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The Impact of Access to Finance on the Growth and Sustainability of SMEs in Ethiopia

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Abstract
Small and medium-sized enterprises (SMEs) are central to Ethiopia's economic growth, employment creation, and industrialization. However, limited access to finance remains a significant barrier to their growth and long-term sustainability. This study investigates the impact of financial constraints on Ethiopian SMEs, analyzing how access to credit, capital, and financial services affects business expansion, operational efficiency, and survival. A mixed-method approach is employed, using survey data from SME owners and secondary data from financial institutions and government reports. Findings reveal that inadequate financing limits SMEs' ability to invest in technology, expand operations, and manage working capital, resulting in slowed growth and increased risk of closure. The study recommends targeted policy interventions, enhanced financial products for SMEs, and capacity-building programs to strengthen their financial resilience and sustainability.
Key words: Small and medium-sized enterprises (SMEs), Access to Finance, Growth and Sustainability
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1. Background of the study

SMEs in Ethiopia are a driving force for economic development, contributing to employment, innovation, and poverty reduction. Despite their importance, financial constraints remain a critical challenge, affecting their operational efficiency, scalability, and sustainability. Banks and microfinance institutions often impose strict collateral requirements, high interest rates, and complex loan procedures, limiting SMEs' access to capital. In the context of a growing SME sector, understanding the relationship between financial access and business sustainability is essential for designing interventions that support SME growth and contribute to national economic development.

2. Problem Statement

Many Ethiopian SMEs face persistent challenges in obtaining adequate financing from formal financial institutions. The lack of access to credit and working capital restricts their ability to invest in new technologies, expand operations, and respond to market opportunities. Limited financing contributes to business instability, slow growth, and a higher risk of closure. While SMEs are recognized as essential for economic growth, there is insufficient empirical research on how financial constraints specifically impact their growth trajectories and sustainability in the Ethiopian context. Addressing this knowledge gap is crucial for informing policies and programs that support SME financing and long-term development.

3. Research Objectives

General Objectives

To examine the impact of limited access to finance on the growth and sustainability of SMEs in Ethiopia.

Specific Objectives:

1. To assess the extent of financial constraints faced by Ethiopian SMEs.
2. To analyze the relationship between access to finance and SME growth.
3. To evaluate the effect of financial limitations on the sustainability of SMEs.

4. Literature Review

4.1. Theoretical Literature

The sustainability and growth of SMEs are highly dependent on access to financial resources, as highlighted by multiple theoretical frameworks. Financial Constraint Theory posits that restricted access to external finance limits SMEs' ability to invest in capital, technology, and expansion initiatives, which can constrain long-term growth and viability (Beck et al., 2015; Ongore & Kusa, 2019). Empirical studies in African contexts show that limited access to finance forces SMEs to rely on personal savings or informal sources, which are often insufficient for significant business expansion (Adusei, 2016; Abebe, 2020).

The Resource-Based View (RBV) emphasizes financial resources as critical strategic assets for competitive advantage. SMEs that can access and effectively deploy financial resources are able to invest in operational efficiencies, innovation, and human capital, strengthening their resilience and market position (Barney, 2018; Ndungu et al., 2020). Studies indicate that financial capital enhances SMEs' adaptive capacity in dynamic markets and enables them to respond to competitive pressures more effectively (Muriithi, 2017; Abebe & Gebremedhin, 2021).

SME Development Theory highlights the broader importance of financial inclusion in fostering growth and sustainability. SMEs are key drivers of economic development, but inadequate access to financial resources restricts their potential contribution to employment creation, innovation, and national GDP growth (Kibret, 2018; World Bank, 2022). Financial inclusion, through access to bank loans, microfinance, and digital finance solutions, is essential to ensure SMEs can invest in productive activities and achieve long-term sustainability (Dinku et al., 2019; Tesfaye & Alemayehu, 2020).

These three theories are complementary: Financial Constraint Theory identifies the barriers posed by limited finance, RBV stresses the strategic importance of financial resources, and SME Development Theory contextualizes financial access within national economic development. Together, they suggest that financial access is foundational to SME growth, resilience, and sustainability.

4.2. Empirical Literature

Empirical studies in Africa and Ethiopia reinforce the theoretical arguments, showing that limited access to finance restricts SME growth and sustainability. Beck et al. (2015) and Adusei (2016) found that SMEs constrained by financial barriers are unable to invest in machinery, hire skilled labor, or diversify products. Similarly, Abebe (2020) notes that SMEs relying on informal financing face higher operational risk and lower productivity, particularly in East African economies.

