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The Effect of Government Incentives on the Performance of Micro and Small Enterprises (MSE's) in Eastern Ethiopia: Evidence from Harar, Dire Dawa city Administration and Haramaya Town

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Abstract

MSE's are serving as a vehicle of the economic development for developing countries and the government is trying to incentivize the enterprises through different mechanisms. But, the effect of government incentives on the performance of MSE's is not yet examined in Eastern part of Ethiopia which is the main aim of this study. In the same vein, there is no study that used both capitals, saving amount and employment together as a proxy measure of performance in the study areas. Based on the findings, enterprises who accessed credit accumulated higher capital, saved higher money, and created higher employment opportunity than enterprises who do not get credit access. MSE's operating on government provided working-premise have lower capital and lower savings but employed higher number of employees than MSE's who work on their own or rented working premises. Enterprises who accessed tax incentives saved higher, but less average capital and less employment compared to enterprises who have not accessed tax incentives. Furthermore, MSE's who accessed training have had higher capital, saving and employment compared to MSE's who have not accessed trainings provided by the government. Finally, based on the findings, necessary recommendations were forwarded for considerations.

Keywords: Capital, Employment, Micro and Small Enterprises (MSE's), Saving

1. Introduction

1.1. Introduction and problem justification

The vast majority of the firms in the developing countries were constituted by Micro and small Enterprises (MSE's). These MSE's generate a considerable share in creating employment and output as well (Nichter, S., & Goldmark, L., 2005). It is recognized that Micro and Small Enterprises (MSE's) are useful to overcome the problem of

unemployment through creation of job opportunities and development of businesses having less capital. The development and growth of these MSE's can activate the business environment and enhance their competitiveness in the market. Broadly speaking it may also help to have equitable distribution of income and wealth between the poor and the rich which is one of the roles of public finance of a given country. The Micro and Small Enterprises (MSE's) have been recognized as an engine of economic growth and development for a given country. In poor countries like Ethiopia, Micro and Small Enterprises (MSE's) are believed to have a vital role in poverty reduction, employment generation as well as economic development (Haftu, B., et al, 2009). Prior attention must be given to MSE's as they serve as sources for sustainable job opportunities for a country (Alemayehu, D. et al., 2016). Due to the fact that MSE's play a key role in job creation, improving household income and well-being, and boosting national economy of the county, it has been one of the top agendas of various policy makers and academics (Drbie, M., & Kassahun, T., 2013). Generally, the MSE's sector have great contribution in enhancement of the economy, particularly in employment opportunity creation, improvement of the income level, women empowerment, changing the habit of operators to save money, skills and knowledge development of operators, improvement of the people's living conditions and social issues (Geleta, D. S., 2013). Even if the assets owned by small enterprises is by far less than that of medium and large enterprises, they do have highest contribution on employment creation compared to the later once. (Weldeslassie, H. A., et al, 2019).

Albeit MSE's were serving as a vehicle of the economic development for a country the effect of the government incentives on the performance of these enterprises is not yet examined in Eastern part of the country. In the same vein, to the best of the researcher knowledge, there is no study that used both capitals, saving amount and employment together as a proxy measure of performance in Eastern part of Ethiopia. The main objective of the study is therefore to measure the effects of government incentives on the performance of MSE's in Eastern part of the country. The government incentives included in this study are incentive through credit access, through provision of working premises to MSE's, through tax and through provision of training on the performance of the enterprises. The specific objective of the study is to measure the economic differences in between the enterprises accessed incentives or not.

1.2. Literature review

1.2.1. Definition of Micro and Small Enterprises (MSE's)

There is no generally accepted definition of MSE's across the globe. Some of the commonly used criteria include number of employees, asset values, revenue (Sales) and amount of capital they have and initial investment (Seyoum, 2016). There is no any single definition that can reflect the differences between MSE's. Even if organizations give a working definition to MSE's, mostly non-definitional policy was adopted by different international organizations across the globe (UNCTAD, no date).

