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# **Small Businesses in Small Towns of the Eastern Amhara Region: Nature and Economic Performance**

## **A Research Report**

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# I. INTRODUCTION

## 1.1 Background and Statement of the Problem

With an urban population of 10.8 million, which is about 15 % of the total population, Ethiopia has a much lower rate of urbanization than most developing countries. This demographic pattern is all the more astounding because the country's total population exceeds 65 million people. Even with this low level of urbanization, most urban centers in Ethiopia suffer from a variety of urban malaise including inadequate infrastructure, housing and services, limited employment opportunities, and weak institutional mechanisms for good urban governance and sustainable urban development. Urban centers in Ethiopia have been stagnating over the last three or four decades due to neglect and lack of urban development policies. Both large and small towns have limited backward and forward linkages with rural areas. Industrial and service activities in urban areas lack the necessary dynamism to foster local economic development.

Recently, the potential for local economic development (LED) has gained considerable global prominence and economic development has become a highly localized phenomena. LED can be defined as the process in which locally based individuals or organizations use resources to modify or expand local economic activity to the benefit of the majority in the community (Nel and Humphery, 1999). It is evident that communities, large or small, can not solely depend on strategies that emanate from the national level. There are even instances that national interests may conflict with local interests (Blakey, 1994). Local economic development and restructuring thus become prerogatives to address local economic problems.

Two closely related impulses for the emergence of LED are a positive desire for local economic development and a more defensive 'regenerative' strategy to avert local economic decline (Rogerson, 1995). Regardless of the different cases, there are several initiatives that can foster local economic development. Rogerson (1995) identified three strategies to bring local economic development. These are: (a) attempts to encourage inward investment and the stimulation of local enterprise; (b) build on a small firm industrial zone model; and (c) pursue local-level economic initiatives and survival strategies. Helmsing (2000) also made a distinction between three categories of local economic development initiatives. These are community-based economic development, enterprise and business development and locality development.

Microenterprises, which mostly are found in the informal sector of a country's economy have a significant contribution to make toward local economic development. In the 1950s and 1960s microenterprises were viewed as marginal and unproductive entities that evaded taxes and had little potential for growth or for the enhancement of entrepreneurial capacity. In the 1980s, however, microenterprises received more favorable attention from donors and governments as potentially sustainable means of combining equity with efficiency in low-income countries. Microenterprises can stimulate the local economy by increasing the aggregate demand and allow for greater investment. Microenterprises are particularly suitable to areas that are unsuitable for viable medium- and large-scale firms, contribute to decentralized development, regionally balanced growth and small town growth. Small towns are found at the lower level of urban hierarchy. These settlements play essential roles as

regional service centers in rural hinterland development through direct production linkages and ‘trickle’ down effects (Henderlink and Titus, 2002). These functions of small towns are achieved through myriad of economic activities carried out in these towns. The nature and dynamism of the local economic activities are important determinants of the performance of the small towns.

The size distribution of Ethiopian towns shows that in the 1994 census, 79 % of urban centers are small towns with population size of less than 10,000. These towns housed about 26.5 % of the urban population. Small towns in Ethiopia are ubiquitously found but generally are not much different from their surrounding rural areas. They contain poor and vulnerable households who pursue a subsistence mode of production (Baker and Tsion, 1994). Possibilities for small towns to contribute to economic growth, impact the development of rural areas, and serve as service centers are limited. This begs a question of how small towns could be invigorated and dynamism instilled in their functions.

One source of growth for small towns development is the performance of the hinterland. Researchers have argued that small towns in rich hinterlands are more vigorous than those in relatively backward hinterlands (Hinderink and Titus, 1988). Macro policies, particularly agricultural policy, trade policy, and infrastructure policy, will significantly influence small towns development. Small towns are also seen as a way of spatially organizing economic activities or enterprises (Pederson, 1989). Thus, the growth of small towns depends to a large extent on the performance of enterprises and their interactions with the environment.

## **1.2 Objectives**

This paper examines local economic activities (enterprises) in small towns of the eastern Amhara Regional State with the view to understanding their nature, economic performance, and the roles of local agglomerations (economic multipliers) and local business environment. The specific objectives are

1. To examine the nature and structure of small businesses found in small towns;
2. To identify local agglomeration factors and different business environments and their influence on small businesses in small towns;
3. To examine the economic performance of small businesses, in terms of their income and capital and identify their determinants; and
4. To derive recommendations for the promotion of local economic development in smaller urban centers.

## **1.3 The Study Area**

The study was conducted in six small towns of the Amhara Region: Dogollo, Werilu, Akesta, Tita, Haik and Bati (Figure 1). Four of the towns, namely Dogollo (Jamma woreda), Akesta (Legambo woreda), Tita (Dessie Zurie woreda) and Bati (Bati woreda) are found in the BASIS study woredas. The remaining two towns (Werilu and Haik) were selected on the basis of their proximity to towns in the study region. Werilu is found very close to Dogollo and has a high interaction with it. Dogollo’s economic activity is thus greatly influenced by businesses in Werilu. Similarly, the selection of Haik is also due its interaction with nearby Tita, which is

a very small settlement with limited businesses and enterprises (see below for description of the woredas and towns).

#### **1.4 Methods of Data Collection and Analysis**

The primary data for this study were obtained through a sample survey of enterprises. A new sampling frame of businesses was constructed for each town by making door-to-door visits of businesses with the help of knowledgeable local assistants. The woreda governments were also consulted regarding the accuracy of the sampling frame. The newly constructed sampling frame was much more comprehensive and inclusive than the list provided by the woreda municipality in each town. The businesses were then distinguished according to whether they were trade, services, food and drinks, manufacturing and processing, or handicraft enterprises. A total of 332 enterprises were randomly selected from the six study towns. From each town, 50 or more enterprises were selected. The enterprises were selected from each category and proportionate to the relative size of the category.

A structured questionnaire was administered to each selected enterprise. The questionnaire contains information on general characteristics of the business, including business type, structure, location, number and type of workers, socio-economic conditions of the operators, and other features. In addition, information was also gathered on the enterprise's finance, income and sales, credit, business environment, licenses, regulations and taxes.

Following data collection, the questionnaires were edited and the data cleaned for data entry and analyses. Frequency tables and means were produced to describe the nature of the businesses. A multivariate analysis was also employed to identify the explanatory factors for the economic performance of the businesses.

#### **1.5 Organization of the Paper**

The first section of the report is an introductory section with a description of the objectives and methods of analysis. Section two presents a theoretical framework that examines the role of enterprises and small towns in regional development. Section three briefly describes the study area and section four presents the nature and structure of small businesses in the study area. Section five describes the economic performance of different enterprises by outlining the capital and income characteristics of the businesses. Section six is a multivariate analysis in which factors affecting income and capital of small businesses are discussed. The final section (seven) of the paper outlines broad policy issues that have implications for local economic development in small urban centers.

## **II. THE ROLE OF MICRO-ENTERPRISES (SMALL ENTERPRISES) AND SMALL TOWNS IN REGIONAL DEVELOPMENT: THEORETICAL PERSPECTIVES**

### **2.1 The Role of Micro-Enterprise (Small Enterprises) in Regional Development**

Classical development theories, such as modernization and dependency theory view small/informal enterprises as generally unproductive organizations. In modernization theory, development is seen as a process whereby agriculture is gradually mechanized and small, low-productivity artisan workshops are eventually replaced by large-scale industrial enterprises with higher production. The theory assumes that the industrial structure in developing countries eventually will mirror what happened in Europe and the USA, where large-scale, capital-intensive enterprises emerged. Production would then be concentrated in towns to exploit urban labor and capital markets and other services and infrastructure. In this scenario, small, informal enterprises would eventually disappear, similar to what happened in the West.

The dependency/dominance theory views large national and international corporations dominating the economy of the world. These corporations are headquartered in the capital cities of developed countries, but their production units are spread over countries and regions where there are cheap production factors. These corporations, which exploit cheap factors of production and enjoy economies of scale, are more profitable than small local enterprise. Under these circumstance, the theory posits that small enterprises survive either in direct dependency on large enterprises, as sub-contractors to them, or as petty producers and traders operating in extremely competitive markets with little possibility for growth and accumulation of capital to invest (Pederson, 1989).

Recently, perceptions of micro-enterprises/informal sectors have changed, in part because large-scale industrial schemes have performed so poorly in Africa and other developing areas, where they did little to integrate regional and national economies. Under this type of industrialization most of the expertise, equipment, and other inputs for the industrial business sector were imported from abroad. Similarly, most of the profits from these large enterprises also left the country, with little sustainable effects on indigenous micro and small enterprises/Informal organizations (MSE/IO) (ECA, 1998). This created a space for the development of MSE/IO to develop in sectors and sub-sectors that were poorly served. Thus, the development of MSE/IO is not a temporary process but part of a process of development from below, in which small enterprises could grow into larger ones in sectors where growth was viable (ECA, 1998). The MSE/ISO, due to their smallness, could survive in regions where limited purchasing power and infrastructure prohibit medium and large enterprises. Thus, MSE/ISO contribute to decentralized development and regionally-balanced growth. MSE in many developing countries have grown and they even create more employment per unit of scarce capital than their larger counterpart businesses. Similarly, output per unit of capital is also found to exceed that which is generated by larger enterprises (Liedholm and Mead cited in Aeroe, 1992). Concomitant to the recognition of the important roles of MSE in the economy, changes in the industrialized countries have recognized the shortcomings of the neo-classical and dependency theories of industrialization.

Some recent theoretical perspectives on micro-enterprises include the network approach, flexible specialization, and industrial district or zone paradigm. Flexible specialization is based on the manufacture of custom-made products by use of multi-purpose technology and flexible production methods operated by skilled workers (Helmsing, 2000a). In flexible specialization, a firm relies on other firms that specialize in the manufacture of certain components or sub-processes and concentrates on its own sub-component and process serving its own requirement, and that of others as well. Inter-firm subcontracting is the basis of sectoral specialization. It is observed that flexible specialization in small- and medium-sized firms occurs in a spatially concentrated manner, so clusters can benefit from economies of scope (Helmsing, 2000a). While small firms were seen as disadvantaged in the past, flexible specialization has created new opportunities for small firms to engage in diverse quality production for niche markets. Clustering allows individual firms to compete in the market.

The network approach views enterprises not as a homogenous and independent entity but in a network of enterprises, organizations, and households through which commodity, labor, money, information and innovation flow. The network theory sees the production system as a system of specialized enterprises linked to other enterprises (as customers or as producers of inputs, investment goods or services), consumers, and workers by a network of commodity, person, and information flows (Pederson, 1989). The approach recognizes individual enterprise as dependent on resources controlled by other member of the network. The enterprise gets access to these resources via its position in the network (Johanson and Mattsson, cited in Aeroe, 1992). Its position is influenced by its ability to innovate which is a function of technological capacity and financial strength, and by its local political power and influential contacts (Aeroe, 1992). In network theory, a production network does not have to be clustered in space but can take many spatial forms: networks dispersed over wide territories, networks with a 'territorial core,' and agglomerated networks. Industrial networks may involve only small industries or a mix of small and large firms.

The network theory has a broad approach that views networks as not limited only to a production network but include the reproduction of the owner and his/her family and others. As such, the approach provides insight into economically-illogical business strategies in small enterprises, since it can be understood in terms of a family's overall 'investment strategy'. The approach is thought to be adequate in the African context, since it advocates for the enterprise to be dependent not only on other enterprise but also on the broader social network of the owner and his/her family.

In this study, small town's businesses are understood from a network theory perspective. Networking implies local and external linkages. The network of an enterprise includes suppliers, customers, employees, public authorities, family and friends, banks, business services, large enterprises, other small enterprises, training institutions, and sectoral and local business associations.

In this body of theory, Aeore (1992) provided a model explaining the business environment of small town enterprises. The elements of the model are agglomeration (multiplier) dynamics, demand, local socio-cultural environment, and the overall societal structure. Agglomeration dynamics is understood in terms of the different business linkages between actors involved in business. The model recognizes industrial, service, labor and local public authority linkages. In addition, linkages to customers are also specified as representing demand that influences the development of the enterprise. These linkages also are influenced by the local socio-

cultural environment. The local socio-cultural environment encompasses technological capacity, social relations, power structures, traditions, norms, and local practices. Both the agglomeration dynamics and the local socio-cultural environment influence the production of information, services, and goods. The model indicates that non-local factors related to central government policies and competition from large, non-local firms, are important factors as well.

## **2.2 Small towns in the (regional) development process**

Different ideas about the actual and potential role of small towns in development are subsumed under different schools of thought and paradigms. These represent both negative and positive views on small towns development. The negative perception is that small towns are exploitive arms of bigger centers which extract resources and capital from the rural hinterland. This view is strongly grounded in the dependency school of underdevelopment. Under this theory, infrastructural and small town development are viewed as nodes for capitalist penetration into the hinterlands to overexploit local production and resources. Consequently, small towns were seen as seats of the rural bourgeoisie and exploitive, superfluous middlemen and, therefore, not considered as a positive force in the development process (Pederson, 1995). This view suggests that small towns should be bypassed as intermediaries between large cities and the rural hinterland. One of the policy consequences of such a view is to focus on the peasants themselves and discourage small towns, even as bases for rural industrialization.

