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## Assessing Transformational Status and Factors Affecting Transformation of Micro and Small Enterprises in Oromia Regional State: The Case of Adama, Dukam and Shashemene Towns, Ethiopia

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### **Abstract:**

*Micro and Small enterprises are generally recognized as the engine of economic development and they have vital contribution to the economic development and creation of wider employment opportunity in developing countries. Thus, it is believed that focusing on the growth and transformation of such enterprises will bring paramount change in growth and development of the developing nations. The research was aimed at assessing transformational status and identifying factors affecting transformation of micro and small enterprises in Oromia regional state with particular focus on three selected towns namely, Adama, Dukam and Shashemene towns. The study was employed both primary and secondary data. The primary data was collected from 220 MSE operators through well-developed questionnaires. In addition, a key informant interview was made with food security and job opportunity creation office heads and experts of the towns. Parallel to this, the secondary data was taken from both the selected towns' food security and job opportunity creation offices and the region's food security and job opportunity creation bureau. To realize the objectives of the study both descriptive statics and binary log it model was employed. The study revealed that transformational status of MSEs into medium enterprises for the last five years was very low which is less than 5%. The log it analysis has also shown that out of six categories of factors, four of them were significantly affecting the growth and transformation of MSEs into medium enterprises namely, financial factors, market managerial factors, political/regulatory factors and infrastructural factors. While the remaining two factors (market related factors and other factors) were found to be insignificant. Thus, it was recommended that the regional government bodies and MSE operators need to work on these factors to increase the transformational status of MSEs into medium enterprises especially, financial factors, market managerial factors, political/regulatory factors and infrastructural factors.*

**Keywords:** *Micro and small enterprises, medium enterprises, factors and transformational status*

## 1. Introduction

### 1.1. Background of the Study

Micro and Small enterprises are generally recognized as the engine of economic development and they have vital contribution to the economic development and creation of wider employment opportunity in developing countries with large number of unemployed people. Micro and Small enterprises are major players in the economic resurgence. They are instrument of change and vehicles of growth and diversification. The study conducted by Habtamu, et al (2013) showed that the importance of MSEs as a means of bringing economic transformation using the skill and the talent of people without requiring high-level training, much capital and sophisticated technology. Thus, focusing on the growth and transformation of such enterprises will bring paramount change in growth and development of the developing nations.

The government of Ethiopia has formulated the national Micro and Small Enterprise Development and Promotion Strategy in 2005 with the primary objective of creating a favorable environment for MSEs so that MSEs could facilitate economic growth, create long-term jobs, strengthen cooperation between MSEs, provide the basis for medium and large-scale enterprises and promote export (MSE Strategy for Ethiopia, 2005). Following the 1997 MSEs Development Strategy, the Federal Micro and Small Enterprises Development Agency (FeMSEDA) was established in 2006 to lead and stir Ethiopia's MSE development. Nowadays, the agency is accountable to the Ministry of Trade and Industry. It was established with the primary goal of implementing the formulated strategies. For the purpose of smooth implementation of the MSE policies and strategies, the agency extended its structure into the regions by establishing Regional Micro and Small Enterprise Development Agencies (ReMSEDA).

The MSEs Development was integrated in the GTP as one of the pillars of the Industrial Development Plan and taken as one of the best tools to implement the country's Industrial Development Strategy. The broad goal of the ongoing Growth and Transformation Plan (GTP) of the country is to ensure broad based economic growth and to lift up the country to middle-income level. In addition, to achieve this broad goal, MSE Development Policy and Strategy has been further

revised in 2012 with general objectives of: creating extensive employment opportunities to increase income; reduce poverty and enhance equitable distribution of income. Moreover, to contribute towards competitive and sustainable economic growth thereby creating foundations for industrial development and linkages with rural development; and to create broad-based developmental investors in urban centers (MSE Development Policy and Strategy, 2012). The strategy was revised with renewed interests and more ambitious targets on employment and number of entrepreneurs and transition to medium size level. This made micro and small enterprises development to have a strategic place within Ethiopia's Industrial Development Strategy through transforming MSEs into medium scale enterprises thereby; transforming the medium scale enterprises into large-scale industries.

MSE development, being one of the key focus areas of the country's development strategy, receives massive support from the government in the form of access to finance, market, technology, training and working space. The government strongly believes that MSEs are the right solution to reduce urban unemployment and hence reduce poverty. This ambition is reflected in the GTP. For instance, it plans to create three million new jobs in the MSE sector in the five years growth and transformation period. Therefore, MSE promotion and support is the vital strategy to fulfill this national plan of employment creation in the short-run and achieving industrialization in the long run. Ethiopia adopts a layered policy support in which MSEs are categorized into startups, growing-middle and maturity.

Start-up stage enterprises refers to those enterprises found at their establishment stage and comprises a group or individual aspiring entrepreneurs that seek various supports to make their enterprise operational. The basic challenges at this stage include lack of initial and working capital, poor knowledge of business management and entrepreneurship and lack of knowhow about the different government policies and directives related to the sector. In order to mitigate these challenges, FEMSEDA has designed a strategy that focuses on facilitating access to initial capital, supporting MSEs in formalization and legalization process and provision of training on business management, entrepreneurship and production technique.

Growing stage enterprises refers to those enterprises that are competent in the market in terms of price and quality and successfully utilize the various government support packages and are profitable in their business. However, enterprises at this stage also suffer from different challenges like financial constraint, lack of appropriate technology and technical skill, absence of sufficient working and sales premises and rent seeking behavior. To alleviate these specific challenges, FEMSEDA has formed a national strategy that focuses on facilitation of financial support and skill and technological development program. On the other hand, enterprises are considered to have reached the maturity stage when they are fully profitable and engaged in further expansion and investments in the sector. At this stage, FEMSEDA has a strategy that aims to strengthen enterprises in terms of productivity and product quality. Moreover, at this stage, knowledge of international standards and better production technology are disseminated to enterprises.

