Role of Financial Institutions in the Growth of Micro and Small Enterprises in Assosa Zone

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Abstract
The study aimed to assess the role of financial institutions in the growth of Micro and Small enterprises in Assosa zone. The study carried through descriptive design in which stratified random sampling method was used to collect data from the selected woredas from 140 populations and 57 respondents were selected from financial institutions and Micro and Small enterprises employees. Questionnaires and interview tools of data collection were used in the study. The data was analyzed using descriptive statistics and regression analysis. The empirical study elicited four major measuring scales which seem to assess the role of financial institutions in the growth of micro and small enterprises in Assosa zone and these are external financing, size of firms, firms age and current capital. The result shows that financial institutions were contributing to Micro and Small enterprises growth. Consequently, the relationship between loans from financial institutions and Micro and Small enterprises growth are positive and statistically significant. However, the extents of contribution were very low. Further, it identified ways of addressing the problems that Micro and Small enterprises face in accessing and settling loans include: flexing terms and conditions, using alternative collateral and credit facilities, refinancing, and postponing maturity period. Finally, the study recommends a serious of measures which are to be performed by the government and by financial institutions. These include: creation of a level playing field, lowering transactional costs, and commercial banks should reappraise their role. The regression result shows that, the SMEs size (Beta Coefficient 0.228) significantly explain at 99% confidence level determines the sales growth of the SMEs; whereas loan form financial institutions indicated by (beta value of 0.162) and SMEs age (beta value of 0.101) are the least predictors of sales growth of SMEs.
Keywords: Role, Financial Institutions, SMEs, Growth, Banks, MFIs

Introduction

Micro and small enterprises (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 do not only provide employment and income opportunities to a large number of people, but also are at the forefront of technological innovations and export diversification. Similarly, financial institutions play an indispensable role in firm's growth and thus industry productivity and economic growth. They provide a sound medium of exchange and facilitate trading, encourage mobilization of resources through savings and allocate resources to activities with highest returns, monitor investments and exert corporate governance, and spreads risk by offering a diversity of financial instruments. Furthermore, they provide financial assistance to fulfill the varied needs of enterprises.

Zeller (2003) broadly defined financial institution as an organization, which may be either for-profit or nonprofit, that takes money from clients and places it in any of a variety of investment vehicles for the benefit of both the client and the organization. Common examples of financial institutions are banks, insurance companies, credit Associations, microfinance, financial and economic firms.

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

Whatever the definition, and regardless of the size of the economy, the growth of SMEs is becoming increasingly crucial to economic growth. The issue of SMEs development ranks high among the priorities of socio-economic development, given the growing need for employment creation and poverty alleviation (Nugent, 2001). Nugent (2001) further noted 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.

Therefore, access to financial services and institutions is a critical element for SMEs growth. However, there appears to be limited evidence that confirms the contribution of financial institutions for SMEs growth. To this end, this study is significantly place as its main focus, the examination of financial institutions role in SMEs growth in Ethiopia, particularly in Assosa zone.

Research Design and Methodology

This study used both descriptive and explanatory research designs. The major purpose of descriptive research in this study was used describe the role of financial institutions in the growth of SMEs. In addition, the study employed explanatory design in that the relationship between variables in the study are correlated each other.

The survey was used to obtain data at one point in time from a sample selected relevant for the investigation of financial institutions role on SMEs' growth. This study employed a cross-sectional survey with semi-structured questionnaires which are open and close ended questions administered through distributing to sample of SMEs in Assosa zone. Apart from survey of SMEs and in-depth interviews with banks and MFIs managers/officials, the study used documentary analysis to obtain other facts that may not be obtained through interviews and administering of questionnaire.

There were around 140 SMEs in Assosa Zone which have been established from 2005 mainly on different economic activities. Among SMEs, 30 service, 33 constructions, 26 small scale industries, 31 trades and 20 are urban agriculture.

To select the sample, stratified sampling method was used. Therefore, from the total population of 140 SMEs, 87 are taken as the target population for this study which includes in Assosa Town (49), Bambasi(21) and Mengie(17). The following formula is used for the calculation of the sample size since it is relevant to studies where a probability sampling method is used (Watson, 2001).

$$n = \frac{P\ [1-P]}{\left(\dfrac{\dfrac{A^2}{Z^2} + \dfrac{P\ [1-P]}{N}}{R}\right)}$$

Where, n = sample size required = 57

N = number of population = 87

P = estimated variance in the population = 50%

A = margin of error = 5%

Z = confidence level = 1.96 for 95% confidence

R = estimated response rate = 96%

Accordingly, 57 respondents are selected from the total of 87 SMEs. These 57 respondents are selected from Assosa Town, Bambasi, and Mengie on proportional basis. Therefore, [(49/87) x 57] = 32 in Assosa town out of 49, [(21/87) x 57] =14 in Banbasi and Mengie [(17/87) x 57] =11.