On the other hand, certain paradigms view the rising people of people who reside in urban versus rural areas, and the corresponding economic growth of cities and towns, as positive and necessary conditions for economic and social development. According to the World Development Report of 2003 (World Bank, 2003)

Urban areas offer possibilities for greater welfare because they give individuals the opportunity (through a myriad of functioning urban markets) to develop a wider and larger portfolio of assets-and to achieve higher returns to their labor. They also exist because of collective concerns to share culture, learning, religious observation and mutual protection....The shift from rural to urban society with greater mingling among diverse people, transforms social attitudes and behaviors. It reveals the limits of traditional values and institutions and intensifies pressures for change in local governance and intergovernmental relations...Cities and towns allow individuals to substitute their human capital (work effort and skills) for natural, financial and physical assets they may lack-and to more steadily transform and expand their portfolio of assets than is possible in many rural areas

The 1980s witnessed new urban theories which suggested that small towns, when supplied with adequate infrastructure, are critical for increasing the productivity of agriculture and developing rural areas generally. In this sense, small towns are expected to absorb rural migrants, who otherwise would go to large centers and cities.

As small towns are intermediaries between the rural hinterland and the large urban centers, they perform a number of functions related to collection, distribution and production. They engage in the local distribution of locally produced goods; collection and processing of local (agricultural) products for export from the region; distribution of products and services

produced outside the region, both consumer goods, inputs and investment goods, to the local market; and local processing of non local inputs for a non-local market (World Bank, 2003). These different functions are carried out by local and non-local enterprises found in these towns.

### III. THE NATURE AND CHARACTER OF THE RURAL WOREDAS AND TOWNS

#### 3.1 Rural Woredas

The study woredas, with the exception of Bati which is located in the Oromiya zone, are found in the South Wello Zone of the region. The woredas vary in their size and population number. The largest woredas in terms of aerial size are Bati and Jamma. Almost all woredas have a population over 100,000. Werilu has the largest population size with 157, 673 people (Table 3.1).

**Table 3.1 Population and area of the woredas**

| Woreda            | Study town     | Area<br>(hectares) | Woreda Population |        |         |
|-------------------|----------------|--------------------|-------------------|--------|---------|
|                   |                |                    | Male              | Female | Total   |
| <b>Jamma</b>      | <b>Dogollo</b> | 11758.75           | 61,133            | 62,515 | 123,688 |
| <b>Werilu</b>     | <b>Werilu</b>  | 11102.0            | 78,520            | 79,153 | 157,673 |
| <b>Legambo</b>    | <b>Akesta</b>  | 107557.5           | 76,562            | 79,417 | 155,979 |
| <b>Dese Zuria</b> | <b>Tita</b>    |                    |                   |        |         |
| <b>Tehuledere</b> | <b>Haik</b>    | 45816              | 71536             | 73301  | 144837  |
| <b>Bati</b>       | <b>Bati</b>    | 124696             | 56331             | 55772  | 112103  |

Source: Field survey and government statistics.

The land use structure shows that agriculture is the major land use type while in some woreda, particularly in Bati, grazing land is the largest land use category. As manifested by its semi-arid environment, Bati is mostly lowland ('kolla') and hence not as suitable for agriculture as the other districts. The woreda also receives the lowest rainfall. Jamma, Dogollo and Legambo, in turn, receive relatively abundant but erratic amounts of rainfall (Table 3.2).

**Table 3.2.: Land use and agro climate in the study woredas**

|                                  | <b>Jamma</b> | <b>Werilu</b> | <b>Legambo</b> | <b>Dese zuria</b> | <b>Tehuledere</b> | <b>Bati</b> |
|----------------------------------|--------------|---------------|----------------|-------------------|-------------------|-------------|
| <b>Land use(ha)</b>              |              |               |                |                   |                   |             |
| <i>Forest land</i>               | 1805         | 17987.5       | 657            | NA                | NA                | 613         |
| <i>Grazing land</i>              | 25808        | 9883          | 7872           | NA                | NA                | 18900       |
| <i>Agricultural land</i>         | 50508        | 52886         | 41501          | NA                | NA                | 11169       |
| <i>Bush land</i>                 | 19940        |               | 42757          | NA                | NA                | 61631       |
| <i>Unproductive land</i>         | 12989        | 15,571        | 1666           | NA                | NA                | 23940       |
| <i>Water body</i>                | 60           | 115           | 351            | NA                | NA                |             |
| <i>Settlement Construction</i>   | 6901.25      | 6864.5        | 8275.5         | NA                | NA                |             |
| <b>Rainfall (mm)</b>             | 875.5        | 691           | 1800           | NA                | >400              | 250         |
| <b>Agro-ecology</b>              |              |               |                |                   |                   |             |
| <i>Dega (highlands) (%)</i>      | 77           | 82            | 48.4           | NA                | NA                | -           |
| <i>Weina dega (midlands) (%)</i> | 23           | 18            | 49.4           | NA                | NA                | 19          |
| <i>Kolla (%) (lowlands)</i>      |              |               | 2.2            | NA                | NA                | 81          |

Source: Field survey and government statistics.

Barley, wheat, teff, peas, and beans are the main crops grown in the different study woredas, with the exception--again--of Bati where sorghum, maize, and teff are the main crops. Livestock resources, such as sheep, goats, camels, and cattle, are also found in good quantity in the study woredas. Other resources, such as mining and forestry, are limited. Minerals are not found in any of the woredas, except Werilu where coal and metallic minerals are reported. Forest resources that could be used in small scale industries are non-existent in the region. Tourism is not developed to exploit the potential of the region. The monastery in Haik is a modest tourist destination but the income from the monastery is used by the monastery itself and not by the woreda. The Bati market is also a potential attraction for cultural tourists, since it is inhabited by numerous ethnic groups (Afar, Argoba, Oromoy, Tigre, and Amahara) and has a large, colorful market.

The main rural non-farm activity practiced almost everywhere in the region is trade. In all towns, key informants have indicated that trade is the number one non-farm activity. Handicraft production is mentioned as the second most important activity in Legambo, Jamma and Werilu, while it is not important in the other three woredas. Carpet making, pottery,

weaving, and leather tanning are indicated as special skills or traditions of the people in Legambo, Jamma, and Werilu.

The majority of the woredas are food insecure and rely on external aid during much of the year. Jamma, however, is relatively food secure, although there is occasional need for food relief in the woreda. Nearly 70 % of the population in Legambo and Haik and about 40 % in Bati were dependent on food aid during at least part of 2002.

### 3.2 The towns

The study was conducted in six small towns in the Amhara region (Figure 1). Akesta, Dogollo, Werilu, Tita, Haik and Bati. As noted earlier, five of the six study towns are found in the South Wello Zone, while Bati is located in neighboring Oromiya Zone. The six towns differ in their size, location and their hinterland. although all of them are designated as small towns (Table 3.3).

**Table 3.3: Some characteristics of the study towns**

| <b>Town</b>    | <b>Population</b> | <b>Status of town</b> | <b>Distance from Desse (km)</b> | <b>Distance (km) from Kombolcha</b> | <b>Food security status of woreda</b> |
|----------------|-------------------|-----------------------|---------------------------------|-------------------------------------|---------------------------------------|
| <b>Werilu</b>  | 12,908            | Woreda capital        | 91                              | 111                                 | Food secure                           |
| <b>Akesta</b>  | 3,488             | Woreda capital        | 100                             | 120                                 | Food insecure                         |
| <b>Bati</b>    | 19,504            | Woreda capital        | 65                              | 42                                  | Food insecure                         |
| <b>Dogollo</b> | 4,959             | Woreda capital        | 119                             | 139                                 | Food secure                           |
| <b>Tita</b>    | 2595              | Other town            | 10                              | 30                                  | Food insecure                         |
| <b>Haik</b>    | 12,000            | Woreda capital        | 30                              | 50                                  | Food insecure                         |

Source: Field survey and government statistics.

Bati and Haik are the largest of the six study towns. Haik is found along the Addis-Mekele road and close to Dessie town and Bati is located along the Addis-Asseb-Djibouti road and near to Kolmbolcha city. The other towns are found off the main road at a considerable distance from Desse and Kombolcha, the two main urban centers in the area. All the study towns, however, are served by all weather roads.

Petty trading is the main source of income for the towns' people. Farming can involve informal commercial contracting, but most is subsistence oriented and accounts for the 2<sup>nd</sup> source of income in the majority of the towns. Services and government work are the third and fourth most important income-earning activities in the towns (Table 3.4).

**Table 3.4 : Main income sources in the towns**

|                | <b>Petty Trade</b> | <b>Farming</b>  | <b>Services</b> | <b>Government</b> |
|----------------|--------------------|-----------------|-----------------|-------------------|
| <b>Werilu</b>  | 1 <sup>st</sup>    | 2 <sup>nd</sup> | 3 <sup>rd</sup> | 4 <sup>th</sup>   |
| <b>Akesta</b>  | 1 <sup>st</sup>    | 2 <sup>nd</sup> | 3 <sup>rd</sup> | 4 <sup>th</sup>   |
| <b>Dogollo</b> | 1 <sup>st</sup>    | 2 <sup>nd</sup> | -               | 3 <sup>rd</sup>   |
| <b>Tita</b>    | NA                 | NA              | NA              | NA                |
| <b>Haik</b>    | 1 <sup>st</sup>    | 2 <sup>nd</sup> |                 | 3 <sup>rd</sup>   |
| <b>Bati</b>    | 1 <sup>st</sup>    | 3 <sup>rd</sup> | -               | 2 <sup>nd</sup>   |

Source: Field survey

Data on licensed businesses in the small towns indicate that merchandise retail, grain trade and grinding mills, and hotels are the main types of businesses in the study towns. This is an indication of the importance of trade and services in the economic structure of small towns. Business related to livestock and hides and skins are important mainly in Akesta and Dogollo because of the sizeable availability of livestock resources. Blacksmithing, woodwork, and metalwork are not widely practiced in the small towns (Table 3.5).

Four towns--Tita, Akesta, Bati and Haik--are found in food insecure woredas while Dogollo and Werilu are found in relatively better off woredas. The fact that the majority of towns are found in food insecure woredas makes enterprise and business development critical for providing alternative income to enhance food security and reduce poverty in the region.

Informants in Tita, Werilu and Haik mainly perceived of their towns either as stagnating or declining. The major problems cited were poorly maintained roads, lack of education and health services, problems of water and electric supply and lack of attention by the government. Bati town, in turn, is noted by local respondents as a growing town. The sources of this growth are believed to be the expansion of trade and government activities in the location.

Though the study towns are selected mainly because they fall in the BASIS project study area, the fact that the towns show distinct characteristics may have some theoretical implications. Classic geographic theories state that small town growth depends on available demand from surrounding areas. As a result, one would expect that the towns in food secure areas would do better than those in food insecure areas. Other theories argue that small towns are intermediary connecting rural areas to wider markets, so roads and market access are essential. According to this view, those towns which are better situated in terms of infrastructure would be expected to have more developed enterprises. The third theory emphasizes the modernization/urbanization roles of cities suggesting that large towns will do better than smaller towns.

**Table 3.5: Number of licensed businesses in small towns**

|   | Werilu | Akesta | Dogollo | Tita | Haik | Bati |
|---|--------|--------|---------|------|------|------|
| <b>Grain trade</b>                              | 32     | 5      | 26      | 3    | 15   | 27   |
| <b>Grinding mill</b>                            | 34     | 15     | 48      | 2    |      | 16   |
| <b>Merchandise retail</b>                       | 57     | 20     | 31      | 15   | 22   | 126  |
| <b>Tej bet (liquor)</b>                         | 37     | 3      | 15      | 2    |      |      |
| <b>Cloth selling</b>                            | 27     |        |         |      |      |      |
| <b>Shoe shops</b>                               | 3      |        |         |      |      |      |
| <b>Butchery</b>                                 | 5      | 3      | 25      |      |      |      |
| <b>Hotels, beds, restaurants and cafeterias</b> | 7      | 4      | 8       | 10   | 24   | 30   |
| <b>Tea rooms</b>                                |        |        |         | 2    | 7    |      |
| <b>Bakery</b>                                   | 4      |        |         |      | 2    |      |
| <b>Grocery</b>                                  | 1      |        |         |      |      |      |
| <b>Photograph</b>                               | 1      |        |         |      | 3    | 2    |
| <b>Pharmacy</b>                                 | 3      |        | 1       | 1    | 3    |      |
| <b>Coffee retail</b>                            | 2      | 3      | 6       |      |      |      |
| <b>Livestock</b>                                |        | 4      | 8       |      |      |      |
| <b>Hides and skins</b>                          |        | 8      | 4       |      |      |      |
| <b>Metal work</b>                               |        |        |         |      | 2    | 2    |
| <b>Wood work</b>                                |        |        |         |      |      | 4    |
| <b>Pottery</b>                                  |        |        | 2       |      |      |      |
| <b>Tailoring</b>                                |        |        |         |      |      | 3    |
| <b>Gold and silver smith</b>                    |        |        |         |      | 1    | 5    |
| <b>Kerosene selling</b>                         |        | 2      | 4       |      |      |      |
| <b>Barber</b>                                   |        |        |         | 2    |      | 5    |
| <b>Tire repair</b>                              |        |        |         |      |      | 2    |

Source: Field survey

## IV. THE NATURE OF SMALL TOWN'S BUSINESSES: BUSINESS AND OPERATORS' CHARACTERISTICS.

### 4.1 Business Characteristics

#### 4.1.1 Activity Type, Periods of Establishment and Premises

A total of 332 businesses are run by 315 operators in the study area. This shows that most operators run a single business and only a few operators run more than one business activity.

