

**THE ROLE OF FINANCIAL INSTITUTION IN DEVELOPMENT OF SMALL AND  
MEDIUM ENTERPRISES (THE CASE STUDY CHAHA WOREDA)**

**A SENIOR RESEARCH PAPER SUBMITTED TO DEPARTMENT OF ACCOUNTING AND FINANCE  
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## List of Abbreviation and Acronyms

**SME** -Small and Medium Enterprises.

**FI**-Financial Institution.

**CSI**- Credit and Saving Institution.

**FDRE**-Federal Democratic Republic of Ethiopia.

**ERCA**-Ethiopia Revenue and Customers Authority.

**ECA** - Economic Commission of Africa.

**MOTI**- Ministry of Trade and Industry

**CSI**- Credit and saving institution

## **Abstract**

*This study deals about the role of financial institutions contribution to the development*

*of small and medium enterprise in cheha woreda. It tries to examine two separate but interrelated issues. On the one hand, it seeks to show the place of small and medium enterprise in financial institutions over all objectives. On other hand it be tried to identify the major constraints of the development of SMEs in cheha. Some question that the researcher address includes, what role financial institution to help SMEs? Are financial institutions services accessible and affordable for the SMEs? And how do financial institutions address the problems that SMEs face in to the process of accessing and settling loan? The study make use of descriptive statics, qualitative research methodology and would be come up with five major findings the first is lack of access to financial services is the major factor that negatively affects the development of SMES in cheha woreda. The second finding is most small and medium enterprises has achieve some level of development thirdly, it found out those financial institution contribute almost some for the development. The fourth one is major factor that affect SMEs assess collateral inadequacy follow by bureaucratic problem. The last major finding is that SMEs usually use their own saving to finance their business activities. The over all, conclusion the study have further support from financial institution is critical for SMEs found in cheha woreda so that it can expand economic development.*

# CHAPTER ONE

## 1. INTRODUCTION

### 1.1. BACK GROUND OF STUDY

Definition of SMEs some of the commonly used criteria are the number of employees, value of asset, value of sale and size of capital or turn over. However the most common basis of The term SMEs covers wide range of definitions and measures, varying from country to country and between the sources reporting SMEs statistics. Although there is no universally agreed defining SMEs is number of employees (Nugent, 2001).

Small and medium enterprise (SMEs) and financial institutions are vital contributors to the overall performance of an economy. SMEs play a crucial role in developing the economy and in creating employment. They not only provide opportunity for employment and income to large number of people, but also are the forefront of the technological innovations and export. They provide facilitate trading, encourage mobilization of resources through savings and allocate resources to activities with highest returns, monitor investments and exert corporate government and spreads risk by offering adversity of financial instruments. Furthermore, they provide financial assistance to fulfill the varied needs of enterprises.

financial institution consider by Ethiopia government as tool when help the poor to improve their quality of life and expanding opportunity for enhancing income at previous of loan access to active clients. Ethiopia government was committed to promote the delivery of finance institution service to medium and small enterprise (Woldayamh 2001). Whatever the definition and regardless of the size of the economy, development of SMEs is becoming increasingly crucial to economic development. The issue of SMEs development give the development need for employment creation and poverty alleviation (Nugent 2001).

Nugent (2001) further note that there is also an urgent need to create a strong

competitive SMEs sector that is able to play a leading role in the development process.

The issue of SME development ranks high among the priorities of socio-economic development, given the developing need for employment creation and poverty reduction. There is also an urgent need to create a strong competitive SME sector that is able to play a leading role in the development process as this is the case everywhere even in the developed world including the USA (Beyene, 2002)

## 1.2. Statements of problems

Obviously, SMEs constitute the backbone of an economy. The SMEs sector plays a vital role in the development of the country. World Bank (1994) indicates that industrial development was earlier believed to have occurred because of large enterprises. However, starting in the late 1970s and early 1980s, SMEs have become perceived as the key agent for industrialization. It is recognized that this sector provides not only employment opportunities to an increasing number of people in the country, but it is also an effective means of fighting poverty and income inequality. At the same time SMEs serve as a training ground for emerging entrepreneurs. It is within this context that SME development has become focal attention for governmental as well as nongovernmental organizations. This requires bringing the specific needs of the enterprise to the center of the policy-making process and recognizing that SMEs are to be assisted not because they are small, but because of their capability to be efficient, innovative and able to compete in the local and national markets (Carter, Jones, Evans 2001)

However, as noted in the majority of developing countries, most SME activities are undertaken in the informal sector even though they play a major role in economic development. The purpose of this idea is to express, before entering the area of formally established financial institutions, the main source of credit in urban and rural areas is accessed informally through relatives and many lenders. Informal institutions remain an important source of credit for rural and urban economic communities. So creation of financial institutions will be established by proclamation 40/1996 issued by the Ethiopia government in 1996 to solve the problems faced in informal institutions (Tageng and Mulul 2005).

