



ada

Appui au Développement Autonome

**SMALL AND GROWING BUSINESSES IN AFRICA:
PROFILES, SUCCESSES AND CHALLENGES**

**Editorial**

ADA – Appui au Développement Autonome
39, rue Glesener
L-1631 Luxembourg
Tel.: +352 45 68 68 1
Fax: +352 45 68 68 68
www.ada-microfinance.org
RCS Luxembourg F 199
CCPL IBAN LU64 1111 1189 2705 0000

Photo credits

Cover: © ADA / Felix Sorger
Copyright: © ADA, May 2016

TABLE OF CONTENTS

- List of figures**4
- Executive summary**5
- Introduction**7
- Methodology**8
 - Definition of MSMEs8
 - Sampling and survey methods10
 - Ethiopia10
 - Kenya10
 - Madagascar.....10
- Local contexts**11
 - Economic situation11
 - MSME sector12
 - Financial sector.....13
- SGB owners: profiles and challenges**.....14
 - Sociodemographic profiles.....14
 - Business characteristics19
 - Growth patterns22
 - Financial Service Use27
 - Non-financial needs30
 - Success factors and challenges for business growth30
- Conclusions and recommendations**33

LIST OF FIGURES

- Figure 1. Classification of MSMEs according to number of employees, net worth and annual turnover .9
- Figure 2. Gender by country 14
- Figure 3. Age at the time of survey and when launching business 15
- Figure 4. Education by gender and country 15
- Figure 5. Number of employees according to education level 16
- Figure 6. Marital status by country 17
- Figure 7. Spouse's occupation 17
- Figure 8. Activity sectors 19
- Figure 9. Type of accounting and person in charge 20
- Figure 10. Business age and time to graduation 22
- Figure 11. Financial resources used to start business 22
- Figure 12. Business growth in number of employees 23
- Figure 13. Average numbers of jobs created by activity sector 23
- Figure 14. Average number of family and non-family employees 24
- Figure 15. Factors leading to graduation..... 24
- Figure 16. Main issues to keep growing 25
- Figure 17. Relationship with MFI 27
- Figure 18. Loan-size growth 28
- Figure 19. First loan purpose..... 29
- Figure 20. Future loan purpose 29

EXECUTIVE SUMMARY

In Sub-Saharan Africa as elsewhere, Micro, Small and Medium Enterprises (MSMEs) play a crucial role in economic development and job creation. However the sector hardly achieves its full potential because of a series of challenges, among which is limited access to financial services, but also because of a more general lack of knowledge about this particular segment. In order to better meet MSMEs' needs, a first step consists in identifying the profiles, growth paths, success factors and challenges faced by those who managed to turn their microenterprises into small or medium entities, hereinafter referred to as "Small and Growing Business" (SGB) owners.

As microenterprises are likely to resort to microfinance institutions (MFIs) to get access to financial services, the study relied on five MFIs in Ethiopia, Kenya and Madagascar to identify a total of 83 SGB owners and interview them individually to get details about their paths. The main findings include the following:

- SGB owners include **both men and women**, but female SGB owners distinguish themselves with a higher level of education on average and by starting their businesses at an older age. This may imply that education is more determining for women's success, and that women were more constrained by household tasks and children care before being able to fully commit themselves into their activity.
- Most SGB owners are married, and a large part of them benefit from their **spouse's support**, who work in their business. However, SGBs are characterized by a **low share of family members** among their employees at the time of survey, showing that those who managed to grow are also those who dared open their business to external skills and not relied on family only.
- Having many dependents may slow down business growth, however most SGB owners have a **family, children and dependents**, which implies that this is **not irreconcilable with business management and growth**.
- A **minimum level of education** seems necessary to be able to make a business grow, since no entrepreneur is illiterate. If the most educated entrepreneurs are not necessarily the owners of the greatest businesses in terms of capital, there is a **positive correlation between education and business size as well as business growth in terms of employees**.
- **Previous experience** may be as determining as education and/or complementary for business growth, as it is a common feature of most SGB owners, whether it is experience in their field of activity or in business management.
- In terms of management, all SGBs are **managed by their owners**, who are not ready to delegate this task to other people. Most SGBs are **officially registered**, with variations across countries due to diverse national legislations. All SGBs **keep accounts**, but not always with a professional accountant or electronically.
- A high proportion of SGB owners run **several activities** at the same time, usually with a single registered company but sometimes with several ones, not always officially registered.
- SGB owners have **launched their businesses with their own savings** and sometimes family support, but faced strong difficulty in accessing finances for their start-up phase due to collateral requirements. They got access to microcredit only after running their businesses for a few years.

- **Growth patterns are diverse:** some SGBs started to grow just after business launch while some others did not; some benefited from regular and continuous growth whereas some others encountered fluctuating growth. Nonetheless, **all interviewed SGB owners remain growth-oriented.**
- The critical factors which enabled SGBs to grow are **personal character**, especially hard work, perseverance, adaptability and reactivity, and **access to finance**. In Ethiopia, access to working spaces and premises thanks to a national policy was also determining for microenterprises working in the manufacturing sector.
- Today, most SGBs claim that **access to finance remains crucial to enable them keep growing**, but a large part of them still face difficulty in accessing the amounts they need, mostly because of collateral requirements. Processing times are also considered as too long. A solution found by Kenyan entrepreneurs is to get several loans at the same time, from different institutions but also sometimes from the same one, which seems inefficient and risky. A lack of adequate financial products for SMEs clearly appears, as neither MFIs nor banks properly serve them.
- With regard to financial services in general, **financial needs of SGB owners evolve and become more sophisticated** as their businesses grow: they especially need savings accounts but also current accounts and electronic payment solutions. However, **microfinance institutions are seldom able to offer such services**. This leads SGB owners to resort to several kinds of financial institutions for other financial services than credit, such as mobile banking solution providers in Madagascar or commercial banks in Ethiopia, while credits are still taken from MFIs.
- Another main challenge faced by SGB owners is **local competition**, especially from the **informal sector**: as a consequence, not only is formalization determining for SGB owners themselves as it provides them with many advantages such as better image and easier access to suppliers, clients and public services, but also for their competitors whatever their size, in order to avoid market distortions.
- The **need for non-financial services appears as less primary** compared to the one for financial services. The non-financial needs mentioned, when there are some, concern training, either technical or managerial, and market linkages. However, some SGB owners do not know the agencies or organizations which would be able to provide them with such services. More consistency and innovative partnerships between providers of financial and non-financial services as well as between private and public entities could help SGB owners benefit from such services.

INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) play a major role in the economic growth and development of most countries, especially as they are often the largest employers. With regard to Africa, according to the International Monetary Fund's Regional Economic Outlook for Sub-Saharan Africa released in April 2015, over the next 20 years, Sub-Saharan Africa will become the main source of new entrants into the global labor force. As a consequence, paying more attention to MSMEs, and especially to what fosters or hampers their growth, seems crucial to ensure their viability and capacity to absorb this coming labor force.

One of the well-known obstacles encountered by MSMEs to boost their growth is access to financial services: whereas the financial needs of small and growing businesses are usually too low for banks which are reluctant to serve this customer segment, they may be or become too high for microfinance institutions which are sometimes constrained in terms of loan ceilings, or not used to serving such clients.

Nonetheless, some of these growth-oriented businesses start as microenterprises, and are therefore likely to be served by MFIs, at least as a first step. Thus, even though SGBs often represent a minority of clients in MFIs' portfolios, which rather focuses on microenterprises, relying on MFIs may help better identify SGBs' profiles, understand their growth models and needs, and hence shed some light on how to bridge the missing middle in terms of financial and business development services.

From this starting point, the study aims at analyzing a sample of SGBs, defined as microenterprises which turned into SMEs, retrieved from the client portfolios of five participating MFIs in three East-African countries. Specifically, the objectives are to examine entrepreneurs' profiles and paths, identify activity sectors conducive to growth, learn more about the main challenges and obstacles faced by entrepreneurs through their growing process and define their current financial and non-financial needs. Based on such information, general recommendations are made to financial services providers, business development services providers, local and international support organizations and other stakeholders.

The report is based on three independent studies carried out in 2017 in Ethiopia, Kenya and Madagascar, which constituted some preparatory work for the African Microfinance Week 2017 organized by ADA in Addis Ababa, Ethiopia. After introducing the research methodologies adopted in each country, the report presents the contexts in which MSMEs evolve, details SGBs' characteristics and growth patterns, and ends with some recommendations. To that extent, it aims at complementing the similar study carried out by the Center for Financial Inclusion at Accion released in 2016, which focused on three countries in Latin America.

METHODOLOGY

The report is based on three independent studies carried out in 2017 by local consultants in Ethiopia, Kenya and Madagascar. The three consultants received the same terms of reference to conduct their research, however, in order to adapt to local contexts, specific methodologies were adopted, especially in terms of MSME definition or sampling method.

Definition of MSMEs

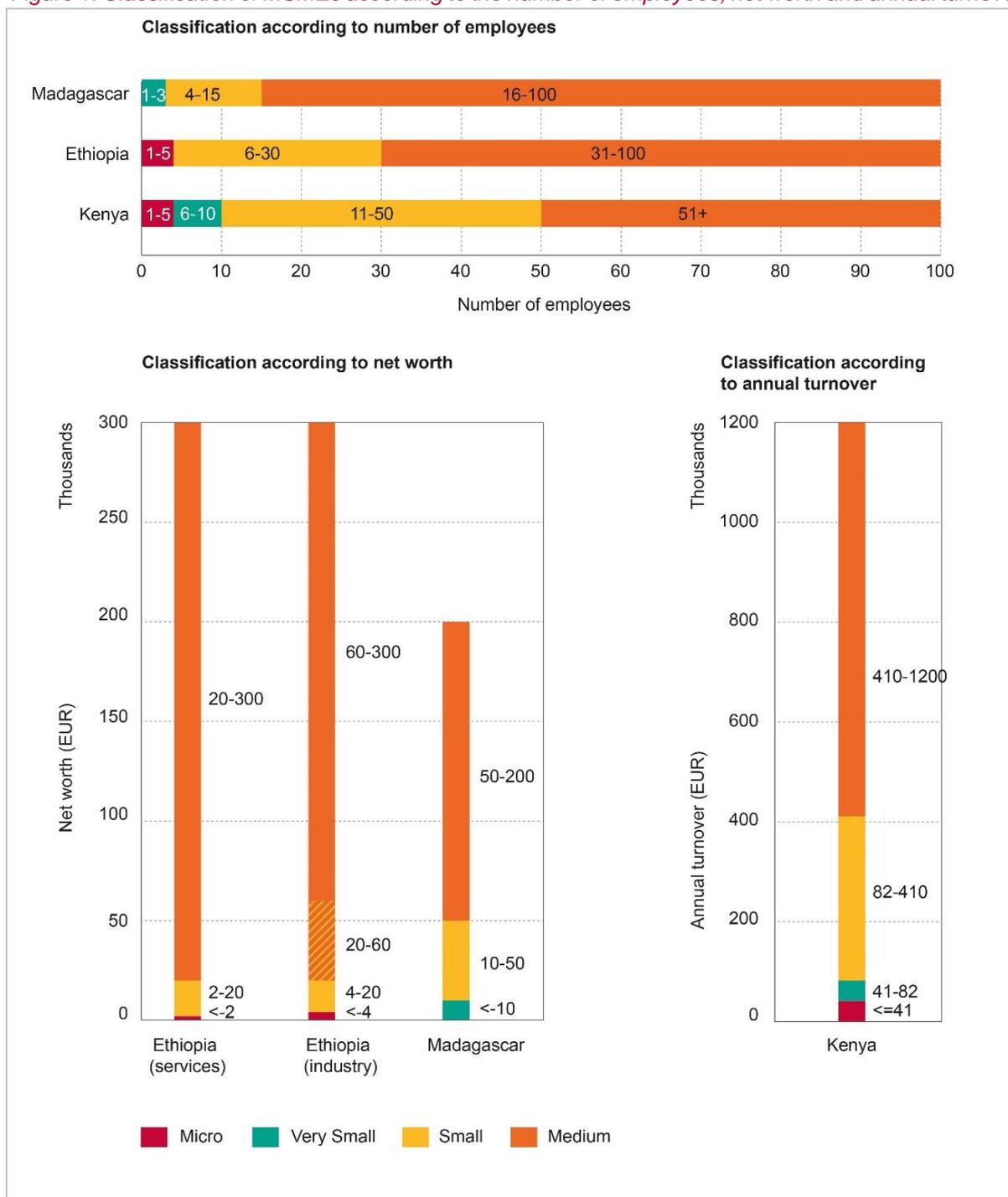
Defining the target population of the survey was a challenge as there is significant variance in the definitions of MSMEs across countries, let alone the fact that several definitions may exist within a single country. For instance in Ethiopia, the Development Bank of Ethiopia distinguishes between services and industry sectors and sets different criteria for each sector. In Kenya, governmental definition differs from the definition used by banks. In Madagascar, there is no shared classification of micro, small and medium enterprises, as the fiscal framework sets a threshold in terms of sales revenues to define SMEs, which differs from the definition established by the National Policy of SMEs Promotion. Additionally, according to the country, either annual turnover or net worth is used as a criterion to classify MSMEs. Finally, if Kenya distinguished four categories, Ethiopia and Madagascar defines three, the smallest one being microenterprises for Ethiopia and very small enterprises for Madagascar. As a consequence, in the frame of this study, methodological choices have been made:

- the definition chosen in Ethiopia consists in a mixing of those used in the National Micro and Small Enterprises Development Strategy and by the Development Bank of Ethiopia for medium enterprises;
- the definition chosen in Kenya is a compromise between the definition used by the MFI under study and the one set by the Kenyan Central Bank;
- the definition chosen in Madagascar is a mixing of those used in the national fiscal framework and in the National Policy of SMEs Promotion.

The diversity of definitions chosen is illustrated in Figure 1.

These methodological choices are necessarily arbitrary, but they are also telling about the lack of attention and/or coordination between agencies, organizations and service providers supporting MSMEs. Without a clear and common definition of this segment, designing relevant policies and ensuring their consistency with the actions implemented by other stakeholders such as financial or non-financial service providers remains difficult, and MSMEs keep being underserved.

Figure 1. Classification of MSMEs according to the number of employees, net worth and annual turnover



¹ For Ethiopia, enterprises in industry with a net worth comprised between EUR 20 001 and 60 000 are classified as small if they have less than 31 employees, and as medium if they have 31 employees or more.

Sampling and survey methods

The strategy adopted in this study was to rely on MFIs in each country in order to identify and analyze groups of SGBs, defined as enterprises which have started as micro for at least three years and have become very small, small or medium enterprises at the time of the survey².

The participating MFIs chosen had to:

- be delivering microcredits for more than 8 years;
- serve more than 10 000 clients;
- offer diverse financial services (such as savings, insurance, etc.);
- show positive financial performance (in terms of ROA, ROA, PAR);
- offer credits of more than USD 5000 to at least 35 clients.

Ethiopia

The study carried out in Ethiopia relied on three different MFIs, Addis Credit and Saving Institution (AdCSI- 292 080 clients), Vision Fund MFI (110 027 clients) and Agar MFI (11 160 clients). If Agar especially targets the missing middle with higher average loan size, AdCSI supports both micro and small enterprises, while Vision Fund primarily focuses on micro enterprises with growth potential. A total of 140 SMEs (50 from AdCSI, 50 from Agar and 40 from Vision Fund) were selected from portfolios using random sampling. The 140 SMEs were contacted by phone to ensure their meeting of the criteria and to get their agreement for an interview. The final sample consisted of 45 SMEs.

Kenya

In Kenya, the study relied on a single microcredit provider, Sidian Bank, which was serving 18 500 clients at the time of the study, 22% of which were SMEs, the rest consisting of microenterprises. Compared to MFIs in other countries, Sidian Bank grants higher amounts of credits relative to GDP per capita (Table 1). Random sampling being impossible because of a lack of detailed data, the sampling frame consisted in a preselection of clients meeting the criteria by six branches of the institution. The final sample consisted of 22 clients.

Madagascar

The study in Madagascar relied on the leader MFI in the country, ACEP Madagascar, which serves its 15 000 clients through two counters, one being dedicated to SMEs and the second focusing on very small enterprises. ACEP provided a list of clients which started as micro and have become SMEs, currently reimburse credits of more than EUR 2254, and got at least five loans. 50 clients were randomly sampled, out of which 16 agreed to be interviewed.

The survey was based on qualitative methods: structured interviews were conducted with entrepreneurs using similar questionnaires in the three countries, with close-ended and open-ended questions about entrepreneurs' personal and family life, business information, financial service use, business development service use, and vision and perspectives for the future.

² To that extent, what is considered as SGB in this study differs from the definition adopted by the Aspen Network of Development Entrepreneurs, a global network of organizations that propel entrepreneurship in emerging markets which focuses on SGBs. For ASPEN, SGBs are commercially viable businesses with five to 250 employees that have significant potential and ambition for growth, and seek growth capital from \$20,000 to \$2 million.

Table 1. Description of MFIs by country

Country	MFI	Number of clients	Target population	Average loan size (EUR)	Average loan size (% of GDP/capita 2016)	Number of interviews
Ethiopia	AdCSI	292 080	Micro and SMEs	326	43%	16
	Vision Fund	110 027	Microenterprises	154	20%	15
	Agar	11 160	SMEs	726	95%	14
Kenya	Sidian Bank	18 500	Micro and SMEs	4372	123%	22
Madagascar	ACEP	15 000	Micro and SMEs	334	89%	16

LOCAL CONTEXTS

One of the determining factors for MSMEs' development and growth is the environment where they evolve, either in terms of economic situation, specific legislation or policies, or financial sector. In the case of this study, the local contexts of the three East-African countries differ on several aspects.

Economic situation

Economic situations drastically vary from a country to another: Ethiopia has become one of the five fastest growing economies in the world, with a growth rate comprised between 8 and 11% for more than a decade. Whereas Kenya had been the economic, financial and transport hub of East Africa for years, Ethiopia has overtaken Kenya as the region's most dynamic economy. Kenya's real GDP growth rate was around 5% for the last eight years but slowed down to 4,7% in the first quarter of 2017, partly because of drought-induced high inflation and a drop in foreign investments due to fears of political instability with upcoming elections. In Madagascar, the situation is more troublesome, as the country has been going through a severe political and economic crisis for 2009, which led to a sharp slowdown in growth (7,1% in 2008 against rates around 3% from 2012 to 2015, and a projection of 4,5% in 2017). Governance issues and a decline in development funding during the crisis hampered the improvement of people's living conditions as well as the achievement of the Millennium Development Goals.

Fewer discrepancies may be observed as far as economic sectors are concerned: in the three countries, agriculture employs most of the working population, with respective shares of 75% in Kenya and Madagascar and 73% in Ethiopia, but remains characterized by low productivity, with contributions to GDP of 32% in Kenya, 25% in Madagascar and 37% in Ethiopia. This is explained by several factors, among which climatic variations and shocks which affect all three countries, and the predominance of subsistence farming, even though some products are dedicated to exportation, such as coffee, tea and flowers in Kenya, coffee in Ethiopia and vanilla and shrimps in Madagascar. Services sector remains the main contributor to GDP in the three countries, with tourism playing a significant role, while industry is the weakest one with respective rates of 16% in Madagascar and Ethiopia and 18% in Kenya, mining and textile prevailing in Madagascar and Kenya against construction in Ethiopia.

Nonetheless, despite the low contribution to GDP, industry is seen as a key sector to foster economic development, especially in Ethiopia where industry is at the core of recent development strategies and plans, MSMEs being seen as the backbone of the transition to an industrial society.

MSME sector

As in many other developing or developed countries, MSMEs play a key role in economic development and job creation in the three countries under study. However, most MSMEs are part of the informal sector, which makes it hard to get an accurate estimation of their number, all the more so as there is no clear and unique definition of MSMEs in any of the countries.

Even though Kenya gets a much better score in the World Bank's Ease of Doing Business Index than the other two, as it is ranked 80th out of 190 in the 2018 Index while Ethiopia is 161st and Madagascar 162nd, some barriers persist for entrepreneurs in each country. If getting a credit seems much easier in Kenya than in the other two countries, as Kenya is ranked 29th on this issue in the same Index, inadequate capital, limited market access, poor infrastructure, inadequate knowledge and skills, corruption and unfavorable regulatory environment keep hindering Kenyan MSMEs' development and growth. Infrastructure and regulatory environment also seem to be the main barriers in Madagascar, which is ranked very low with regard to getting electricity, enforcing contracts or dealing with construction permits. In Ethiopia, lack of access to adequate finance appears as the most constraining factor to MSMEs' growth, as Ethiopia is ranked 173rd on this issue in the 2018 report. This result is consistent with those of the 2015 World Bank Enterprises Survey Report, according to which 40% of the surveyed enterprises mentioned access to credit as a major business constraint, resulting in only 33% of them having a bank loan.

Therefore, respective governments have recently implemented some measures to improve MSMEs' business conditions and environment. The Kenyan good score in Ease of Doing Business may especially be explained by legal measures making starting a business easier, with fewer requirements and elimination of some fees. The Kenyan Government also enforced legislation in favor of local products for public projects and established "Buy Kenya, Build Kenya" policies in public procurement. Additionally, it promotes small and medium manufacturing firms and plans to develop SME clusters. However, the Kenyan Government sees its role in supporting MSMEs more as a market enabler, and avoids direct intervention in the financial sector. If the Financial Sector Deepening (FSD) program aims at facilitating access to financial services for low-income households and small enterprises, only research projects to better understand SMEs financial market have been implemented so far. In the same way, in 2010 the Kenyan Treasury implemented a special SME scheme entitled the MSE Fund, consisting in a credit line targeting commercial banks interested in lending to SMEs and including a capacity building component for participating banks. However, no new loan has been approved since 2012.

Apart from the government, the other key stakeholders of the MSME sector in Kenya are IFC, which provides credit lines to commercial banks lending to SMEs, USAID, which manages the largest credit guarantee scheme in Kenya, as well as other international donors such as EIB, Proparco, FMO, SIDA, etc. Additionally, 10 business incubators exist in Kenya, mostly focusing on start-up or tech-based young businesses.

In Ethiopia, the first National Micro and Small Enterprise Development Strategy was launched in 1997, and aimed at strengthening the collaboration between SMEs as well as ensuring the proper conditions

for transformation into medium or large enterprises. It was followed by several poverty reduction and economic development plans (PASDEP, GTP I and GTP II) strongly relying on SMEs. In the frame of PASDEP (Plan for Accelerated and Sustained Development to End Poverty) which ran from 2005 to 2010, MSMEs benefited from business management trainings, entrepreneurship and production workshops and upgraded business development services. Contrary to Kenya, MSMEs also benefited from direct public financial support: in the frame of GTP I (Growth and Transformation Plan, 2010-2015), ETB 16,4 million (USD 689 000) were disbursed as loans to MSMEs, which would have resulted in more than 7 million employment opportunities created. GTP II (2016-2020) still focuses on MSMEs with greater emphasis on manufacturing, higher productivity and competitiveness, and plans to disburse ETB 21 billion (USD 904 million) in loans to MSMEs through MFIs, in order to create about 8,4 million jobs.