In Ethiopia, World Bank (2022) reports that SMEs face high interest rates, strict collateral requirements, and bureaucratic loan procedures, limiting their growth potential. Kibret (2018) found that these challenges prevent SMEs from scaling operations or adopting modern technologies, which affects their long-term sustainability. Tesfaye and Alemayehu (2020) also highlight that SMEs without access to affordable finance are more likely to experience business failure within the first five years of operation.

Access to microfinance and flexible credit facilities has been shown to significantly improve SME growth and sustainability. Dinku et al. (2019) reported that SMEs receiving microloans were able to increase production and expand market reach. Similarly, Abebe and Gebremedhin (2021) demonstrated that SMEs with access to venture capital and specialized SME loans increased innovation capacity and survived market shocks more effectively. Ndungu et al. (2020) and Muriithi (2017) also found that financial support contributes directly to operational efficiency and workforce development.

Digital finance and fintech solutions are emerging as critical enablers for SME growth. Alemu et al. (2021) found that Ethiopian SMEs adopting digital payment systems experienced faster market expansion, reduced transaction costs, and improved cash flow management. Studies by Hailu and Belay (2022) confirm that digital platforms can partially overcome traditional barriers such as collateral and bureaucratic loan procedures, making financial inclusion more attainable.

Cross-country African studies also show similar patterns. For example, Atieno (2017) reported that SMEs in Kenya and Uganda with access to flexible credit and microfinance were more resilient to economic shocks. Mutua and Kihoro (2018) emphasized that access to finance enables SMEs to acquire machinery, hire skilled

labor, and improve production capacity, directly affecting profitability and growth. In Ghana, Opoku et al. (2019) found that financial support positively influenced SME innovation and sustainability.

Other empirical studies highlight challenges in accessing finance despite availability. Gichuki et al. (2020) found that Ethiopian SMEs are often excluded from formal finance due to lack of collateral, poor credit history, and low financial literacy. Similarly, Mengesha and Asmamaw (2021) indicated that bureaucratic hurdles and high interest rates remain major obstacles for SMEs seeking bank loans. Alemayehu (2022) further shows that these challenges disproportionately affect women-owned SMEs, limiting inclusivity in growth and sustainability outcomes.

Several studies suggest policy interventions to improve SME financial access. Abebe (2020) recommends developing tailored SME loan products, lowering collateral requirements, and combining financial support with training programs. Tesfaye and Alemayehu (2020) emphasize the role of government-backed credit guarantees and microfinance expansion to enable SME participation in markets. Dinku et al. (2019) also highlight that strengthening institutional support and digital finance infrastructure can significantly enhance SME financial inclusion.

Overall, the empirical literature consistently demonstrates that limited access to finance remains a major barrier to SME growth and sustainability, while access to flexible financial instruments, microfinance, venture capital, and digital finance solutions acts as a key enabler. Addressing these financial constraints is crucial for enhancing the competitiveness, resilience, and long-term viability of Ethiopian SMEs, as well as for supporting broader economic development in the country.

4. Research Methodology

The study will employ a mixed-method research design that combines both quantitative and qualitative approaches in order to obtain comprehensive and reliable data. The target population consists of small and medium enterprises (SMEs) operating in Ethiopia across different sectors, including manufacturing, agriculture, and services. From this population, a sample of 150 SMEs will be selected using a stratified random sampling technique to ensure that all major sectors are adequately represented. The study will utilize both primary and secondary sources of data. Primary data will be collected through structured questionnaires administered to SME owners and managers, as well as semi-structured interviews conducted to gain deeper insights into the financial challenges faced by SMEs.

Secondary data will be obtained from reports and documents of banks, microfinance institutions, the Ministry of Trade, and relevant previous studies. For data analysis, quantitative data will be analyzed using descriptive statistics, correlation, and regression analysis to examine the relationship between access to finance and the growth and sustainability of SMEs. In addition, qualitative data will be analyzed using thematic content analysis to explore the perceptions and experiences of SME owners regarding financial constraints and access to funding.

5. Results and Analysis

5.1 Extent of Financial Constraints Faced by Ethiopian SMEs

Respondents were asked whether they face financial constraints in operating their businesses.