They use their own saving reinvestment of profits and own labor as the main source for their development. Despite this their sustainable development will largely depend on the capacity of financial institution to mobilize resources form low value to high value and invest in SMEs activities.

Since SMEs sector does have a very significant role in Ethiopia economy, the government was striving to create competitive and productive SMEs sector. In order to support market concern bodies should link medium with large firms to serve as a market out lets, provide train on quality improvement and cost reduction modalities provide update information on market opportunities

## **Research Question**

The researcher tries to address the following questions

- What is role financial institution in the development of SMEs in cheha woreda?
- Are the financial institutions services and product such as very small loan, saving and money transfer to assist the poor are accessible and affordable for the SMEs?
- How financial institutions address the problems that SMEs face in the process of accessing and setting loans?

### **1.3 Research objectives**

The study has the following general and specific objectives

#### **1.3.1 General objectives**

The general objective of study was to analyze the role of financial institution in development of small and Medium Enterprise in cheha woreda.

#### **1.3.2. Specific objectives**

- To assess the role of financial institution help for small and medium enterprise development in cheha woreda.
- To identify the financial institution product and service such as small loan, saving and money transfer to assist poor are accessible to SMEs or not.

- To analysis how financial institution solve problems those SMEs face in the process of accessing and setting loans.

#### **1.4 Scope of the study**

This study will be limited to assess the role of financial institution development of small and medium enterprises (SMEs) in cheha woreda.

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

There appeared to be a number of attempted to investigate the role of financial institutions in the promotion of SMEs in Ethiopia. Therefore, this study is the initially to provide a comprehensive approach to the understanding of role of financial intuitions and its intend to fill the gap in this area.

Generally, this study contributes to the knowledge in many important areas of financial institution and SMEs studies. Firstly, it advances to a better understanding of functions and roles of finance institutions secondly, it increases the understanding of SMEs and third, it will give the way forward for the government policy makers financial institution and to the general public at large to understand the different roles of financial institution in the enterprises development process.

#### **1.6 Limitation of study**

The limitation of this study was lack of sufficient of finance and the time to allow for data collection was not sufficient.

#### **1.7 Organization of the study**

The study is organize in to five chapters first chapter gives, back ground of the study, statement of problem, study of objectives ,limitation of study, significance of study and scope of study. Chapter two reviews literature on factors which affect the development of SMEs with particular focus on financial institution. Chapter three specifies the analytical frame work and methodology of the study. Chapter four reports results from the descriptive analysis. Finally, the last chapter presents conclusion and recommendation.

## **CHAPTER TWO**

### **2. LITERATURE S REVIEW**

This chapter reviews the theoretical and empirical literature on the role of financial institution in the development of SMEs. This review of the literature establishes the frame work for the current study. Which in turn, help in clearly identifying the gap in the literature and formulating research question for the study.

#### **2.1 Theoretical studies**

This section briefly sketches of financial institutions, which have proven Effective in providing services to SMEs. The section opens with an overview of financial institutions. This shows the various products and services that finance institutions have and explain the theoretical role of financial institution to the development of firms. These give an idea on how financial institutions contribute to the development of SMEs. Finally, the concern is to show the nature, importance, measures of development and constraints of SMEs.(Karata2007)

##### **2.1.1 Overview of financial Institutions**

A financial institution is an institution that provides financial services for its clients or

society. Most financial institutions are regulated by the government.

Financial institutions are the ones that supply the investment needed to achieve sustainable development. As innovators they developed new financial products to encourage sustainable development. They also perform activities such as pricing risks and estimating returns, for companies, projects and others. Furthermore, as powerful stakeholders and lenders they can exercise considerable influence over the management of companies including SMEs (Ageba & Wolday, 2006).

### 2.1.2 Role of financial Institutions

Although the formal financial institutions have taken various measures to strengthen their operation and expand their services, they could not address the financial needs of medium and small enterprises satisfactorily. It is thus necessary to design special instruments and mechanisms to meet the financial requests and promote the development of MSEs (FDR, 1997). Financial institution as a development tool provides financial services and products such as loans, savings, leasing, insurance and money transfer to assist the poor in expanding or establishing their businesses. It is mostly used in developing economies where firms do not have access to other sources of financial assistance. In addition to financial intermediation, financial institutions provide social intermediation services such as the formation of groups, development of self-confidence and the training of members in that group on financial literacy and management (FDR, 1997).

