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Keywords: *Access to Finance, SME's, Challenges, Wolaita Sodo Town, Ethiopia.*

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Challenges for Small and Micro Enterprises in Accessing Finance (Case of Wolaita Soddo Town)

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I. Introduction

Small and Micro Enterprises (SMEs) are the lifeblood of developing economies. Finance is the backbone of SMEs and any other business enterprise (McKernan & Chen, 2005). Both in the developing and developed economies small firms have little access to external finance and are thus constrained in their operation and growth (Galindo & Schiantarelli, 2003).

The SME sector in Ethiopia is considered as an instrument in bringing about economic transition by effectively using the skill and talent of the people particularly women and youth with least training, limited capital and available technology. The Small and Medium Enterprises sector (SMEs) contributed nearly Birr 8.3 million in 1996 to the exchequer. Based on the 1992/93 data, this figure constitutes about 3.4% of the GDP, 33% of the industrial sector's contribution and 52% of the manufacturing sector's contribution to the GDP of the same year (Gebrehiwot, 2006).

The development of the sector in Ethiopia believed to be the major source of employment and income generation for a wider group of the society in general and urban youth in particular. The five-year Growth and Transformation Plan (GTP) of Ethiopia envisages creating a total of three million micro and small-scale enterprises at the end of the plan period (NBE, 2011). Citing the source from the Federal Micro and Small Enterprise Development Agency (FMESDA), the EEA Research Brief noted that seventy thousand five hundred (70,500) new SMEs were established in 2011/12 employing eight hundred six thousand three hundred (806,300) people across the country. The performance is below the target set in GTP (EEA, 2015).

In this project, we analyze the financing gap of SMEs in Ethiopia and recommend ways of addressing the financing gap. Specifically, the study addresses a) the financing needs and financing options of SMEs in Ethiopia, b) Key constraints of SMEs access to finance, c) extent of banks and MFIs involvement with SMEs, and the drivers and obstacles of SME bank financing, and d) the impact of existing government policies and potential areas of government involvement. Unlike many previous studies that address either the demand side or the supply side limitations of access to finance (see for e.g., Petersen and Rajan, 1994; Wiedmaier-Pfister et al, 2008; Ngoc et al., 2009; Ghimire and Abo, 2013) this study synthesizes the demand side constraints.

a) Statement of the Problem

In almost all economies of the world, especially in developing countries in Africa, micro and small enterprises are crucial and are a key factor for sustained growth and development. SMEs play pivotal roles in creating dynamic, market oriented economic growth, employing the growing workforce in developing countries, alleviating poverty and promoting democratization. (Obwocha, 2006).

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Africa's SMEs have little access to finance, which thus hampers their emergence and eventual growth. Their main sources of capital are their retained earnings and informal savings and loan associations, which are unpredictable, not very secure and have little scope for risk sharing because of their regional or sector based focus. Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities. Small businesses in Africa can rarely meet the conditions set by financial institutions, which see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans.

The financial system in most of Africa is under-developed however and so provides few financial instruments. Capital markets are in their infancy, shareholding is rare and no long-term financing is available for SMEs. Non-bank financial intermediaries, such as microcredit institutions, could be a big help in lending money to the smallest SMEs but they do not have the resources to follow up their customers when they expand (Kauffmann, 2005).

According to the World Bank recent report of Ethiopia, small-scale enterprises are the most marginalized in getting access to financial institutions. As to the report, the private sector plays a crucial role as a catalyst for economic change through offering financing options, which allow firms to expand and innovate. Despite the role of SMEs in the Ethiopian economy, the financial constraints they face in their operations are daunting and this has had a negative impact on their development and limited their potential to drive the national economy as expected. This is worrying for a developing economy without the requisite infrastructure and technology to attract big businesses in large numbers.

Thus, this research is attempted to analyze the gaps in accessing the finances by SMEs in Ethiopia and recommend measures to bridge those gaps. Specifically, the study aims to address the financing needs, key constraints in accessing finance, and the extent of involvement of banks and MFIs in driving away the obstacles thereby creating a room for reforms in Government policies. Moreover, unlike many previous studies that address either the demand side or the supply side limitations of access to finance (see for e.g., Petersen and Rajan, 1994; Wiedmaier-Pfister et al, 2008; Ngoc et al., 2009; Ghimire and Abo, 2013) this study synthesizes both the demand side and supply side constraints. Hence, this research guided by the following basic research questions.

