------|
| Other | 3  | 5%   |
| Total | 60 | 100% |

Source: questionnaire, 2015E.C

The result collected from the survey in table 4.8 shows the frequencies of factor hindering SMEs in securing loan for their business. 58.33% representing of 35 respondents of the 60 ranked lack of collateral as the major factor preventing them from accessing loan from the financial institution. 12 or 20% ranked small equity base as factor affecting their access to credit, lack of experience management was the opinion of 6 or 10% of the respondents with 5% thinking other factor such as the inability to provide audited financial statement are preventing them accessing credit with 6.67% related with default on previous loan. From this the researchers understand more of the SMEs have been a major problem on the collateral requirements from the financial institution and does not supported by finance due to accessing credit. Again from the collateral issues and other factor as indicated above which make it very difficult for SMEs to access the maximum amount needed for various expansion projects, the interest rate charged on the loan facility on various banks are very high and also unattractive for most SMEs to access the credit. Almost all the respondents expressed an opinion the level of the interest rate charged by financial institution on facilities received, to be extremely high while other also say the rate are just.

#### 4.9 Level of interest rate on loan

Table 4.9 Frequency distribution of the level of interest rate on loan

| Measure        | Frequency | Percentage |
|----------------|-----------|------------|
| Extremely high | 41        | 68.33%     |
| High           | 16        | 26.67%     |
| Acceptable     | 3         | 5%         |
| Low            | 0         | 0          |

|       |    |      |
|-------|----|------|
| Total | 60 | 100% |
|-------|----|------|

Source: questionnaire, 2015E.C

The above table shows the opinion of respondent on the level of interest rate charged on loan from the bank and non-bank financial institution. 41 out of the 60 respondents received from participant saw the interest rate on loan to be extremely high. This represent 68.33% of the total respondents 16 or 26.67% of the total respondents think the rate are high with just 5% saying the rate are manageable.

One significant thing is that among the respondents, none say the interest rate charged by the financial institution to be low. The extremely high interest rate group numbering about 41 out of the total respondents of 60 pay interest rate between 8%-10% per annum. 26.67% of the respondents which indicated that the rate charged by the financial institution are high, also pay interest rate of 5%-8% per annum, with just 5% which will term fortunate one's servicing their loan at an interest of less than 5% per annum. This makes their business unprofitable as the profit made are eroded by huge finance cost. This high interest rate demanded from SMEs sector from the bank is due to high risk nature of this sector, resulting from the high default rate associated with SMEs financing.

Boom et al, 1983 like most other writer on the subject of SMEs financing described two basic types of financing namely debt and equity. Which further classified by His rich and Peter, 1995 also in two sources internal and external. Since finance is the major constraints to the SMEs development and growth various source ought to be explored by these SMEs to run their business. It came the fore through the survey that most of these SMEs depend on mostly external source such as the bank non-bank financial institution, families and friends and personal saving; the only internal source as alternative source of financing for SMEs. Therefore this implication also supported by the major source of finance in the following tables 4.10.

#### 4.10 SMEs major source of finance

Table 4.10 frequency distribution of SMEs major source of financing

| Source of finance | Frequency | Percentage |
|-------------------|-----------|------------|
| Bank loan         | 14        | 23.33%     |

|                                |    |       |
|--------------------------------|----|-------|
| Personal saving                | 3  | 5%    |
| Retained profit                | 4  | 6.67% |
| Families or friends            | 9  | 15%   |
| Non-bank financial institution | 30 | 50%   |
| Other                          | 0  | 0     |
| Total                          | 60 | 100%  |

Source: questionnaire, 2015, E.C

Among the various source in above table 30 out of the total respondents ranked their major source of funding from the non-bank financial institution followed by 23.33% getting their finance from the bank loan, the third source of funding for SMEs operation are from families and friends with 15% and the forth being retained profit with 6.67% personal saving was ranked the fifth.

This goes to show that the SMEs operating in Wolkite town are skewed more towards the external source funding, which is not also easy to access by inhabiting their growth. From the above the only internal source of funding is just from their personal saving none of the other internally generated option of funding are being exploited. This internal source operation and investment profit, sales of assets, extended payment terms, reduction in working capital and proper management of account receivable, which are less expensive and also reliable.