This is the further transformation of the processed data to look for patterns and relationship between/ among data groups by using descriptive and inferential (statistical) analysis. The Statistical Package for Social Science (SPSS) version 20 was used to analyze the data obtained from primary sources.

According to Sekaran (2000), inferential statistics allows to infer from the data through analysis the relationship between two or more variables and how several independent variables might explain the variance in a dependent variable. The following inferential statistical methods would be used in this study.

Multiple OLS regression model is used to test the hypothesis.

$$GRit = \beta 0 + \sum_{t=0}^{n} \beta 1\ Xit + \epsilon$$

GRit**:** Growth of enterprises i at time *t*; i = 1, 2. . . . 140 enterprises

$\beta 0$: The intercept of equation

$\beta 1$: Coefficients of X i t variables

X1t: The different independent variables for growth of enterprises *i* at time *t* : Time = 1, 2,……,5 years; *i:* number of enterprises

ϵ: The error term.

Specifically, when the above general least squares model converted into current study Specified variables it becomes:

GRit = β0+β1 (LBM) + β2(SZ) + β3(AGE) +β4(CC) + €

β0= a constant; the average growth when all independent variables are zero

B1-4= the coefficient; the contribution of each marginal change in independent variables on SME growth respectively.

€= the error term; the error in predicting the value of growth

The variables (with expected sign in parenthesis) are:

GRit = Growth (defined as percentage change in assets for *i* enterprises at time *t* for the last five years from 2008/09 to 2013/14), or what is being predicted or explained

LBMit = Loans from banks and MFIs, defined as percentage change in total borrowed capital for *i* enterprises at

time *t* (+)
SZit = Size of firm, defined as percentage change in both permanent and temporary employees of *i* enterprises at time *t* over the period of last five years -2008/09 to 2013/14 (+)
AGEit = Age of enterprises *i* at time *t* (- or +)
CCit = the amount of current capital held with.

Result and Discussion

The field survey result indicates that from the total respondents the majority (59.7%) replied that they accessed to MFIs and banks loans whereas as the remaining 40.3% did not get the loans from banks and MFIs. Regarding the reason for not obtain the loans from FIs, 40.35 percent of respondents indicated that they have not accessed or have been unsuccessful in accessing finance from the bank due to the lack of collateral security. In addition, 47.37 percent replied that the main reason for not getting the loans from MFIs is due to business size, the target for credit facilities, not aware of MFIs loans facilities.

Result from interviewee showed that the problems that SMEs face in the process of accessing and settling loans are high collateral and transactional costs, inadequate supply of finance, forms of finance, liquidity, and long and difficult application process were some of the problems that SMEs face in accessing funds. Information asymmetry between loan provider and loan receiver was also other constraints that hindering SMEs growth.

Pearson's Product Moment Correlation Coefficient

In this study, Pearson's Product Moment Correlation Coefficient was used to determine whether there is significant relationship between debts, firm size, age and current capital variable with annual profits (sales). The following section presents the results of Pearson's Product Moment Correlation on the relationship between independent variables and dependent variable. The table below indicates that the correlation coefficients for the relationships between annual profit and its independent variables are linear and positive ranging from substantial to strong correlation coefficients.

The relationship between independent variables and annual profit

Independent variables	Pearson correlation	Profit
Debt	Pearson correlation P – value N	0.736 0.000 5
Firm size	Pearson correlation P – value N	0.825 0.000 5
Age	Pearson correlation P – value N	0.761 0.000 5
Current capital	Pearson correlation P – value N	0.808 0.000 5

Correlation is significant at the 0.01 level (2-tailed).

As it is clearly indicated in the above table, a strong positive relationship was found between SMEs size and Sales growth ($r = .825$, $p < .01$), and current capital and sales growth ($r = .808$, $p < .01$ which are statistically significant at 99% confidence level. This implies that at a 1% level of significance it was discovered that the SMEs size and their current capital plays a significant role in determining the annual profits in the selected micro and small enterprises. Moreover, the above table presented the association between the selected variables and annual profits. There is a substantial, however statistically significant relationship between debt and sales growth ($r = .736$, $p <.01$ and SMEs age and sales growth ($r = .763$), which is statistically significant at 99% confidence level.

Regressions Analysis

For the purposes of determining the extent to which the explanatory variables explain the variance in the explained variable, regression analysis was employed. The results of such analysis are narrated under the study.