A wide range of activities are practiced in the study area. These include services, trade, food and drink making and selling, manufacturing and processing, handicraft and cottage. Services account for 33 % of total business activities and are the predominant type of activities in the study area (Table 4.1). They include construction, repair, tailoring, photographing, transport, shoe shining, barbers, etc. Food and drinks, accounting for 27 % of all the activities in the study area, are the second most important activity. Hotels and beds, restaurants, tea and pastry, bakery, injera making, butchery, and traditional drink making are included in this category. The two activities, services and food and drinks, 60 % of all enterprise activities in the study area. Trade, handicraft and manufacturing and processing account for 22, 11 and 7 percent, respectively, of the interviewed establishments. Traditional crafts and processing represent the smallest category of business activities in the study area. However, some towns, such as Werilu and Tita, have a relatively high proportion of businesses in the handicraft sector.

**Table 4.1: Activity type in the study towns**

| Activity type                       | No  | %     |
|-------------------------------------|-----|-------|
|                                     |     |       |
| <b>Trade Activities</b>             | 72  | 21.7  |
| <b>Food and drinks</b>              | 91  | 27.4  |
| <b>Manufacturing and processing</b> | 24  | 7.2   |
| <b>Handicraft and cottage</b>       | 35  | 10.5  |
| <b>Services</b>                     | 110 | 33.1  |
| <b>Total</b>                        | 332 | 100.0 |

Source: Enterprise survey

Most of the businesses (53.3%) are recently established enterprises and have been in operation for 6 years or less (Table 4.2). The operators of these enterprises have little experience in running a business. Those businesses, which were established from 6 to 16 years ago are about 33 %, while those 17 years or older comprise 13 % of our sample.

**Table 4.2: Year Businesses Started and Number of Years Since Establishment**

| <b>Year started</b> | <b>Number of business</b> | <b>%</b> |
|---------------------|---------------------------|----------|
| <b>1953-1963</b>    | 6                         | 1.8      |
| <b>1964-1974</b>    | 13                        | 3.9      |
| <b>1975-1985</b>    | 25                        | 7.5      |
| <b>1986-1996</b>    | 111                       | 33.4     |
| <b>1996-2002</b>    | 177                       | 53.3     |
| <b>Total</b>        | 332                       | 100      |

Source: Field survey

Location is a key factor for successful informal enterprises, since it is essential for gaining access to resources and the necessary markets for accumulation and growth (Ranjit and Nurlamin, 1995). Moreover, the physical premises of small, informal businesses not only determines their profitability, but also their credit worthiness. They reflect the viability of the enterprise and can help to secure a loan. In most cases, informal enterprises use their home as work places because of a lack of suitable premises in advantageous locations.

The survey data show that about 71 % of the enterprises have no fixed business premise. These businesses mainly use their home, a road side or traditional market sites as their working places. The home is used by 38 % of enterprises, while traditional market and road side locations are used by 18 % and 10 %, respectively (Table 4.3).

**Table 4.3: Location of businesses in different towns (percentage in parentheses)**

| Location                           | Akesta       | Dogolo       | Weriliu      | Tita         | Haik         | Bati         | Total         |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| <b>Home</b>                        | 25<br>(20)   | 21<br>(16.8) | 20<br>(16.0) | 29<br>(51.7) | 18<br>(14.4) | 12<br>(9.6)  | 125<br>(37.7) |
| <b>Traditional market</b>          | 5<br>(27.8)  | 3<br>(16.7)  | 3<br>(16.7)  | 4<br>(22.2)  | -            | 3<br>(16.7)  | 18<br>(18.38) |
| <b>Commercial district shop</b>    | 13<br>(14.3) | 13<br>(14.3) | 14<br>(15.4) | 7<br>(7.7)   | 24<br>(26.4) | 20<br>(22.0) | 91<br>(27.49) |
| <b>Roadside</b>                    | 6<br>(18.8)  | 4<br>(12.5)  | 4<br>(12.5)  | 7<br>(21.9)  | 2<br>(6.3)   | 9<br>(28.1)  | 32<br>(9.66)  |
| <b>Mobile</b>                      | 12<br>(20.0) | 9<br>(15.0)  | 11<br>(18.3) | 8<br>(13.3)  | 8<br>(13.3)  | 12<br>(20.0) | 60<br>(18.12) |
| <b>Industrial site</b>             | -            | -            | -            | -            | -            | 1<br>(100)   | 1<br>(0.3)    |
| <b>Around the court</b>            | -            | -            | 1<br>(50)    | -            | -            | 1<br>(50)    | 2<br>(0.6)    |
| <b>Home and traditional market</b> | -            | -            | -            | 1<br>(100)   | -            | -            | 1<br>(0.3)    |
| <b>Home and roadside</b>           | -            | -            | -            | -            | 1<br>(100)   | -            | 1<br>(0.3)    |
| <b>Total</b>                       |              |              |              | 56           |              |              | 331<br>(100)  |

Source: Field survey

Those who use commercial district shops are about 28 %. A significant proportion (18 %) are mobile businesses with no fixed locations.

The location of a business seems to have some relationship with the size of the town. For example, a relatively large proportion of businesses in Bati and Haik are located in commercial districts, while business in smaller centers such as Tita and Akesta are based at home or are mobile.

#### **4.1.2 Reasons for Starting up Business and Activity**

Business enterprises in the study towns are mostly started by those who had no option at all. About half (51 %) of those who are heading enterprises cited lack of an alternative livelihood as the prime motive for engaging in a business activity (Table 4.4). This response is in line

with the hypothesis that most microenterprises, especially in the petty trade sector, are initiated by those with few or no alternatives.

**Table 4.4: Reasons for starting up business**

| Reasons                              | No         | %          |
|--------------------------------------|------------|------------|
| No options available                 | 161        | 51.1       |
| Small business provide better income | 33         | 10.5       |
| Preference to work for oneself       | 93         | 29.5       |
| To supplement income                 | 28         | 8.9        |
| <b>Total</b>                         | <b>315</b> | <b>100</b> |

Source: Field survey

The response of ‘no alternative’ is the most frequently cited reason for choosing a particular activity type within the small business sector (Table 4.5). A belief that a specific business venture could be profitable was only cited by about 26 % of enterprise operators.

**Table 4.5 : Reasons for engaging in small business activity**

| Reasons   | Number     | %          |
|---|------------|------------|
| Skilled in the activity                                 | 50         | 15.9       |
| Family has worked in the same activity                  | 41         | 13.0       |
| Business is profitable                                  | 81         | 25.7       |
| Capital requirement of the business match own resources | 31         | 9.8        |
| Had no alternative other than the current activity      | 112        | 35.6       |
| <b>Total</b>  | <b>315</b> | <b>100</b> |

Source: Field survey

## 4.2 Business Operators' Characteristics: Demographics and Socioeconomic Conditions

### 4.2.1 Gender and Age of Operators

Table 4.6 gives the gender of interviewees for the main activity groups. It shows that about 19 % of the operators are females. A higher participation of females (79 %) is noted in the food and drinks category. Perhaps this is not surprising given the fact that businesses in the food and drinks category involve 'injera making and selling'; 'tela and araki making and selling' which are both dominated by women. The second highest proportion of females, with each accounting for 8 %, are found in trade activities and handicraft sector. There are no females participating in manufacturing and processing. A significant proportion of males (39.4%) is found mainly in the service sector, followed by trade (26.4%) and food and drinks (14.2%).

**Table 4.6: Gender of operators by activity type (percentage in parentheses)**

| Activity type                | Male          | Female       | Total         |
|------------------------------|---------------|--------------|---------------|
| Trade Activities             | 67<br>(26.4)  | 5<br>(8.2)   | 72<br>(22.9)  |
| Food and drinks              | 36<br>(14.2)  | 48<br>(78.7) | 84<br>(26.7)  |
| Manufacturing and processing | 23<br>(9.1)   |              | 23<br>(7.3)   |
| Handicraft and Cottage       | 28<br>(11.0)  | 5<br>(8.2)   | 33<br>(10.5)  |
| Services                     | 100<br>(39.4) | 3<br>(4.9)   | 103<br>(32.7) |
| <b>Total</b>                 | 254<br>(100)  | 61<br>(19.4) | 315<br>(100)  |

Source: Field survey

The average age of business operators is nearly 38 years old, with females being older (43.5 years) and males being younger (36.4 years) (Table 4.7). The reason for the younger average age of males is due to the presence of some younger males (ages 13-14 years) engaged in street-based activities, such as shoe shining. The age group distribution shows that most of the operators (34.9%) are found in the 26 to 36 year age group, which shows that most operators are relatively young. Only 12.4 % of business operators are 59 years or older. The proportion (24.6 %) of female operators in this older age group is considerably higher than it is for males (9.4%).

**Table 4.7: Age and gender distribution of business operators**

| <b>Age group</b>   |              |              | <b>Total</b>  |
|--------------------|--------------|--------------|---------------|
|                    | Males        | Females      |               |
| <b>13-14</b>       | 6<br>(2.4)   | -            | 6<br>(1.9)    |
| <b>15-25</b>       | 46<br>(18.1) | 11<br>(18.0) | 57<br>(18.1)  |
| <b>26-36</b>       | 95<br>(37.4) | 15<br>(13.6) | 110<br>(34.9) |
| <b>37-47</b>       | 54<br>(21.3) | 8<br>(13.1)  | 62<br>(19.7)  |
| <b>48-58</b>       | 29<br>(11.4) | 12<br>(19.7) | 41<br>(13.0)  |
| <b>59 +</b>        | 24<br>(9.4)  | 15<br>(24.6) | 39<br>(12.4)  |
| <b>Total</b>       | 254<br>(100) | 61<br>(100)  | 315<br>(100)  |
| <b>Average age</b> | 36.4         | 43.5         | 38            |

Source: Field Survey

#### **4.2.2 Family Size and Family Status of Operators**

The average family size of those interviewed is 3.93, which is considerably smaller than the size of rural households in the region (see Little and Negatu 2003). The mean size of the economically active members of the average household is 2.6 persons (Table 4.8). The proportion of economically active members is 0.67, which indicates that nearly two-thirds of family member are active. The inter-town variation in family size and economically active members is very slight.

**Table 4.8: Household Size and Economically Active Members**

| Town         | Mean family size | Average number of economically active household members | Proportion of economically active household members |
|--------------|------------------|---|---|
| Akesata      | 4.10             | 2.61  | 0.63  |
| Dogolo       | 3.63             | 2.48  | 0.68  |
| Werilu       | 3.52             | 2.65  | 0.75  |
| Tita         | 4.76             | 2.86  | 0.60  |
| Haik         | 3.58             | 2.59  | 0.72  |
| Bati         | 3.98             | 2.64  | 0.66  |
| <b>Total</b> | 3.93             | 2.64  | 0.67  |

Source: Field survey

Table 4.9 shows that almost all businesses are run by family members, who are either heads, spouses or children. Most of the business operators are household heads (87.9%), while spouses and children represent 5.1 % and 5.7 %, respectively.

**Table 4.9: Gender and family status of business operator (percentage in parentheses)**

| Operator status in the family | Male           | Female       | Total         |
|-------------------------------|----------------|--------------|---------------|
| <b>Head</b>                   | 231<br>(90.9)  | 46<br>(75.4) | 277<br>(87.9) |
| <b>Spouse</b>                 | 3<br>(1.2)     | 13<br>(21.3) | 16<br>(5.1)   |
| <b>Child</b>                  | 17<br>(6.7)    | 1<br>(1.6)   | 18<br>(5.7)   |
| <b>Relative</b>               | -              | 1<br>(1.6)   | 1<br>(0.3)    |
| <b>Hired worker</b>           | 1<br>(0.4)     | -            | 1<br>(0.3)    |
| <b>Delegate</b>               | 1<br>(0.4)     | -            | 1<br>(0.3)    |
| <b>Cooperative</b>            | 1<br>(0.4)     | -            | 1<br>(0.3)    |
| <b>Total</b>                  | 254<br>(100.0) | 61<br>(100)  | 315<br>(100)  |

Source: Field survey

### 4.2.3 Education and Training

Table 4.10 shows that 23 % of business operators have no formal education. Nearly half or 48 % of the female operators fall in this category. At the other end of the spectrum, only 4.4 % of household heads have more than 12 years of education.

**Table 4.10: Educational status of business operators**

| Education level               | Male         | Female       | Total         |
|-------------------------------|--------------|--------------|---------------|
| <b>None</b>                   | 43<br>(16.9) | 29<br>(47.5) | 72<br>(22.9)  |
| <b>Church/Kuranic school</b>  | 1<br>(0.4)   | -            | 1<br>(0.3)    |
| <b>Primary (1-6)</b>          | 76<br>(29.9) | 14<br>(23.0) | 92<br>(28.6)  |
| <b>Junior secondary (7-8)</b> | 36<br>(14.2) | 2<br>(3.3)   | 38<br>(12.1)  |
| <b>Secondary</b>              | 84<br>(33.1) | 16<br>(26.2) | 100<br>(31.7) |
| <b>12+2</b>                   | 2<br>(0.8)   | -            | 2<br>(0.6)    |
| <b>Diploma</b>                | 11<br>(4.3)  | -            | 11<br>(3.5)   |
| <b>Degree</b>                 | 1<br>(0.4)   | -            | 1<br>(0.3)    |
| <b>Total</b>                  | 254<br>(100) | 61<br>(100)  | 315<br>(100)  |

Source: Field survey

In the sample there is no female respondent with more than 12 years of education. The modal group (32 %) had some secondary education. A substantial number (29 %) also had primary education. These indicate that a significant number of business operators in the study towns have had considerable exposure to formal education, especially when compared to the general population of the region (see Little and Negatu 2003). Since most operators (about 35 %) fall in the age group between 26 to 36 years, it is safe to conclude that business opportunities are skewed toward younger and better educated persons (especially males). However, there is limited opportunity for uneducated, older and female group particularly in such activities

‘food and drinks.’ In looking at gender and education by activity category it is revealed that the majority of females (79.3 %) with no education are engaged in ‘food and drinks.’