Enterprise development services or non-financial services that assist medium entrepreneurs include skills development, business training, marketing and technology services, and subsector analysis (proclamation No. 626/2009).

### 2.1.3 Nature and importance of SMEs in Economic Development

#### 2.1.4 What is an SME?

The issue of what constitutes an SME is a major concern in literature. Different authors have usually given different definitions to this category of business. Some attempt to use the capital assets while others use number of employees and turnover level. Others

define SMEs in terms of their legal status and methods of production. In the context of Ethiopia, the ministry of Trade industry adopted official definition of medium and small enterprises. According to the ministry's definition small enterprises are business enterprises with a paid-up capital of more than Birr 200,000, but not more than Birr 500,000. Large and medium scale manufacturing enterprises have been classified as business establishments with more than ten employees using automated machinery. The Ethiopian Revenue and Custom Authority( ERCA) also defined enterprises for the tax purpose as enterprises having below 1 million annual turnovers as small enterprises, from 1 million to 4 million annual turnovers as medium and above 4 million annual turn overs as large enterprises. And this definition of SMEs is used in this research.(Lidger wood 1997).

### 2.1.5 Importance of small and medium enterprises (SMEs)

Small firms are backbone of national development. For a country to reach its full potential in terms of economic and social development it should not ignore the importance of its indigenous small and medium enterprises (MSMEs) and the contribution that they make to the country's economy. As indicated below, facilitation of economic development creation of long term jobs and providing the long term loan are major contributions of SMEs

Facilitate economic development or bring about equitable development by give long credit for poor society.

Medium and small enterprises /MSEs/ by making use of predominantly local resources engage in the production goods and services of mass consumption and stimulate the development of the economy. The expansion of MES s also contributes towards a more equitable distribution of income and wealth among the society (Robinsons).

#### **Create long –term jobs**

While small and medium enterprise activities have absorbed a large number of unemployed people. Therefore, support for SME has include skill upgrading programs for MSE operators and strengthening the use of appropriate modern technologies that

boost their capacity to create long term- jobs (Asmelash2002).

### **Provide the basis for large scale enterprises**

MSEs provide the foundation for growth and stimulate indigenous entrepreneurship. They provide training for entrepreneurs and managers and through this learning process MSEs grow in the organization

#### **2.1.6 Indicators of development**

Development reflects both short and long term changes in a firm / business organization. A development process is likely to be driven by increased demand for the firm's products or services. That is, sales increases first and thus allow the acquisition of additional resources such as employment or other assets. Thus sales development has high generality and is the best growth measure. The researchers use volume of sales as a measure of development of SMEs (Hailey, 2003).

#### **2.1.7. General Constraints to SMEs Development**

Despite their potential role to accelerate economic development and reduce poverty, in most developing countries, SMEs face a wider range of constraints and problems and they are unable to address the problems they face on their own. The constraints relate, to the legal and regulatory environments, access to markets, finance, business information, business premises (at affordable rent), the acquisition of skills and managerial expertise, access to appropriate technology, access to quality business infrastructure and in some cases discriminatory regulatory practices (FDRE, 1997 &Ghebreyesus, 2009).

In Ethiopia MSEs have been confronted by various problems which are of policy, structural and institutional in nature. To start with, lack of smooth supply or raw materials, serious marketing problems, lack of working premises and lack of sufficient capital are the major challenges for small and medium scale enterprises to start and develop/expand. Although the economic policy of the country paid due emphasis for entrepreneurship values and appreciation of the sector's contribution to the economy, service, consultancy, information provision, preferential treatment and many others

which need proper attention (FDRE 1997).

### 2.1.8 The policy and Regulatory Framework

Whether they produce for national or domestic markets, SMES can highly benefit from favorable policy and regulatory environment. Absence of such an enabling environment can force small and medium Enterprises/SMEs/ to early exit the market such framework should include:

- Stable fiscal and monetary setting with reasonable interest rates, a system of financial markets that provides incentives to save and mechanisms to channel savings to investments;
- Policies that minimize the cost of business licensing and registering while protecting public interests;
- Policies that facilitate business transactions such as infrastructure development. (Ghebreyesus, 2009).