For the sake of consistency with GTP I, the National Micro and Small Enterprises Development Strategy was revised in 2011, and support to MSMEs is provided through various agencies; this support consists in providing working spaces, favoring access to market through linkages, facilitating access to credit through guarantee provision, providing business development services and trainings to foster industrial extension.

The Ethiopian federal government appears as the main actor supporting MSMEs, while the other stakeholders are governmental agencies and technical vocational education and training centers, cooperating to provide support packages to MSMEs.

With regard to Madagascar, a National Policy of Promotion of SMEs also exists and focuses on three main issues, which are access to information, access to training and proper legal and administrative framework. However, this policy seems to prioritize support to larger-scale SMEs, and not properly suited to microenterprises' needs. Malagasy MSMEs may also benefit from the support of other stakeholders, such as intermediary business support organizations (professional associations, chambers of commerce, training centers) or private consulting firms, but the former often lack of resources to meet MSMEs' needs while the latter may charge too high prices. The Ministry of Finance has created Chartered Management Centers in order to foster MSMEs' formalization, and recently, a few incubators have also launched their operations, but these initiatives are new and still have to demonstrate effectiveness.

Financial sector

In Kenya, the banking sector consists of 41 commercial banks, one mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 18 money remittances providers and 3 credit reference bureaus. The non-banking financial sector is comprised of around 25 MFIs offering credit only and 176 licensed Savings and Credit Cooperative Organizations (SACCOs). Banks are regulated by the Central Bank of Kenya, SACCOs are by the SACCO Regulatory Authority while MFIs offering credit only are not regulated. Mobile network operators have also become significant players in the financial sector as they provide payment services and act as a channel for loans and saving products in partnership with commercial banks. They fall under the regulation of the Central Bank and the Communications Authority of Kenya. In 2015, three Kenyan commercial banks faced difficulties leading to a liquidity crisis, which resulted in new legislation in 2016 capping loan interest rates. One of the consequences was a sharp shrinkage of credit in the economy, while SMEs were already underserved by the commercial banking sector.

In Ethiopia, the financial sector is dominated by the banking sector, which accounts for 76% of the total capital, followed by MFIs with 15%, and insurance and leasing companies with 9%. The banking sector consists of one development bank, one state-owned commercial bank and 16 private commercial banks, while there are 35 MFIs, 5 of which are regional government-affiliated, dominate the market and account for 84% of total capital. Because the Ethiopian government recognizes that access to credit is crucial for MSMEs, these 5 MFIs are expected to play a leading role in the provision of credits to MSMEs in their respective regions, and a regional credit guarantee fund has been established with them in order to deal with collateral issues. Nevertheless, MFIs are facing a number of challenges, especially limited access to funding, high operational costs and limited management capacities.

In Madagascar, in 2015 the 11 private commercial banks accounted for 76,2% of total capital, while the 25 MFIs existing represented 4,3%. Five MFIs concentrate the major part of microfinance activities in the country, as they manage 75% of total loan portfolio. Most MFIs are organized as cooperatives, and are classified in three categories according to the law, which defines the operations authorized for each category. Malagasy MFIs are regulated by the Commission of Banking and Financial Supervision within the Central Bank. Despite the crisis, the banking sector has remained strong, liquid and profitable. In contrast, Malagasy MFIs have more suffered and remained insecure, especially because of their small size and low-quality governance. Over the last years, the part of bad debts has continuously increased, which has led MFIs to slow down the granting of credits. Finally, some other financial institutions aim at dealing with MSMEs' collateral issues, such as the Malagasy Guarantee Fund, or at filling the middle gap in terms of equity, such as the National Society of Acquisition, but these facilities are unrecognized and underused.

SGB OWNERS: PROFILES AND CHALLENGES

The following results are based on individual interviews conducted with 83 SGB owners who are currently clients of participating MFIs in Ethiopia (45 interviews), Kenya (22) and Madagascar (16).

Sociodemographic profiles

Out of the 83 SGB owners interviewed, the share of women differs according to country: whereas the numbers of men and women are rather balanced in Madagascar and Kenya, there are far more men among the surveyed clients in Ethiopia (Figure 2). This low share is not representative of the Ethiopian MFIs' total portfolios, which include around 50% of female clients, therefore it rather seems specific to the SGB segment. This may imply that it is relatively more difficult for women in Ethiopia than in the other two countries to make a business grow, even though small sample sizes require caution in interpretation.

Figure 2. Gender by country

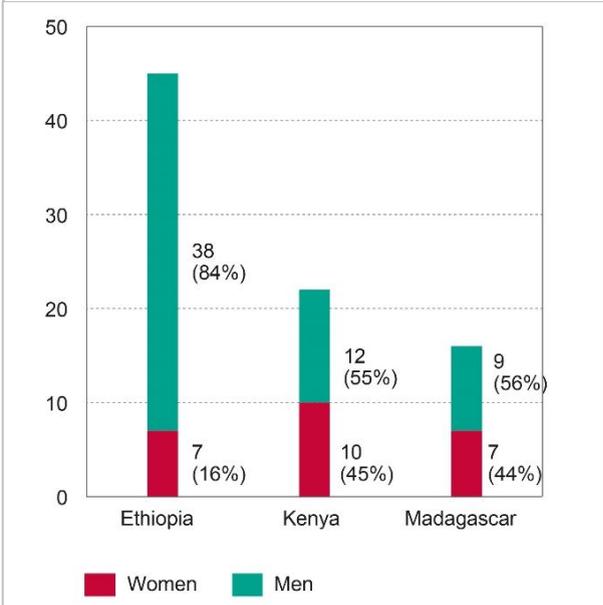
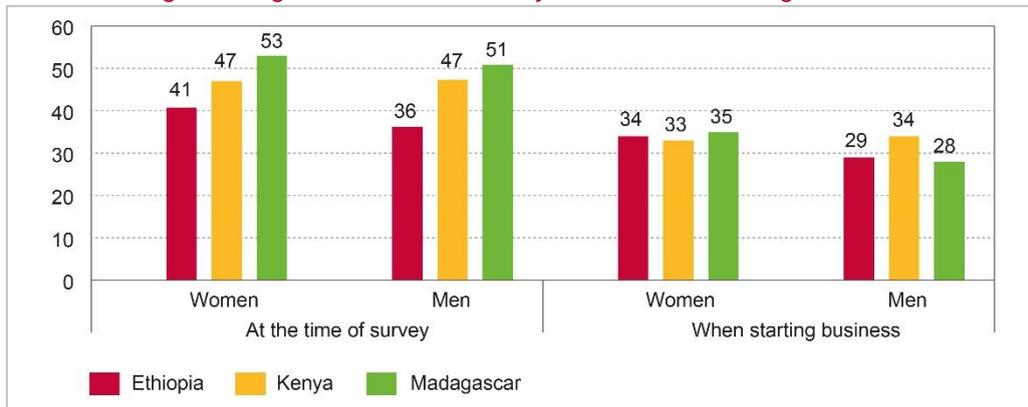


Figure 3. Age at the time of survey and when launching business

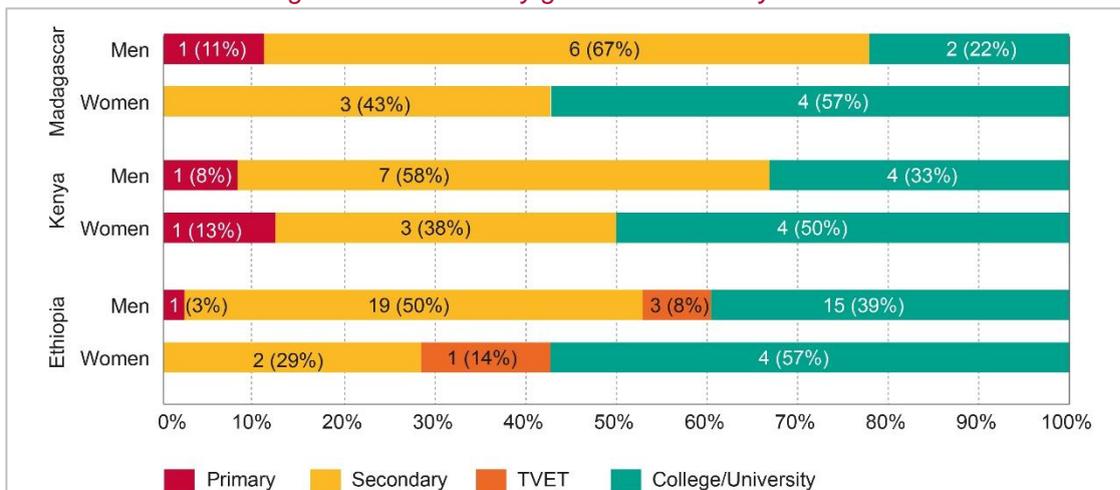


On average, SGB owners are 37 years old in Ethiopia, 47 in Kenya and 52 in Madagascar. The difference across countries may partly be explained by the fact that the MFI under study in Madagascar makes it a point of honor to keep its older clients, and that 75% of the surveyed clients got their first loan after 35. The Kenyan MFI under study tends to make the same effort towards retention of older clients.

Female entrepreneurs interviewed are slightly older than men in Ethiopia and Madagascar. Looking at age when clients launched their businesses reveals that this difference is due to the fact that on average, Ethiopian and Malagasy women were significantly older than men when they started their activities. Some of them explained that they had to wait for their children leaving the house before dedicating their time to their businesses.

With regard to education, female SGB owners appear as more educated than men whatever the country: the proportion of women who went to university or college is higher than for men, and there are relatively more male SGB owners who have primary education level only. This could indicate that higher education is more determining for women managing a business than for men, as most male SGB owners have secondary education only.

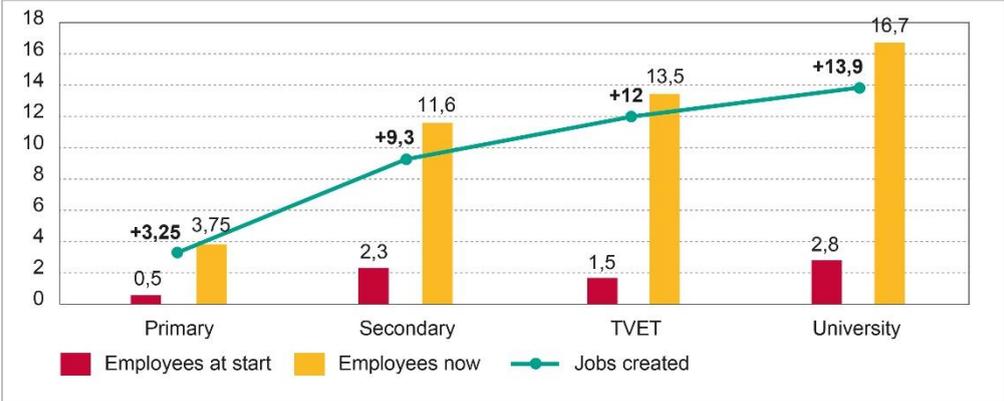
Figure 4. Education by gender and country



A higher education level may represent an advantage, not only in terms of knowledge and skills, but also with regard to social and professional network that facilitates growth. Besides, it can be noticed that no surveyed entrepreneur is illiterate, which implies that SGB owners most likely needed a minimum education level to be able to make their businesses grow. If the most educated entrepreneurs are not necessarily the owners of the greatest businesses in terms of capital, the higher the education level, the higher is the number of employees now, and the higher the average number of jobs created since business launch (Figure 5). Hence there is a positive correlation between education and business size as well as business growth in terms of employees.

If there is no clear link between education level and time to graduation in general, there is in Ethiopia, where graduation significantly took less time for the best educated entrepreneurs. This could be due to better communication and management skills among more educated entrepreneurs. Those with tertiary education especially indicated that such education helped them carry out market research and adapt their products and services accordingly, which had a positive impact on their business growth.