The overwhelming majority of both male and female business operators do not have any business training (Table 4.11). Less than 3 % of entrepreneurs reported some kind of business training, ranging from 1 to more than 12 months. This reflects very minimal linkages between business owners and local and external training institutions. Along similar lines, the majority of operators (96 %) have not received any form of technical training. Only 1.3 % or four males reported that they had received training from a technical training institute.

**Table 4.11: Business Training Received by Sex of Operators**

| <b>Duration of business training</b> | <b>Male</b>   | <b>Female</b> | <b>Total</b>  |
|--------------------------------------|---------------|---------------|---------------|
| <b>None</b>                          | 243<br>(96.8) | 58<br>(95.1)  | 301<br>(96.5) |
| <b>1-4 weeks</b>                     | 1<br>(0.4)    | -             | 1<br>(0.3)    |
| <b>1-3 months</b>                    | 1<br>(0.4)    | 2<br>(3.3)    | 3<br>(1.0)    |
| <b>4-12 months</b>                   | 2<br>(0.8)    | 1<br>(1.6)    | 3<br>(1.0)    |
| <b>More than 1 year</b>              | 4<br>(1.6)    | -             | 4<br>(1.3)    |
| <b>Total</b>                         | 251<br>(100)  | 61<br>(100)   | 312<br>(100)  |

Source: Field Survey

#### **4.2.4 Asset Ownership**

Family assets have important implications for business operations. For instance, a person who has his/her own residence can use it as loan collateral. This, of course, depends on the type of residence owned, since some housing structures may have little or no market value. The survey shows that more than 50 percent of business operators possess their own residence (Table 4.12). A significant proportion (about 42 %), however, do not own a residential building. Those who lack their own business separate premises account for a large proportion of the total sample (about 71 %). Assets, such as televisions, are owned by only 11 % of operators, while most (62 %) own a radio. The lack of TV ownership by operators limits their access to market and other important information.

**Table 4.11: Asset ownership by families (number in parentheses)**

| <b>Asset type</b>                         | <b>Yes</b>    | <b>No</b>      |
|---|---------------|----------------|
| <b>Own building</b>                       | 57.8<br>(182) | 42.2<br>(133)  |
| <b>Own building-<br/>Business premise</b> | 28.9<br>(91)  | 71.1<br>(224)  |
| <b>Vehicle</b>                            | 4.8<br>(15)   | 95.2<br>(22.4) |
| <b>TV</b>                                 | 11.1<br>(35)  | 88.9<br>(280)  |
| <b>Radio</b>                              | 61.9<br>(195) | 38.1<br>(120)  |
| <b>Refrigerator</b>                       | 9.5<br>(30)   | 90.5<br>(285)  |

Source: Field survey

## **V. SMALL TOWN BUSINESS IN A NETWORK**

### **5.1 Agglomeration Dynamics and business linkages**

The agglomeration dynamics and business linkages of small towns' business are discussed by looking at their different linkages. The discussion in this section attempts to identify employment levels (participation in labor market), partnership and cooperation and linkages with the banks and traditional financial institutions, the farm sector, and local authorities.

#### **5.1.1 Employment levels and participation in labor market**

Employment levels vary by type of business. The total number employed by the sample enterprises is 601 (Table 5.1). About 64 % of this total is accounted by 'food and drinks' (38 %) and services ( 26 %). Thus, 'Food and drinks' and services dominate both the number of enterprises and employment in the study towns. Handicraft and cottage and manufacturing and processing industries generate considerably less employment.

Most of the businesses are single-person operated enterprises. Trade, handicraft, and services average 1.43 employees per establishment. Those with over 2 persons per establishment are food and drinks (2.48) and manufacturing (2.71) (Table 5.1).

**Table 5.1 : Employment in the study area**

| Activity type                       | Hired labor |      |                   | Family labor |      |                   | Total |      |                   |
|-------------------------------------|-------------|------|-------------------|--------------|------|-------------------|-------|------|-------------------|
|                                     | No          | %    | Avg/establishment | No           | %    | Avg/establishment | No    | %    | Avg/establishment |
| <b>Trade Activities</b>             | 12          | 7.7  | 1.50              | 91           | 20.4 | 1.26              | 103   | 17.1 | 1.43              |
| <b>Food and drinks</b>              | 79          | 50.1 | 2.19              | 147          | 33.0 | 1.65              | 226   | 37.6 | 2.48              |
| <b>Manufacturing and processing</b> | 31          | 19.9 | 1.82              | 34           | 7.6  | 1.42              | 65    | 10.8 | 2.71              |
| <b>Handicraft and cottage</b>       | 9           | 5.8  | 2.25              | 41           | 9.2  | 1.21              | 50    | 8.3  | 1.43              |
| <b>Services</b>                     | 25          | 16.0 | 1.79              | 132          | 29.7 | 1.22              | 157   | 26.1 | 1.43              |
| <b>Total</b>                        | 156         | 100  | 1.97              | 445          | 100  | 1.36              | 601   | 100  | 1.81              |

Source: Field survey

Family labor is by far the most important source of labor. About 74% of the total workers are family members. Unpaid family labor helps the small enterprises to minimize their cost of operation, but the firms cannot tap the best talents from the labor market.

The gender dimension of enterprises shows there is a gender-based specialization in the different types of businesses, since some sectors are entirely dominated by males, and others by females (see table 4.6).

The labor market is dominated by new entrants. Prior to their present business activities, many operators were students (25%), farmers (14%), military (11%), and/or unemployed (10%) (Table 5.2). These new entrants face great difficulty in establishing a reputation in their business. About 8 % had prior experience in the particular type of business while another 9 % worked in a totally different line of work. Thus, it is only a few operators who had prior relative business experience. The extent to which employees and owners offer technical capability to the enterprise depends on his (her) training background and previous experience as an entrepreneur. From an examination of the characteristics of the operators, although the majority have been exposed to formal education at primary and secondary levels, they lack business and technical training. Similarly, previous entrepreneurship experience is rare, especially among new business owners. Only about 13 %) of the respondents reported that they are engaged in the business because the family worked in the same type of enterprise activity (Table 4.5). These individuals must have learned the trade from their parents, even if they had no formal business training.

**Table 5.2: Occupation before heading the enterprise**

| Previous occupation  | No         | %            |
|--|------------|--------------|
| Unemployed   | 33         | 10.5         |
| First job (previously too young to work)                   | 22         | 7.0          |
| Stayed at home   | 5          | 1.6          |
| Worked as paid employee in same line of work               | 8          | 2.6          |
| Worked as paid employee in other line of work              | 9          | 2.9          |
| Operated another small business in same line of work       | 17         | 5.4          |
| Operated in another small business in another line of work | 20         | 6.4          |
| Farmer   | 45         | 14.4         |
| Military   | 34         | 10.9         |
| Student  | 77         | 24.6         |
| Other  | 39         | 13.7         |
| <b>Total</b>   | <b>313</b> | <b>100.0</b> |

Source: Field survey

### 5.1.2 Partnerships and Cooperation

Joint venture partnerships hold very significant advantages for small enterprises, because they enable them to acquire experience and skills and also to enter new markets and access additional financing. However, almost all of the businesses in the study area are sole proprietorships. In total, about 97 % are run by a single owner. There are no subsidiary businesses or share-holding companies. Those who reported some form of partnership are only about 2 % of total businesses. This is in stark contrast to the experiences of other countries, where small town business tend to be subsidiary operations of large companies located elsewhere.

Business associations help to protect the interests of members. However, the overwhelming majority (98%) in the study region do not belong to any kind of business association. Only six enterprise owners (all in Tita town) indicated that they are members of an association. Because of Tita's proximity to Dese town, businesses there are more likely to be part of a Dese-based association. The fact that businesses are not part of any association implies that collective actions among operators are non-existent. An enabling institutional policy

environment cannot be created without an organization (s) representing the interests of small businesses.

**Table 5.3: Membership in business groups or informal associations**

| <b>Town</b>   | <b>Yes</b> | <b>No</b>     | <b>Total</b> |
|---------------|------------|---------------|--------------|
| <b>Akesta</b> | 0          | 60<br>(100)   | 60<br>(100)  |
| <b>Dogolo</b> | 0          | 46<br>(100)   | 46<br>(100)  |
| <b>Werilu</b> | 0          | 50<br>(100)   | 50<br>(100)  |
| <b>Tita</b>   | 6<br>(12)  | 44<br>(88)    | 50<br>(100)  |
| <b>Haik</b>   | 0          | 53<br>(100)   | 53<br>(100)  |
| <b>Bati</b>   | 0          | 56<br>(100)   | 56<br>(100)  |
| <b>Total</b>  | 6<br>(1.9) | 309<br>(98.1) | 315<br>(100) |

Source: Field survey

### **5.1.3 Use of Bank Services and Traditional Financial Institutions**

A relatively significant number of businesses in Haik and Bati towns have bank accounts for both business and personal savings. In both cases nearly 25 % of the enterprises have bank accounts for business activity, while nearly one-third have bank accounts for personal savings. The use of banks in Akesta and Tita is very minimal (Table 5.4).

**Table 5.4: Percentage of enterprises who own bank accounts**

| Town           | Bank account for business<br>(number) | Bank account for personal<br>savings (number) |
|----------------|---------------------------------------|---|
| <b>Akesta</b>  | 5<br>(3)                              | 6.7<br>(4)                                    |
| <b>Dogollo</b> | 15.2<br>(7)                           | 19.6<br>(9)                                   |
| <b>Werilu</b>  | 20<br>(10)                            | 18<br>(9)                                     |
| <b>Tita</b>    | 2<br>(1)                              | 6.1<br>(3)                                    |
| <b>Haik</b>    | 24.5<br>(13)                          | 32.1<br>(17)                                  |
| <b>Bati</b>    | 25<br>(14)                            | 33.9<br>(19)                                  |

Source: Field survey

\*Figures in parenthesis are reporting numbers.

Very few enterprises reported borrowing in the last 12 months. Only 43 establishments or 13.6 % borrowed funds in the past year (Table 5.5). The average amount borrowed was 40,255.12 birr, which is relatively large because a few sizeable enterprises borrowed a significant sum of money from formal banks. A fairly large percentage of borrowers (30 %) needed a guarantor to take a loan.

**Table 5.5: Number of businesses who borrowed during past year and average amount of the loan**

| Town          | Number borrowed | Average amount borrowed | Number of Business which needed collateral | Number of business which needed Guarantor |
|---------------|-----------------|-------------------------|--|---|
| <b>Akesta</b> | 3               | 26883                   | 0  | 1   |
| <b>Dogolo</b> | 10              | 17310                   | 4  | 2   |
| <b>Werilu</b> | 8               | 16912.50                | 3  | 2   |
| <b>Tita</b>   | 9               | 544.44                  | 0  | 2   |
| <b>Haik</b>   | 7               | 189314.29               | 2  | 5   |
| <b>Bati</b>   | 6               | 1970                    | 0  | 1   |
| <b>Total</b>  | 43              | 40255.12                | 9  | 13  |

Source: Field survey

The Amhara Credit and Savings Institute (ASCI), as well as friends and relatives are the main sources of business credit in the region (Table 5.6). Banks and other micro-finance institutions are not as important. Those who borrowed from banks was only nine out of the 43 enterprises that had loans. Borrowing from friends and relatives signifies the importance of social capital in running a business. In fact about 42 % of the interviewees indicated that they were able to borrow at any time relatively large amounts of money from friends and relatives.

**Table 5.6: Source of Credit by town**

| Town          | Source of credit |                     |       |                       |       |       |
|---------------|------------------|---------------------|-------|-----------------------|-------|-------|
|               | ASCI             | Other micro finance | Banks | Friends and Relatives | Other | Total |
| <b>Akesta</b> |                  |                     |       | 3                     |       | 3     |
| <b>Dogolo</b> | 7                |                     | 2     | 1                     |       | 10    |
| <b>Werilu</b> | 3                |                     | 2     | 1                     | 2     | 8     |
| <b>Tita</b>   | 6                |                     | 2     | 1                     |       | 9     |
| <b>Haik</b>   |                  | 1                   | 2     | 4                     |       | 7     |
| <b>Bati</b>   | 1                |                     | 1     | 4                     |       | 6     |
| <b>Total</b>  | 17               | 1                   | 9     | 14                    | 2     | 43    |

Source: Field survey

Those who reported that they can rely on friends and relatives for credit comprise 43 % of surveyed business owners in Akesta, 30 % in Dogollo, 28 % in Werilu, 31 % in Tita, 62 % in Haik, and 54 % in Bati. The average potential loan amount from friends and relatives was indicated to be about 8,153 birr, which could be kept for about 40 days without repayment. Again, this signifies the importance of friends and relatives as a source of capital for small businesses in small towns, a pattern that is even more important for farmers in the area (see Little and Negatu 2003). Those who have borrowed money from different sources pay a small amount of interest. The total average is only 26 birr per year (Table 5.7). This could be due to the absence of interest on much of the credit obtained from friends and relatives. On the other hand, the borrowers have short repayment periods, only an average of about 8 months. Loans are mainly used to finance working capital requirements.