### 2.1.9 Access to finance

Access to finance is one of the major constraints faced by small and medium Enterprises/SMEs/ Everywhere. The potential sources of finance include financial institutions, cooperatives, government projects, semi-formal and informal lenders, as well as trade credit. Although often SMEs acquire their capital from their own savings or from family and other informal sources they also seek financial institution loans to meet their financial requirements. However, because of their weak financial base they are regarded as high risk areas and do not get enough loans from financial institutions. Because of the high transactional cost involved and inability of SMEs to provide the financial institutions require SMEs find it difficult to get funds/loans at all stages of their development ranging from start-up expansion (Amha&Wolday, 2006).

### 2.1.10 Lack of non-financial Support services: Technology, skills development and marketing

Support services can assist small and medium enterprises/SMEs/ in performing well and becoming competitive. However, even if such services may exist in many African

countries their effectiveness is doubtful (Asmelash, 2002). Support services for marketing for instance requires connecting companies products and services with regional and international markets But in Africa, according to United Nations economic Commission for Africa/ECS/ (2001:29), the experience is variable, with some countries having a good and relatively efficient network of institutions providing marketing services (Mauritius, south Africa and Tunisia), whereas some others have none (Cameroon Gabon, and Senegal). In other countries such as Ethiopia, Kenya and Uganda the network of institutions is somewhat inadequate. All in all, it seems that marketing services are more widespread in Africa than technological –related ones, but the overall effectiveness tend to be below in both cases (Peter, 2001).

## 2.2 Empirical Review

In spite of the above theoretical recognition of role of financial institutions and their contribution to the development of SMEs, there appears to be limited empirical evidence available and most of them generally focused on challenge of SMEs in access external finance and on role of financial institutions in economic development. As a result, slight studies had been done on the contribution of financial institutions in the development of SMEs.

One line of inquiry points to financial institutions and their role in economizing on information costs. For example, Rajan and Zingales (1998) argued that well-developed financial markets and institutions help a firm to overcome problem of moral hazard and adverse selection, thus reducing the firms cost of raising money from outsiders, this researchers uses under this view, firms in less financially developed countries are likely to exhibit lower levels of firm investments because of financial constraints, consistent with this predication, several studies find financial development to be positively related to the level of industry and/or firm growth rate Kanga et al, (2000) .

Allen and Gregory (2005) also assessed the presence of small and large or state owned and foreign-owned financial institutions effect on SME credit availability through comparative advantages in the different lending technologies. In particular, a greater presence of foreign-owned institutions and a lesser presence of state-owned

institutions are likely to be associated with significantly higher SME credit availability in developing nations because foreign-owned institutions appear to have advantages in some of the lending technologies, and state-owned institutions appear to be generally disadvantaged. This may occur if a restrictive regulatory environment constrains the potential financial institution structure, preventing some types of financial institutions from gaining sufficient market shares to capitalize on their comparative advantages in specific lending technologies. The research evidence suggests that some of these effects may be quite strong. Many nations explicitly or implicitly restrict the entry of foreign institutions. These restrictions may have significant negative effects on SME credit availability, given the advantages that foreign owned(Allen and Gregory).

financial institutions appear to have in SMEs credit availability in developing nations. In addition, the governments of a number of nations maintain large market shares for state-owned financial institutions with lending subsidies and tax collection procedures .these practices appear to “crowd out” more efficient privately-owned institutions and result in lower overall SME credit availability, despite the mandates of state owned institutions and result in lower overall SME credit availability, despite the mandates of state owned institutions to the contrary. This research deals with the issue of medium and small enterprises finance and is the first empirical work on trade credit in Ethiopia.

### **2.3 .Research gap (theoretical vs. empirical frame work)**

When I have been seen theoretical literature review by related with empirical frame work, there in many things that is described in the theoretical frame work, but no conceptualizing in the empirical finding. This makes gap between them. Also there is some significance between researcher finding and activities performance, when the research did.

That is term which are not conceptualizing in empirical finding which is should consider in the involvement of the effective in proving service to small and medium enterprise. As minimum plan should contain information intended to do small and medium enterprises like personal and business. Lending money may also reduce small and medium enterprises development. Key word strategy or plan, performance use

improperly is main obstacle in development of small and medium enterprises. However, financial institution must be carefully and intelligently continuous expressed goal, object and plan for development in small and medium enterprises.

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Research Design

The study is descriptive cross section nature being design to find out from a cross section of SMEs their experience and opinion about the role of financial institution in their development. This study would use descriptive type of study which has the proposed to describe the existing situation about relationship between SMEs and financial institution.