1. To what extent Small Business Enterprises have an access to finance to run the business in Sodo Town administration?
2. What are the means to finance the Small Business Enterprises in Sodo Town?
3. What are the major challenges that hinder the Small Business Enterprises access to finance in Sodo Town Administration?
4. What is the mechanism to overcome the challenges of Small Business enterprise facing with access to finance?

b) Objectives

i. *General Objective*

The general objective of this study is to explore the challenges of SMEs while mobilizing finances to support the venture in Sodo Town and advise the Administration through workable recommendations.

ii. *Specific Objectives*

The study would have the following specific objectives:

1. Explore access to finance to run the business in Sodo Town administration.
2. To identify the means to finance Small Business Enterprises in Sodo Town.
3. To dig out the major challenges that hinder the Small Business Enterprises in accessing the related financial support vis-à-vis Sodo Town
4. To formulate the intervention mechanisms in overcoming the challenges of Small Business Enterprises and mobilize sufficient financial support in the study area.

c) Significance of the Study

Considering the significance of SMEs in Ethiopia, it is important to understand the challenges facing SMEs in accessing credit facilities in Wolaita Sodo Town. The research expected to benefit various groups of stakeholders as follows:

- The research would have enable the policy makers to come up with a viable and focused entrepreneurship strategy that can help SMEs access to credit facilities. The study would have help develop a University and SME interface to boost the sector by encouraging young graduates in exploring employment potential.
- The study would have be a source of reference for future research
- The research would have come up with products, which are tailor made to fit into entrepreneurship financial needs.
- To stakeholders like financial institutions, investors, shareholders, employees, pressure groups, etc., the research provides information for suggesting improvement in service delivery of the respective credit facilities providers in Wolaita Sodo Town.

II. Literature Review

Access to external sources of finance may increase growth possibilities since it facilitates the development and improvement of firm's products and services or hire new employees. In transition economies,

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the development that financial markets experience may create barriers linked to the access to finance. Hence, academic research considers financial constraints as an important obstacle for entrepreneurship and firm growth. Empirical evidence supporting the importance of access to external finance for business growth can be found in Brown, Earlem & Lup, (2005), who examines firm growth determinants. Conversely, Johnson, McMillan and Woodruff (2000) evaluate institutional reforms in five Eastern European countries (including Romania), and they conclude that access to bank finance does not prevent business growth.

Lack of access to credit facilities is almost universally indicated as key problem for small and micro enterprises. In most cases, even where credit is available mainly through banks, the entrepreneurs may lack freedom of choice because the banks' lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the bank. Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends and relatives. Lack of access to long-term credit for micro, small and medium enterprise forces them to rely on high cost short term finance (Wanjohi & Mugure, 2008).

Matavire et al., (2013), in their study on challenges facing SMEs in accessing finance from financial institutions: The case of Belaway, Zimbabwe found out that SMEs fail to secure loans because of restrictive requirements of the financial institutions, top among them being collateral security. Among their recommendations is that the government should play its role of enabling SMEs to obtain finance from financial institutions. Makena, et al., (2014), in their study on challenges facing women entrepreneurs in accessing business finance in Kenya: Case of Ruiru Township, Kiambu County, lack of collateral was one of the objectives. However, the study found out that lack of collateral was a greater hindrance to credit accessibility by women entrepreneurs. This is due to lack of tangible assets like land, which used as an asset to secure credits. Among their recommendations is that the government should play its role of enabling SMEs to obtain finance from financial institutions.

Gitari, (2012) in her study on factors affecting women entrepreneurs' financial performance in Kenya: a case of Ngara Market found out that lack of information on who is offering what and the cost of obtaining such services limit them and that high inventory costing are some of the major drawbacks for success in women entrepreneurship. The high cost of running the entrepreneurs is a big threat to the women development due to lack of adequate capital and on the other hand lack of information on how to access funds to boost the business also is a major threat. At Wolaita Sodo town (2017), did a study on factors affecting the performance of SMEs traders at Wolaita Sodo town, Ethiopia. The study concluded that access to finance affected performance of SME's largely because it limited the entrepreneurs' ability to take advantage of opportunity as and when they arose.