**Table 5.7: Average interest rate and repayment period.**

| Town          | Average Interest rate/year | Average Repayment period in months |
|---------------|----------------------------|------------------------------------|
| <b>Akesta</b> | -                          | 4                                  |
| <b>Dogolo</b> | 44.67                      | 9.3                                |
| <b>Werilu</b> | 31.43                      | 10                                 |
| <b>Tita</b>   | 22.78                      | 7.22                               |
| <b>Haik</b>   | 7.33                       | 6.65                               |
| <b>Bati</b>   | 1.51                       | 8.75                               |
| <b>Total</b>  | 25.96                      | 8.2                                |

Source: Field survey

The principal source of funds for initial investment and operating capital is one's own savings. Over 60 % of the respondents reported own savings for initial investment and over 90 % reported the same source for operating capital. The second most important source of funds to start the business are friends and relatives. The two sources together account for over 80 % of the capital borrowed, while the proportion of those who reported both sources of credit for working capital is even higher than this. The importance of banks, moneylenders, and government loans as sources of capital to start businesses is not significant.

Supplier credit is not very common among small businesses. On average only 20 % of enterprises reported that they buy items from suppliers on credit, including 37 % in Haik, 17 % in Bati, and 17 % in Tita. Bati is a relatively large center in the study area while Tita is very close to Desse, the capital city of South Wello Zone. As a result, fewer enterprises in these towns purchase items on credit and even in the other three towns, only 10 to 13% of businesses utilize supplier credit.

Inadequate banking and credit services are among the major constraints to small business development in the study areas. Most of the enterprises are forced to operate using a small amount of capital obtained through their own savings or from relatives.

**Participation in Iquib and Iddir.** Iquib and iddir (also called kire in some areas) are traditional means of raising money for different purposes. Iquib is a local institution that involves a revolving fund, which is contributed by its members. Iddir has more of a social function, assisting members with the costs of funerals and other expenses related to the loss of a family member or relative.

About one fourth of the interviewees participated in iquib (Table 5.8). The highest is found in Dogolo where a little over half of those interviewed have participated in Iquib over the last 12 months. The duration of the iquib is mostly for about 10 months during which time members contribute an average of 313 birr. This money can be drawn from the profits of the enterprise and is an indication that those who are participating have a higher saving capacity.

**Table 5.8: Participation in Iqib and the amount of payments**

| <b>Town</b>    | <b>% Participation in Iqib (# of cases)</b> | <b>Average Monthly contribution (birr)</b> | <b>Average duration of Iqib (month)</b> | <b>Average number of Iqib members</b> | <b>Average amount paid to individuals</b> |
|----------------|---|--|---|---------------------------------------|---|
| <b>Akesta</b>  | 30<br>(18)                                  | 81.94                                      | 7.58                                    | 38.17                                 | 287.25                                    |
| <b>Dogolow</b> | 54.3<br>(25)                                | 285.60                                     | 10.33                                   | 42.92                                 | 410.42                                    |
| <b>Wereilu</b> | 26<br>(13)                                  | 691.54                                     | 13.31                                   | 60.62                                 | 2454.55                                   |
| <b>Tita</b>    | 20<br>(10)                                  | 47.30                                      | 9.20                                    | 40.11                                 | 1923.11                                   |
| <b>Haik</b>    | 13.2<br>(7)                                 | 283.71                                     | 7.57                                    | 24.00                                 | 20520.0                                   |
| <b>Bati</b>    | 17.9<br>(10)                                | 594.0                                      | 9.00                                    | 26.60                                 | 1055.56                                   |
| <b>Total</b>   | 26.3<br>(83)                                | 313.3                                      | 9.66                                    | 40.77                                 | 2308.84                                   |

Source: Field survey

Only 41 % of those who participated responded to the question on the use of money, but of those the majority used the money for business expansion (Table 5.9). This indicates that Iqib could be used as an instrument to promote businesses in the area. A substantial number of those who responded also use their savings from Iqib for consumption purposes, particularly for food and clothes purchases.

**Table 5.9 : Use of Iqub**

| <b>Reason</b>                       | <b>Number</b> | <b>%</b> |
|-------------------------------------|---------------|----------|
| <b>Food and clothes</b>             | 11            | 32.35    |
| <b>Health and Education</b>         | 3             | 8.88     |
| <b>Expanding small business</b>     | 14            | 41.17    |
| <b>Purchase of Cattle and horse</b> | 2             | 5.88     |
| <b>Household assets</b>             | 2             | 5.88     |
| <b>Food and business expansion</b>  | 2             | 5.88     |
| <b>Total</b>                        | 34            | 100      |

Source: Field survey

Iddir is more frequently practiced in the area than iqub (Table 5.10). About 79 % of the interviewees participate in iddir. The monthly contribution is very low (about 2 birr). Iddir has no role in business expansion, since it does not provide loans nor is used as a capital fund for businesses. The major purpose of iddir as expressed by participants is for assistance at times of death. In the absence of functioning credit and insurance markets and welfare services, communities need to retain traditional institutions like iddir to assist with funeral costs.

**Table 5.10 : Participation in Iddir and Amount of Monthly Contributions**

| Town   | % of Participation in Iddir (# of cases) | Monthly contribution (birr) | Estimated number of Iddir members | Purpose of Iddir funds by reported cases |              |  |
|--------|--|-----------------------------|-----------------------------------|--|--------------|--|
|        |  |                             |                                   | Assist at times of death                 | Provide loan | Assist at time of death and provide loan |
| Akesta | 75 (45)                                  | 1.63                        | 238                               | 45                                       | -            | -  |
| Dogolo | 85 (39)                                  | 2.53                        | 352                               | 39                                       | -            | -  |
| Werilu | 86 (43)                                  | 2.84                        | 656                               | 43                                       | -            | -  |
| Tita   | 88 (44)                                  | 0.49                        | 360                               | 43                                       |              | 1  |
| Haik   | 77.4 (41)                                | 1.69                        | 342                               | 40                                       | 1            |  |
| Bati   | 67.9 (38)                                | 2.04                        | 190                               | 37                                       |              | 1  |
| Total  | 79.4 (250)                               | 1.84                        | 359                               | 247                                      | 1            | 2  |

Source: Field survey

#### 5.1.4 Linkage with the local farm sector

Business enterprise linkages with the farm sector take on three major dimensions. First, the farm sector is a major provider of inputs for the business sector. Second, the farm sector provides a major consumer market for small businesses. Finally, the business sector, in turn, provides inputs like fertilizer and tools to the farm sector. These and other linkages are stronger in situations in environments where the economy is dynamic and growing.

Nearly 38% of enterprises use farm produce in their businesses (Table 5.11). These agricultural products, however, come both from local and non-local sources. About one-quarter of the businesses use entirely local farm products, while a combination of local and non-local farm produce are used by about 5% of the businesses. Industrial products (soap, salt, etc.) seem to be the most important sale item used by more than one-third of the enterprises. The extent of backward business linkages to the local farm sector, therefore, is not significant indicating that local agriculture has limited market outlets in the area. On the other hand, most businesses (82 %) rely on both farmers and town dwellers as their customer base. Thus, while

the farm sector is an important market for small businesses in small towns, it is not an important source of supply for the business sector.

**Table 5.11: Type of inputs used by small businesses**

|               | Local farm produce | Non-local farm produce | Local and non local farm produce | Industrial products | Locally available raw materials | Others       | Total        |
|---------------|--------------------|------------------------|----------------------------------|---------------------|---------------------------------|--------------|--------------|
| <b>Akesta</b> | 34.4<br>(21)       |                        | 1.6<br>(1)                       | 59.0<br>(36)        | 1.6<br>(1)                      | 3.2<br>(2)   | 100<br>(61)  |
| <b>Dogolo</b> | 42.0<br>(21)       | 4.0<br>(2)             | 2.0<br>(1)                       | 36.0<br>(18)        | 8.0<br>(4)                      | 8.0<br>(4)   | 100<br>(50)  |
| <b>Werilu</b> | 41.5<br>(22)       | 3.8<br>(2)             |                                  | 37.7<br>(20)        | 1.9<br>(1)                      | 15.1<br>(8)  | 100<br>(53)  |
| <b>Tita</b>   | 16.1<br>(9)        | 25.0<br>(14)           | 5.4<br>(3)                       | 25.0<br>(14)        | 5.4<br>(3)                      | 23.2<br>(13) | 100<br>(56)  |
| <b>Haik</b>   | 9.4<br>(5)         |                        | 15.1<br>(8)                      | 28.3<br>(15)        | 9.4<br>(5)                      | 37.7<br>(20) | 100<br>(53)  |
| <b>Bati</b>   | 8.6<br>(5)         | 12.1<br>(7)            | 6.9<br>(4)                       | 32.8<br>(19)        | 20.7<br>(12)                    | 18.9<br>(11) | 100<br>(58)  |
| <b>Total</b>  | 25.1<br>(83)       | 7.6<br>(25)            | 5.1<br>(17)                      | 36.9<br>(122)       | 7.9<br>(26)                     | 17.5<br>(58) | 100<br>(331) |

Source: Field survey.

\* Figures in parenthesis are reporting cases.

A very small number of businesses are engaged in providing inputs for farmers. It is only 20 businesses or 6 % which reported input provision to farmers. These businesses provide fertilizers and seeds. The linkage with the farming sector in terms of input provision is therefore weak, in part because the government supplies many of the inputs. With limited use of non-farm inputs, the productivity and income of the rural population remains very small. The extent to which farming is also a source of income for business owners was also investigated in the study. About 36 business owners or about 11 % own farm lands with an average size of 0.85 hectares. The farm sector does not serve as supplementary income for the majority of small business operators.

### 5.1.5 Local and External Linkage

The local and external linkages of businesses are examined in terms of the sources for their inputs and markets for their outputs. The sources and market places were designated as local, regional and national. In terms of inputs, 52 % of the businesses receive their inputs from local sources, while nearly 46% receive them from the regional capitals, particularly from Desse and Kombolcha (Table 5.12). Very few (5%) enterprises receive their inputs from the

national market, which mainly refers to the Addis Ababa market. Trade and services are by far the most important activities which receive their inputs from the region. Merchandise trade involves the local distribution of imported goods from the regional market.

**Table: 5.12 Sources of inputs and destinations of output**

|                      | Input         |               |             |               | Output        |              |             |                |
|----------------------|---------------|---------------|-------------|---------------|---------------|--------------|-------------|----------------|
|                      | Local         | Regional      | National    | Total         | Local         | Regional     | National    | Total (number) |
| <b>Trade</b>         | 33.3<br>(24)  | 56.9<br>(41)  | 9.7<br>(7)  | (72)          | 75<br>(54)    | 23.6<br>(17) | 0.01<br>(1) | 72             |
| <b>Food</b>          | 64.8<br>(61)  | 32.9<br>(31)  | 2.12<br>(2) | (94)          | 95<br>(88)    | 5.3<br>(5)   | -<br>-      | 93             |
| <b>Manufacturing</b> | 47.6<br>(10)  | 38.1<br>(8)   | 14.3<br>(3) | (21)          | 76.2<br>(16)  | 19.0<br>(4)  | (4.7)<br>1  | 21             |
| <b>Handicraft</b>    | 55.5<br>(20)  | 38.8<br>(14)  | 5.5<br>(2)  | (36)          | 80.5<br>(29)  | 16.6<br>(6)  | 2.8<br>(1)  | 36             |
| <b>Services</b>      | 49.0<br>(53)  | 49.1<br>(53)  | 5.4<br>(2)  | (108)         | 85.4<br>(88)  | 12.6<br>(13) | 1.9<br>(2)  | 103            |
| <b>Total</b>         | 52.3<br>(168) | 45.8<br>(147) | 4.9<br>(16) | 100%<br>(321) | 84.6<br>(275) | 13.8<br>(45) | 1.5<br>(5)  | 100%<br>(325)  |

Source: Field survey

\* Figures in parenthesis are reporting cases

Regional linkages are not strong with regard to the outputs of local businesses. Overall about 85% of businesses are oriented to local markets, while only 14 % supply the regional market. The national market is very insignificant for businesses in small towns. Trade and service-oriented business are usually have better linkages with the regional market than other enterprises. The fact that 85 % of businesses cater to the local market means that these businesses depend on the low buying capacity of the area's low-income farmers and town residents. Regional and national exports cannot be the source of growth for most businesses, because they are only minimally involved with these markets.

### **5.1.6 Contact with Local Authorities (contact through taxes, license etc)**

Interactions of small enterprises with local authorities takes several different forms. For example, business licenses are issued by local authorities. A significant proportion (52.1 %) of establishments, in the small towns operates without licenses. Handicraft and cottage and service enterprises are two of the most important activities where the majority have no licenses. This includes about 88 % of businesses in the handicraft sector and 67 % in the service sector which are not licensed. Manufacturing and processing enterprises usually are licensed (91 % of the total).

Licensed enterprises are formal and pay taxes, while non-licensed ones are informal businesses and may not pay taxes. Formality has its own costs. There is an initial cost of being formal (fees for registration, time spent on trying to be registered, licensing, permits to construct a facility, etc.) and, later on, the costs of maintaining ‘formality,’ such as costs related to renewal of licenses and compliance with regulations. As a result, most of the microenterprises choose to stay informal, rather than seek a license or registration . It should, however, be noted that remaining informal also has its costs, including the costs of illegality, harassment, eviction, and lack of access to banks and credit.

## 5.2 Local Business Environment

The local environment can determine the performance of businesses in small towns. The local environment includes available facilities and services and local policies that impact on local business. These factors influence the performance of business by influencing profitability and production costs.

Tables 5.13 and 5.14 show the economic and financial infrastructure available in the study towns. Economic infrastructure has important implications for business development, since they are used as inputs in businesses. Water and telephones seem to be present in all towns.