#### 3.2 Target population and Sample techniques

The researcher use census sampling techniques for selecting the sample from the total population. The target population of the study was 19. Census method was used because the number of population is small. The researcher used Census method to draw representative data by selecting all population on census accessibility. This method is select because of its prefer for small population size.

#### 3.4 Data type

Qualitative approach is the researcher be utilized to do the research. This approach place the emphasis on measurement when collecting and analyzing data. The reason the researcher choose this methodology because of well design and implement qualitative research has the advantage of making generalizations by using questioners to get information from the target population. It uses strategies of inquiry such as questioner and survey collect information using standardize instrument and uses statistical method in describing patterns of behavior and generalizing from census to population patterns Also the reason for using qualitative is to address the research question and design analysis.

#### 3.5 Source of data

The researcher would use primary data to achieve its objectives. Primary data would be collected through questionnaire. The questionnaire use close ended because to provide question having alternative answers. Whereas secondary data were gathered from

those which have already have been collected/written by someone else (Yamane: 2004). In this research secondary data which are relevant to the study: such as books, journal articles and official publications are consult.

### **3.6 Data collection Tools**

There are several methods of collecting data particularly in surveys and descriptive researches. The most important primary data collection tools are: observation, and questionnaires. From these methods this study used be utilized structure questionnaires to collect data from SMEs as it is appropriate. Secondary data would be collected from literature review from sources indicated from books, journal articles and official publication are consult.

### **3.7 Data presentation and Analysis**

After it is collected, it used be processed and analyzed in accordance the proposed plan. This will process implies editing, classification and tabulation of collects data. So that, they are manageable for analysis. The term analysis refers to the computation of certain measures along with searching for patterns of relationship that exist among data groups( Yamane: 2004)

## CHAPTER FOUR

### Data presentation and analysis

#### Introduction

This chapter presents and analyses the data collected through the different data collection techniques. “Questionnaire” is used as a primary data collection method to gather the required information. Section 4.1 presents the qualitative statistics on the finding from the small and medium enterprise employees along with demographic profile and their response to the study related questions by using questionnaires.

#### 4.1 qualitative statistics

##### 4.1.1 Results from questionnaire

Questionnaire is very essential and it is also important to gather information from respondent easily. For this studies which requires individual’s response about the role of financial institution in development of small and medium enterprises. To gather information about small and medium enterprise, the researcher used this data source as a primary source and has got in-depth information by using this technique.

##### *4.1.1.1 Background Information of respondents*

From total 19 questionnaire distributed to employees of small and medium enterprise in Cheha worda 19 questionnaire representing 100 % are filled and returned.

Table4. 1 Respondent's personal information

	Description	No of respondents	Percentage
<b>❖ Gender</b>	Male	12	63.16%
	Female	7	36.84%
	<b>Total</b>	19	100%
<b>❖ Age</b>	18-25	7	36.84
	26-33	11	57.89
	34-41	1	5.26
	Above 41	-	-%
	<b>Total</b>	19	100%
<b>❖ Educational status</b>	Diploma	17	89.47%
	Degree	2	10.52%
	Master's degree	-	0%
	<b>Total</b>	19	100%
	< 2 years	6	31.57%

<b>❖ Work experience</b>	3-5 years	11	57.89%
	6-10 years	2	10.52%
	> 10 years	-	0%
	<b>Total</b>	19	100%

Source: Questionnaire 2019

As it is shown on the above table from 19 respondents, 12 respondents, representing 63.16 % are males and 7 respondents, representing 36.84% is female. The table shows the gender distribution for male employees are large than the female employees.

Based on classification of respondents by age, 7 respondents, representing 36.84% are their age between 18-25years, 11 respondents, representing 57.89% are their age between 26-33 1 respondents, representing 5.26% are their age between 34-41 and there are no anyone above 41 years. This shows that the largest (57%) employee's age is lies between 26-33 years. This indicate that many of small and medium enterprise of Cheha woreda are adult age group.

With regard to educational status of respondents, the table shows that 2 respondents, representing 10% of the employees are degree holders and 90% employee's holds diploma, on the other hand there is no master holder and other educational level from the sample. This shows that the highest percentages of employees are diploma holders.

In relation to work experience of employees, the table shows that 6 respondents, representing 31.57% of the employees have an experience of less than 2 years, 11 respondents, representing 57.89% of the employees have an experience between 3-5 years, and 2 respondents, representing 10.52% of the employees has an experience of 6 – 10 years. This shows that most of employee's work experiences were between 3-5 years.