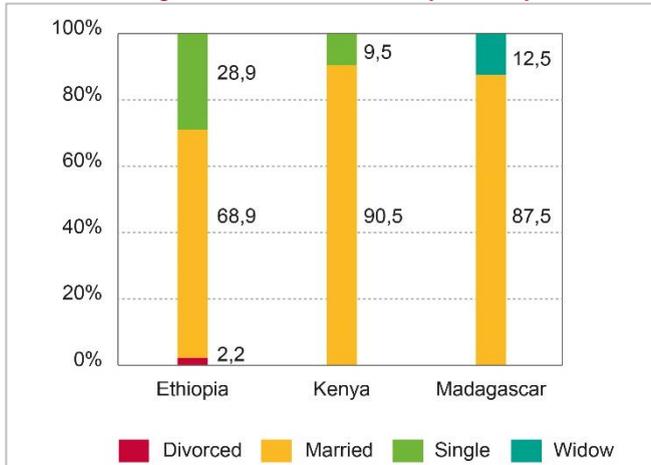
Figure 5. Number of employees according to education level



Professional experience prior to business launch is another feature which can be determining for SGBs: before starting their businesses, surveyed entrepreneurs had significant previous experiences of 7 years on average in Ethiopia and 10,5 years in Kenya. In most cases (62% in Ethiopia and 53% in Kenya), these experiences were related to their current activity; in the other cases, interviewees were employed in another sector or had other kinds of businesses before. For instance, a Kenyan female entrepreneur started as a charcoal seller along the road, what she did for 10 years in order to save the necessary capital to set up her first shop in 2008. Today, she owns three bars and two liquor shops. In Madagascar, surveyed entrepreneurs' businesses were existing for 11 years on average when they received their first loan from the MFI, against 6 years in Kenya and 2 years in Ethiopia; no information on their experience preceding the launching of their business was available, but they had at least a long experience in their field before getting their first loan and start growing.

³ TVET: Technical and Vocational Education and Training

Figure 6. Marital status by country

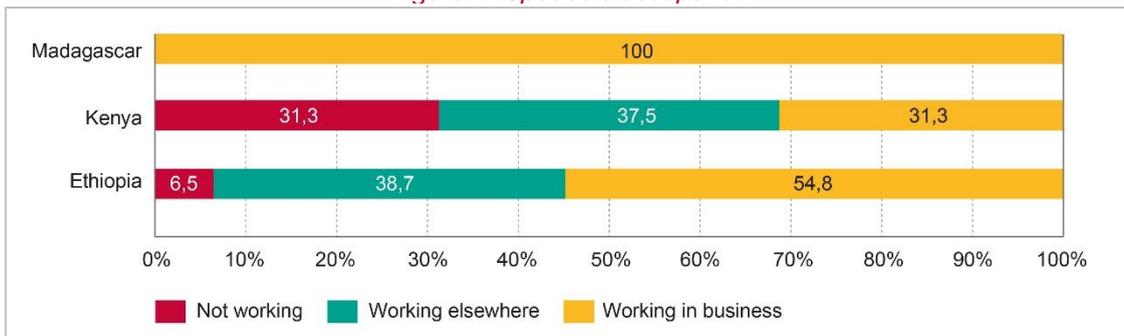


With regard to marital status, in each country most entrepreneurs are married, even though the share of single clients is more significant in Ethiopia than elsewhere (Figure 6).

As far as married entrepreneurs are concerned, the more educated the entrepreneur, the more educated the spouse as well, and again, no spouse is illiterate.

Most entrepreneurs' spouses work, with a significant part working in entrepreneurs' businesses, especially in Madagascar where it is the case of 100% of spouses (Figure 7).

Figure 7. Spouse's occupation



Most entrepreneurs have children or dependents, but it seems that those with higher numbers of children or dependents started with smaller businesses in terms of employees and/or net worth, and then grew more slowly. Some Kenyan entrepreneurs with a certain number of dependents explained that they had to use a part of their business loans for school and/or medical fees, in particular at early stage of development, which may explain the negative correlation between the number of dependents and business growth.

“Start small, think big” - from Passion to Profit

Having grown up at the Kenyan coast, Alice Simba - wife and mother of 3 - comes from a background where baking and cooking is a very important part of life. After moving to Nairobi, she couldn't find any fresh and quality homemade cakes, and



decided to turn her passion and love for cooking into a business. This did not happen overnight. It started as a hobby while going to college and working as HR assistant at an oil company. At that time, in 2000, Alice had no equipment, no mixer or oven, but simply started with a wooden spoon, a plastic basin and a jiko⁴, baking cakes with charcoal and selling slices for KES 50 (EUR 0.40) to colleagues and people she knew. She did this for a number of years. People really started appreciating what she made, so Alice then realised she could make money out of it and started building the concept slowly. She did not need a lot of capital: only used KES 500 (EUR 4) to commence baking. With support from her husband, who by then realised she had a good business opportunity, she was able to purchase an oven and from there she slowly continued.

“If you are an entrepreneur and have the passion, the passion will give you the kick, the drive. Start from where you are is what I believe in. Don't wait until you have the necessary capital, register your business name and start small from the house”.

In 2004 she received her first loan of KES 35,000 (EUR 285) from Equity Bank to purchase a mixer. In 2008 she formally registered her business and opened her first cake shop in Nairobi. In 2011 she obtained her first Sidian (then K-Rep) loan at an amount of KES 400,000 (EUR 3,257) for working capital. Through K-Rep, which informed her about the possibility, she managed to enroll on the Goldman Sachs 10,000 women programme which taught her a lot about business and people management and about daring to take risks. After finishing the programme, Alice had the confidence to open more cake shops and she started a cooking school to empower women and children and transfer her love of baking and cooking to others.

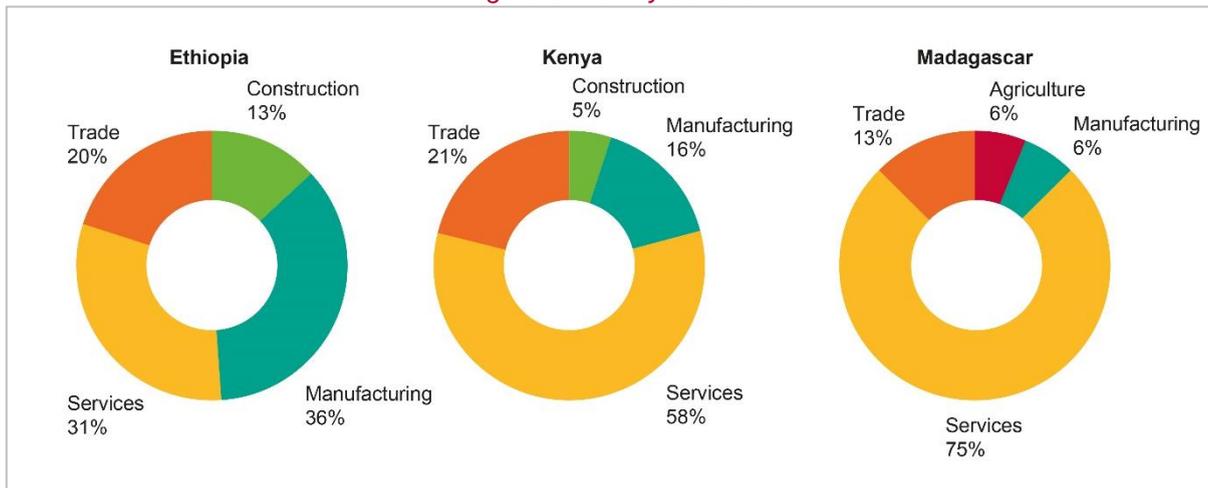
Over time and thanks to her business success, her borrowing appetite grew and she obtained higher loan amounts to help her expand the business and invest in equipment. She claims the bank loans have really helped her business grow, by enabling her to invest and purchase assets. Without her husband this would have been more challenging though, as his property serves as collateral. Her latest loan was KES 4 mln (EUR 32,555) for 5 years. The business has flourished by always keeping the focus on quality and freshness and putting a lot of effort in marketing via social media and tv commercials. She makes sure she is creative and comes up with new concepts. The company currently consists of 6 cake shops in Nairobi, 1 in Kisumu (Western Kenya) and 1 training center. She employs 38 people and aspires to open more outlets throughout Kenya and in time also abroad.

⁴ A container made of clay used for burning charcoal or small pieces of wood, for cooking or to give heat.

Business characteristics

The distribution of activity sectors differs across countries (Figure 8): services constitute the main sector in Madagascar (75%) and Kenya (58%), followed by trade and manufacturing. In Ethiopia, manufacturing is the main sector, which is consistent with the current public policies, followed by services and trade. Construction also represents a higher share in Ethiopia than in Kenya or Madagascar, while agriculture is almost not represented among the surveyed entrepreneurs, as only 6% of them operate in agriculture in Madagascar and none in the other two countries.

Figure 8. Activity sectors

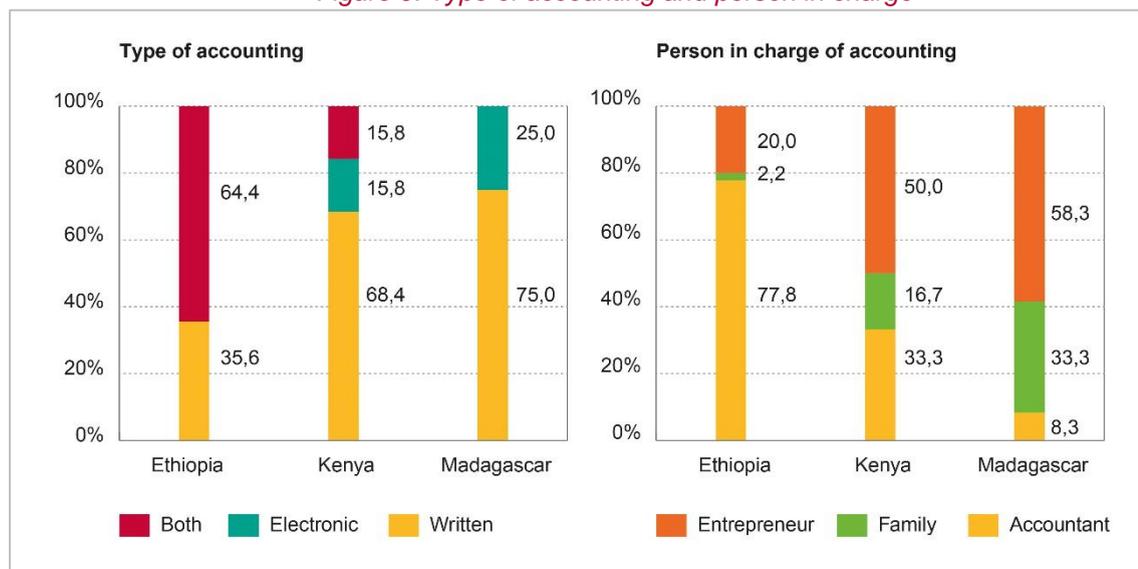


Most entrepreneurs target domestic market, as only two Kenyan and one Ethiopian entrepreneurs also aim at selling their products (shoes and corporate uniforms) or services (IT in law firm) abroad. They operate in neighboring countries though, and their core activity remains domestic. The entrepreneurs in the manufacturing sector explained that the main constraints to export were the lack of information and shortage of capital.

All surveyed SGBs are managed by their owners. In Ethiopia, the interviewees mentioned the fact they do not sufficiently trust other people to let them manage their businesses. The lack of trust and fear of loss of control are potential reasons for this kind of management in Kenya as well, even though some entrepreneurs also explained that they do not have the proper skills to adapt the type of management to the size of their companies.