In Ethiopia, because of the comprehensive support extended from the government the sector had some considerable achievements. For instance, during the first four years of the GTP I (2011-2014) the sector was able to create 6,671,012 jobs, which exceeds exceeding the goal set for the total GTP period (3 million Jobs); generate revenue of ETB 25.62 billion through Domestic Market linkage, exceeding the goal set for the total GTP period (ETB 10 billion). Moreover, the sector brought a hard currency of 65,375,026 USD through Foreign Market linkage, exceeding the goal set for the total GTP period (46,166,142USD) (<http://www.awib.org.et/>). However, various researches conducted on MSEs showed that a number of factors were hindering the growth of MSEs in the country in general and in the region in particular. These problems are financial factors, marketing, management and HRM factors, environmental factors and sources of credit. More over Shortage of working capital, intensity of competition, like lack of business development services, collateral requirement by financial institutions, conflict with neighbors and lack of transparency among SMEs office at the time of allocating the working place were challenging the growth of MSEs in the country as well as in the region (Belay et al, 2015; Weldegbriel, 2012; Victor Egan, 2010).

### *1.2. Statement of the Problem*

The growth of micro and small enterprises (MSEs) is major driver of the economy because MSEs contribute to employment growth at a higher rate than larger firms do. It is a fact that in most developing countries, MSEs by virtue of their size, location, capital investment and their capacity to generate greater employment have proved their powerful propellant effect for rapid economic growth. The sector is also known as an instrument in bringing about economic transition by effectively using the skill and talent of the people without requesting high level training, much capital and sophisticated technology. Therefore, in developing countries; the MSEs sector is a large source of employment and income, particularly for the urban population (INLC, 2015; Habtamu, et al 2013). Asefa (2014) has also showed that MSEs have significant contribution in community development by boosting communities' capital (Social, financial, human, physical and natural).

Despite these facts, the growth of SMEs faces a number of constraints that hinders its rapid growth and development, which ultimately reduce the weight of its potential contribution to the national economy. These are entrepreneurial characteristics, social linkages, marketing problems, inadequate finance, lack of working premises, inadequate infrastructures, poor management practices and absences of proper business plan due to knowledge or other reasons (Joshi and Gebreselassie ,2015; Mulu, 2013; Abera,2012; S Nichter and L. Goldmark, 2005). In addition, environmental factors such as social, economic, cultural, political, legal and technologies along with, internal (personal) factors like individual attitudes, training and technical know-how are all the constraints that are challenging the success of SMEs in developing countries (IPA,2017; Kamau, J. M. & Ngugi, J. K.; 2014Werotew, 2010 cited in Negash and Kumera, 2016; Gebrehiwot & Wolday, 2005)

Despite the Ethiopian government unreserved efforts in formulating and designing MSEs policies and strategies, in practice however, the sector is still suffering from a number of challenges and problems. For instance, lack of entrepreneurial capability of the MSEs operators; poor technical and technology support are some of the challenges the sector is facing currently. Moreover, weak saving culture (though at the end of GTP-I period 80 percent of the financial sources of the MFIs should have been from saving); the gap between the demand and supply of credit service; limitation of the outreach of MFIs capacity and Budget constraint to prepare working premises for MSEs another challenges the MSEs sector is confronting. Furthermore, there are major problems that are identified and affecting the performance of MSEs in different towns of the country. These include lack business plan, lack of formal and informal association, lack of favorable business environment, high cost and shortage of raw materials, lack of proper institutional support, lack of proper marketing practice, shortage and small size of credit, and shortage of working and sales spaces. Moreover, lack of rental machinery, stringent licensing requirements and stiff competition among MSEs in the same business line and medium and large companies were among the identified factors (Birhanu et al, 2014; Mulu, 2014; Mekonnen and Tilaye, 2013; Weldegbriel, 2012).

In Ethiopia, during the first four years of the GTP I (2011-2014) the development of the sector is also reflected in the transfer of 3,141 MSEs to Medium Enterprises level (<http://www.awib.org.et/>). In addition, it was reported that in 2015 Oromia Micro and Small Enterprise Agency also has transformed 979 enterprises drawn from various parts of Oromia State into medium enterprises (<http://allafrica.com>). However, majority of the MSEs were failing to grow to be transformed into medium scale enterprises both in the country and in the region. This is also supported by Amare and Raghurama (2017) as they stated "despite the efforts made to support Micro and Small Enterprises, transition from Micro to Small and then to Medium Enterprises is rarely happening which makes the onlooker to vacillate the success of the Micro and Small-Scale Enterprises (MSEs) development strategy in Ethiopia".

Therefore, the purpose of the study is to investigate the transformational status of Micro and Small Enterprise and identifying the critical factors that hinder their growth and transformation in Oromia Regional State particular in Adama, Dukam and Shashmane Towns during the last 5 years.

### *1.3. Objectives of the Study*

#### 1.3.1. General Objectives

The general objective of this research is to examine the transformational status of Micro and Small Enterprises and identifying factors affecting their transformation into medium enterprises in the study areas.

#### 1.3.2. Specific Objectives

- Examining the transformational status of Micro and Small Enterprises in the last fifteen years in the region
- To compare the relative transformational status and creation of job opportunity among the towns
- Identifying factors affecting the transformation of Micro and Small Enterprises into medium enterprises in the study areas.

### *1.4. Review of Related Literature*

#### 1.4.1. Definitions of MSEs

Microenterprise is a small business that employs a small number of employees. It will usually operate with fewer than 10 people and is started with a small amount of capital (<http://www.investopedia.com/>). Most microenterprises specialize in providing goods or services for their local areas. A small-scale enterprise is a business that employs a small number of workers and does not have a high volume of sales. Such enterprises are generally privately owned and operated sole proprietorships, corporations or partnerships (<http://www.Chron.com/>). Medium-scale businesses typically result from the slow and steady growth that results from a successful small business. As the business earns more revenue, it sets aside the capital needed for buildings, equipment and more employees, eventually bridging the gap between small business and large corporations.