The kind of banks operating in the country have limited interest in the funding the SMEs sector, most especially those seek fund as a startup capital for the business because of the risk associated with the new business where it is known that 8 of 10 new business fail with in the first three years (Mason, M.K, 2011,).The limited interest of the banks to finance startup business is also supported by the data in table 4.11

#### 4.11 Funds for startup capital

Table 4.11 frequency distribution of source of funds for startup capital business

| Source | Frequency | Percentage |
|--------|-----------|------------|
|--------|-----------|------------|

|                       |    |        |
|-----------------------|----|--------|
| Personal saving       | 22 | 36.67% |
| Bank credit           | 7  | 11.67% |
| Friends and relatives | 28 | 46.67% |
| Other                 | 3  | 5%     |
| Total                 | 60 | 100%   |

Source: questionnaire, 2015E.C

The above table shows the distribution of SMEs source of funding in establishing their business. It is clear from the table that 46.67% of the fund is granted from friends and relatives, 36.67% granted from personal saving with 11.67% of SMEs startups getting their finance from the banks. The remaining 5% get their fund from other source. There for the researchers understand from this more of the source of funds for startup business on SMEs in Wolkite town is in personal saving and friends. This makes it extremely difficult for the SMEs sector to pursue growth there by hindering their growth just to stay afloat. In spite of this challenges there is a strong desire among this SMEs to pursue the agenda of growth when the question was as to whether or not they would like to expand their business to other with in the cities should their financing needs be met. 58.1% of the respondents showed interest in that direction as indicated in the table 4.12 below.

#### 4.12 Establishing branches

Table 4.12 frequency distribution of participants SMEs establishing more branches in the cities of Wolkite town

| Ranking        | Frequency | Percentage |
|----------------|-----------|------------|
| Strongly agree | 35        | 58.33%     |

|                   |    |       |
|-------------------|----|-------|
| Agree             | 21 | 35%   |
| Not sure          | 4  | 6.67% |
| Disagree          | 0  | 0     |
| Strongly disagree | 0  | 0     |
| Total             | 60 | 100%  |

Source: questionnaire, 2015 E.C

The above table shows that the distribution on the question relating to SMEs expanding their business to other branches of the cities. 58.33% of the respondents agreed with the statement meaning that all things been equal all they would like to grow their business. 21 or 35% of the same respondents also agreed to the statement, with just 6.67% not sure as to whether they will expand or not. One critical point is that none of the respondents disagree with the statement of whether SMEs would like to establish more branches in the town.

This seems to a dream for them as the funding to undertake such an expansion project is difficult to access, because of the stringent criteria of the banks. The only sure way of getting such an amount to embark on these expansions is mainly through the formal financial institution or banks, which most of the SMEs are not qualified. This leaves the banks the only viable source and even then, because of the duration given in repayment of loan, which is mostly up to 2 years (see table 4.13), such facility will not be appropriate for investing in to business expansion.

**4.13 Frequency distribution of loan recovery period**

Table 4.13 f requency distribution of loan recovery period

| Factor       | Frequency | Percentage |
|--------------|-----------|------------|
| Up to 1 year | 42        | 70%        |
| Up to 2 year | 18        | 30%        |
| Up to 3 year | 0         | 0          |
| Above 3 year | 0         | 0          |
| Total        | 62        | 100%       |

Source: questionnaire, 2015 E.C

This show the frequency distribution of loan repayment duration by the respondents usually received from the financial institution by which time they should have repaid the loan amount.

From the above record, 70% are given a repayment period of up to one year, while 30% or 18 of the total respondents of the 60 indicated a repayment period of up to 2 year. The finding enumerated above corroborate the opinion about the difficult that SMEs in Wolkite town faced when it comes to accessing credit (bank loan) to run their business. There for the researchers understand from this more of SMEs operates their account mainly due to insecurity associated with holding and transacting in cash as well as the fact that the bank have been enticed and enticing SMEs to open and operate account after realizing that they form large part of the country economy.

## **CHAPTER FIVE**

### **5. Conclusion and Recommendation**

This chapter is the last chapter of the research, which include conclusion of the study and recommendations to the different responsible bodies, take remedial measure in solving major problems obtained through the finding. In this chapter researchers tried to draw conclusion about the finding of the study. This part of the research is the most important to the organization (SMEs). The researchers also tried to provide potential recommendation which is valuable to the organization in the ongoing operations.

#### **5.1 Conclusion**

The theme of this study which is the challenge faced by SMEs in accessing finance in wolkite town sort to highlight difficulty faced by this SMEs in accessing credit from the financial institution to operate and grow their business.