Most entrepreneurs in each country keep accounts, however, accounting remains less sophisticated in Madagascar, where most entrepreneurs keep written accounts only and do it themselves, which contrasts with the situation in Ethiopia, where most entrepreneurs keep both written and electronic accounts, and pay an accountant to do it (Figure 9). Kenyan entrepreneurs are in an intermediary position.

Figure 9. Type of accounting and person in charge



With regard to current size, the classification of surveyed SGBs varies according to the criterion chosen. Table 2 illustrates that some businesses may be today classified in different categories whether the number of employees or annual turnover/net worth is considered. For instance in Ethiopia, 36 businesses out of 45 may be classified as small enterprises according to their number of employees, but only 15 considering net worth, and 14 considering both criteria at the same time. Three businesses may even be considered as small when employees are considered but larger than medium looking at net worth.

This difficulty in classifying surveyed businesses might reflect their current growing process: the growth of the number of employees may be more or less quick than the growth of financial indicators. This might indicate that the growing process is not over and that these SGBs are likely to keep evolving through categories. It also reveals that despite the effort to create categories as much relevant as possible, some SGBs do not fit them, even when there are distinct definitions by sector as in Ethiopia.

With regard to formalization, all Ethiopian entrepreneurs have formally registered their businesses, only one Malagasy did not, but a bit less than half of Kenyan entrepreneurs did so. This specific situation in Kenya may be explained by the fact that there are several levels of registration: the 10 informal businesses are actually locally registered and pay a yearly business permit. They just did not see the interest of national registration, all the more so as some of them are nevertheless registered for VAT and National Hospital Insurance Fund. In Ethiopia, the interviewed SGB owners claimed that formalization had a lot of benefits, such as better access to suppliers, clients, or government support services; in some cases, the reason for formal registration was the fear of penalties from the authorities. In Madagascar, all entrepreneurs explained that formal registration is legally compulsory.

Table 2. Classification of MPMEs according to two criteria

Kenya				
	Number of employees			
Annual turnover	Micro	Very small	Small	Total
Micro	2	0	0	2
Very Small	6	2	1	9
Small	3	1	3	7
Medium	0	0	3	3
Total	11	3	7	21

Madagascar				
	Number of employees			
Annual turnover	Very Small	Small	Medium	Total
Small	4	9	0	13
Medium	0	2	1	3
Total	4	11	1	16

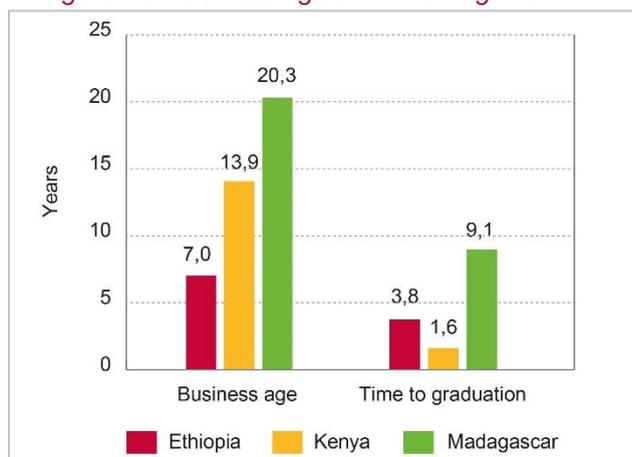
Ethiopia				
	Number of employees			
Net worth	Micro	Small	Medium	Total
Small	1	14	0	15
Medium	3	19	5	27
Above Medium	0	3	0	3
Total	4	36	5	45

If most entrepreneurs are currently managing only one business, some others run several at the same time, especially in Madagascar, where it is the case of 69% of surveyed entrepreneurs, against 32% in Kenya and 33% in Ethiopia. Most of them manage one other business only, but four Malagasy and two Kenyan entrepreneurs run three businesses at the same time, while another Malagasy even has five. Additionally, among the entrepreneurs having only one registered business, some undertake multiple activities with a single company: for instance, a female entrepreneur in Kenya runs a hotel, a restaurant, gas bottle distribution, lorries and rental apartments within the same company. More often, entrepreneurs have only one registered business but also run an unregistered side activity such as rental houses or a farm. In Kenya, entrepreneurs affirm that these side activities do not take too much time and core business activities are not negatively impacted; in Madagascar, managing several activities at the same time is very common and does not appear as an obstacle to growth.

Growth patterns

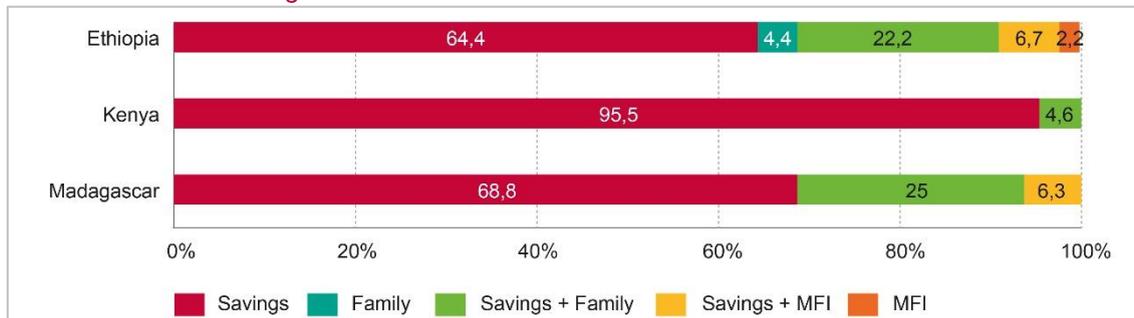
On average, businesses had been operating for 7 years in Ethiopia, 14 years in Kenya and 20 years in Madagascar at the time of the study (Figure 10). The difference across countries might be explained by different targeting policies among MFIs, since some MFIs especially target small but long-time operating businesses: this is particularly the case in Madagascar, where surveyed entrepreneurs' businesses were existing for 11 years on average when entrepreneurs received their first loan, against 6 years in Kenya and 2 years in Ethiopia.

Figure 10. Business age and time to graduation



This means that most entrepreneurs did not start their business with an MFI. Indeed, only four entrepreneurs did so, three of whom with their savings at the same time, but the vast majority started with their own savings only, sometimes with family financial support (Figure 11). Some entrepreneurs confided that access to finance was the main challenge to start their business because of a lack of collateral, this is why they borrowed from close friends or family free of interest. As a result, informal loans and personal savings remain the major source of finance for start-up businesses, whereas MFIs tend to target already operating businesses.

Figure 11. Financial resources used to start business

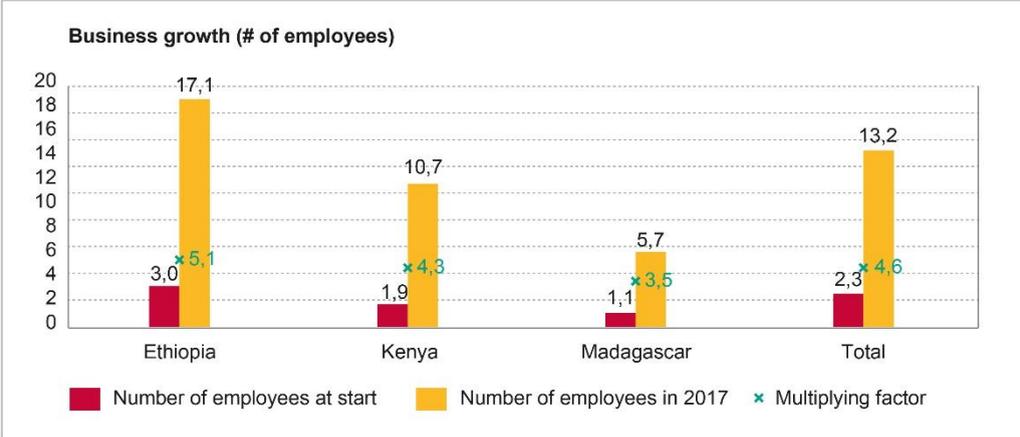


The time it took to graduate from micro to larger-scale activity also differs across countries: whereas time to graduation was only 1,6 year on average for Kenyan entrepreneurs, it was 3,8 years in Ethiopia and 9,1 years in Madagascar. Again, this might be explained by different targeting policies: the Kenyan MFI tends to target entrepreneurs who have already larger-scale businesses, since the average loan size is higher in percentage of GDP per capita than in the other MFIs under study. This may explain that graduating was quicker for those entrepreneurs.

Almost all entrepreneurs have seen their sales grow in 2017 compared to the previous year; most still intend to grow, even though time to graduation was longer than expected for a third of them. Nevertheless, there is high heterogeneity in growth paths within each country. In Kenya for instance, a third of surveyed entrepreneurs encountered fluctuating growth, another third benefited from a steady growth, while the others have been stagnating or decreasing for a couple of years, because of the worsening political and economic situation, and because of increasing competition.

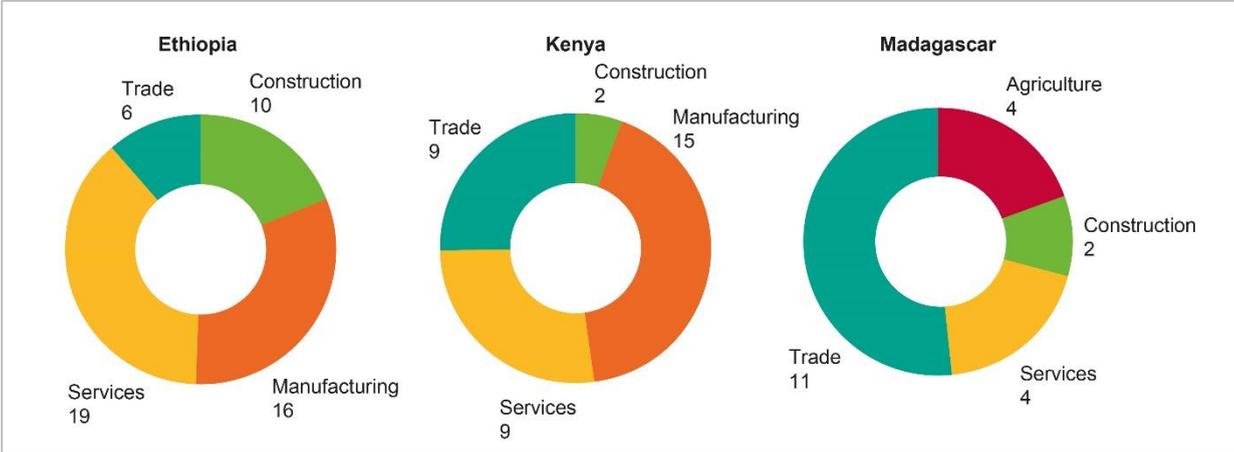
Despite the diversity of growth patterns, business growth in terms of number of employees was significant in each country: the staff was multiplied by 3,5 on average in Madagascar, by 4,3 in Kenya and by 5,1 in Ethiopia, to reach respective average numbers of 5,7, 10,7 and 17,1 employees (Figure 12).