Different international institutions and countries define SMEs differently by taking their own definition criteria. For instance, in Kenya the classification of enterprises is primarily by the number of employees engaged by firms and their turnover. The Micro and Small Enterprises (MSE) Bill 2012 defines: Micro enterprises as any firm, trade, service, industry or a business activity, formal or informal that has an annual turnover that does not exceed Kenya Shillings 500,000 and employing (or rather engaging) 1- 9 people. The total assets and financial investment or the registered capital of the enterprise does not exceed Ksh 10 million in the manufacturing sector and does not exceed Ksh 5 million the service and farming sector. Small enterprises as those firms, trade, service, industry or business activities that post an annual turnover of between Ksh500, 000 and Ksh5 million and have an employee list of 10 to 50. In the manufacturing sector, investment in plant and machinery should be between Ksh 10 million and Ksh 50 million and registered capital of the enterprise between Ksh 5 million and Ksh 25 million in the service and farming sector. Medium enterprises are therefore firms with between 51-100 employees and a capital investment of not more than Kshs 30 million

In Sudan the SMEs are defined as those industries which have a capital investment of less than Ls 50,000 (\$ 142,000) or which employ less than 30 full-time workers. On the other hand, European Commission uses the criterion of the number of staffs as the main condition. The commission has also used annual turnover and annual balance sheet (EU, 2015). While the World Bank uses three quantitative criteria for defining SMEs: number of employees, total assets in U.S.

dollars and annual sales in U.S. dollars (IEG, 2013). As total asset and annual sales are similar in the definition set, taking total asset is chosen due to ease availability of data. The definitions are described in the subsequent tables (Table 1 and 4.2).

Enterprise Category	Headcount: Annual Work Unit (AWU)	Annual Turnover	Annual Balance Sheet Total
Medium-sized	< 250	≤ €50,000,000 (in 1996 € 40,000,000)	≤ €43,000,000 (in 1996 € 27,000,000)
Small	< 50	≤ €10,000,000 (in 1996 € 7,000,000)	≤ €10,000,000 (in 1996 € 5,000,000)
Micro	< 10	≤ €2 million (previously not defined)	≤ €2 million (previously not defined)

Table 1: Definition of Small and Medium Enterprises with European Union Standards  
Source: European Commission (2005)

Enterprise category	Headcount: Annual Work Unit (AWU)	Total Assets	Total Annual Sale
Medium-sized	>50; ≤300	> \$3,000,000; ≤15,000,000	> \$3,000,000; ≤15,000,000
Small	>50; ≤50	> \$100,000; ≤3,000,000	> \$100,000; ≤3,000,000
Micro	< 10	≤\$ 100,000	≤\$ 100,000

Table 2: Definition of Small and Medium Enterprises by World Bank Standards  
Source: Independent Evaluation Group (2008)

#### 1.4.2. MSEs Definition in Ethiopia

Though Micro, Small and Medium Enterprises constitute the major share in terms of number in Ethiopia, there is no consistently placed definition for the sub sector by different bodies. In 2005, Ethiopia has defined Micro Enterprises as an enterprise with a total asset of less than 20,000 Birr (\$1200) and Small Enterprises as Enterprises with a total asset of Birr 500,000 (\$30,000) or less (MSEs Development strategy, 2005). In this definition, the only base used is the total asset unlike international organizations' definition base (WBG, 2015; EU, 2015). To align the definition with at least some countries and international organizations, the country has revised the definition of Micro and Small Enterprises in 2012 by considering some of the attributes used by other countries and international organizations in the new definition. In addition, the definition has segregated sectors as service and manufacturing. However, still there is no uniform definition among different governmental organizations such as Ministry of Trade, Central Statistics Agency, & Federal Micro and Small Enterprises Development Agency (FeMSEDA) in defining MSEs. Central Statistics Agency (CSA) had grouped both large and Medium Enterprises together when these enterprises have employed more than 10 employees and used automated machinery. Furthermore, the definition of CSA does not consider the total asset; and service sectors are overlooked.

Federal Micro and Small Enterprises Development Agency (FeMSEDA), on the other hand, put definition of Micro and Small-Scale Enterprises and categorize them from support provision perspective. Since it only focusses on Micro and Small Enterprises, the new definition does not put any demarcation between Small and Medium; and Medium and large Enterprises. Thus, according to the new Small & Micro Enterprises Development Strategy of Ethiopia (published 202) the working definition of MSEs is based on capital and Labor.

No	Enterprise Level	Sector	Hired Labor	Capital
1	Micro	Industry	≤ 5	\$6000.00 or £ 4500.00 ≤ Birr 100,000.00
		Service	≤ 5	\$3000.00 or £2200.00 ≤ Birr 50,000.00
2	Small	Industry	6-30	90,000.00 or £70,000.00 ≤ Birr 1,500,000.00
		Service	6-30	≤ Birr 500,000.00

Table 3

#### 1.4.3. Role of MSEs

Micro Small and Medium Enterprises play a key role in the industrialization of a developing nation. "This is because: they provide immediate large-scale employment and have a comparatively higher labor-capital ratio; they need only a shorter gestation period and relatively smaller markets, to be economic; they need lower investments. They offer a method of ensuring a more equitable distribution of the national income and facilitate an effective mobilization of the resources of capital and skill which might, otherwise, remain unutilized; and they stimulate the growth of the industrial entrepreneurship and promote a more differed pattern of ownership and location". The small-scale sector has stimulated economic activity of a far-reaching magnitude and has played a significant role in the elimination of the economic backwardness of the urban and the under - developed regions in the country, attained self-reliance and reduction of regional imbalances. It has also led to the reduction of disparities in income, wealth and consumption.

### 1.4.3 The Challenges of Micro and Small Enterprises

Even though MSE's have important roles in economic development, poverty alleviation, employment opportunity, they are critically challenged by certain impeding factors to sustain within the sector. The research conducted by Bowen, Morara and Mureithi (2009) in Kenya revealed that three out of five micro and small businesses failed within the first few months of operation due to competition, managerial inefficiency, insecurity, debt collection, lack of working capital, power interruptions, political uncertainty, cost of materials and low demand of the products. The problem confronting MSE's appears to be similar in least developed or developing countries. However, the extent of the problems varies from country to country and industry to industry; and it depends on firms' characteristics (Aremu & Adeyemi, 2011).

Some of the major constraints of micro and small enterprises in Ethiopia affecting the performance of MSEs are cumbersome rules/regulations related problems such as high tax level, uncertainty about tax policy, high collateral requirement, inadequate business premise and lack of business support service. In addition, inadequate access to credit, an inadequate access to finance, lack of infrastructure, weak supporting institutional quality, access to land, and access to raw material, access to training, marketing and competition are found among constraints. Bureaucratic requirements, penalties, weak legal enforcement, entry regulations and inability to use the institutional enforcement mechanism were also among the major problems of MSEs (Commission on Legal Empowerment of the Poor, 2006). The interruption of electric power, unavailability of adequate transport service and unavailability and unreliability of water supply and other infrastructures are hindering the development of MSEs (Gebrehiwot & Wolday, 2004).