Electricity is available in the larger towns, such as Haik and Bati. In smaller towns electricity is either absent or the service is available for only a limited period of the day (often 4-6 hours). Sewerage, bus stations, cattle dip and slaughter houses are available only in larger towns. On the other hand, the Amhara Savings and Credit Institution

**Table 5.13: Availability of Physical and Economic Infrastructure**

|                            | <b>Akesta</b> | <b>Dogollo</b> | <b>Werilu</b> | <b>Tita</b> | <b>Haik</b>     | <b>Bati</b> |
|----------------------------|---------------|----------------|---------------|-------------|-----------------|-------------|
| <b>Electricity</b>         | No            | Yes *          | Yes*          | Yes         | Yes             | Yes         |
| <b>Piped water</b>         | Yes           | Yes            | Yes           | Yes         | Yes             | Yes         |
| <b>Stand pipe water</b>    | Yes           | Yes            | Yes           | Yes         | Yes             | Yes         |
| <b>Telephone</b>           | Yes           | Yes            | Yes           | Yes         | Yes<br>(manual) | Yes         |
| <b>Sewerage</b>            | No            | No             | No            | No          | Yes             | Yes         |
| <b>Bus stations</b>        | No            | Yes            | Yes           | No          | Yes             | Yes         |
| <b>Cattle dip</b>          | No            | No             | No            | No          | Yes             | No          |
| <b>Slaughter house (s)</b> | NF            | No             | Yes           | No          | Yes             | No          |

Source: Field survey

\* only available part of the day

\*\* NF = not functional

(ASCI) is found in all towns except Tita but there are few commercial banks even though financial services and facilities form an important element of the business environment. Table 5.14 shows that only two towns, Bati and Werilu, have a commercial bank. Businesses in Tita also use the financial services of banks in Dese town.

**Table 5.14: Availability of financial services**

|   | <b>Akesta</b> | <b>Dogolo</b> | <b>Werilu</b> | <b>Tita</b> | <b>Haik</b> | <b>Bati</b> |
|---|---------------|---------------|---------------|-------------|-------------|-------------|
| <b>Commercial bank</b>                        | No            | No            | Yes           | No          | No          | Yes         |
| <b>ASCI</b>                                   | Yes           | Yes           | Yes           | No*         | Yes         | Yes         |
| <b>Other micro-enterprise credit services</b> | No            | No            | No            | No          | No          | No          |

Source: Field survey

\* Businesses in town get credit from Dese.

Primary and secondary schools are available in all the study towns, except Tita. By contrast, health services are not widely available. Tita and Dogolo do not have any public health facility. Only Akesta has a hospital (Table 5.15)

**Table 5.15: Available Social Infrastructure**

|                                | <b>Akesta</b> | <b>Dogollo</b> | <b>Werillu</b> | <b>Tita</b> | <b>Haik</b> | <b>Bati</b> |
|--------------------------------|---------------|----------------|----------------|-------------|-------------|-------------|
| <b>Elementary school</b>       | Yes (1)       | Yes (1)        | Yes (2)        | Yes (1)     | Yes (2)     | Yes (2)     |
| <b>Junior secondary school</b> | Yes (1)       | Yes (1)        | Yes(1)         | Yes (1)     | Yes (1)     | Yes (1)     |
| <b>Senior secondary school</b> | Yes (1)       | Yes (1)        | Yes (1)        | No          | Yes (1)     | Yes (1)     |
| <b>Skills training</b>         | Yes (1)       | Yes(1)         | Yes (2)        | No          | Yes (1)     | Yes (1)     |
| <b>Health post</b>             | No            | No             | No             | No          | Yes (1)     | Yes (1)     |
| <b>Health station</b>          | No            | No             | Yes (1)        | No          | Yes (1)     | Yes (7)     |
| <b>Hospital</b>                | Yes (1)       | No             | No             | No          | No          | No          |
| <b>Private clinic</b>          | No            | Yes (1)        | No             | No          | Yes (3)     | Yes (2)     |
| <b>Pharmacies</b>              | No            | Yes (1)        | Yes (1)        | Yes (1)     | Yes (2)     | Yes (2)     |

Source: Field survey

Almost all towns except Tita are the capital of their respective woredas. Their administrative status helps them to attract different government services, which in turn creates a favorable demand for the establishment of businesses and to serve as potential growth centers for further development. Table 5.16 shows the government services available in the study towns. Only three towns have a municipality to manage the activities of the settlement. The rest are managed as part of the woreda administration.

An attempt was made to identify which elements of the business environment prohibit the growth and development of small enterprises in the small towns. Telecommunication, electricity and access to land were indicated by 43 %, 46% and 41 % of the enterprises, respectively, as forming major obstacles to their businesses. Tax rates and tax administration were also considered as a major obstacle by 33 % and 34 % of the businesses, respectively, while collateral requirement for obtaining finance was regarded as a major problem by 24 % of business owners. Other aspects of the business environment, such as regulations, economic policy, corruption, crime, theft and public disorder were regarded as obstacles only by a small number of enterprises. Infrastructure, land and taxes are seen as the major obstacles for the development of small businesses.

**Table 5.16: Availability of government offices and the number of their employees**

|                      | <b>Akesta</b> | <b>Dogollo</b> | <b>Weriiu</b> | <b>Tita</b> | <b>Haik</b> | <b>Bati</b> |
|----------------------|---------------|----------------|---------------|-------------|-------------|-------------|
| Post office          | Yes (1)       | Yes (1 agent)  | Yes (1)       | Yes (1)     | Yes (1)     | Yes (1)     |
| Police office        | Yes (10)      | Yes (33)       | Yes (29)      | Yes (2)     | Yes (45)    | Yes (35)    |
| Woreda council       | Yes (7)       | Yes (11)       | Yes (15)      | Yes (2)     | Yes         | Yes (2)     |
| Keble                | Yes (1)*      | Yes (12)       | Yes (2)*      | Yes (7)     | Yes (20)    | Yes (5)     |
| Municipality         | No            | No             | Yes (9)       | No          | Yes (22)    | Yes (35)    |
| Courts               | Yes (6)       | Yes (8)        | Yes (14)      | Yes (1)     | Yes (5)     | Yes (8)     |
| Education office     | Yes (14)      | Yes (4)        | Yes (3)       | No          | Yes (30)    | Yes (22)    |
| Finance office       | Yes (4)       | Yes (8)        | Yes (11)      | No          | Yes (15)    | Yes (15)    |
| Health office        | Yes (7)       | Yes (4)        | Yes (8)       | Yes (7)#    | Yes (20)    | Yes (12)    |
| Agricultural office  | Yes (15)      | Yes (21)       | Yes (21)      | Yes (1)#    | Yes (38)    | Yes (18)    |
| Capacity building ** | Yes (30)      | Yes (22)       | Yes (32)      |             |             |             |
| Rural*** development |               | Yes (35)       | Yes (37)      |             |             |             |
| Justice office       |               | Yes (9)        | Yes (5)       |             |             |             |
| Information office   |               | Yes (18)       |               |             |             |             |

Source: Field survey

\*Refers to number of kebeles

\*\* includes workers in health and education

\*\*\* includes agriculture office

# are agents

## **VI. ECONOMIC PERFORMANCE OF ENTERPRISES: CAPITAL AND INCOME**

### **6.1 Initial Investment, Current Capital and Working Capital**

The initial investment of most of enterprises is low (Table 6.1). About one-quarter (24.8%) of all enterprises have an initial investment that ranges between 5 and 100 birr, while a little over one-half of the enterprises started their business with initial capital up to 500 birr. Enterprises in the handicraft and cottage and food and drinks category require the lowest initial investments. About 48 % and 28 % of enterprises in handicraft and food-and-drinks category, respectively, started their business with initial capital ranging from only 5 to 100 birr. Those business with capital start up costs up to 500 birr (about US \$ 58) are 87 % for ‘handicraft and cottage’ industries and 66 % for ‘food and drinks’ businesses. The low initial investment for these enterprises reflects the minimal capital barriers for these firms.

Those enterprises with higher initial capital than the above mainly are found in the manufacturing and processing sub-sector. About one-third or 32 % of these enterprise had capital start up costs ranging between 2000 and 5000 birr, while the majority (36.4 %) of enterprises in this category began their business with over 20,000 birr.

The amount of working capital used by the enterprises repeats the patterns observed for the initial investment with slight differences (see Table 6.1). The working capital in the scale category of up to 500 birr is reported by 50.8% of the enterprises. Enterprises in the handicraft sector have by far the smallest amount of working capital. It is revealed that nearly 61 % of the enterprises in this category report working capital of up to 100 birr and nearly 80 % of the enterprises have working capital only up to 500 birr. Manufacturing and trade are those enterprises with relatively high amounts of working capital (Table 6.2). The current capital of all businesses is also very small. Generally about 42 % of all businesses have current capital investments that are less than 500 birr. Some sectors, such as services and handicrafts, have a very high proportion of enterprises with less than 500 birr of current capital.

An attempt was made to examine scale differences among different enterprises. The presence of hierarchies or scale differences in any business sector provides dynamism for the sector, since it creates space for expansion. The bigger, more vibrant sectors can lift smaller sectors or create opportunities for smaller but related business activities. In the Fordist industrialization process, technological development is perceived as being an in-plant process. The result could trickle down to other enterprises within a vertical industrial hierarchy (Aeroe, 1992). Within the trade sector, merchandise retail and grain trade businesses were examined and it was found that the majority (66%) have capital that ranges from 500 to 10,000 birr. In the food and drinks sector, 70 % of the ‘restaurant and cafeteria’ businesses have capital between 500 to 5000 birr, while 75 % of the tea, pastry, bakery and injera-making businesses have capital of less than 500 birr. In the service sector, 74 % of the carpentry, masonry, and plumbing businesses operate with capital of less than 500 birr. This is an indication that most businesses in the region’s small towns are similar in they operate at very low levels of capital investment. This constraint prohibits the growth of small businesses and limits their opportunity to grow and expand.

An attempt is made here to look at the expansion opportunities of enterprises by comparing current capital with the firm's initial capital. About 20 % of the businesses reported a negative change, which indicates that these enterprises are perhaps decapitalizing. The remaining 80 % showed a very low positive increase in capital accumulation. For instance, about 9 % of businesses have not shown any capital accumulation, with the amount of their current capital similar to that of their initial investment. About 26 % showed an increase in capital accumulation of up to 20 % per year, while 14 % showed an increase between 20 and 50 %. Once again, the amounts of capital represented by these increases are very small (see Tables 6.2 and 6.3).

The perception of operators about expansion opportunities were sought in the study. A little over half (51.7 %) of the enterprises indicated that it is not at all possible to expand their enterprises. Only 10 % of operators indicated that it is possible to expand. Business owners were asked to rank the most important obstacles for expansion. Lack of working capital was indicated by nearly 54 %; lack of demand was considered by about 23 % and about 6 % mentioned lack of premise at affordable rent as the major problem. These three obstacles are mentioned by 83% of the enterprises.

**Table 6.1 :Initial investment by activity type**

|                | Category Of Business Activities |                 |                              |                       |                 |                 |
|----------------|---------------------------------|-----------------|------------------------------|-----------------------|-----------------|-----------------|
|                | Trade Activity                  | Food And Drinks | Manufacturing and Processing | Handcraft and cottage | Services        | Total           |
|                | 16.4%<br>(12)                   | 27.6%<br>(24)   |                              | 48.4%<br>(15)         | 26.4%<br>(28)   | 24.8%<br>(79)   |
| 100.01-500     | 23.3%<br>(17)                   | 39.1%<br>(34)   | 4.5%<br>(1)                  | 38.7%<br>(12)         | 32.1%<br>(34)   | 30.7%<br>(98)   |
| 500.01-2000    | 24.7%<br>(18)                   | 14.9%<br>(13)   | 13.6%<br>(3)                 |                       | 14.2%<br>(15)   | 15.4%<br>(49)   |
| 2000.01-5000   | 16.4%<br>(12)                   | 8.0%<br>(7)     | 31.8%<br>(7)                 | 6.5%<br>(2)           | 13.2%<br>(14)   | 13.2%<br>(42)   |
| 5000.01-10000  | 9.6%<br>(7)                     | 4.6%<br>(4)     | 4.5%<br>(1)                  | 6.5%<br>(2)           | 5.7%<br>(6)     | 6.3%<br>(20)    |
| 10000.01-20000 | 8.2%<br>(6)                     | 1.1%<br>(1)     | 9.1%<br>(2)                  |                       | 1.9%<br>(2)     | 3.4%<br>(11)    |
| >20000         | 1.4%(1)                         | 4.6%<br>(4)     | 36.4%<br>(8)                 |                       | 6.6%<br>(7)     | 6.3%<br>(20)    |
| Total          | 100.0%(73)                      | 100.0%<br>(87)  | 100.0%<br>(22)               | 100.0%<br>(31)        | 100.0%<br>(106) | 100.0%<br>(319) |