Figure 12. Business growth in number of employees



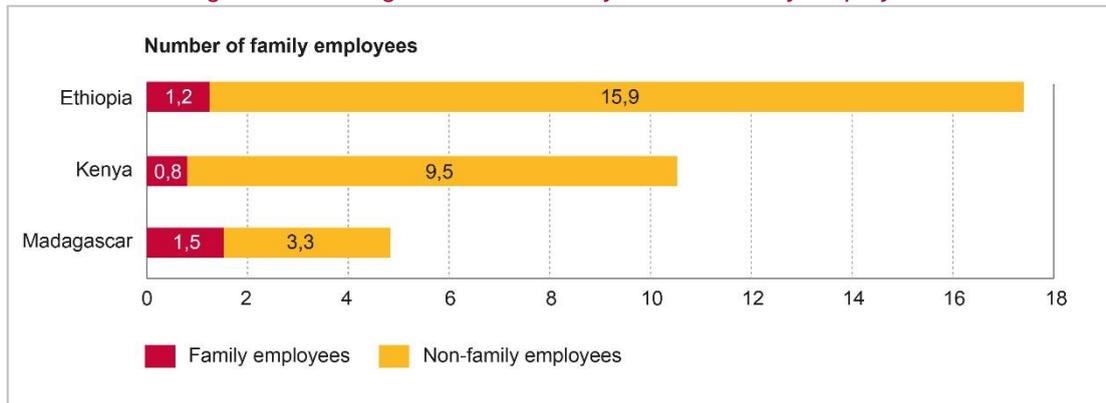
Some activity sectors appear as more conducive to job creations than others: indeed, the shares of created jobs are not balanced across sectors. In Kenya and Ethiopia, manufacturing and services sectors are the ones where the most numerous jobs were created on average, whereas in Madagascar, trade is the first one.

Figure 13. Average numbers of jobs created by activity sector



Among these new employees, only a tiny part belongs to entrepreneurs' families: in Madagascar on average, 1,5 employee out of the current 5,7 are family members, against 0,8 out of 10,7 in Kenya, and 1,2 out of 17,1 in Ethiopia. This indicates that the businesses under study have demonstrated their willingness and ability to recruit and manage employees, who are generally young people with a low level of qualification; these SGBs hence distinguish themselves from small family businesses. Besides, the businesses under study employing a higher share of family members tended to grow less rapidly than the others.

Figure 14. Average number of family and non-family employees



Critical factors leading to graduation were financial for more than half of surveyed entrepreneurs, but also non-financial, especially for a particularly high share of Ethiopian entrepreneurs (Figure 15), these non-financial factors being hard work, trustworthiness, resilience, support from family and friends, or external government support. Indeed, thanks to the Ethiopian Micro and Small Enterprises Development Strategy, start-up enterprises can operate in a shed created by the government for 5 years, which is the period during which they are supposed to graduate to medium-size enterprises. After that, graduated enterprises are provided with another working space or land at an affordable lease price. The others have to leave the cluster but may benefit from other support services such as provision of finance, training, information and market linkages. This governmental measure contributed to some Ethiopian SGBs' growth, especially in the manufacturing sector through the working spaces provided, even though some entrepreneurs interviewed complained about the low quality of non-financial services offered by the government.

Today, the main current issues faced by entrepreneurs to keep growing are access to financial capital, which concerns 65% of all entrepreneurs, and especially 87% in Ethiopia, but also competition (25%), in particular in Madagascar (81%), and inappropriate premises, which is an issue for 18% of all surveyed entrepreneurs.

Figure 15. Factors leading to graduation

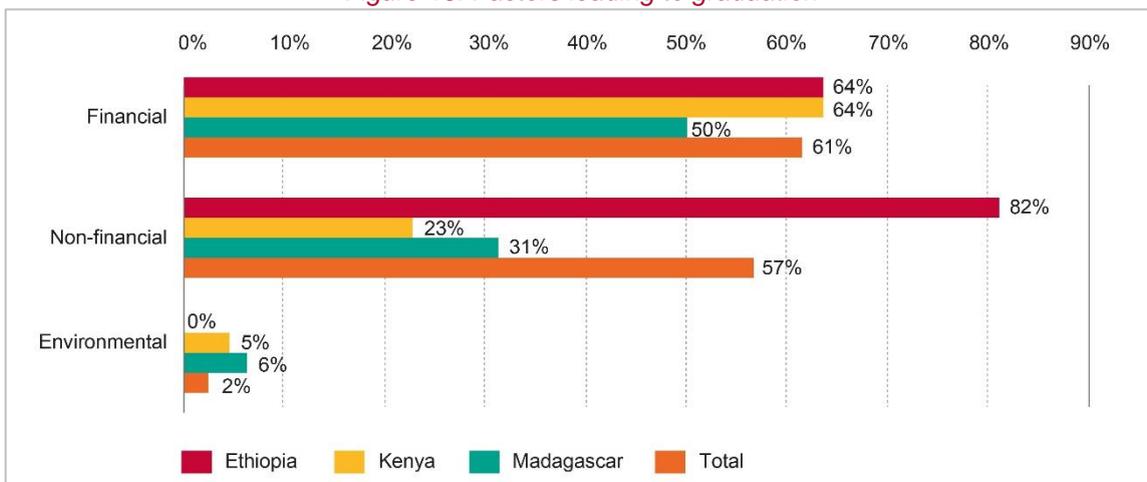
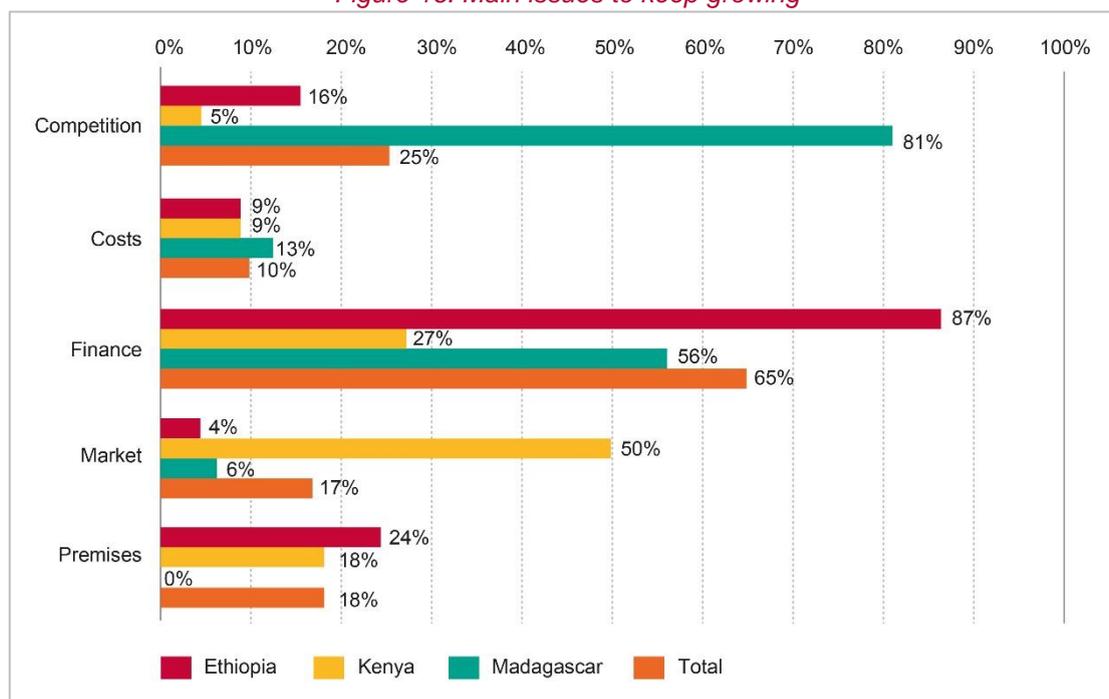


Figure 16. Main issues to keep growing



From Maid to Made: At the beginning, she had nothing, not even hope...

Aynalem⁵ had never believed that she could make a good life for herself working in her homeland in Ethiopia. Instead, she decided to fulfil her dream of travelling to the Middle East to engage in domestic work and earn a better living.

Aynalem worked in Beirut for 4 years as a maid for a rich family. However, since she did not have a valid visa, her employer refused to pay her the salary she had accumulated over 2 years and eventually reported and had her arrested by the police. She was sentenced to 6 months in prison for working without proper documentation and deported to back to Ethiopia in 2015.

"At first, I thought I was going to change my life and those of my family. Unfortunately, I ended up in prison and came back home empty handed."

Unlike her employment history, her time in jail proved to be a fortunate turn of events. While she was in prison, she received vocational training in fashion design and sewing. She was smart enough to make use of the training as soon as she returned back home. She started her business with ETB 15,000 (EUR 565) worth of savings by acquiring a sewing machine and the necessary raw materials. She began making t-shirts and tights for women in a rental space.

By that time, the government took the initiative to help returnees from Middle East by organizing them as MSEs and providing them with work places (sheds) and other support services (facilitating access to finance, business registration, trainings etc.). The idea seemed absurd compared to her dreams of

⁵ The name of the SME owner has been changed to protect clients' identities.

earning a better salary in Beirut, but she steeled herself and pushed the business forwards with the support of the government and MFI.



To expand her business, she borrowed ETB 170,000 (6,400 EUR) from a close friend and invested in more sewing machines and raw materials. She subsequently recruited 30 female returnees and trained them in fashion design and clothes making and gave them the opportunity to work in her business. Her factory became a haven for returnees who were confused and did not have any idea what they were going to do next. To date, she has created job opportunities for 42 youth who returned empty handed from the Middle East.

Early on, she had difficulties selling her product in the local market due to branding. She used to label her products “Made in

Ethiopia”. Due to customer perceptions about the quality of Ethiopian products, her product was not selling in large quantities. After recognising the problem, she changed the label from “Made in Ethiopia” to “EKO Fashion”. Thanks to the change in label combined with the high quality of her products, she gained acceptance from the market in a short period of time and sales shot upwards.

Aynalem borrowed for the first time in 2015 with a loan amount of ETB 400,000 (about EUR 15,000). She used the entire amount of the loan for the acquisition of sewing machines and raw materials. Although the tenure of the loan was for 36 months, she was able to pay back within 4 months. She only borrowed twice. The last loan she took out amounted to ETB 700,000 (about EUR 26,000) and she utilized the entire amount for the acquisition of raw materials. She claimed that the collateral requirement is the biggest bottleneck in accessing credit from MFIs.

Aynalem is now in her mid-thirties and is passionate about her job. She spends most of her time managing her business. She acts as manager, purchaser, trainer, machine operator and designer. Based on the graduation recognition system of the Regional SME Development Agency⁶, it took her only 1 year and 9 months to graduate the business from a micro to a medium enterprise. She received advanced training from TVET in fashion design, machine operation, business management and KAIZEN⁷. She has a Certificate of Competence (CoC) in garment and apparel from the Addis Ababa TVET Bureau.

Aynalem lives with her 2 children and mother in a condominium she bought a year ago. She used the condominium as collateral when she took out her last loan in 2016. She covers the living costs of her children, mother and 3 other family members.

Aynalem aspires to expand her business and hire up to 40 additional employees. In order to do so, she would need a loan of ETB 1.5 million (EUR 56,500). However, she does not think that she will obtain the amount she needs from MFIs due to strict collateral requirements.

⁶ In terms of total capital/asset MSEs in the industry sector are required to have more than EUR 60,000 million while MSEs in the service sector should have more than EUR 20,000 worth of capital.

⁷ Kaizen is the Japanese word for "continual improvement". In business, kaizen refers to activities that continuously improve all functions and involve all employees from the CEO to the assembly line workers.