### 1.4.4. Conceptual Framework

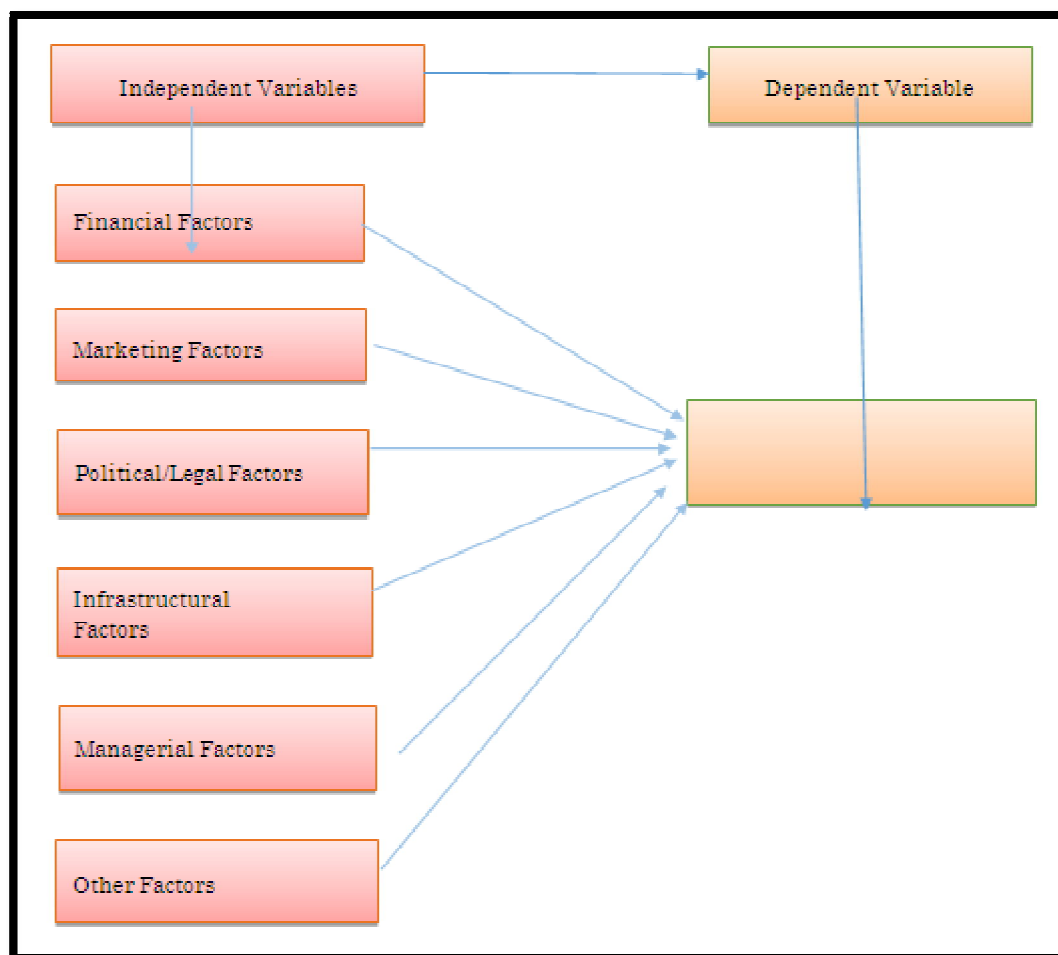


Figure 1

## 2. Research Methodology

### 2.1. Research Design

The research design refers to "the overall strategy that we choose to integrate the different components of the study in a coherent and logical way, thereby, ensuring we will effectively address the research problem; it constitutes the blueprint for the collection, measurement, and analysis of data" (www.busines dictionary.com).

The study employed both qualitative and quantitative research methods. According to Cameron (2015) "mixed methods research represents research that involves collecting, analyzing, and interpreting quantitative and qualitative data in a single study or in a series of studies that investigate the same underlying phenomenon". It involves philosophical assumptions that guide the direction of the collection and analysis of data and the mixture of qualitative and quantitative

data in a single study or series of studies with central promise that it provides a better understanding of research problems than either approach alone. Qualitative research was used to analyze qualitative data that was gathered through interviews and observations. This approach is also supported by Smith (2008), who mentioned that qualitative methods include the researcher's experience and employs data collecting techniques such as focus groups, case studies, interviews and personal observation. On the other hand, quantitative research was employed to describe and to test relationships; and to examine the cause-and-effect of relationships of the factors affecting transformation of MSEs in the towns.

## 2.2. Sampling

To undergo the study, both simple random sampling and purposive sampling techniques were used to identify the respondents from operators of MSEs and the towns' food security and job opportunity creation experts and officials respectively. Fifteen officials and experts from the towns' food security and job opportunity offices and two hundred twenty respondents were taken from MSE operators.

## 2.3. Methods of Data Collection

The study has employed both primary and secondary data collection techniques. The primary data were collected using well-structured and standardized questionnaires. The selected respondents were provided with both close ended and open-ended questionnaires to collect the necessary information for the study. In addition, key informant interview was undertaken to get details about the micro and small enterprises in the region in general and in the towns in particular from purposively selected officials and experts of the towns' food security and job opportunity creation offices. Physical observation during data gathering was part of the study to substantiate the analysis. Furthermore, time series data was taken from the region's food security and job opportunity creation bureau and the towns' food security and job opportunity creation offices.

## 2.4. Data Analysis

The study has employed both quantitative and qualitative data analysis techniques. The qualitative data was narrated to show the facts in the study area. In addition, the quantitative data was described using descriptive data analysis method. Moreover, different factors were analyzed using binary logistic regression model. Data were analyzed using Statistical Package for Social Sciences (SPSS) version 20.

## 2.5. Logistic Regression

Binary logistic regression is extension of linear regression used to predict dichotomous dependent variable. It is applied when the relationship between dependent variable and independent variables is nonlinear. Linearity is considered to be in logit. Logistic regression predict likelihood that  $Y=1$  and not 0 given certain values of  $X$ . This implies that if  $X$  and  $Y$  are linear related, probability of  $Y=1$  increase as value of  $X$  increases.