III. Conceptual Framework

- A conceptual framework is a product of qualitative process of theorization, which interlinks concept that together provides a comprehensive understanding of a phenomenon or phenomena (Jabareen, 2009).
- The concepts that constitute a conceptual framework support one another, articulate their respective phenomena, and establish a framework-specific philosophy that defines relationships. The conceptual framework of this study relates to independent variables; collateral requirements, cost of credit, availability of information on finance, business risks and the dependent variable; access to credit facilities by micro and small enterprises in Wolaita Sodo

IV. Research Methodology

a) Research Design

This study would have adopted descriptive statistics and econometric analysis. The target population would have been drawn from all micro and small enterprises in Wolaita Sodo town. Currently the total micro and small enterprises registered with Wolaita Sodo Town is 957. The businesses in operation are mainly in manufacturing, construction, trade, service and urban agriculture.

Table 3.1: Shows Population and sample of the study

Type of business	Population	Sample size(n)
Manufacturing	135	40
Construction	230	68
Trade	223	65
Service	295	87
Urban Agriculture	74	22
Total	957	282

Source: Field Survey, 2017

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b) Data Type

The data for this study would have been gathered through the use of primary and secondary sources. The primary data source for this study involves the use of questionnaire. The questionnaires would have been distributed to SME operators and/or owners for first hand information for processing towards answering the research questions. The questionnaire would have been divided into three sections.

c) Sampling and Sampling Techniques

i. *Sample Size*

Sample sizes for survey data would have been calculated using simplified formula for determining proportional sample sizes survey (Gay et al., 2009). The formula used to calculate the sample sizes, where a 95% confidence level and P = 0.5 are assumed in the calculation. Described by Yemane (1967), a simplified formula for calculating sample size of a population proportion is unknown that is given.

N	=	the population size
n	=	the sample size
	=	is the level of precision
N	=	282

ii. *Sampling Techniques*

The study would have used stratified random sampling technique to select the sample. The study would grouped the population into strata. From each stratum, the study used simple random sampling to select 282 respondents. This sampling design would have been used because the population of study would have not homogenous and was to be sub-divided into sub-units namely manufacturing, construction, trade service and urban agriculture. Kothari (2004) recommends stratified random sampling because it is accurate, easily accessible, divisible into relevant strata and it enhances better comparison; hence representation across strata. Another advantage of stratified random sampling is its ability to ensure inclusion of sub-groups, which would otherwise be omitted entirely by other sampling methods because of their small number in the population.

d) Data Collection Instruments

The study would have used questionnaire to collect data. Questionnaires would have been constructed based on the research objectives. The questionnaire contained closed-ended questions using a Likert scale (ranging from 1 = highly disagree; 2 = disagree; 3 = neutral 4 = agree; 5 = highly agree).

e) Hypothesis Testing

Research statements are tested using the Z-test statistical tool. The tests are measured within 95% confidence interval having 0.05 significance levels. The following are the hypothesis drawn:

H1: Sources of initial capital are not due to challenges of Small and Micro Enterprises in accessing the required finances.

H2: Availability of information on finance is not a serious challenge for Small and Micro Enterprises in accessing the required finances

H3: The major constraints to SMEs are not a serious challenge for Small and Micro Enterprises in accessing the required finances.

f) Data Analysis and Interpretation

i. *Data Analysis*

Under this section, the process by which outputs are generated through three steps: preparing data for analysis, analyzing the data, and interpreting the output data, i.e. testing the research hypothesis and drawing valid inferences. Qualitative analysis consisted of examining, categorizing, tabulating and recombining evidences to address the research questions. Qualitative data grouped into meaningful patterns and themes that observed to help in the summarizing and organization of the data.