Source: Field Survey

\*US \$1=8.6 Eth birr

**Table 6.2 Working Capital by business category**

|                | Category Of Business Enterprises |                 |                              |                       |                 |                 |
|----------------|----------------------------------|-----------------|------------------------------|-----------------------|-----------------|-----------------|
|                | Trade Activities                 | Food And Drinks | Manufacturing and Processing | Handcraft and cottage | Services        | Total           |
| 0-100          | 13.5 %<br>(10)                   | 29.5%<br>(26)   |                              | 61.3%<br>(19)         | 34.3%<br>(37)   | 28.5%<br>(92)   |
| 100.01-500     | 12.2%<br>(9)                     | 30.7%<br>(27)   | 4.5%<br>(1)                  | 19.4%<br>(6)          | 26.9%<br>(29)   | 22.3%<br>(72)   |
| 500.01-2000    | 18.9%<br>(14)                    | 18.2%<br>(16)   | 22.7%<br>(5)                 | 6.5%<br>(2)           | 15.7%<br>(17)   | 16.7%<br>(54)   |
| 2000.01-5000   | 17.6%<br>(13)                    | 10.2%<br>(9)    | 22.7%<br>(5)                 |                       | 9.3%<br>(10)    | 11.5%<br>(37)   |
| 5000.01-10000  | 24.3%<br>(18)                    | 5.7%<br>(5)     | 27.3%<br>(6)                 | 6.5%<br>(2)           | 7.4%<br>(8)     | 11.5%<br>(37)   |
| 10000.01-20000 | 5.4%<br>(4)                      | 1.1%<br>(1)     |                              | 6.5%<br>(2)           | 1.9%<br>(2)     | 2.8%<br>(9)     |
| >20000         | 8.1%(6)                          | 4.5%<br>(4)     | 22.7%<br>(5)                 | 6.5%<br>(2)           | 4.6%<br>(5)     | 6.8%<br>(22)    |
| Total          | 100.0%(74)                       | 100.0%<br>(88)  | 100.0%<br>(22)               | 100.0%<br>(31)        | 100.0%<br>(108) | 100.0%<br>(323) |

Source: Field Survey

\*US \$1=8.6 Eth birr

**Table 6.3: Current Capital by business category**

|                | Category Of Business Activities |                 |                              |                       |                 |                 |
|----------------|---------------------------------|-----------------|------------------------------|-----------------------|-----------------|-----------------|
|                | Trade Activity                  | Food And Drinks | Manufacturing and Processing | Handcraft and cottage | Services        | Total           |
| 10-100         | 8.1%<br>(6)                     | 13.6%<br>(12)   |                              | 45.3%<br>(154)        | 25.0%<br>(27)   | 18.3%<br>(59)   |
| 100.01-500     | 14.9%<br>(11)                   | 33.0%<br>(29)   | 4.5%<br>(1)                  | 32.3%<br>(10)         | 25.0%<br>(27)   | 24.1%<br>(78)   |
| 500.01-2000    | 10.8%<br>(8)                    | 17.0%<br>(15)   | 9.1%<br>(2)                  | 3.2%<br>(1)           | 12.0%<br>(13)   | 12.1%<br>(39)   |
| 2000.01-5000   | 16.2%<br>(12)                   | 14.8%<br>(13)   | 22.7%<br>(5)                 | 6.5%<br>(2)           | 13.0%<br>(14)   | 14.2%<br>(46)   |
| 5000.01-10000  | 23.0%<br>(17)                   | 9.1%<br>(8)     | 27.3%<br>(6)                 | 3.2%<br>(1)           | 8.3%<br>(9)     | 12.7%<br>(41)   |
| 10000.01-20000 | 10.8%<br>(8)                    | 2.3%<br>(2)     | 9.1%<br>(2)                  |                       | 6.5%<br>(7)     | 5.9%<br>(19)    |
| >20000         | 16.2%<br>(12)                   | 10.2%<br>(9)    | 27.3%<br>(6)                 | 9.7%<br>(3)           | 10.2%<br>(11)   | 12.7%<br>(41)   |
| Total          | 100.0%<br>(74)                  | 100.0%<br>(88)  | 100.0%<br>(22)               | 100.0%<br>(31)        | 100.0%<br>(108) | 100.0%<br>(323) |

Source: Field Survey

\*US \$1=8.6 Eth birr

## 6.2 Sales (Revenues) and Trends in Income

Sales or revenue data are used to assess the economic status of enterprises<sup>1</sup>. The survey shows that over half of the enterprises (57%) reported weekly sales of up to 100 birr. About 90 % of the enterprise owners noted weekly sales of up to 500 birr. Nearly two-thirds (65.2%) of the enterprises in food and drinks category and 59.3 % in services category earn only up to 100 birr per week. Enterprises in the 'Manufacturing and Processing' category have relatively higher weekly sales, with 17 % of them having weekly sales between 500 and 2000 birr (Table 6.4). The distribution of enterprises by revenue category demonstrates the low income that is derived by these enterprises.

Notwithstanding, the low level of income, trends in income can reveal which enterprises in the study towns have potential for the future. The overwhelming majority--70 % in trade activities, 72 % in food and drinks, 65 % in manufacturing and processing, 71 % in handicraft and cottage and 64 % in Services-- reported that their incomes are decreasing. The category of enterprises with the highest proportion of enterprises with increasing income is service-oriented businesses. In this category, nearly 22% of the enterprises reported an increasing income trend. It is, however, worthwhile to mention that those business types in the service category, which reported an increase in income, are dominated by hotels.

Reasons for decreasing incomes for enterprises were solicited in the survey. Two reasons that were given by over 70 % of the enterprises in all categories of businesses are: (1) the presence of too many operators; and (2) weak purchasing power of the customers. The former indicates that there are too many enterprises that are chasing limited markets, while the latter reason shows the problem of market size mainly is due to the low income of customers. The major customers for micro enterprises are the hinterland farmers. These farmers, who mainly are living in food-insecure woredas, are impoverished and cannot afford to purchase the outputs and services of these enterprises.

About 12 % of the respondents indicated that they use the income they derive from the business for reinvesting in their business or adding a new business. About 64 % or nearly two-thirds of the businesses use the income mainly for household consumption. Another 8 % of the enterprises indicated that they use their income both for household consumption and for the costs of children's education. The fact that the majority use the income for household consumption indicates that businesses in small towns remain at subsistence levels.

The extent to which business income is supplemented by other sources of income was also solicited in the questionnaire. About 70 enterprise owners or 22.2 % of the sample reported one additional source of income. This figure indicates generally limited opportunities for income diversification in the study area.

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<sup>1</sup> Net earnings which relates revenues to costs would have been a better indicator but since the cost data from the enterprises were not realistic, this indicator was not used.

**Table 6.5: Weekly Sales/Revenue by business category**

|              | Category Of Business Enterprises |                 |                            |                       |                 |                 |
|--------------|----------------------------------|-----------------|----------------------------|-----------------------|-----------------|-----------------|
|              | Trade Activities                 | Food and Drinks | Manufacture and Processing | Handcraft and cottage | Services        | Total           |
| 0-100        | 47.9 %<br>(35)                   | 65.2%<br>(60)   | 4.3%<br>(1)                | 82.4%<br>(28)         | 59.3%<br>(64)   | 57.0%<br>(188)  |
| 100.01-500   | 42.5%<br>(31)                    | 25.0%<br>(23)   | 69.9%<br>(16)              | 8.8%<br>(3)           | 32.4%<br>(35)   | 32.7%<br>(108)  |
| 500.01-2000  | 5.5%<br>(4)                      | 3.3%<br>(3)     | 17.4%<br>(4)               | 8.8%<br>(3)           | 5.6%<br>(6)     | 6.1%<br>(20)    |
| 2000.01-5000 | 2.7%<br>(2)                      | 5.4%<br>(5)     | 4.3%<br>(1)                |                       | 2.8%<br>(3)     | 3.3%<br>(11)    |
| >5000        | 1.4%<br>(1)                      | 1.1%<br>(1)     | 4.3%<br>(1)                |                       |                 | .9%<br>(3)      |
| Total        | 100.0%<br>(73)                   | 100.0%<br>(92)  | 100.0%<br>(23)             | 100.0%<br>(34)        | 100.0%<br>(108) | 100.0%<br>(330) |

Source: Field Survey

\*US \$1=8.6 Eth birr

### **6.3 Regression Analyses**

Two different dependent variables, namely gross sales per week and estimated total capital, were identified for regression analyses in this study. The aim is to understand the determinants of gross sales, which represent business income. Similarly, the scale of operation (captured by total capital of the business) is analyzed to infer about the potential for modernization of the different enterprises.

Average weekly sales vary significantly across the different activities and the study towns. For instance, weekly average sales vary from a low of birr 155 for handicraft and cottage businesses, to a high of birr 2,803 for manufacturing and processing (Table 6.6). Gross income (birr 271) from services are also low, while those from trade activities (birr 420) and sale of food and drinks (birr 471) are slightly below the overall average of about birr 524. Differences between the towns are also significant, ranging from birr 89 in Tita to birr 1,734 in Bati.

A significant variation is also observed between the different activities and towns with respect to size of business as proxied by total business capital. On average the intensity of capital is relatively low for handicraft and services and high for food and drinks and manufacturing and processing (Table 6.6). A few generally large hotels account for the unusually large capital in the food and drink sector.

**Table 6.6: Average weekly sales and total capital (birr)**

|                              | Average weekly sales |                    | Estimated total capital |                    |
|------------------------------|----------------------|--------------------|-------------------------|--------------------|
|                              | Mean                 | Standard deviation | Mean                    | Standard deviation |
| Activities                   |                      |                    |                         |                    |
| Trade activities             | 420.37               | 914.12             | 16093.73                | 27556.52           |
| Food and drinks              | 470.74               | 1405.89            | 33028.09                | 151315.00          |
| Manufacturing and processing | 2803.04              | 10318.44           | 25406.82                | 45191.67           |
| Handicraft and cottage       | 154.85               | 294.20             | 1965.70                 | 6001.08            |
| Services                     | 270.69               | 627.09             | 7394.02                 | 17501.06           |
| Total                        | 523.98               | 2892.71            | 17362.19                | 83286.46           |
| Towns                        |                      |                    |                         |                    |
| Akesta                       | 109.89               | 141.74             | 2920.49                 | 5838.55            |
| Dogolo                       | 179.92               | 459.00             | 5738.75                 | 12930.31           |
| Wereilu                      | 181.06               | 379.01             | 9533.75                 | 21176.83           |
| Tita                         | 88.71                | 103.13             | 2383.26                 | 4373.49            |
| Haik                         | 801.06               | 1749.64            | 59864.62                | 194929.50          |
| Bati                         | 1736.50              | 6569.50            | 24458.70                | 39731.64           |
| Total                        | 523.98               | 2892.71            | 17362.19                | 83286.46           |

Source: Field survey data.

### 6.3.1 Determinants and Results of Weekly Sales

#### 6.3.1.1 Determinants

Several independent variables are thought to influence sales and business capital. These are: demographic (Education, age, gender); access to utilities (use of electricity ,use of telephone); savings activities (e.g., use of bank services and membership in *equib*); government regulation (own business license); access to information (own radio, own TV); asset base and income diversification (own residence house; own business premise); number of income sources; and access to capital(current working capital). To capture location and activity differences, site dummies (five dummy variables for the six sites) and activity dummies (four dummy variables for the five activities) were used in the analyses.

### 6.3.1.2 Results of Regression Analysis of Weekly Sales

#### **Demographic factors**

None of the demographic characteristics (education, sex and age ) was found to have a significant influence on the volume of sales. All other factors held constant, female operators perform as well as their male counterparts. This is very different from rural areas where empirical studies show that agricultural performance of female-headed households, who operate with small capital and labor endowments, is lower than that of male-headed families<sup>2</sup>. Women operators of small business do not seem to be as constrained in their activities as their rural counterparts.

It is often argued that education is important in a modern environment. As shown in the descriptive part, most businesses in the study areas do not use modern technologies and operate using mainly their own finance and family labor. A more dynamic environment is perhaps necessary to make education more useful in managing small enterprises.

#### **Access to utilities**

Contrary to general expectations, the coefficient of electricity is negative and significant. There is no doubt that many small businesses do not use electricity in their activities. With the exception of some manufacturing and processing plants (e.g. flour mills), electric power in enterprise activities is mainly used for lighting purposes. Although access to electric power could have helped to introduce new technologies and machines, small businesses continue to rely on the same old technologies. Lack of effective demand and financial constrains may have discouraged any investments in new technologies. Nonetheless, the reasons for underutilization of certain technical opportunities and the unexpected results need further checking and analyses.

Access to telephones is supposed to remove information constraints and facilitate networking and partnerships. However, the coefficient of the variable, 'telephone,' is not significant, although it has the expected positive sign. It appears that business operators in the study towns have yet to realize the potential of telephone and associated technologies. Lack of partnerships and networking could also undermine the importance of telephone.

#### **Saving efforts**

In the absence of financial services, operators mainly rely on their own savings. Those who utilize back savings accounts seem to make more of an effort to improve the performance of their businesses, than those who do not. In this regard, the influence of maintaining a bank account and participating in *equib* (an informal savings association) was tested, and the results show that the two variables positively and significantly influence weekly sales. It appears that business owners with no effort to save and participate in local credit institutions face less pressure to perform efficiently, than do other entrepreneurs.

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<sup>2</sup> See for instance, Mulat Demeke and Bekele Hundie. 2003. The determinants of yield of major cereals: the contribution of new technology in selected villages of Ethiopia, in Mulat Demeke et al (eds.), Technological Progress in Ethiopian Agriculture, Proceedings of the National Workshop on Technological Progress in Ethiopian Agriculture, Nov. 29-30, 2001, Addis Ababa, Ethiopia.

### **Access to information**

Information is critical to the social and economic activities of enterprises. It was thus hypothesized that operators owning TV and/or radio are more likely to make informed decisions than those who don't.

The regression results clearly prove that the performance of owners of these assets is significantly better. In the absence of alternative sources of information, access to mass media could be vital to gain knowledge and information about new ways to do business and learn about markets (e.g. advertisements). Individuals need to recognize the value of information to build their capacity and human resource base.

### **Government support and regulations**

Evidence of government support for microenterprises virtually is non-existent in the study area. Public support in the form of training and improved access to finance, markets, and new technologies is largely unknown. Small enterprises do not benefit from investment and program incentives of the government. Regulatory measures to enforce registration, contracts, and standards are either weak or absent. The presence of government is felt only in relation to licenses and tax payment. But even these are not uniformly applied as the majority of the businesses operate without licenses. Nevertheless, license holders consistently performed better than non-holders. This may be attributed to indirect pressure to innovate, improve performance, and compete with the unlicensed operators who have no costs related to license renewal, taxes, and other forms of regulation.