The Logit analysis used primary data which were collected in the field through questionnaire from the respondents. The analysis was done to identify factors that most influence transformational status of MSEs. A chi-square test was used to indicate how well the logistic regression model fits the data. The likelihood of the data set as the product across all cases of the probabilities is;

$$L(Y/X) = P_i^{Y_i} (1 - Y_i)^{1-Y_i}$$

$$L(Y/X) = \left[ \prod_{i=1}^6 \left( \frac{e^{\beta_0 + \sum_{i=1}^6 \beta_i X_i}^{Y_i}}{1 + e^{\beta_0 + \sum_{i=1}^6 \beta_i X_i}} \right) * \left( \frac{1}{1 + e^{\beta_0 + \sum_{i=1}^6 \beta_i X_i}} \right)^{1-Y_i} \right]$$

Whereby  $Y$  is the 0 or 1 outcome for the  $i^{\text{th}}$  case.

The use of  $Y_i$  and  $1-Y_i$  as exponents in the equation above included in the likelihood the appropriate probability term dependent upon whether  $Y_i=1$  or  $1-Y_i$ . Assumption for logistic regression differs from that of linear regression. In order to have prediction model like that of linear regression there is a need of manipulating the logistic regression model, which is commonly called logit (natural logarithm of an odds ratio).

$$\text{Simplified logistic regression model is Logit (Y) = ln (odds) = ln} \left( \frac{\pi}{1-\pi} \right) = \beta_0 + \beta_1 X$$

$\pi$  stand for probability that  $Y$  is 1 while  $1-\pi$  stand for  $Y$  is 0.

$$\pi = \frac{e^{\beta_0 + \beta_1 X}}{1 + e^{\beta_0 + \beta_1 X}}$$

Thus, logistic regression coefficients were estimated using the following likelihood ratio model;

$$\log\left(\frac{\pi}{1-\pi}\right) = \beta_0 + \beta_1 X_1 + \dots + \beta_6 X_6$$

### 3. Result and Discussion

#### 3.1. Transformational Status

The transformational status of MSEs in the selected towns and the regional state was analyzed from the secondary data taken from towns' job opportunity creation and food security offices and the region's job opportunity creation and food security bureau. The summaries of descriptive analysis of these secondary data were shown in Table 4 and Table 2 below.

Year	Dukem Town			Adama Town			Shashamane Town		
	Total No Of Mses	Transformed Mses	%	Total No of MSEs	Transformed MSEs	%	Total No of MSEs	Transformed MSEs	Percent
2012/2013	382	1	0.26	670	23	3.43	827	11	1.33
2013/2014	327	3	0.92	3672	64	1.74	2854	15	0.53
2014/2015	380	8	2.11	1725	86	4.98	1468	15	1.02
2015/2016	338	10	2.96	2087	25	1.20	1467	27	1.84
2016/2017	424	19	4.48	1496	22	1.47	1696	40	2.36
Total	1851	41		9650	235		8312	110	

Table 4: Rate of transformation of the studied towns

The secondary data taken from the towns' job opportunity creation and food security offices showed that the rate of transformation was found to be very low in all the three towns (Table 1). More specifically, in all the three towns the rate of transformation was found to be less than 5% in every year for the last five years. Despite this very low transformational status, the rate of transformation, in general, has shown progressive increase from year to year in both Dukem and Shashemene towns. However, in Adama town it has shown irregular pattern for the past five years with the highest rate (4.98%) in the year 2014/2015 and with dramatic decline in the followed year to be the lowest rate (1.2%).

Year	Total Number of MSEs	Transformed MSEs	Percent
2012/2013	54092	68	0.48
2013/2014	91925	793	0.86
201342015	43704	997	2.28
2015/2016	25479	891	3.50
2016/2017	49,292	959	1.95
Total		<b>3992</b>	

Table 5: Rate of Transformation of Mses at Regional Level

Similar to that of the study towns, the secondary data taken from Oromia job creation and food security bureau also indicated that the transformational status of the region's MSEs is found at very low level (Table 2). Differently, the rate of transformation MSEs in Oromia regional state was found to be less than 4% ranging from 0.48 to 3.5% for the past five years. Despite this fact, as revealed in Table 2, the rate of transformation has shown progressive increase up to the year 2015/2016 then declined in the year 2016/2017 due to relative increase in newly established MSEs.

#### 3.2. Comparison of Created Job Opportunities in the Study Towns

The job opportunities created in selected towns by MSEs for the past six years are summarized from secondary data taken from towns' job opportunity creation and food security offices in figure 4.1 below.

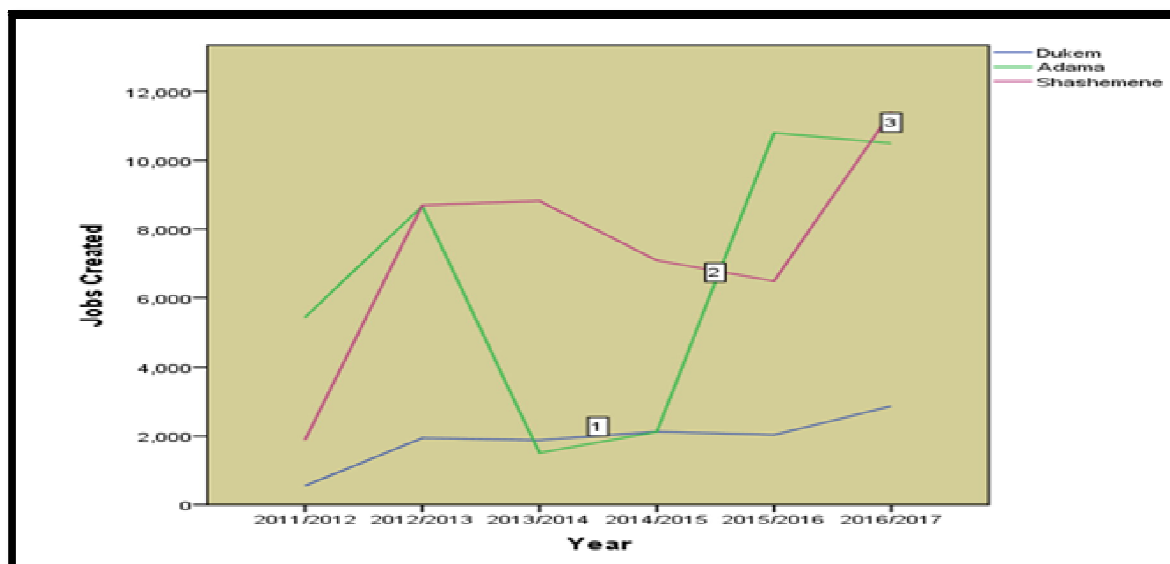


Figure 2: Job Opportunities Created by Sample Towns  
 Source: Food Security and Job Creation Offices of the Sample Towns