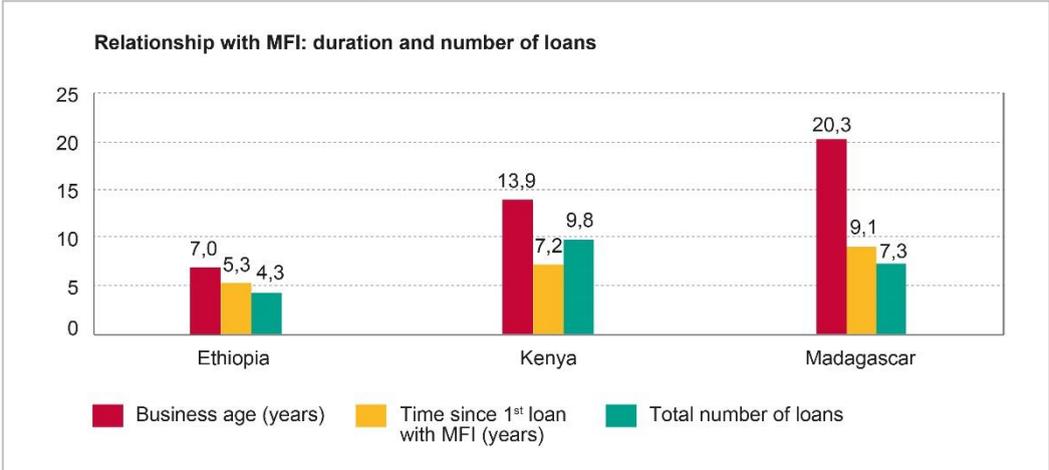
Financial Service Use

As previously mentioned, the vast majority of entrepreneurs started their businesses with their own savings, and got access to microcredit later. The period of time between business launch and first loan from the MFI under study varies across countries (Figure 17), and is particularly significant in Madagascar, where the MFI tends to target long-time operating businesses.

On average, in Ethiopia clients received 4 loans, against 7 in Madagascar and almost 10 in Kenya. The latter figure is pulled up by an outlier, as a client got around 50 loans from the MFI; without this outlier, the average number of loans received by surveyed entrepreneurs in Kenya is 7,5.

These loans may have been taken from the MFI under study or other financial institutions. In Kenya in particular, multiple borrowing is very common, and 74% of surveyed entrepreneurs borrowed from several institutions, one of them even having borrowed from 10 of them. The other institutions are commercial banks in all cases, and multiple borrowing may have started when the business was launched, and not necessarily after reaching a certain scale. This reveals that the quality of data from credit bureaus in Kenya is not much reliable, as full information sharing between commercial banks, microfinance banks, credit-only MFIs and SACCOs is still missing. As a consequence, the risk of over-indebtedness is still important.

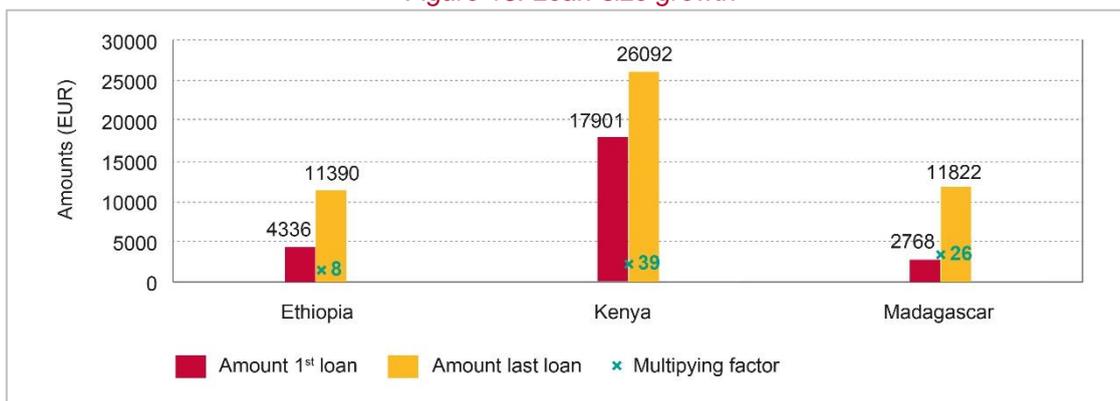
Figure 17. Relationship with MFI



Most last loans' terms fall between 12 and 36 months, and loan amounts have considerably grown between first and last loans: on average, they have been multiplied by 8 in Ethiopia, 26 in Madagascar and 39 in Kenya⁸.

⁸ These numbers are pulled up by some outliers, as some entrepreneurs received very low amounts at the beginning and very high amounts for their last loans. The median multiplying factors are 2 in Ethiopia, 10 in Kenya and 10 in Madagascar, which still remains significant.

Figure 18. Loan-size growth



As already noticed, both first and last loans granted by the Kenyan MFI are higher than in the two other countries, including in percentage of GDP per capita, which tends to indicate that the MFI targets larger-scale businesses than the others under study. However, even with higher first amounts, Kenyan entrepreneurs still have seen their loan amounts grow more than the others.

Interpreting such loan-size growth should be done with caution: indeed, if a part of it is very likely to be explained by entrepreneurs' businesses growth, another part is also probably due to progressive lending policy applied by most MFIs, which consists in increasing credit amounts over credit cycles as the trusting relationship between MFIs and clients builds, lasts and strengthens. Additionally, some Malagasy loan officers specified that the restrictions on credit amounts were considerably relaxed over the last years within their MFI, which may also explains a part of this growth.

Moreover, in Ethiopia and Madagascar, loan size is highly determined by the value of collateral offered by the client; in both countries, surveyed entrepreneurs were able to accumulate capital over credit cycles, and hence to offer higher value of collateral, which gave them access to greater loans.

Most entrepreneurs claimed having used the whole part of their loans or most for their businesses. Only 2,5% of them confessed having used only half for business purposes, and 3% less than half. Interestingly, a Kenyan entrepreneur explained that at the beginning, he was using half of his loan amounts for his business and half for personal purposes, but as his business grew, the share dedicated to it increased, and today, he uses the full amount for his business.

In terms of loan purposes, some differences may be observed across countries, and may explain other differences in terms of business size: in Madagascar, more than a third of surveyed entrepreneurs used their first loans for working capital only, which is the case of none Kenyan entrepreneur. By contrast, 86% of the latter used their first loans for investment, which is more conducive to growth, and may at least partly account for the quicker growth of Kenyan businesses compared to Malagasy ones. In Ethiopia, most entrepreneurs used their loans for both purposes.

At the time of the survey, 95% of entrepreneurs intend to borrow again, most of them expecting to require higher amounts than currently, except in Madagascar, where it is the case of 35% of surveyed entrepreneurs only, while 50% plan to require same amounts, the remaining 15% wanting to borrow less. In Ethiopia and Kenya, the share of entrepreneurs intending to use their future loans for working capital only is higher than for the first loans, which tends to indicate that for a part of entrepreneurs, the

start-up phase of their businesses is over and that they plan a slower growth than at the beginning. By contrast, in Madagascar, the share of entrepreneurs planning to use their loans for both investment and working capital is higher than for first loans, which might reflect that a greater part of Malagasy entrepreneurs intend to make their businesses grow than when they receive their first loans (Figure 20). Nonetheless, all surveyed entrepreneurs affirm that they still plan to grow in the future.

Figure 19. First loan purpose

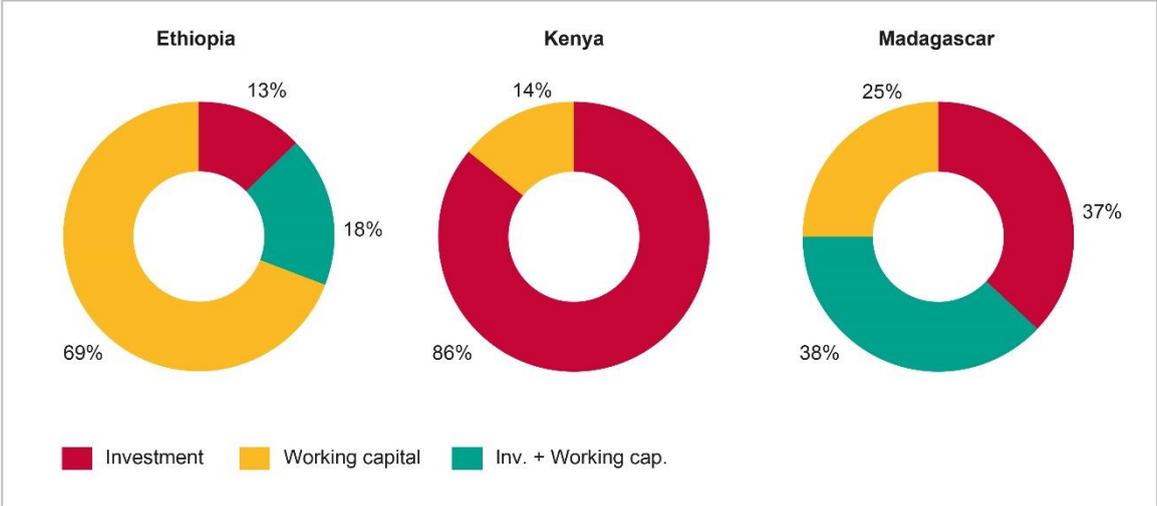
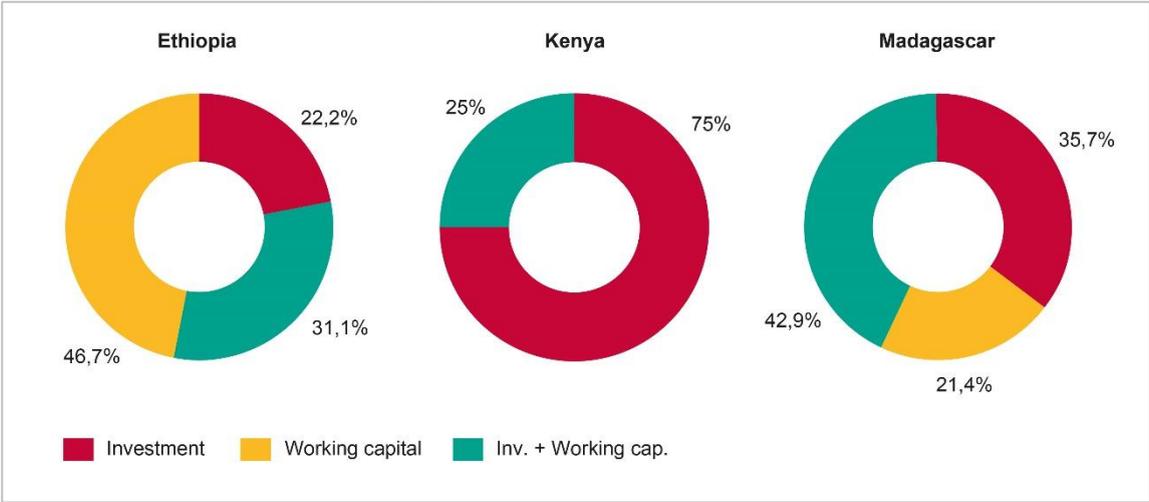


Figure 20. Future loan purpose



When entrepreneurs are asked if they think they can get the amount they need, most Kenyan and Malagasy entrepreneurs answer affirmatively, whereas almost half of Ethiopians say they cannot, mostly because they lack of collateral. Indeed, the MFIs under study require collateral values of at least 100% of amounts borrowed, whatever the client’s credit history. This considerably limits the amounts entrepreneurs are able to borrow. This shows that even after the start-up phase, SGB owners still may have difficulty in accessing the financial products and services they need, which hampers their business growth. The few Kenyan and Malagasy entrepreneurs who think they cannot get the amount they need also mention the lack of collateral as an obstacle. Not only is this problematic for entrepreneurs themselves, but it may be also a loss in terms of job creation, as most entrepreneurs claim they would hire more employees if they could get the amount they need.

In order to circumvent these difficulties, many Kenyan entrepreneurs among the ones interviewed are actually combining different types of loans, not only from different institutions, as already mentioned, but also within the institution under study: whereas they have been getting SME loans from Sidiya Bank for several years, they are still taking group loans as members of solidarity groups with the same institution, even though the amounts are lower. Indeed, this is still interesting for them as no collateral is required (only a saving deposit representing 30% of the amount), and as the amounts are disbursed more quickly than greater individual loans.