Quantitative data analyzed with statistical techniques such as frequency counts, percentages, arithmetic means, standard deviations, bar charts and tabulation to show differences in frequencies. Qualitative data would have been analyzed descriptively with questionnaires. Statistical Package for Social Sciences (SPSS) version 20 was used to aid in coding, entry and analysis of quantitative data obtained from the closed ended questions.

Besides, descriptive statistics, the linear regression model would be used to determine the covariates of the likelihood of having a loan from a formal financial institution. The linear regression model is extremely flexible and widely used function, and leads itself to meaningful interpretations when the dependent variable is dichotomous outcome. It is a powerful tool in its ability to estimate the individual effects of the continuous or categorical variables on the qualitative dichotomous dependent variable (Wright, 1995). The dependent variable in model is whether SME's benefit from banking facilities or not. It is a categorical variable with a value of 1 when a SME's benefits from banking facilities and 0 otherwise. This is regressed against factors that possibly limit a firm's access to bank loan. The model specified as follows:

Formula: $Zi = \beta 0 + xji + \mu i$

Where Zi is the dependent variable with a value of 1 when firm i benefits from micro finance facilities and 0 other wise. Xji are a vector of explanatory variables which include major obstacle of SME's, availability of financial information, sources of initial capital, working capital financed by firm size and purchase of fixed assets financed by. Finally, μi is the discrepancy term.

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V. Findings and Discussion

a) Introduction

This chapter presents the analysis of data collected from respondents. The collected data was edited and cleaned for completeness and consistency in preparation for coding. Once coded, the data was keyed into the Statistical Package for Social Sciences (SPSS-20) for analysis.

b) Results of the Pilot Study

i. *Data Reliability*

A pre-test of 5% of the population size was conducted to give a representation of the selected population thus the designed questionnaire was tested on 12 potential respondents (Mugenda and Mugenda, 2003). To test the internal consistency of the Likert scale used in this study, reliability analysis was done using Cronbach's Alpha as the measure. A reliability co-efficient of $\alpha \geq 0.7$ was considered adequate. A co-efficient of 0.761 was registered indicating that the scale used had a high level of internal consistency. This indicated that the scale was reliable enough to test the extent to which micro and small enterprises faced challenges in accessing finance facilities. The results of the reliability analysis are shown in Table 4.1;

Table 4.1: Results of the Pilot Study Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha	No. of Items
0.761	0.780	280

Source: Field Survey, 2017

The researchers administered 282 questionnaires and 280 were completed and returned successfully. This represents a response rate of 99.3%. This response rate was adequate to allow the researchers to continue with the analysis. The questionnaires were composed of questions that addressed the objectives of the study. The study sought to establish the influence of major obstacles of SMEs, sources of initial capital, working capital financed by firm size, availability of information on accessibility of credit facilities by MSEs in Wolaita Soddo town.

VI. Sex of the Respondents

The study sought to know the distribution of the respondents by gender. The study findings indicated that 62.5% of the respondents' were male while 37.5% were female. This implied that the male participants dominated the businesses at Wolaita Soddo town. The findings also indicated that the researchers observed gender balance during the administration of questionnaires. It reveals that, the SME is largely dominated by the male participants. Thus, it needs attention to increase the number of women entrepreneur in the SMEs to sustained their economic independence and improve the level of employment of women.

Table 4.1: Sex of Respondents

Sex	Frequency	Percent	Cumulative Percent
Female	105	37.5	37.5
Male	175	62.5	100.0
Total	280	100.0	

Source: Field survey, 2017

VII. Level of Education

The study also sought the distribution of the respondents by their level of education. The study established that most (48.9%) of the respondents' were TVET levels followed by diploma levels at 37.5% and then BA 13.6%. This implies that the respondents were educated enough to understand the issues being sought by the researchers.

The results of the study are as shown in Table 4.2.

Table 4.2: Education Level of Respondents

Qualification	Frequency	Percent	Cumulative Percent
BA	38	13.6	13.6
Diploma	105	37.5	51.1
TVET	137	48.9	100.0
Total	280	100.0	

Source: Field survey, 2017

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VIII. Age of Respondent

The survey result shows that about 66.4% of the sampled respondents were under the age of 25-35 followed and 31.1%, 2.5% of respondents were under the age of <25 and 35-45 respectively. This implies that the researchers-sought opinions from respondents who had the age of respondents were enough to understand the challenges faced when trying to access credit facilities. The study findings are as shown in Table 4.3.