#### 4.1.1.2 Employees response to the study related question with the role of financial institution in development of small and medium enterprise.

Table4. 2 Nature business activities

Item	Frequency	Percentage
Trade	2	10.52%
Manufacturing	13	68.42%
Service	2	10.52%
Construction	2	10.52%
Others	0	0
Total	19	100%

Source: questionnaire 2017

Trade, manufacturing, service and construction are the major areas of business operation that SMEs usually engage in. In this connection, the researcher tried to identify the area of business activity that most SMEs in Cheha woreda are engaged in. As the table above (table 4.2) shows that most SMEs 13 (68.42%), are engaged in manufacturing followed by trade, 2(10.52%) and construction, 2(10.52%). Only 2(10.52%) of the SMEs are engaged in service. The reasons that most SMEs, engaged in manufacturing and trader are we can get easily what we want from the potential customers so that this nature of business activities would preferable.

Table 4.3 Age of business

Item	Frequency	Percentage
Less than 2 years	6	31.57%
3-5 years	10	52.63%

6-10 years	3	15.78%
10 years and above	0	-
Total	19	100%

Source: questionnaire 2019

Age of business is one of the factors that affect the development of SMEs. Because, as age of business increase there is a potential to get experience and increased market share. In this regard, the researcher tried to identify the age of the SMEs found in cheha worda. As indicated in the above table the greatest number of SMEs 57.89%, are 3-5 years of age. 31.57% of the SMEs are Less than 2 years; while 10.52% of theme are 6-10.

*Table 4.4.loans taken at least once*

Item	Frequency	Percentage
Yes	7	36.84
No	12	63.15%
Total	19	100%

Source: questionnaire 2019

It is argued that access to money is a major determinant of development of development of SMEs. Hence, the researcher tried to find out whether SMEs in Cheha worda have got enough access to loan service of financial institution. However, as the above table shows only 36.84% of them got loan service at least once. 63.15%, of them never got loan from financial institution. This implies the majority of SMEs are not beneficiaries of loan service of financial institution. This might be because of some bureaucratic and collateral inadequate problems are bottleneck for the access to the loan.

*Table 4.5 Adequacy of loan funds*

Item	Frequency	Percentage
Yes	7	36.84
No	12	63.15
Total	19	100%

Source: questionnaire 2019

Business enterprises such as SMEs use loan service which financial institution provide money their investment and operating activities. So, identifying the adequacy of these loan funds is appropriate. As depicted in table 4.5 most SMEs, 36.84%, are of the opinion that the loan fund which SMEs are able to get from financial institution is to adequate to cover their financial needs. 63.15% of the respondents believe it is inadequate. This indicates SMEs demand for finance is not met. This might be because of high borrowing cost and fear of inability to repay and no collateral.

*Table 4.6 Affordability of criteria*

Item	Frequency	Percentage
Yes	9	47.36%
No	10	52.64%
Total	19	100%

Source: questionnaire 2019

The level of affordability of loan criteria which financial institution require from SMEs to give loan is very important. However, as table 4.6 depicts, the criteria are said to be affordable only by 47.36% of the SMEs. The remaining 52.64% believe that the criteria are not affordable. This shows a considerable size of SMEs are not benefiting from loan service of financial institution due to the fact that the criteria are not affordable to fulfill. The affordability of criteria are not fulfill, because of high borrowing cost, lack of

availability of raw material.

Table 4.7 Factors affecting access to money from financial institution

Item	Frequency	Percentage
Bureaucratic problem	8	42.11%
Collateral inadequacy	3	15.78%
High borrowing cost	6	31.57%
Fear of inability to repay	2	10.52%
Total	19	100%

Source: questionnaire 2019

Financial institution is the major formal source of financial service for any business organization including SMEs. But accessing these service is not always an easy task due to several reasons. The researcher tried to identify these factors that affect SMEs, access to finance in Cheha woreda. As indicated in table 4.7 above, bureaucratic problem is the major factor that affects access to money. It contributed 41.11% followed by collateral problem, 15.78%; high borrowing cost, 31.57% and fear of inability to repay 10.52%. the reason that affect access to money financial institution might be fear of inability to repay.

Table 4.8 Factors negatively affect the development of SMEs.