With regard to other financial services, all surveyed entrepreneurs have diversified needs, such as savings and/or current accounts, transfers, debit or credit cards. If the Kenyan MFI is able to provide these services to its clients, it is not always the case of the MFIs under study in Madagascar and Ethiopia. As a consequence, Malagasy entrepreneurs use mobile banking for payments and transfers, while Ethiopian ones resort to banks, which especially enable them to get current accounts and access funds via ATMs, which are services not provided by MFIs.

This shows that as businesses grow and become larger, financial needs evolve and become more sophisticated, and MFIs are seldom able to meet these needs. On the other hand, SGBs remain ineligible for credits from banks. In Ethiopia, this leads SGB owners to resort to MFIs for credits and to banks for other financial services, which is probably not efficient.

Non-financial needs

All surveyed entrepreneurs mention access to finance as the main support needed, far ahead non-financial services. As a matter of fact, the entrepreneurs who benefited from and used non-financial services, either from the financing institution or from other public or private entities, represent a minority. Some entrepreneurs affirm they do not need non-financial services, and are not even aware of the existence of other actors providing non-financial support and services, especially in Madagascar. Among those who do need such support, management and/or technical training and market linkages are the most commonly mentioned needs. With regard to government support, simplification of legal rules and procedures, especially concerning taxes and licenses, is often advocated in Kenya.

Success factors and challenges for business growth

All surveyed entrepreneurs intend to keep growing, and most of them mention access to finance as the main challenge. This does not mean that entrepreneurs do not have access to funds at all, but rather that loan size is often too limited, requirements too high, especially in terms of collateral, and processing time too long.

Some of them also mention local competition, in particular from the informal sector, as well as economic and political context, especially in Kenya, or access to proper premises in Ethiopia.

With regard to success factors, personal character appears as determining in each country: most entrepreneurs explain that above all, they had to be hardworking, determined and fully committed to make their business grow. Some Kenyan female entrepreneurs explained that they were able to make their business grow once their children had left the house, because full commitment into business affairs is necessary.

Flexibility and reactivity are also quoted as success factors. For instance, many Malagasy entrepreneurs explain that they were able to grow because they seized opportunities to diversify their activities when it was time to do so. Some Kenyan ones say that they made their best to quickly adapt to changing markets and new customer needs, which ensured a growing customer base.

“Where there is a will, there is a way”: Amazing transformation

Noises from different machines can be heard inside a big compound which contains a number of sheds constructed by the government for MSEs engaged in wood and metal works. One of the sheds is owned by the visionary entrepreneur, Dereje Gizaw, who started his wood and metal works business as a micro-sized enterprise 12 years ago.

Dereje⁹ was born 41 years ago. He was raised in a poor family whose entire lives were dependent on the income generated by his father through employment as a security guard in a private company. Dereje attended a nearby public school and continued his education until the age of 10. He dropped out of school at 17 to work as a taxi driver assistant and later as a taxi driver. It was the best he could do to financially support his family. He earned 20 to 50 birr per day (EUR 1 to 2) and used the whole amount to cover the cost of his family's daily basic needs.



Like many taxi drivers and their assistants, he started to consume khat and alcohol at a young age as a way to cope with boredom at work. Over time, he was drawn deeper into this habit and finally became addicted. He was no longer able to provide financial support to his family as the income he earned was not even enough to buy khat and alcohol for his daily consumption.

“I was a cigarette, khat and alcohol addict. For a long time, my addiction dominated my life and hurt myself and the people around me.”

His parents, frustrated by his addiction, made him quit his taxi driving job and asked a neighbour who had a furniture making business to hire Dereje as a driver. The neighbour accepted and hired Dereje as a driver and salesperson. While he was working there, he used to see how workers were making furniture and other woodworks.

Although he acquired some skills and experience in furniture making, the owner fired him after a year because of his addictions and poor performance at work.

⁹ The name of the SME owner has been changed to protect clients' identities.

After he lost his job, his father borrowed ETB 700 (EUR 26) from a close friend for Dereje to buy some basic carpentry tools and start making simple wood products for household uses at his parents' house. However, his addiction continued to consume him and he spent the advance payments received from customers to satisfy his needs for khat and cigarettes.

Despite these repeated failures, his family did not give up on him. They helped him to recover from his addictions. Once he understood that his addictions were causing great pain to his family, he decided to try and find himself. After a long and hard struggle, he finally succeeded in overcoming his addictions.

In 2005, he established his wood working business with an initial capital of ETB 5,000 (EUR 190) which he received in the form of a loan from a close family friend. After the registration of his business as a micro enterprise, the Wereda MSE Development office provided him with a work space. He produced different types of wood and metal products for households and cafeterias. He started out with 2 employees who had been trained in wood works from TVET. The products were of high quality and were accepted by the market within a short period of time. In 2011, the total capital of the business reached over ETB 1.5 million (approx. EUR 56,000) and the business graduated from a micro to a medium-sized enterprise.

For his accomplishments in the business, Dereje was awarded a certificate of recognition from the hands of the late Prime Minister, Meles Zenawi. He was also given the opportunity to acquire the usage and construction rights of a 1,000 m² plot of land from the government at a price of ETB 280,000 (EUR 10,500) to build his own workshop. Currently, the total capital and annual turnover of the business stands at ETB 4 million (EUR 150,000) and ETB 2 million (EUR 75,000) respectively. The business now employs 16 people.

For his first loan, Dereje borrowed ETB 50,000 (EUR 1,900). The whole amount was used for the acquisition of fixed assets and raw materials. Last year, Dereje borrowed ETB 500,000 (EUR 19,000) from the same MFI to buy additional machinery and lay down the foundations of a workshop he is building on a 1,000 sq. meter plot of land he acquired from the government.

Today, Dereje is married with four children. His wife works in his company as an assistant accountant. She is studying accounting and will become head accountant of the company upon completion of her studies. Dereje received assistance from the Wereda OSS (One-Stop Shop) in the form of working space and training on business development, Kaizen, bookkeeping and entrepreneurship.

Dereje envisages borrowing ETB 2 million (EUR 75,000) to complete his expansion plans. He anticipates finishing the construction of the workshop within the next couple of years and wants to expand to manufacturing car bodies. However, he believes that it's unlikely that he'll be able to finish the workshop within the expected timeframe as the collateral he has to pledge is insufficient to borrow the amount needed.

CONCLUSIONS AND RECOMMENDATIONS

As in most countries, SMEs are crucial for economic growth, development and employment in Sub-Saharan Africa. By relying on five MFIs in Ethiopia, Kenya and Madagascar, this study aimed at better identifying the profiles of small and growing business owners, that is to say of micro-entrepreneurs who managed to turn into very small, small or medium enterprises, and at better understanding their growth paths, success factors and challenges.

On the basis of the results detailed in the previous section, some recommendations can be made in order to foster the development of the MSME sector and facilitate their growth. These recommendations may be relevant for a diversity of actors, from policy makers to all kinds of financial and non-financial services providers. They concern the following issues:

- **The role of the government and public agencies.** Despite the various measures and policies implemented in each country, the efforts seem insufficient to enable MSMEs to evolve and grow in a proper environment and access the services they need. The variety of definitions of MSMEs within a country, even sometimes their inconsistency or irrelevance, may reflect the lack of attention dedicated to this segment. Even though interesting initiatives have been launched in Ethiopia, especially with regard to the provision of working spaces and premises, public support is inadequate and insufficient everywhere. The legal environment is sometimes constraining, especially in Kenya, where licenses and taxes seem too numerous, let alone corruption, and incentives towards financial service providers to facilitate access to credit for SMEs are missing.
- **Access to adequate credit.** Indeed, a high share of SGB owners face difficulty in accessing the amounts they need to keep growing. This is mostly due to collateral requirements from the financial institutions currently funding them. Even with clean credit histories, requirements remain too high and processing time too long. The conditions demanded by MFIs seem inappropriate for SMEs, while banks still refuse to serve them: this is the “missing middle” issue often referred to when talking about challenges faced by SMEs. Whereas the trend in public policies is rather to create a proper and supporting environment for start-ups and microenterprises, the same kinds of initiatives in favor of the expansion of small and medium enterprises are missing, and yet SMEs are likely to create more jobs. It could be more relevant to consider microenterprises and start-ups as a part of a value chain which also includes SMEs, and to think about how to ensure access to financial and non-financial services for the whole value chain.
- **Access to diverse and sophisticated financial services.** Most SGB owners resort to diverse financial institutions in order to make up for the lack of appropriate financial services offered by the institution currently funding them. The Ethiopian case is particularly striking, with SGB owners taking credits from MFIs but all other services such as current accounts and electronic payment solutions from banks. If MFIs or banks are not able or willing to offer all the services needed by SMEs, at least synergies and collaborations between various financial service providers could be created in order to ensure that SMEs are properly served. MFIs could also innovate and scale-up their services to better meet SMEs’ needs, especially by including FinTech solutions, either internally or in cooperation with specialized providers.
- **The burden of informal sector.** All SGBs are formally registered in Ethiopia and Madagascar, whereas it is not the case in Kenya, where several levels of registration exist. The Kenyan legislation does not seem to efficiently incite SMEs to register. However, more generally

speaking, formalization is a key issue, not only because it facilitates access to suppliers, clients and government support for SGBs, but also because it minimizes market distortions: for now, many SGBs have to face competition from other local enterprises which are not always formalized and are not submitted to the same rules and costs, which is definitely an obstacle to their growth. As a consequence, more incentives to formal registration should probably be implemented, not only for SMEs but for all economics actors whatever their size.

- **The need for non-financial support.** Few SGB owners benefited from non-financial services. If some of them claim not needing any, some others acknowledge that training, either technical or managerial, and business development services (BDS) in general could be useful for their growth. So far, the offer of such services has remained insufficient, inappropriate, and even too costly when provided by private organizations. More coordination between providers of financial and non-financial services and/or public-private partnerships could be solutions to test in order to develop more organized, efficient and quality-driven BDS sectors.
- **The need for more knowledge and information about SGBs.** The outcomes of studies of this kind may be particularly useful for several types of actors. For MFIs first, they may help them better know their clients, train loan officers, and especially give them some clues to identify SGBs in their existing portfolios but also among their possible future clients. Hence, such studies may provide MFIs with relevant information to implement specific and adapted support dedicated to SGBs, whether for pre-launch phase or post-creation phase. Second, for governments, donors and national or international organizations willing to focus their efforts on job creation, such studies give insight on the segments to target to maximize the potential number of jobs created. As a consequence, more studies with other MFIs, in other countries and other continents should be launched in order to contribute to knowledge creation on SGBs. These studies could also adopt a different perspective by focusing on entrepreneurs' life stories, and/or deal with complementary issues, such as SGB owners' resilience capacities and strategies to manage risks and face shocks; this could give food for thought about the needs for other kinds of products and services, such as insurance. These are only suggestions and illustrate the large scope of questions to tackle and research initiatives to launch to keep extending financial inclusion of all population segments.

Acknowledgements

ADA would like to thank all the persons who contributed to this study, especially the three local consultants who carried out the local surveys with microfinance institutions and entrepreneurs in each country: Seifu Teshome Engida and John Guzowski from First Consult PLC in Ethiopia, Hery Andriamialjaona from Consulting Plus in Madagascar and Ingrid Smit in Kenya.

ADA is also grateful to the five microfinance institutions which agreed to take part in the survey: AdCSI, Vision Fund MFI and Agar MFI in Ethiopia, Sidian Bank in Kenya and ACEP in Madagascar, as well as to all the entrepreneurs who took some time to share their experience.

Finally, this study would not have been possible without the contributions of the following colleagues: Benjamin Mackay, Carla Palomares, Christian Baron and Mathilde Bauwin.