Table 2- Regress profit (as dependent variable) on the selected variables (as independent variables) using multiple regressions.

R	R Square	Adjusted R square	Std. Error of the estimate		Sig.
.902	.814	.810	.245		.000
Model	Un standardized Coefficient		Standardized coefficients	t	
Variables	B	Std. Error	Beta		Sig
Constant	-350	.115		-3022	.003**
Debt	.102	.030	.162	2.944	.000**
SMEs size	.221	.036	.228	6.502	.003**
Age	.085	.023	.101	3.516	.000**
Current capital	.202	.029	.200	5.452	.003**

** P < .01 Source: Field survey, 2012

a. Predictors: ***(constant) debt, SMEs size, age and current capital***

Table4.31 revealed that, the correlation between the observed value of sales growth and the optimal linear combination of the independent variables (debt, SMEs size, age of the SMEs and Current capital) is 0.902, as indicated by multiple R. Besides, given the R Square value of 0.814 and adjusted R square value of 0.810, it may be realized that 81.4% of the variation in sales growth can be explained by the independent variables. The remaining 18.60% of the variance is explained by other variables not included in this study. The unstandardized coefficients B column, gives us the coefficients of the independent variables in the regression equation including all the predictor variables as indicated below.

Predicted sales growth scored = -.350 + .102 (debt) + .221 (SMEs size) + .085 (age) + .202 (current capital).

The table4.31 further showed that, all the explanatory variables included in this study can significantly explain at 99% confidence level to the variation on the dependent variable. The standardized beta coefficient column shows the contribution that an individual variable makes to the model. The beta weight is the average amount the dependent variable increases when the independent variable increases by one standard deviation (all other independent variables are held constant).

As these are standardized we can compare them. Thus, the largest influence on the sales growth of the SMEs is from the SMEs size (.228) and the next is current capital (0.200).

On the other hand loan from financial institutions with the beta value of .162 and SMEs age with the beta value of .101 are the poorest predictor of sales growth when it is compared with the other explanatory variables under this study.

CONCLUSION

Based on the results of findings the following conclusions were made:

SMEs have a serious difficulty in gaining access to products and services from financial institutions, particularly from banks and MFIs. Inadequate collateral, difficulty of processes, fear of inability to repay, and high borrowing cost were frequently mentioned reasons by SMEs for inaccessibility of banks products and services.

Although they had limited access from banks financial resources due to the above reasons, SMEs were received both short term and long term loans. Thus SMEs were used banks and MFIs as one source of financing either for working capital or investment requirements even though their main sources were from their own saving and retained earnings as well as from their relatives and Equb.

Similarly, banks were typically provided a variety of additional financial services such as cash management, saving and payment, and other transactional products. Besides providing financial services, banks were help SMEs growth through amenable information, asymmetry, inter temporal smoothing of risks, and by ensuring proper utilizations of funds. But such contributions of financial as well as non financial services were found to be by far lower than the SMEs demand.

Concerning the forms of financial assistance, banks offered short term loans, cash credit, and over draft facility to finance SMEs working capital requirements. Similarly, banks also offered medium and long term financial assistance by way of term loans. This is in line with the traditional role of commercial banks. In general, although limited provision of banks products and services, banks help the SMEs development and growth.

Apart from banks, MFIs played significant role in SMEs development process. In the context of Ethiopia, MFIs were established to broaden access to financial services for poor and small enterprises. MFIs provided both term loan and installment loans. It was shown that access to MFIs enabled SMEs, particularly small enterprises that are underserved by banks, to overcome financing constraints and thereby accelerating their growth rate. Despite their importance in SMEs growth, MFIs still provided inadequate financial access to finance

SMEs working capital as well as investment needs.

In addition, MFIs typically provided a variety of additional financial services include: cash management, saving and payment, third party asset management (trustee) and insurance. Besides providing financial services, MFIs also provided social intermediation, non financial services, and enterprise development services. However, some MFIs failed to provide such products and services. The most frequently mentioned reasons are low lending capacity, business size were beyond the target, inadequate funds, and high borrowing cost. However, the social benefits that gained by clients of MFIs supersede the high borrowing cost.

In addition, MFIs also support the development of SMEs through training in book keeping and manpower development, business control and monitoring, and by providing available business as well as others relevant information but they failed to does so.

Finally, in terms of the stated explanatory explanations, the specific empirical findings emerged from the investigation that there exists significant positive relationship between independent variables and dependent variable. Moreover, the selected independent variables may significantly explain the variations in the dependent variable i.e. profit.

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