Table 4.3: Age of Respondents

Age	Frequency	Percent	Cumulative Percent
<25	87	31.1	31.1
25-35	186	66.4	97.5
35-45	7	2.5	100.0
Total	280	100.0	

Source: Field Data of 2017

IX. Age of the Company

The study further sought to know the duration the businesses had been in existence. The study found out that most (49.3%) of the businesses had been in existence for below two years followed by 43.6% of the businesses that had been existence for 2-5 years. Only 7.1% of the businesses had less than 6-10 years' existence. This implies that the researchers-sought opinions from respondents who had been in business long enough to understand the challenges faced when trying to access credit facilities. The study findings are as shown in Table 4.4.

Table 4.4: Age of the Company

	Frequency	Percent	Cumulative Percent
2-5 years	122	43.6	43.6
6-10 years	20	7.1	50.7
Below 2 Years	138	49.3	100.0
Total	280	100.0	

Source: Field Survey 2017

X. Nature of Organization

In this section, the study sought to know the distribution of respondents by the nature of business they were engaged in. According to the study findings, most (29.6%) of the respondents were engaged in the service followed by 23.6% of construction and Traders accounted for 23.9% respectively. Manufacturing and Urban agriculture (14.3% and 8.6%) accounted only. This indicates that the researchers sought views from people of diverse businesses to avoid any bias. The findings are shown in Table 4.5.

Table 4.5: Nature of the Organization

	Frequency	Percent	Cumulative Percent
Construction	67	23.9	23.9
Manufacturing	40	14.3	38.2
Service	83	29.6	67.9
Trade	66	23.6	91.4
Urban Agriculture	24	8.6	100.0
Total	280	100.0	

Source: Field Survey, 2017

XI. Current Position in the Organization

In this section, the study sought to know the distribution of respondents by their position in the organization. The respondents position within the organization was categorized in to four categories namely accountants, cashiers, mangers and secretary. According to the study findings, most (74.3%) of the respondents were mangers in the organization, 13.6% of the respondents were cashier and accountants and secretary were accounted for 2.1% and 10% respectively. This implies that the researchers-sought opinions from respondents who had been in business were mangers and this helped the researchers to get their feelings regarding the challenges they faced when

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trying to access credit facilities. The findings are shown in Table 4.6

Table 4.6: Current position of respondents

		Frequency	Percent	Cumulative Percent
	Accountant	6	2.1	2.1
	Cashier	38	13.6	15.7
	Manger	208	74.3	90.0
	Secretary	28	10.0	100.0
	Total	280	100.0	

Source: Field Survey, 2017

c) Descriptive Analysis of access to finance of Small and Micro Enterprise

This part explains the descriptive statistics based on the factors that affect the access to finance of SME's. The results for measures of central tendency and dispersion were obtained from the sample of respondents of manufacturing, construction; trade, service and urban agriculture are shown in the following tables.

The study sought to know the extent to which various factors influenced access to credit facilities for micro and small enterprises in Wolaita Sodo town. The extent to which the factors influenced access to credit was measured on a Likert scale of 1-5 where 1- highly disagree, 2- disagree, 3- neutral, 4- agree and 5- highly agree.

Table 4.7: Access to Finance SME's

	N	Mean	Std. Deviation	Variance
Y	280	2.088	.7310	.534
X1	280	3.5205	.61876	.383
X2	280	2.41652	.552472	.305
X3	280	2.833333	.6392200	.409
X4	280	3.436	.9595	.921
X5	280	3.800	.6259	.392

Source: Field Survey, 2017

The study found out that the extent of major obstacles influence of access to credit facilities to a moderate extent (M = 3.52, SD= 0.731) while source of initial capital influenced access to financing to a moderate extent also (M= 3.5205, SD= 0.618). The influence of working capital financed by firm size was to a moderate extent (M= 2.41, SD= 0.552) and so did purchase of fixed assets finance such as internal fund, owners contribution (M= 2.83, SD= 0.639). Availability of information like limited information on financial management and limited training /experience had the least influence but still it was to a moderate extent (M= 3.8, SD= 0.625). The standard deviations indicated the extent to which the responses were dispersed from the mean. Overall, measure obstacles influenced access to credit facilities only to a moderate extent (M= 3.52, SD= 0.731. This implies that access to credit was highly limited by measure obstacles such as lack of skilled manpower, lack of good telecommunication services, high interest rate and group guarantee. The results are as shown in Table 4.6.