As indicated in figure 4.1 MSEs' job opportunities created in Dukem was found to be lowest across the years as compared to the two towns. However, it has shown generally an increasing trend from year 2011/2012 (550) to 2016/2017(2867) with few decline in the year 2013/2014(1880) and 2015/2016 (2034) in the town. With regard to Adama town, the case was observed to be very different from that of Dukem town. The MSEs' job opportunities created in the town has shown significant increase from year 2011/2012 (5433) to 2012/2013 (8661) with sharp decline in year 2013/2014(1557). Then after the number of jobs created has started to increase in 2014/2015 and reaching the maximum point in 2015/2016 (10801) with little decline in the year 2016/2017(10492). Unlike the other two towns, Adama town has recorded the lowest jobs created by MSEs in the year 2013/2014. In the same manner, when we come to Shashemene town the jobs created by MSEs in the town has shown a sharp increase from 2011/2012(1884) to 2012/2013 (8695) with smooth decline up to the year 2015/2016 (6480) ending with sharp increase in the year 2016/2017(11400).

3.3. Factors Affecting Transformation of Micro and Small Enterprises

In identifying factors affecting transformation of MSEs in the study areas, both descriptive and inferential statistics were employed. The respondents were asked to rank the influence of 29 factors on transformation of SMEs on a scale ranging from strongly agree to strongly disagree and "I don't know". Since it is difficult to analyze and compare all these factors, they were taken under six theoretical categories: financial, managerial, marketing, and political/ legal, infrastructural and others factors.

3.3.1. Financial Factors

The transformation of SMEs is affected by financial factors, which include low start up finance, inadequacy of credit institutions, inadequate availability of loans from lenders, collateral request by lender institutions, high interest rate and short duration of returning the principal.

Financial Factors	Agree		Disagree		I do not know		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Low start up finance	153	69.5	58	26.4	9	4.1	220	100
Inadequacy of credit institutions	59	26.8	143	65	18	8.2	220	100
Inadequate availability of loans from lenders	161	73.2	41	18.6	18	8.2	220	100
Collateral request by lender institutions	132	60	62	28.2	26	11.8	220	100
High interest rate	171	77.7	39	17.7	10	4.5	220	100
Short duration of returning the principal	166	75.4	36	16.4	18	8.2	220	100

Table 6: Financial Factors  
 Source: Survey Result

As it can be seen from Table 1 about 70% of the respondents agree that their business transformation was affected by their law startup capital. Moreover, most of the respondents (60%) believe that collateral request by the lender institution has negative influence on the transformation and growth of their business enterprise as it limits their potential



access to credit. In a similar manner, about 72% of respondents do agree on the influence of inadequate availability of loans from lender institutions on their business transformation. Similarly, above 75% of the respondents agree that both high interest rate and short duration of returning the principal have significant influence on their business transformation from micro and small level to medium enterprises. Contrary to these, 65% of the sample business operators do not agree that their business transformation was affected by inadequacy of credit institutions.

### 3.3.2. Market Related Factors

Market related factors are among the major factors that affect the growth and transformation of MSEs. These factors include lack of marketing skills, problem of quality product, strong competition in the market, low demand for your product, low price of your product, low price of your product, market chain problem and lack of access to international market.

Market Related Factors	Agree		Disagree		I do not know		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Lack of marketing skills	127	57.7	79	35.9	14	6.4	220	100
Problem of quality product	36	16.4	174	79.1	10	4.5	220	100
Strong competition in the market	131	59.5	71	32.3	17	7.7	220	100
Low demand for your product	132	60	70	31.8	18	8.2	220	100
Low price of your product	130	59.1	74	34.1	15	6.8	220	100
Market chain problem	135	61.4	67	30.5	18	8.2	220	100
Lack of access to international market	122	55.5	72	32.5	26	11.8	220	100

Table 7: Market Related Factors

Source: Survey Result

The survey result showed that 57.7% of the respondents agree that they have marketing skill gap, which has a negative impact on growth and transformation of their business (table 4.4). Similarly, as majority of the sample business operators (60%) believe both strong completion and low demand for their product are the major obstacles for the transformation of their business. This is also supported by a study conducted in Ethiopia that identified strong competition in the markets and low market demand for MSEs' products/service as critical barriers, among others, for the growth of small and medium enterprises (Amentie, etal, 2016).

Moreover, low price of their product and creation of market chain are found to be hindering factors of growth and transformation of their micro and small enterprises into medium enterprises (table 4.4). However, 79.1% of the respondents do not agree that they produce low quality product. The interviewees also agree on this fact stating, "The MSEs are producing quality products rather it is attitude of the society that need to be changed towards the products of MSE operators".

### 3.3.3. Political and Legal /Regulatory Factors

The political and legal or regulatory factors include the bureaucracy in business registration and licensing, political instability and high taxation.

Political and Legal /Regulatory Factors	Agree		Disagree		I do not know		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Bureaucracy in business registration and licensing	78	35.4	126	57.3	16	7.3	220	100
Political Instability	126	57.3	76	34.5	18	8.2	220	100
High Taxation	132	60	69	31.4	19	8.6	220	100

Table 8: Market Related Factors

Source: Survey Result

Bureaucracy in business registration and licensing is one of the political and legal factors that might hinder transformation of business enterprises. However, the survey study revealed that 57.3% of the respondents do not agree its impact on their business transformation. Contrary to this, about 57 % of the sample business operators agreed that the country's political instability has significant influence on the growth as well as transformation of their business (table 4.3). In addition, majority of the respondents (60%) agree that high tax estimation has a great impact on their business growth and transformation. This fact is also supported by the result of interview that was made with MSEs food security and job creation offices of the towns as the interviewees stated that high and partial tax estimation by tax and revenue offices was

one of the factors that has endangered the transformation of MSEs into medium enterprises. Moreover, they have pointed that a number of MSEs were forced to shut down their business because of such high, partial and not transparent tax estimation. Thus, a number of enterprises have fear of such high taxation and its potential increase after transformation. To this end, they were forced to hide their real capital, making difficult to identify those who are transformed and not yet transformed.