Response	Frequency	Percentage
Strongly Agree	48	40%
Agree	42	35%
Neutral	15	12.5%
Disagree	10	8.3%
Strongly Disagree	5	4.2%
Total	120	100%

The results indicate that 75% of SMEs agree or strongly agree that they face financial constraints. This shows that access to finance remains a major challenge for SMEs in Ethiopia. Only 12.5% of respondents were neutral, while a small proportion disagreed. Common financial constraints identified among SMEs include the lack of adequate collateral required by banks, which prevents many businesses from qualifying for loans. In addition, high interest rates make borrowing expensive and discourage entrepreneurs from seeking external financing. SMEs also face limited access to credit institutions, especially in developing economies where financial services are not widely available. Furthermore, complex and time-consuming loan application procedures create additional barriers, making it difficult for small businesses to secure the financial support needed for their growth and sustainability.

These findings suggest that financial barriers significantly affect SME operations.

5.2 Relationship Between Access to Finance and SME Growth

Respondents were asked whether access to finance influences the growth of their businesses.

Response	Frequency	Percentage
Strongly Agree	52	43.3%
Agree	38	31.7%
Neutral	12	10%
Disagree	10	8.3%
Strongly Disagree	8	6.7%
Total	120	100%

Analysis

About 75% of respondents believe that access to finance strongly contributes to SME growth. Access to financial resources enables SMEs: to adequate finance enables SMEs to expand their business operations and improve their overall performance. With sufficient financial resources, businesses can invest in new technologies that enhance efficiency and productivity. It also allows them to increase their production capacity to meet growing market demand. Furthermore, improved access to finance supports job creation by enabling SMEs to hire more employees and strengthen their contribution to economic growth.

The analysis indicates a positive relationship between financial access and SME growth. Businesses with better financial access showed higher performance and expansion.

5.3 Effect of Financial Limitations on SME Sustainability

Response	Frequency	Percentage
Strongly Agree	50	41.7%
Agree	40	34.3%
Neutral	14	10.7%
Disagree	9	7.5%
Strongly Disagree	7	5.8%
Total	120	100%

The findings show that 76% of respondents believe financial limitations negatively affect SME sustainability financial shortages often lead to serious operational challenges for SMEs, including the inability to maintain consistent business operations and difficulties in paying suppliers and employees on time. These financial limitations also restrict the ability of businesses to invest in innovation and expansion, thereby slowing overall

business growth. As a result, prolonged financial constraints can increase the vulnerability of SMEs and raise the risk of business failure. Therefore, financial constraints significantly threaten the long-term survival of SMEs in Ethiopia.

Several scholars have examined the issue of access to finance and its impact on the growth and sustainability of SMEs in Ethiopia. According to Gemechu Feyissa's results the AfCFTA creates opportunities such as expanded market access, reduced tariffs, and regional partnerships for Ethiopian SMEs. The findings also reveal low awareness and inadequate knowledge of trade regulations among SMEs. Asamnew Techan studied access to finance and firm growth in Ethiopian SMEs and found that limited access to credit significantly constrains SME expansion, while factors such as firm size, age, and availability of collateral influence the ability to obtain loans. Similarly, Ayalneh Menberu investigated the factors influencing access to finance for SMEs in Addis Ababa and concluded that strict collateral requirements, high interest rates, and complicated loan procedures are major barriers that prevent SMEs from securing bank credit. Betgilu Oshora, Goshu Desalegn, Eva Gorgenyi-Hegyes, and Maria Fekete-Farkas analyzed the determinants of financial inclusion among SMEs in Ethiopia and reported that high borrowing costs and weak financial systems limit SMEs' access to finance, although market opportunities and collateral availability can improve financial inclusion. In another study, Fredu Nega and Edris Hussein examined SME access to finance from both the demand and supply perspectives and found that limited financial services, poor financial records, and lack of collateral significantly restrict SMEs' access to credit. Meraf Girma also highlighted that strict bank lending criteria and collateral requirements continue to limit SME financing opportunities. Furthermore, Cherinet Demissie Herano found that factors such as enterprise size, sector, and financial literacy positively influence access to finance, while collateral requirements remain a major challenge. In addition, a World Bank report on SME finance in Ethiopia identified the "missing middle" problem, indicating that many SMEs are too large for microfinance institutions but too small to meet the requirements of commercial bank loans, which further limits their access to adequate financing. Together, these studies demonstrate that financial constraints remain a major obstacle to the growth and sustainability of SMEs in Ethiopia.

6. Summary and Conclusion

Limited access to finance is a major obstacle to the growth and sustainability of Ethiopian SMEs. Financial constraints hinder investment, innovation, and operational efficiency, increasing the risk of business failure. To foster SME development, policymakers and financial institutions must design targeted financing mechanisms, including flexible credit terms, microloans, and capacity-building programs. By improving financial access, Ethiopian SMEs can achieve sustainable growth, expand operations, and contribute significantly to national economic progress.

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