These findings are in line with those of Matavire et al (2013) who their study on challenges facing SMEs in accessing finance from financial institutions, the case of Belaway, Zimbabwe found out that SMEs fail to secure loans because of measure obstacles to access to finance, top among them being collateral security.

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XII. Econometric Result

Table 4.8: Result of Linear Regression

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	3.456	.421		8.214	.000		
	X1	-.034	.079	-.029	-.431	.667	.768	1.303
	X2	-.190	.089	-.143	-2.132	.034**	.754	1.325
	X3	-.106	.073	-.092	-1.454	.147	.847	1.181
	X4	-.100	.047	-.132	-2.154	.032**	.911	1.098
	X5	-.038	.073	-.033	-.525	.600	.868	1.152

a) Dependent Variable: Y where as X1, X2, X3, X4 and X5 were independent variables
b) Note: B=regression coefficient, Exp (B) = odds ratio Overall, correct prediction = 95% Sig. = significance S.E = standard error

Source: Field Survey, 2017

NB: X1 = major obstacle of SMEs
X2 = Source of initial capital
X3 = Working capital finance
X4 = Purchasing of fixed asset
X5 = Availability of Information that affects access to finance

In accordance with the above table, it can be inferred that the researchers rejects the H1 and H2 as there is an indication that a strong and significant relationship exists between sources of capital X2 and major obstacles faced by SMEs X1, as well as the obstacles faced by SMEs X1 is not due to availability of information to access finance X5. The scores p = 0.147 and p = 0.6 reveal their significant association and hence we fail to reject the hypothesis. Further, working capital finance X3 and purchasing of fixed assets X4 having p values less than 0.05 shows no significant association with major obstacle of SMEs X1 and hence alternate hypothesis gets accepted by rejecting the null.

XIII. Conclusion and Recomendation

a) *Conclusions*

The study sought to establish the extent to which major obstacles of SMEs, sources of initial capital, working capital financed by firm size, availability of information on accessibility of credit facilities by MSEs in Wolaita soddo town. From the study findings, it can infer that, sources of initial capital influences accessibility to credit facilities to a great extent followed by purchase of fixed assets financed by and major obstacles of SMEs which influenced access to credit facilities to a moderate extent and then availability of information on finance which has an influence in accessing credit facilities for micro and small enterprises only to a small extent. The study also concludes further that the respondents preferred to get their start-up capital from personal savings, relatives and friends because the collateral requirements and high repayment costs by financial institutions.

i. *Recommendations*

The study findings yielded the following recommendations in view of the challenges faced by MSEs when accessing credit facilities for the expansion of their businesses.

- The management of banks should stretch further to more business people so as to be able to serve their banking needs. This will serve in increasing their chance of securing credit facilities.
- Credit provider institutions should come up with products for MSEs where collateral requirements are lenient.
- The credit giving institutions come up with programs of educating the MSEs on how they can go about obtaining credit facilities. The study therefore recommends that the management of these businesses should put in place proper accounting practices and adequate internal control systems, which will counter problems of information asymmetry that make MSEs risky for credit giving institutions.
- The management of the institutions should increase their product portfolios they offered to MSEs.
- The marketing departments should endeavor to research on the clients' desired options and be able to include the probable and realistic ones onto the list. This will help to reach out to the MSEs that cannot access to credit facilities.

XIV. Areas for Further Research

The study recommends further research in the following areas; the effect of initial capital to start up and on the profitability of micro and small enterprises; the

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effect of finance to acquire fixed assets on MSEs access to credit facilities in Wolaita Sodo town. In future, a similar research should be done covering other towns as this research only covered micro and small enterprises in Wolaita Soddo town.

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