### 3.3.4. Managerial Factors

Many researchers and practitioners claim that the major cause of micro and small business enterprises not growing and failure is associated with managerial factors. For instance, according to Abera (2012) lack of strategic business planning, lack of experience in managing their business and lack of well trained and experienced employees were among the major managerial factors that contribute to the poor performance of their business.

Managerial Factors	Agree		Disagree		I do not know		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Lack of strategic business plan	125	56.8	75	34.1	20	9.1	220	100
Lack of clear division of activities and duties among owners and employees	119	54.1	75	34.1	26	11.8	220	100
Lack of well trained and experienced employees in operating the business	114	51.8	86	39.1	20	9.1	220	100
Lack of experience and capacity in managing the business	114	51.8	88	40	18	8.2	220	100
High employee turnover	102	46.4	92	41.8	26	11.8	220	100

Table 9: Managerial Factors

Source: Survey Result

As it is shown in table 4.4, lack of strategic business plan is found to be one of the managerial factors that hinder transformation of micro and small enterprises into medium enterprises. Likewise, about 54% of the respondents agreed that lack of clear division of activities and duties among owners and employees are negatively affecting their business transformation. Moreover, near 52% of the sample business operators agree that both lack of well trained and experienced employees in operating the business and lack of experience and capacity in owning/ managing the business are also among the factors that deter their business transformation. Less than 50% of the respondents agree (46.4%) and less than 50% of the respondents do not agree (41.8%) on the influence of employee turnover on the transformation of micro and small enterprises into medium enterprises.

### 3.5.5. Infrastructural Factors

Infrastructural Factors	Agree		Disagree		I do not know		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Power Interruption	124	56.4	84	38.2	12	5.5	220	100
Shortage of Water Supply	122	55.5	81	36.8	17	7.7	220	100
Telecommunication Network Problem	126	57.3	74	33.6	19	8.6	220	100
Poor Rural to Urban Roads	120	54.5	78	35.5	22	10	220	100

Table 10: Infrastructural Factors

Source: Survey Result

As shown in table 4.5, respondents agree on all the infrastructural factors for their influencing transformation of their micro and small enterprises into medium enterprises. Thus, as it can be seen from the table power interruption (56.4% agreed), telecommunication network problem (57.3% agreed) and poor rural to urban roads (54.5% agreed) are found to be deterring factors of the respondents' business transformation.

### 3.5.6. Other Factors

Other Factors	Agree		Disagree		I do not know		Total	
	Number	%	Number	%	Number	%	Number	%
Inadequate Supply of Raw Materials	137	62.3	72	32.7	11	5	220	100
High Price of Input Used	126	57.3	75	34.1	19	8.6	220	100
Lack of Working Premises	142	64.5	66	30	12	5.5	220	100
Inadequate Government Support	129	58.6	73	33.2	18	8.2	220	100

Table 11: Other Factors

Source: Survey result

The survey result revealed that both inadequate supply of raw materials and their high prices are highly contributing in deterring the transformation MSEs in the study areas (table 4.6). It can be seen that majority of the respondents (64.5%) agreed that lack of working premises is among the major factors that hinder the growth as well as transformation of MSEs into medium enterprises. One of the working promises is provision of convenient working places for the MSE operators. The result of interview with the selected towns' MSE office heads and experts showed that very few or none of the transformed enterprises was provided with the necessary working places. This is found to be contrary to the promised support by the government to the transformed enterprises in providing working places at minimum lease value of urban land. This is also believed to be another reason that has been causing the MSE owners to hide their real capital and not willing to be transformed as the transformed ones are not getting the necessary working place support from government.

Similarly, 56.8 % of the respondents agreed that inadequacy government support/subsidy is another factor that hinders transformation of their business. Despite the government support for the last two years in providing with revolving fund at very low interest rate, which is age specific 18-34 years old, the MSE owners do not believe in its sufficiency. The towns' MSE office heads and experts stated that, on the side of the MSE owners there is a problem of returning the minimum requested principal within the given time frame which limits its additional release for the borrowers.

### 3.5.7. Logistic Regression Result

The beginning block, which comprised constant reduced model, showed that correct percentage is 75%. This correctness percent is when independent variables are excluded. Table 4.10 presents Omnibus Tests of model coefficients, which shows the result of including independent variables to the model. In this table the interest is look the contribution of initial predictors added above or beyond correct percent to the constant model.

Six variables (financial factors market factors, managerial factors, political/regulatory factors infrastructural factors and other factors) have been added to the model. By adding these variables, -2loglikelihood (deviance) has reduced by 77.030 on 6 degree of freedom which implies that there is much variations of transformational status. Moreover, looking p value of step, block and model it can be seen that these items are significant (at < 0.05). This indicates that the additions of the independent variables to the model are statistically significant. This shows that the independent variables explain variations in transformational status.

Furthermore, Cox & Snell R Square and Nagelkerke R Square indicate that the model which includes the six independents variables explains between 53.9% and 79.8% of the variation in transformational status of MSEs.

	Chi-square	Df	Sig.
Step	170.397	6	.000
Block	170.397	6	.000
Model	170.397	6	.000

Table 12: Omnibus Tests of Model Coefficients

From Table 4.11, it can be seen that only four variables (financial factors, market managerial factors, political/regulatory factors and infrastructural factors) are significant (sig at < 0.05) while the remaining two are insignificant.

The Exp (B) column presents odds ratio and indicates that improving financial factors is 10.713 times more likely to make MSEs transformed. Improving infrastructural factors is 5.765 times more likely to make transformed, improvement in political/regulatory actors is 4.220 times more likely to make MSEs transformed than being untransformed. Moreover, improvement in market factors was 1.506 times more likely to make MSEs transformed while other factors was 1.255 times more likely to make MSEs transformed than being untransformed.