Based on received from the questionnaire circulated, it become evident that SMEs in wolkite town are faced with major challenge in accessing credit. These challenges were revealed by the study to include, the inability of SMEs to provide collateral and other information needed by the bank such as audited financial statement, couples with the high cost of loan in terms of high interest rate make it extremely difficult to access bank loan. Because of these constraints which relates to access to bank SMEs in Wolkite town are not mobilize cash as quickly enough to grow and expand in a way that them are supposed to. They still remain small without expand their business to the other parts of the town, even though SMEs have expressed the desire to do so when they have the financial assistance required.

#### **5.2 Recommendation**

It is absolutely fundamental that there is insufficient access to finance for SMEs. Affordable and appropriate finance enable business to operate efficient and grow. It facilities business startup ensure that business able to finance potentially viable investment, enabling them to expand operation to meet demand, provide funds for business to innovative, generating new technology

and more productive way of operation, allocate resources in the economy to their most productive use, use funds business growth and creating employment and wealth.

The challenges that make the SMEs for not accessing finance or factors called as major problems for accessing finance are mostly lack of collateral and high interest rate asked from the financial institution, so the researchers tried to provide potential recommendation which is valuable to the SMEs and also for the other stake holders who have connection with it.

The researchers recommended that the National bank should endorse policy measures designed at moderating collateral requirements, recognized from collected data, current banking practice on collateral appear to be excessive and should alleviate the National bank of Ethiopia through issuance of clarifying directives.

With regarded to interest rate we recommend the National bank of Ethiopia to set the interest rate amount as minimum as possible and make it accessible to the SMEs and to avoid excessive interest rate, from the side of SMEs we recommended that to seek another financial institution like Micro finance, to access credit at the lowest interest rate than accessing credit from formal financial institution on the period of high interest rate, and they should have to prepare a proper financial statement because it simplifies the requirement set by the bank in order to access finance and it also speed up the credit accessing process.

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## Appendix

Wolkite University

College of business and economics

Department of accounting and finance

**Dear respondent**

I would like to thank in advance for your kind cooperation in responding this questionnaire which is designed to collect data that will be conducted associated problems challenges faced by small and medium enterprise (SMES) in accessing finance in wolkite town for partial fulfilment of BA degree in accounting and finance at wolkite university.

The information that will give will be kept confidential and will be used only for academic purpose.

Instructions

Please mark

In the box of your answer

General characteristics of respondents

Part A. Demographic question

1. What is your sex? Male  Female

2. In which age group are you?

Under 18-30  31-40  41-50  51-60  above 60

3. What is your level of education? Does not read and write  read and write  elementary school  secondary school  college diploma  first degree and above

4. Size of your business? Small  Medium

5. Nature of organization

Private limited company

Partnership

Public limited company

Sole proprietorship

Family owned business

Other -----

6. Kinds of organization

I. Manufacturing

III. trade

II. Service

IV. Other

7. What is the average monthly turnover of your business

Less than 15000

III. Birr 25,000-35,000

II. Birr 15,000-25,000

IV. Above

The following questions related the financing issues of your company. The difficulty in accessing credit, options your company is resulting to and future of your business

8. Have you ever denied or refused credit from bank?

Yes

No

9. What was the main reason your bankers refused offering you're your loan?

Default and previous loan

lack of experience management

No security to pledge

too small equity base

Other -----

10. What was the purpose of the loan?

Startup capital

working capital

Expansion of business  other

11. What was the maturity period of the loan?

Up to 1 year  up to 3 year

Up to 2 year  other

12. How did find the lending rate?

Extremely high  acceptable

High  low

13. What percentage of interest is on the loan?

Less than 5%  8%-10%

5%-8%  above 10

14. How did you financed the startup of the business?

Personal saving  friends and relationship

Bank credit  other

15. What is your source of finance for the business?

Bank loan  retained profit

Personal saving  private intuition

Trade credit  family or friend

16. In your opinion what are the major constraint to the growth of your company

Lack of finance  high interest on bank loan

Computation  taxes

Part 3. agree or disagree to the following statement

17. would like to employ more hands in the future

Strong agrees  Not sure.  Agree

Disagree.      Strong disagrees.

18. Would like to establish more branches in another town of the country.

Strong agrees.  Not sure.  Agree.  Disagree.