Item	Frequency	Percentage
Access to financial service	8	42.10%

Access to market	5	26.32%
Managerial and entrepreneur skill	1	5.26%
Availability of raw material	2	10.52%
Legal and administrative problem	3	15.78%
Total	19	100%

Source: questionnaire 2019

The development of business enterprise could be effected by several internal and external factors. The researcher tried to list out the most common ones and identify their level of influence. As table 4.8 shows, lack of access to financial service (41.10%) is found to be the most important factors that hindered the development of SMEs in cheha woreda. Access to market comes second with 26.32%. Lack of availability of raw material cover 10%; while managerial and enterprinnal skill 5.26% and 15.78% due to mal-administration problem in organization.

**Table 4.9 Loan selection criteria**

Item	Frequency	Percentage
Collateral	6	31.58%
Third part guarantee	2	10.53%
Business plan	11	57.89%
Total	19	100%

Source: questionnaire 2019

It is common practice that financial institution ask for some sort of precondition/criteria in order to give loan service. These precondition could be either collateral, third party guarantee or business plan. The researcher tried to identify the most commonly used criteria that financial institution in cheha woreda use to give loan service. As indicated in

the table above (table 4.9.) business plan (57.89%) and collateral (31.53%) are the most commonly used criteria and third party guarantee cover 10.53%, it is less important as compared to the first two. The reason for loan selection criteria to select business plan and collateral are high guarantee and minimize of default risk and other problems related with loan.

*Table 4.10 Loans received from financial institution*

Item	Frequency	Percentage
Purchase of input raw materials	6	31.58%
Purchase of long lived assets	5	26.32%
Payment of previous loans	8	42.11%
Others	0	0
Total	19	100%

Source: questionnaire 2019

Therefore, the most of loans received from financial institution would use payment of previous loans and purchase of inputs, raw materials. So, that the researcher would tried to identify the loans received from financial institution predominantly uses. As table 4.10 indicated the above the most employees use loan received from financial institution for the payment of previous loans 42.11% and follows by purchase of long lived asset 26.52%, while the purchase of input raw materials 31.58%. This might be because of SMEs uses loans received from financial institution mostly for payment of previous loans because firstly we borrow money from financial institution than we pay again the payment for these we would use.

**Table 11**The performance of financial institution

Item	Frequency	Percentage
Excellent	4	21.05%

Very good	8	42.11
Good	3	15.79%
Poor	3	15.79%
Very poor	1	5.27%
Total	19	100%

Source: questionnaire 2019

To sum up this analysis the performance of financial institution mostly at better position and the researcher would tried to identify the point of ponder of financial institution. As table 4.11 indicated above the performance of financial institution 42.11% are very good performance followed by 21.05% excellent, 15.79% Good and also 15.79% poor the last 5.27% very poor other. These might be the performance of financial institution eagerly support SMEs by providing loans and give advice how to use and manage the resource.

Table 4.12 the requirement fulfill by SMEs

Item	Frequency	Percentage
Yes	10	52.36%
No	9	47.37
Total	19	100%

Source: questionnaire 2019

The service that asking from customers are all requirement is to fulfill by SMEs. Mostly 52.36% accept the requirement 47.37% reject. The reason that criteria rejected are because of the condition difficult

## **CHAPTER FIVE**

### **Summary, conclusion and recommendation**

## 5.1. Summary and conclusion

Currently, there is a wide consensus about strong relation between the development of SMEs and socio-economic development on the one hand, and the need to provide/fulfill the necessary condition for their development such as the provision of adequate financial service on the other. This is much truer in development countries like Ethiopia given the develop need for employment creation, rural urban linkage, export diversification and poverty reduction in general. For the development of SMEs, financial institutions are one essential organ. Therefore, access to financial service and institution is a critical element for SMEs development. Cognizant of this fact the government of the federal democratic republic of Ethiopia has formulated a national medium and small enterprises (MSE) development and promotion strategy, which enlightens a systematic approach to alleviate the problems/constraints and promote the development of Mses. As discussed in the research financial institutions play an indispensable role in the development of an economy in general and of SMEs in cheha worda also. This is because, under normal circumstance, they facilitate trading, encourage mobilization of resource through saving and allocate resource to activities with high returns, monitor investments, spread risks by offering a diversity of financial instruments etc.

In the light to this and as part of its objectives which is sets at the beginning, this research tried not only to uncover the major constraints of the development of SMEs in cheha worda, but also analyzed the drives of SMEs development and tried to identify means of financial institution.