The MSE's sector is a diversified activity which creates livelihood opportunity and serve as a remedy to curb the problem of unemployment and poverty (Firasew, 2011). Considering different factors, MSE's are defined in different ways across the world. Even though, many countries use common factors for the definition of MSE's their degree of emphasis and measures employed quite differ considerably. The factors considered include number of employees, sales volume, and the capital of MSE's. Generally, there are operational and theoretical definition of MSE's. The first one is largely used for working purposes and the latter is employed to characterize the sector. Recently, particularly in Europe, there has been some degree of convergence in the definition of MSE's. The European Commission used a combination of employee numbers, annual turnover or balance sheet total and ownership while defining MSE's (Zemenu, A., & Mohammed, M., 2014). The official definition of Micro and Small Enterprises is an enterprise having 10 or less workers (Gebrehiwot, A., & Wolday, A., 2006). Enterprises having a paid-up capital below 20,000 ETB excluding consultancy or other firms that use advanced technology are Micro enterprise whereas enterprises having paid up capital ranges between Birr 20,000 and 500,000 and save other firms using high technology are small enterprises (Belay, K., Asmera, T., & Tekalign, M., 2015).

1.2.2. Determinant factors of MSE's

Albeit the degree of the effects is different from one to another, MSE's can be affected by both internal and external

factors. The factors having strong positive relationship with the growth of MSEs include factors related with working premise, management and experience, marketing, infrastructural, financial factors, and also factors related with the external environment (Mengesha, B. T, 2018). Some of the most critical factors affecting MSE's include work premises, access to finance, infrastructure, entrepreneurship and business managerial problems (Cherkos, T., etal, 2018). Furthermore, age of manager's or owner's, marital status and education were also important factors affecting growth of MSE's in the study area (Tarfasa, S., et.al, 2016). The development of MSE's can be affected by internal and external factors the former includes human resources, finance, production, marketing and development strategy and the external one includes policies of the government, socio-economic, cultural, the role of related institutions, and information technology as well. Moreover, there are also other factors that determine the performance of MSE's including capital, training, information about the market, marketing network, product promotional, and institutional capacity (Munizu, M., 2016).

1.2.3. Challenging factors of MSE's

In Addis Ababa Ethiopia, about 55% and 64% of MSE' affected by the problem of access to finance. Majority of the MSE's in Addis Ababa have not accessed loan due to bulky bureaucracy, limited working premises, and also high collateral requirement (Tarfasa, S., et.al, 2016). Sources of finance and loan term, low educational level of managers and entrepreneurs, the problem of working premise provided by government are the problems of MSE's (Fufa, F. G., 2015).

The problems that MSE's are facing include: intensive competition, lack of credit facility, starting business without conducting survey, inappropriate imposition of tax, inappropriate tenure, lack of business training, lack of working capital, absence of appropriate technology, bad debts and lack of financial management skill and experience (Zemenu, A., & Mohammed, M., 2014). Some of the challenges that MSE's are facing in Ethiopia includes the problem of access to finance, selling at less price compared with other similar enterprises, lack of access to raw material, lack of experience in own business, limited market access, lack of working premise, lack of training access, cultural oppressions, high level of competition, the development strategy and policy of the country focusing on agriculture than others, unappealing market, lack of promotion due to the problem of working capital, high tax, unachievable collateral requirement and high interest rate by credit institutions, lack of technology, weak performance, and lack of financial management skill (Abdumelike A, 2018). Some of the foremost regulatory challenges that MSE's are facing include high taxes, the problem of tax administration, high collateral requirement, absence of working premise and lack of supports (Gebrehiwot, A., & Wolday, A., 2006).

While taking credit most MSEs are forced to use the informal institutions in which there is limited amount of money to meet their credit needs and requirement. This is due to the fact that there is requirement of collateral, high interest rate and also other governance and related accountability issues in the formal financial institutions (Abera A, 2012). The most challenging factors that hinders the growth of MSE's were problems related with marketing, accounting and financial related factors, infrastructural factors, technological, business location, educational status and experience (Samuel B, 2019). Less amount of capital for investment, regulatory framework, lack of collateral and socio-cultural beliefs and practices are among constraining factors that influence the MSE's performance (Osoro, K., & Areba, A., 2013).