Confidence interval for financial factors is 2.379 to 48.236 which indicates that improvement in financial factors is between 2.379 to 48.236 times as likely to make MSEs transformed. This variable has highest confidence interval compared to other variables showing that the variable has the highest explanatory power compared to others. It can also be seen infrastructural factors have the next higher Confidence interval (1.036 to 32.070) followed by political/regulatory factors (1.032 to 17.252).

Factors	B	S.E.	Wald	Df	Sig.	Exp(B)	95% C.I. for EXP(B)	
							Lower	Upper
Financial Factors	2.371	.768	9.543	1	.002	10.713	2.379	48.236
Market Factors	.409	.475	.743	1	.389	1.506	.593	3.822
Political/Regulatory Factors	1.440	.718	4.016	1	.045	4.220	1.032	17.252
Managerial Factors	-1.990	.858	5.382	1	.020	.137	.025	.734
Infrastructural Factors	1.752	.876	4.003	1	.045	5.765	1.036	32.070
Other factors	.227	.426	.284	1	.594	1.255	.544	2.891
Constant	-15.678	3.274	22.935	1	.000	.000		

Table 13: Variables in the Equation

The table above shows that the estimated model is now:

$$\text{Logit}(Y) = -15.678 + 2.371X_1 + 0.409X_2 + 1.440X_3 - 1.990X_4 + 1.752X_5 + 0.227X_6$$

Whereby;

$Y$  = Transformational status,  $X_1$  = Financial Factors,  $X_2$  = Market Factors,  $X_3$  = Political/Regulatory Factors,  $X_4$  = Managerial Factors,  $X_5$  = Infrastructural Factors and

$X_6$  = Other factors

From the model, it can be seen that except the managerial factors, all variables (financial factors market factors, political/regulatory factors infrastructural factors and other factors) are positively related to the transformational status of MSEs.

## 4. Conclusion and Recommendation

### 4.1. Conclusion

The study was aimed at examining the transformational status of Micro and Small Enterprises; and identifying factors affecting their transformation into medium enterprises in Adama, Dukem and Shashemene towns. Based on the objectives and findings of the study, the following conclusions are worth drawn.

The research findings showed that the transformational status of Micro and small enterprises into medium enterprises is very low. The rate of transformation was found to be less than 4% in the regional state ranging from 0.48% to 3.5% for the past six years. As far as the job opportunity is concerned, the highest job opportunity creation by MSEs was achieved in the year 2016/2017 in the selected towns, in general, with fluctuating trend for the past six years.

The research finding revealed that a number of factors have been contributing for the very low level of transformation MSEs into the medium enterprises in the selected towns and in the Oromia regional states. For instance, low start up finance collateral request by lender institutions, high interest rate and short duration of returning the principal were found to be the most important financial factors that hinder the growth and transformation of MSEs in the regional state. Moreover, political instability during the last three years and high taxation had higher contribution in hindering transformation of the MSEs in the regional state.

Similarly lack of strategic business plan; lack of clear division of activities and duties among owners and employees; lack of well trained and experienced employees in operating the business and lack of experience and capacity in managing the business were also found to have higher influence in lowering the rate of transformation of MSEs in the regional state.

Finally, the Logistic regression model has revealed that out of the six of variables included in the model four of them (financial factors, managerial factors, political/regulatory factors and infrastructural factors) were found to be significant (sig at  $\alpha < 0.05$ ) while the remaining two were found to be insignificant (at  $\alpha = 0.05$ ). The Exp (B) column presents odds ratio of the Logit regression model has also revealed the financial factors (10.713) infrastructural factors (5.765), political/regulatory factors (4.220) that the managerial factors (1.024), market factors (1.506) and other factors (1.255) were found have powerful influence on the transformational status of MSEs.

### 4.2. Recommendations

Suggestions for corrective and complementary measures to enhance transformation of MSEs are essential. Based on the findings and conclusions of the study, the following recommendations are forwarded.

As financial factors were found to be the most influential factors (revealed by the model) in affecting transformation of MSEs, the Oromia Regional State government bodies should give the necessary attention in improving the financial factors to enhance transformation of MSEs in the regional state. This can be done:

- By maintaining provision of the revolving fund and making it effective to solve the problem of collateral request by lender institutions, high interest rate and short duration of returning the principal.
- By providing affordable alternative financial sources and interest free fund provision; and subsidizing those who may operate at a loss for different reasons.

Infrastructural factors were found to be the second most influential factors by the logistic model, which include power interruption, shortage water supply, and problem of telecommunication network and poor rural to urban roads. Thus, working on changing the low level of the regional state's infrastructures which has a direct impact on transformation of MSEs would have fasten the transformation of MSEs.

The political/regulatory factors were found the third most influential variable by logistic regression model, which include bureaucracy in business registration and licensing, political instability and high taxation. Thus, on behalf of the regional state government working on political/regulatory factors will have enormous contribution to growth and transformation of MSEs in the region. More specific consideration should be given on the high, partial and nontransparent taxation practice in the region that became the major deterring factor for growth and transformation of MSEs in the region possibly by:

- Strengthening coordination between food security and job creation offices and tax and revenue offices in towns of the region to increase transparency and to avoid partial estimation of taxes.
- Setting stage based upper limit of taxes on the MSE operators that is different upper limits taxes for the startups, growing/middle and maturity stage MSEs.

Marketing factors are frequently indicated by a number of studies as one of the critical factors affecting growth and fruitfulness of MSEs. Thus, here are some of the ways forded to solve the problem:

- Interlinking different MSEs that are working in similar areas in which one can input provider for the other so that they can create a market chain for themselves.
- Linking the MSEs with other private investors by market in different towns of the region so that the operators are able to access and secure market opportunity.
- Changing the perception of the public towards the quality of their product through extensive awareness creation mechanisms, providing selling and display places in areas open to the public.

As lack of working promises particularly working place and inadequate government support are still among the major deterring factors for growth and transformation of MSEs in the region, the regional government needs to reconsider their practical aspects beyond what is written in the form of the sector's policy and strategies. The regional government should realize the promised support by of providing working places at minimum lease value of urban land for the transformed into medium enterprises, i.e., those graduated from MSEs, which is almost not yet.

Finally, to change this very low level of micro and small enterprises transformation, increasing the capacity and skill of the operators by on job long term training particularly for those who are at low educational level and through continuous trainings, experience sharing from successful enterprises and provision of advice and consultancy from expertise is very crucial.

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