## 5.2. RECOMMENDATION

In connection to this the study analyzed major issues pertinent to SMEs and financial institution performance. The researcher found out that contrary to what is theoretically expected SMEs development is not attributed to service provided by financial institution. In other words the role of financial institution in the development of SMEs in cheha worda is in significant. This shows that financial institution in cheha worda is not playing their role as expected. The reasons for not playing their role as expected because of most SMEs use their own saving (understandably a limited amount) rather

than loan from financial institution. Collateral inadequacy and bureaucratic problem are found out to be the major constraints of access to loan from financial institution and hence for the development of SMEs.

It is also found out that the demand for SMEs products and service is the major driver of the development registered by SMEs. But most SMEs are not development as their expectation. It is clear that this development would have been better had it not been for the financial constraints. The result indicates that SMEs are not operating in full capacity and utilize the market potential (the demand for their products and service). Unless this situation is improved it would be difficult to expect SMEs in cheha worda. To play their role described in the development strategy employment creation, expert diversification and contributing for the socio-economic development of the nation.

Based on the forgoing finding and conclusion, the following recommendation is given to help the SMEs to improve its loan gets performance:-

- In order to improve the standards of the SMEs for loan requested and provide sufficient support for SMEs, the financial institution recommended to be allocated enough capital (funds) to upgrade the financial strength of the business.
- The researcher would be recommended that to give priorities for having those a good business plan.
- The researcher also recommended to cheha worda SMEs to minimize bureaucracy that problem of the organization.
- It would be recommended that SMEs initially some amount of saving before applying a loan request to the organization.
- Small business support group including the government should focus on financial assistance but also through education, training, strategic awareness programs, and entrepreneurial orientation are essential.
- In order to achieve the goal of small and medium enterprise the increasing the

moral ability about the repayment of loan and generating benefit is very essential for both debtor and creditors of the finance.

- This study also recommended the SME the must have full fill their duty in order to get loan and support from the financial intuition by preparing collateral, business plan and other material requirement to get loan.

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The issue of SMEs development ranks high among priorities of socio economic development

according to given the development need for employment creation and poverty alleviation (NUGENT 2007)

**APPENDIX**  
**WOLKITE UNIVERSITY**

**Department of business and economics**

**Department of accounting and finance**

Research questionnaires

General direction respondent

My name is Mebrhit tesfaye lam graduating student in Wolkite University. This questionnaires designed to get information on the role of financial institution in development of small and medium enterprise (in case of cheha woreda small and medium enterprise). The aim of this study is to find out the relationship between financial institution and small and medium enterprises in development of cheha woreda. Participation in the research is completely voluntary.

**Part I personal information**

**Instruction: please put a think (x) marking in the boxed corresponding your opinion.**

1. Gender : male  female

2. Age: 18-25  26-33  34-41  above 41

3. Education level: degree  diploma  masters (MSc)

4. Work experience: <5years  6-10 year  11-15years   
>16 years

**Part II Back ground of study**

1. Please indicate your business activity?

Trade       Manufact        rvice      c  uction

2. How old your business?

Less than one ye       1  r       ears       10  
years above

### **Part III The role of financial institution in the development of Small and Medium Enterprises**

3. Have your enterprises ever get access to loan from financial institution?

Yes       No

4. Do you know about all the services that financial institutions provide to SMEs?

Yes       No

**5. What are the requirements to get loan from financial institution?**

Collateral       Third party guarantee       Business pla

6. Are the requirements easy to fulfill by SMEs?

Yes       No

7. Is the loan that financial institution provide adequate to meet the financial need of your business?

Yes       No

8. How do you rate the performance financial institution regard to the support they give to the development of SMEs?

Excellent       Very goods       Good       Poor

9. Has your business registered a steady development of sale product?

Yes       No

10. If yes, what do you think is the reason for this development?

Marketing and managerial efficiency

Support from financial institution

Favorable legal and administrative environment

High demand

Other, please identify.....

11. Do you think your business is developing as expected?

Yes  No

12. If not what do you think is the reason? (Multiple answers is possible)

Lack of market

Lack of access to finance

Unfavorable legal and administrative environment

Lack raw material  other

13. In your opinion what are the factors that affect SMEs access to financial resources?(Multiple answer is possible)

Bureaucratic Problem

Collateral inadequacy

High borrowing cost

Fear of inability to repay

Other please, specify

14. What specially, service do financial institution provide for the development of your business?

Re schedule loans

Low interest rate on borrowing fund

Training and counseling

15. Please, indicate the means that your business use to money its activities?

Own saving

Borrow from financial institutio

Government advance

Borrow from relative and Iquib associati