1.2.4. Micro and Small Enterprises (MSE's) in Ethiopia

In Ethiopia, particularly for the low-income earners, the poor and women groups, the micro and small enterprises (MSE) sector is important. These can be seen from their relatively large presence in the country, share in employment and small capital requirements. There are sufficient reasons for governments and other stakeholders in development to be interested in micro and small enterprises. MSEs are seen as an emerging private sector, forming the basis for private-sector-led growth in the context of many developing countries, including Ethiopia. In Ethiopia, at the level of strategy and policy, the roles of MSE's have received recognition and seen as means of providing employment, alleviating poverty, ensuring food security, and private sector development (Gebrehiwot, A., & Wolday, A., 2006). With regard to the promotion in the community-building and social activities in the rural and small towns, the private small businesses and micro-enterprises create jobs and new opportunities (Weldeslassie, H. A., Etal, 2019).

To improve the performance and role of MSE's in reducing poverty, transformation of industries, reducing unemployment and overall development of the economy, lot of efforts has been made by the government (Cherkos, T., et al, 2018).

In Ethiopia MSE's are recognized as important vehicles of economic growth, employment creation, income generation, and poverty reduction, due to these facts, they occupy a prominent position in the development agenda of the country (Fufa, F. G., 2015).

Even though MSMEs make the smallest total proportion of assets, their contribution to employment creation is much higher than that of medium and large enterprises (Weldeslassie, H. A., Etal, 2019). In Ethiopia's industry development plan, MSE's given a recognition in and they are considered as vehicles for employment opportunities (Alemayehu, D. et al., 2016). Within the Industrial Development Strategy of the country, the Micro and small enterprise (MSE's) development holds a strategic place. They are the key instruments of job creation in urban centers, at the same time as job creation is the core of the country's development plan. MSE's development should be one of Ethiopia's top development priorities as they play a pivotal role in employment creation (MoUDH, 2016).

2. Methods

2.1. Description of the study areas

The study areas included in this study were Harari regional state, Dire Dawa administration and Haramaya towns. They are taken from three different regions and City Administrations of the Federal Democratic Republic of Ethiopia.

2.1.1. Harari Regional state

The Harari People Regional State is one of the nine regional states of the Federal Democratic Republic of Ethiopia. The total area of the region is 343.2 sq. km. (19.5 sq. km urban and 323.7 sq. km. rural) According to the 2007 Central Statistical Authority (CSA) Report, the total population of the Region is 183,415. It is the only region in Ethiopia where the majority of its population, i.e., 99,368 or 54.18% is urban inhabitants (Harari BoFED, 2006).

2.1.2. Dire Dawa city Administration

Dire Dawa city is one of the cities organized under the federal democratic republic of Ethiopia. The city administration area covers nearly 130,000 hectares, of which only 2 percent constitute built-up urban areas and the remaining 98 percent is considered rural (Habitat, U. N., 2008).

2.1.3. Haramaya Town

Haramaya is a town which is located within the Eastern Hraraghe zone of the Oromia regional state which is 21 KM Northwest of Harar town and 505 KM away from the East of capital city Addis Ababa. (Shishaye, H. A., & Nagari, A., 2016).

2.2. Research Design

This study used a cross-sectional survey study design. The researcher used this design due to the fact that there was a limitation of available resources including previous years data in this topic. Furthermore, the study used a survey type as it will try to generalize the data collected from sample respondents representing the whole population of the study areas.

2.3. Data and Methods

The study employed both primary and secondary data. The primary data were collected from sample respondents of the entrepreneurs engaged in MSE's using structured questionnaire. The questions included in the questionnaire are both open ended and close ended. From secondary source of data, the study used journal articles and previous studies of researchers and/or scholars in the sector as they provide detailed and latest findings on the field of study.

2.4. Sampling technique and Sample Size Determination

In this study, the researchers distributed a total of 360 respondents which includes 129 from Harar, 211 from Dire Dawa and 20 from Haramaya using proportionate sampling design from the total population of 3447 MSEs (1230 from Harar, 2017 from Dire Dawa and 200 from Haramaya). The sample size for the study calculated using to the formula recommended by Yamane (1973) as cited by (Wickramasinghe, 2007).

$$n = N / (1 + Ne^2) \text{ ----- Equation 3.1}$$

Where:

n => Sample size

N => Total population

e² => Probability of error

Therefore, the sample size for this study is:

$$n = 3,447 / (1 + 3,447(0.05)^2)$$

$$n = 359 \approx 360$$

With N = 3447, e = 5% (at least 95 % confidence level), thus the sample size is 360