### **Access to capital**

The results of the semi-log function for gross revenue showed that revenue is positively and significantly influenced by the amount of working capital. Given that access to credit is extremely limited, it is not surprising that enterprises with more capital have managed to produce and sell more. Indeed, the amount of working capital is the single most important determinant of gross revenue in the study towns.

### **Asset base and income diversification (risk-taking capacity)**

Operators with stronger asset bases and with more sources of income are more likely to have better capacity to take risks. Attitudes towards risk generally begin to change as resource base improves and diversifies, and income moves well ahead of minimum consumption needs. Nevertheless, none of the proxy variables to measure risk-taking capacity (i.e. ownership of residence house and business premise or number of income sources) are significant, although all show expected positive sign. Once again, this might be attributed to the absence of a conducive economic environment where rewards to innovate are high.

### **Site dummies**

All the site dummies are significant and negative, implying that business performance (as measured by weekly volume of sales) in Bati (which is the control town in the analysis) is better, holding other factors constant. It should be recalled that Bati has a larger population than other study towns and is situated on the road to the port of Djibouti/ Assab. As expected, a larger population and a more dynamic business environment positively influence performance.

### Activity dummies

Among the activity dummy variables only the coefficient for manufacturing and processing is significant and positive. This finding suggests that the performance of the manufacturing and processing sector is better than food and drinks (the control sector) and other sectors.

**Table 6.7 Model Summary**

| Model | R    | R.Square | Adjusted R Square | Std.Error of the Estimate |
|-------|------|----------|-------------------|---------------------------|
| 1     | .824 | .678     | .650              | .9048                     |

Note: Dependent variable: Natural log of sales.

**Table 6.7 cont**

| Model        | Sum of Squares | Df  | Mean Square | F      | Sig. |
|--------------|----------------|-----|-------------|--------|------|
| 1 Regression | 464.657        | 24  | 15.361      | 23.649 | .000 |
| Residual     | 220.226        | 269 | .819        |        |      |
| Total        | 684.883        | 293 |             |        |      |

**Table 6.7 Cont: Regression Results: Dependent Variable: natural log of sales per week**

|                                | Unstandardized Coefficients | t- value | Significance |
|--------------------------------|-----------------------------|----------|--------------|
| (constant)                     | 3.304                       | 7.095    |              |
| Level of education             | 1.860E-02                   | .3620    | .718         |
| Age square                     | 1.077E-05                   | .051     | .960         |
| Gender                         | -5.703E-02                  | -.326    | .745         |
| Electricity                    | -.375                       | -2.653   | .008         |
| Telephone                      | .200                        | .936     | .350         |
| Radio                          | .290                        | 2.109    | .036         |
| TV                             | .426                        | 2.108    | .036         |
| Own residence                  | 9.679E-02                   | .682     | .496         |
| Own business premise           | .131                        | .884     | .378         |
| Working capital (natural log)  | .256                        | 6.217    |              |
| Bank account                   | .276                        | 1.672    | .096         |
| Iquib                          | .251                        | 1.936    | .054         |
| Number of income sources       | 4.637E-02                   | .382     | .703         |
| D-Akesta                       | -1.122                      | -5.800   | .000         |
| D-Dogolo                       | -1.385                      | -6.321   | .000         |
| D-Wereilu                      | -1.248                      | -6.285   | .000         |
| D-Tita                         | -.753                       | -3.485   | .001         |
| D-Haik                         | -.523                       | -2.772   | .006         |
| License                        | .559                        | 3.377    | .001         |
| Age                            | -4.422E-03                  | -.231    | .818         |
| D-Trade                        | -.140                       | -.783    | .434         |
| D-Manufacturing and processing | .553                        | 2.159    | .032         |
| D-Handicraft and cottage       | .104                        | .465     | .642         |
| D-Service                      | .111                        | .627     | .532         |

### 6.3.2 Results of Scale of operation (as measured by business capital)

As the above results clearly demonstrate, lack of finance (to serve as working or fixed capital) is the most important constraint to the growth and development of small and micro enterprises. A low-level of capitalization is also a major characteristic of the firms. Hence, attempts were made to identify factors correlated with the amount of total estimated capital of the sample enterprises. A similar set of independent variables were used in the regression.

Among the variables positively and significantly related to business capital are: telephone, radio, TV, bank account and *equib*, license and gender (Table 6.8). Operators with access to telephone, radio, and TV appear to have more capital than those who do not. Similarly, bank account, *equib* and license are positively related to the amount of capital controlled by the enterprise. Moreover, male owners operate with more capital than female owners. Unlike sales, there are no major differences between the study areas in the amount of capital controlled by the business.

**Table 6.8: Model Summary**

| Model | R    | R.Square | Adjusted R Square | Std.Error of the Estimate |
|-------|------|----------|-------------------|---------------------------|
| 1     | .845 | .714     | .692              | 1.3393                    |

Note: Dependent variable: Natural log of estimated capital.

**Table 6.8 cont ANOVA<sup>b</sup>**

| Model        | Sum of Squares | Df  | Mean Square | F      | Sig. |
|--------------|----------------|-----|-------------|--------|------|
| 1 Regression | 1255.478       | 21  | 59.785      | 33.329 | .000 |
| Residual     | 504.056        | 281 | 1.794       |        |      |
| Total        | 1759.534       | 302 |             |        |      |

**Table 6.8: Regression Results: Dependent Variable: natural log of estimated capital**

|                                | <b>Unstandardized Coefficients</b> | <b>t</b> | <b>Significance</b> |
|--------------------------------|------------------------------------|----------|---------------------|
| (constant)                     | 2.955                              | 4.485    |                     |
| Level of education             | 9.400E-02                          | 1.249    | .213                |
| Age                            | 8.274E-02                          | 3.054    | .002                |
| Age square                     | -8.081E04                          | -2.700   | .007                |
| Electricity                    | -.158                              | -.769    | .443                |
| Telephone                      | 1.263                              | 4.205    | .000                |
| Radio                          | .624                               | 3.246    | .001                |
| TV                             | .882                               | 3.068    | .002                |
| Bank account                   | .862                               | 3.687    | .000                |
| Iqub                           | .390                               | 2.064    | .040                |
| Number of income sources       | .132                               | -.763    | .446                |
| D-Akesta                       | -.479                              | -1.725   | .086                |
| D-Dogolo                       | -.211                              | -.678    | .498                |
| D-Wereilu                      | -.440                              | -1.542   | .124                |
| D-Tita                         | -.284                              | -.934    | .351                |
| D-Haik                         | .377                               | 1.378    | .169                |
| License                        | 1.942                              | 8.939    | .000                |
| Sex                            | .627                               | 2.442    | .015                |
| D-Trade                        | .643                               | 2.532    | .012                |
| D-Manufacturing and processing | .669                               | 1.822    | .069                |
| D-Handicraft and cottage       | -.743                              | -2.273   | .024                |
| D-Service                      | -.240                              | -.936    | .350                |

## **VII. CONCLUSIONS: SUMMARY AND POLICY IMPLICATIONS**

### **7.1 Summary**

The enterprises in this study are generally characterized by low productivity and economic stagnation. With few other options, small-scale enterprises (especially petty trading) become a means of self-employment at relatively low wages. The capital requirement is very small and the technology is minimal and easily accessible in most cases. Demand for output and services are also very limited as the bulk of the hinterland population is dependent on high-risk, low-yielding agriculture that limits the availability of disposable incomes to buy goods and services. Export to other regions is very limited for most enterprises. As a result, too many operators chase limited markets, creating minimal profits and little incentive for business expansion. The primary aim is to maintain the same level of operation, with little business and entrepreneurial innovation. Access to financial services is limited and partnership and networking are unknown. Skills in business training and technical knowledge are lacking, which inhibits benefiting from the innovative capacity of workers and employees. The majority of operators have started or joined the enterprise for lack of a better economic opportunity. Contact with local authorities is limited to licensing, although the majority do not have an appropriate license.

The lack of effective linkages with the rural sector is one of the major features of town enterprises. At present, the small towns are not a good source of farm inputs or new technologies in the region. Hence, any attempt to develop the local economy will be constrained town-based enterprises provide better services for transforming rural areas and improving the productivity of small farmers. Sustainable development requires traders, transporters, and processors to be integrated with the activities and needs of rural producers of crop, livestock, forest products, etc.

The lack of purchasing power among the local people is cited by the majority of enterprise owners as a major bottleneck. The main customers of micro-enterprises in small towns are local farmers and town dwellers. Any improvement in agricultural incomes would thus enhance local demand for goods and services, which could stimulate enterprise development. There must also be serious thought to how to raise incomes of town residents either through government transfers or new sponsored activities.

The business environment, in terms of infrastructure and financial services, is not conducive to the development of sustainable enterprises.

The major determinant of business performance is the amount of working capital. The lack of financial resources is a critical limiting factor. Because of expanded market opportunities, larger urban centers are associated with enterprises who have higher sales than in small, stagnant towns. Access to mass media information, attempts to save funds in banks, and acquire business licenses encourage operators to perform more efficiently than other firms. However, the overall business environment is so weak that human capital and physical infrastructure do not seem to have significant impacts.

The theoretical implications of the study is that the network approach does not seem to adequately explain the nature of enterprises in small towns. The different elements of

networks need to be developed and designed in a policy that would stimulate interactions among various local actors and the development of important networks of enterprises.

## **7.2 Policy implications**

Expanding urban centers create opportunities for small enterprises to grow and innovate. Government policies should thus encourage, not discourage, the growth of small towns if the goal of rapid local and regional/rural development is to be achieved. It should also be noted that a growing urban center is necessary to fully absorb surplus from rural areas.

Microenterprises in small towns need government support to reverse the stagnation and instill dynamic growth. In this regard, ad-hoc and piece-meal approaches are not helpful. A comprehensive package of support is necessary given the diverse and complex problems of the sector in South Wollo and Oromoya zones. These interventions should address both the supply and demand side of business development. Undoubtedly, adequate provision of credit should be the key component of any stimulus package. Ways must be sought to ensure that small enterprises benefit from the services of formal commercial banks, specialized banks and micro-finance institutions. Among other critical components for enterprise development are extension services and information provision, consultancy, training, research, and prototype business development.

Government support interventions in other countries often include the establishment of industrial zones, commercial zones, and/or other common facility centers to ease the problem of premise availability and to introduce new technologies and ideas. The incubators (business start-up premises) could also involve information and communication technologies to widen market opportunities. The recent initiative by the Federal government to introduce such an approach to enterprise development should be taken up by local and regional governments without delay.

On the demand side, enterprises should be able to tap regional and national markets at least in locations near big towns. Thus, enterprises in Bati should be able to export to the nearest large regional market, Kombolocha, while enterprises in Haik and Tita should be able to market products and services to Dese. Those at a distance from the big centers, such as Legambo, Jamma and Werilu, should also be able to use each others' market and build on their comparative advantages.

A major prerequisite for the introduction of business support programs is institutional capacity at the local level. The government has created several institutions, including Trade and Industry Bureaus and Agency for Micro and Small Enterprise development, to implement its support programs. Nonetheless, these and other similar institutions are noticeably absent at local levels. Policies and support measures announced at federal or regional levels often fail to reach the intended targets due to missing institutional links at local levels.

Lack of an enabling legal and regulatory framework has given rise to high transaction costs and uncertainties in the market place. One major outcome of this is the absence of partnership and networking among business operators. Enterprises prefer to operate individually and incur high costs, even though scale economies of partnership and cooperation are evident.

Business operators in the survey towns have no institutions to defend their interests or voice their concerns. There are no forums for discussing development issues among government

agencies and the private sector in small towns. Business people often feel excluded from the development process and some of them point out that the current business environment is not significantly different from that of the old regime.

More specifically, policies for small town businesses should include:

1. **Enhanced capacity through associations and network:** One of the major problems faced by enterprises are limited capacities to tap external markets, reduce input cost, and avoid competition in a very limited market. As the enterprises are operating individually they cannot make use of economies of scale to export to regional and national markets. Association formation would enhance their capacity and enable them to tap external markets and increase their profits. Partnership should also be encouraged under the umbrella of associations and network
2. **Entrepreneurship to exploit niche markets and diversify regional production:** One of the ways to overcome the problem of producing similar items for a competitive local market is to develop and promote entrepreneurship. Entrepreneurship helps to identify new niche markets that could identify a new production system for which different towns have comparative advantage. Entrepreneurship could also bring some dynamic qualities such as resilience (to respond to changes in the environment), initiative taking, innovativeness, and diversity.
3. **Enhance local demand through improved agricultural productivity in the hinterland and increased income of town dwellers:** Lack of purchasing power of the local people is cited by a majority of enterprise owners as a major constraint. The main customers of micro-enterprises in small towns are local farmers and town dwellers. Any improvement in the agriculture sector and town incomes would thus enhance local demand for goods and services.
4. **Improving the local business environment:** Enterprise operators indicate that a lack of access to land, telephones, and electricity are immediate obstacles for their businesses. These deficiencies have to be dealt with by local government. Lack of working capital is also cited as a major reason for the poor performance of enterprises. The availability of adequate business premises is also crucial and could be addressed by local government.
5. **Regional approach to the development of small towns:** Although a sectoral approach could be pursued to develop micro enterprises, agriculture, and infrastructure on their own, a regional approach that is multi-sectoral has a much better chance of success.

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