Table 1. Sample size determination

S.No	Areas	Total population (N)	Proportion	Sample (n)
1.	Harar	1,230	$\frac{1,230}{3,447} * 360$	129
2.	Dire Dawa	2,017	$\frac{2,017}{3,447} * 360$	211
3.	Haramaya	200	$\frac{200}{3,447} * 360$	20
Total		N= 3,447	100 %	<u>n= 360</u>

2.5. Sampling Technique

The researchers applied two stage sampling procedures, in the first stage, MSE's which are found in the study areas were categorized into Five groups. These are MSE's engaged on manufacturing sector, service sector, trade associations, construction, and urban agriculture. In the second stage, the researchers proportionally selected respondents from each city as per the table 3.1 above. A total of 360 questionnaires were distributed and 354 questionnaires were collected representing a response rate of 98.33 percent. The samples taken includes 129 from Harar, 211 from Dire-Dawa and 20 from Haramaya considering the total population and their sectoral classifications as depicted in the table 3.2. here below.

Table 2. Data collected from each sector and respondent's city.

		Type of MSE's					Total
		Manufacturing	Service	Trade	Construction	Urban Agriculture	
Respondent's City	Harar	12	18	18	74	5	127
	Dire Dawa	64	47	18	60	22	211
	Haramaya	4	6	4	1	1	16
Total		80	71	40	135	28	354

2.6. Method of Data Analysis

In this study, the researcher used the descriptive analysis. The descriptive method of analysis used to make necessary assessments about the activities of MSE's among different sectors of investment and across different cities. Simple descriptive statistical tools such as percentage, mean, standard deviation, frequency and cross-tabulation, are employed in the study.

3. Result

In many nations, especially in developing countries including Ethiopia, Micro and Small Enterprises are one of the areas of development and also considered as a center of innovation. These MSE's may serve the nation in different ways including generating immediate employment opportunity with relatively small amount of capital requirement. Due to this and many other reasons, the government has been supporting the MSE's in terms of different incentives and many other supporting mechanisms.

The supports provided by the government to MSE's include facilitating credit access, providing working premises, and also providing tax incentives. Therefore, in this study the researcher tried to analyse the incentives provided by the government on the performance of MSE's.

3.1. Government Incentive through credit

Table 3 below shows summary statistics of average values of capital, saving, number of employments and MSE's experience between enterprises which have accessed credit and enterprises which have not.

Table 3: Statistics on difference on Capital, Saving, Number of employment and experience between Credit accessed and Not accessed enterprises

MSEs Loan from Government	Credit accessed =46				No Credit accessed =307			
	Mean	Std. Dev.	Min	Max	Mean	Std. Dev.	Min	Max
Net Capital	215832.15	214073.84	12500.00	900,000	124677.34	165130.63	600	950,000
Saving	92623.17	135719.93	3000.00	700,000	33992.60	46877.01	0	300,000
No of Employment	11.50	11.20	1.00	42.00	9.78	9.63	1.00	65.00
Age of MSE	5.09	2.75	1.50	11.00	5.28	2.92	0.50	19.00

As we can see from the above table that, around 87 % of the sample respondents did not received credit from government and only 13 % of them took credit from government. This implies that the role of government in providing credit is so low in the study areas. But, since one of the limitations of MSE's is having small amount of capital to run their business, there must be another mechanism that may allow them to access credit from government.

The average experience of enterprises which accessed credit equals 5.09 years and the average experience of enterprises which do not get access to credit equals 5.28 years. This result indicates as that emphasis of giving credit is given for newly established enterprises compared to experienced once. On the other hand, Credit accessed

enterprises have higher average capital (=215832.15) than the enterprises who do not received credit from government indicating an average capital of (=124677.34). Also, credit accessed enterprises saved, on average, more (=92623.17) than no-credit accessed MSEs (=33992.60). Besides, average employment creation (=11.50) is higher for the enterprises who accessed credit compared to enterprises who do not accessed credit which is (9.78).

In general, credit accessed enterprises accumulated higher capital, saved higher money, and created higher employment opportunity than enterprises which do not get access to credit. This indicates as that the credit access provided by the government had great effect on the performance of MSE's. in the study areas.

On the other side, the distribution of credit across the different types of business activities looks like the following.

Table 4. Distribution of credit based on the type of business activity

Credit access based on enterprises' business activity						
	Manufacturing	Service	Trade	Urban agriculture	Construction	Total
Number of MSE's accessed credits	12	8	9	12	5	=46
Number of MSE's Not-accessed credits	68	62	31	123	23	=307
Total samples	80	70	40	135	28	=353
Proportion	0.15	0.114286	0.225	0.088889	0.178571	0.130312

Table 4 shows that a total of 80 samples taken were engaged in manufacturing activities, out of this, only 21 or 15 percent obtained credit. Similarly, out of 70 enterprises which engaged on services business, only 8 or 11.43 percent have got access to credit. The proportion of credit access for enterprises which are involved in trade activity is 22.50 %. Similarly, the proportion of urban agriculture is equal to 8.88 % and the proportion of the credit accessed enterprises engaged in a construction sector are only 5, or 17.80 percent.

In addition, respondents were asked to write their reasons for not taking credit from government. From the result we can observe that majority of them (79.10 %) responded that the complicated loan approval procedures are the major factors hindering them to take credit from government.

Table 5: Reasons for not taking credit

Reasons	Frequency	Percent
The Amount of Loan is Insufficient	6	2.00
Loan approval Procedure is Complicated	238	79.10
Other	57	18.90
Total	301	100.00

3.2. Government Incentive through provision of working premises to MSE's

Another form of incentive provided by the government comes from provision of working premise. In some towns of the country, for example, micro and small-scale development agencies-built plants which MSEs can use to sell their products or they may provide land access to MSE's. These will be essential especially for newly established enterprises since they may face capital constraint.

Table 6. Statistical difference on Capital, Saving, Number of employments and Experiences of MSE's between enterprises which are provided work premise and not

	Work on gov't =50				Private or rented in =299			
	Mean	Std. Dev.	Min	Max	Mean	Std. Dev.	Min	Max
Net Capital	102,361.18	143,194.06	600.00	800,000.00	144,318.27	179,347.29	2,000.00	950,000.00
Saving	23,072.22	36,074.44	750.00	200000.00	45,104.34	72,268.75	0	700,000.00
Number of employments	11.10	10.46	2.00	43.00	9.89	9.81	1.00	65.00
Age of MSE's	6.13	3.41	0.50	15.00	5.10	2.79	0.50	19.00

Table 6 indicates as that only 50 out of 349 operate on government provided work premise. The remaining 299 MSE's on the other hand work of either their own work-premise or rented-in work-premise. When we observe their average capital, enterprises which operate on government provided work-premises have less average capital of 102,361.18 birr, than that of MSE's who operate on their own or rented working premises having 144,318.27 birr. Similarly, enterprise who operate on either on their own work-premise or rented-in work-premises have higher savings on average (=45,104.34) compared to enterprises who operate government provided work premise (=23,072.22). Generally, MSE's who operate their businesses on government provided work-premise have lower capital and also lower average savings than MSE's who work on their own or rented-in working premises.

But, when we see their employment status of enterprises, those MSE's who operate on either on their own work-premise or rented-in work-premises have lower average number of employees (=9.89) compared to enterprises who operate government provided work premise (=11.10).

From the above result we can observe that, enterprises who accessed government provided working premise employed higher number of employees on average compared to enterprises working by their own or rented working premises.

In addition, if we see the average experience between the two groups, it is 6.13 years for enterprises working on government provided premises and 5.10 years for enterprises who work on private or rented in. This indicate on average more experienced business enterprises have an access to working premises supplied by the government compared to the new enterprises.

3.3. Incentive through tax

As we all know, one of the main sources of revenue for a government is a tax revenue. By the money collected through tax and other sources, governments will provide necessary services to the society such as building infrastructures including roads, health canthers, schools and universities. To see the effect of incentive through tax, the researcher tried to see the difference in capital, saving and number of employees between enterprises accessed tax incentives provided by the government or not.

Table 7. Statistical differences on Net Capital, Saving, Number of employments and Experiences of MSE's between enterprises accessed tax incentive or not

	Enterprises accessing tax incentive =21				Enterprises not accessed tax incentive =331			
	Mean	Std. Dev.	Min	Max	Mean	Std. Dev.	Min	Max
Net Capital	59000.00	50466.82	5000.00	186000.00	141816.38	178712.77	600.00	950000.00
Saving	79777.78	158378.76	3000.00	700000.00	39477.74	58584.94	0	350000.00
Number of employments	9.43	10.19	1.00	32.00	10.04	9.84	1	65.00
Age of MSE's	4.24	2.71	1.50	11.00	5.32	2.91	0.50	19.00

As we can see from the above table, that 21 enterprises who have accessed tax incentives provided by the government have less average capital which is 59,000 compared to the remaining 331 enterprises who have not accessed tax incentive which is 141,816.38 birr. Similarly, MSE's who have not accessed tax incentive have higher number of employees on average (=10.04) compared to enterprises who accessed incentives through tax (=9.43). Note also that the average experience of enterprises not accessed tax incentive (=4.24 Years) is smaller than the average experience accessed enterprises (=5.32 years). This indicates that government gives tax incentive for newly established enterprises whose experience is less compared to other experienced enterprises. Hence, as we can see from the above result, incentivized enterprises have smaller capital compared to other once. So, this happened due to the fact that the average experience of the incentivized enterprises is relatively smaller than the average experience of enterprises not accessed tax incentive.

But, when we see their savings, enterprises who are got access of tax incentive provided by the government saved higher amount of money on average (=79777.78) compared to enterprises who are paying tax (=39477.74).

3.4. Governments incentive through provision of training

Table 8: Statistical differences on Net Capital, Saving, Number of employments and Experiences of MSE's between enterprises which have accessed training or not

	Provision of Training for MSE's							
	Enterprises not accessed Training (90)				Enterprises accessed Training (263)			
	Mean	Standard Deviation	Maximum	Minimum	Mean	Standard Deviation	Maximum	Minimum
Net Capital	72440.26	95416.52	670000.00	600.00	159051.70	189494.73	950000.00	2000.00
MSE's Saving Amount	24168.48	47152.51	350000.00	.00	46689.28	72657.99	700000.00	400.00
Number of Employees	4.61	5.05	33.00	1.00	11.87	10.40	65.00	1.00
Age of MSE's	4.72	3.23	15.33	.50	5.45	2.75	19.00	0.50

As we can see from the above table 8 that from the sample a total of 263 enterprises have accessed training provided by the government, but the remaining 90 enterprises do not accessed training. 263 MSE's who accessed training have an higher average capital of 159,051 birr compared to the remaining 90 enterprises who have not accessed training having an average capital of 72,440 birr. Similarly, when we see their savings, enterprises who accessed training saved by far higher amount of money on average (=46,689.28) compared to enterprises who have not accessed trainings (=24,168.48). In addition, MSE's who accessed training have higher number of employees on average (=11.87) compared to not accessed MSE's (=4.61). This result implies as that on average MSE's who took training are performing well both in terms of capital, saving and also employment compared to MSE's who do not took trainings provided by the government.

4. Conclusion and Recommendation

MSE's were serving as a vehicle of the economic development and also considered as a foundation of job opportunities specially for developing countries. This study mainly aimed at measuring the effects of government incentives on the performance of MSE's in Eastern part of the country. The government incentives employed in this study are incentive through credit access, provision of working premises to MSE's, incentive through tax and provision of training on the performance of the enterprises. Performance of the enterprises measured in terms of growth in capital, saving and number of employees. Furthermore, the study measured the economic differences in between the enterprises accessed incentives or not.

Based on the finding of the study, very limited number of enterprises accessed credit in the study areas, mainly due to complicated loan approval procedures. Albeit their small numbers, credit accessed enterprises accumulated higher capital, saved higher amount of money, and created higher employment opportunity compared to enterprises who do not get access to credit. Therefore, the provision of credit access to MSE's and simplifying the loan approval procedures should be given due consideration.

MSE's operating on government provided working-premise have lower capital and lower average savings but employed higher number of employees than MSE's who work on their own or rented-in working premises. Enterprises who have accessed tax incentives provided by the government have less average capital and also less employment number compared to enterprises who have not accessed tax incentives. This happened due to the fact that the average experience of the incentivized enterprises is relatively smaller than the average experience of enterprises not accessed tax incentive. But, enterprises who have accessed tax incentives provided by the government saved higher amount of money compared to enterprises who have not accessed tax incentive. MSE's who accessed training have had higher capital, saving and employment compared to MSE's who have not accessed trainings provided by the government. Thus, the government in general and particularly the MSE's development agency should prepare periodical trainings to MSE's.

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