

**An Assessment of Barriers of Micro And Small
Businesses Encountering in their Business Start-Up
(A case of North Gondar zone)**

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ABSTRACT

The purpose that this study was to assess the problems and challenges encountered with business startups of micro and small businesses in North Gondar zone. The target population comprised of SMEs new small business owners 0-12 months since start-up. Gondar city and Woreda (sub- district) towns, (namely, Debarq, Maxesengit and Aykel) were selected by their convenience sampling m. A total of 341 samples was used. Data is collected through adapted standard research instruments. The reliability of the instruments is tested using cronbache's alpha was tested. The findings of this study reveal that the major barriers encountered during business start up and success of the micro and small business in the order of top to least Marketing problems, financial source problems, Infrastructure, work place and management problems.

Key words: *SMEs, Start up, Challenge, Small Business*

1. INTRODUCTION

SMEs are the back of many economies across the world. In many countries, where small businesses constitute a majority of the business sector, the failure rate is high (Bowler & Dawood 1996). On average, 50 % of small businesses that are started finally failing. This failure rate goes up to 80 % in some regions (Macleod, as quoted by Ladzani & van Vuuren, 2002:155).

Small business development in North Gondar is no exception. Some of the SMEs that were started in the early 1990s are no longer in survival. Many of them were not growing beyond the survivalist stage. The high failure rate can be partly credited to the need of support that the SMEs experienced. Most developing countries' governments have since initiated SMEs support actions aimed at developing and promoting the SMEs (Bowler & Dawood 1996).

The purpose of undertaking this study is to provide answers to and problems further so that the study may show some light regarding the challenges experienced by new micro and small business start-up. The results will help prospective and current SME practitioners not to commit the same mistakes that have led to failure of the long-ago. It is hoped that this approach will reduce the high failure rate of SMEs and will lead to their success.

2. METHODS OF THE STUDY

The study is exploratory, descriptive and qualitative in nature. The study was mainly primary data collected through questionnaire from a sample population of micro and small businesses in North Gondar Zone. The subjects of the study were SME service providers and those in the process of new businesses initialization (pre-start-up, 0-6 months and 6-12 months). The sample is selected using two-stage sampling from the small and medium scale enterprises in North Gondar zone started in 2007 E.C. Three Woredas (sub- district) were selected randomly and households selected from these words by their convenience. The sample size was determined by using Yamene (1967) minimum sample size determination formula. According to this formula: $n = \frac{N}{1 + Ne^2}$, where n refers to sample size, N is total population e is level of significance. Using 2348 total population and 5% significance level, the

sample size becomes 341 SME owners. But at last only 272 workable questionnaires were distributed and analysis of this study is made based on these responses. The instruments used for this study were adapted from the research instrument used by Saleh, A. S., Caputi, P. & Harvie, C., (2008). The instrument's reliability was checked by using Cronbach's Alpha, and the result of the analysis shows that the instruments are acceptable (that is, Marketing, 0.712; Management and experience, 0.738; Financial factors, 0.699; Infrastructure factors, 0.759; and Workplace, 0.985).

3. LITERATURE REVIEW

3.1 Factors That Encountered During Business Startup

There have been few studies into the matter of why small businesses fail. The study of Dickey (1994) reveals that small businesses fail, more often than not cash flow is properly managed. When a new business starts or expands; more finance needs to be invested for a while and gives the business owner very little in return. According to Hall (1995), the most well-known reasons for failures are with respect to its skills base are unbalanced; a weak finance function occurs; lack of management skill. Buckley (1998) reported that in the last quarter of the twentieth century, many new SMEs were started and still more are failing every year. The feeling of SMEs is that they utilize poor financial information, respond badly to change, maybe well over trade and allow their gearing too rise to levels that change normal business risks into constant threats.

Kinunda-Rutashobya & Olomi (1999) stated that reasons why businesses fail include bad stock control, dreadful customer and personnel relations, are short of staff training and bad budgeting. Mambula, (2002) reported that smallest business from the 32 SMEs studied in Nigeria failed because of not have of training and lack of acquired foreign capital to purchase machinery and small parts. Other additional barriers consisted poor infrastructure, such as, bad roads, inadequate water supply, shortage of electric supply, and deprived telecommunications systems. Be deficient in of these facilities costs the most firms, higher because they are responsible for getting such facilities at their own expense (Ibid). Van Aardt, et al., (2002) recognized eight main reasons for the failure of small businesses. These reasons are poor managerial skills, bad recordkeeping, poor finance management, and too little effort to market the business, poor planning, pricing practices and human resource management.

According to the study of Macleod, as quoted by Ladzani and van Vuuren (2002) a large number of SMEs fail just before many of them start to operate their business. This is caused by lack of awareness and failing to accurately guess the cost of opening and running one's own business. Ladzani and van Vuuren (2002) emphasize that constraints such as the be deficient in of financial resources, lack of access to markets, need of support services, and low literacy levels should also be addressed.

4. RESULT AND DISCUSSION

4.1 Sources to Startup capital, and work place

As it can be depicted in the table 1, Personal savings and self financial sources account for 55 per cent of entrepreneurs' source startup capital. The second sources of start-up capital appear to be family source and assistance of relatives which account about almost 27.6%. The third and least source of startup capital are loaned from financial institutions. From this it can be concluded that the majority of entrepreneurs depend on their personal and family financial source than from other sources like loans. The table also shows that 54% of the respondents' the amount of capital they invest in start up their business was about Ethiopian Bar 5,000 (250USD). About 40% of the respondents required Ethiopian Br 6000-10,000 to start their business. Therefore, we can conclude that the startup capital is on average not more than around bar 10,000 (500USD).

As it can be observed from the table the work premises they use are predominantly rent house which is about 39% .the entrepreneurs that use their own house amount of 6 %, followed by rent from Kebele (government) a house which is about 4.8% and the others are using family houses. The larger amounts of 46.5 % are using other means like using open air during market days or using containers or just use the roadside and tents temporarily to make micro business.

The workplace is one of the determining elements to start any business. It is obvious that all business around us in our living premises is mostly started not only because the owners are entrepreneurs rather the work place is very suitable to run a business. This may be because the place is near main roads, or it is at the center of the town or the area is much more populated than other areas or other reasons.

Table 1: Sources to Startup capital, and work place (N=272)

| Sources to start up small business | Frequency | %(%) |
|---|------------------|-------------|
| Self | 150 | 55.1 |
| Family | 75 | 27.6 |
| Loan from financial sources | 46 | 16.9 |
| Other | 1 | .4 |
| Startup capital | Frequency | %age |
| 5000 | 147 | 54.0 |
| 6000-10,000 | 110 | 40.4 |
| 11,000-20,000 | 10 | 3.7 |
| More than 20000 | 5 | 1.8 |
| work place | Frequency | %age |
| Own | 16 | 5.9 |
| family house | 11 | 4.0 |
| kebele house (government house) | 13 | 4.8 |
| Rent | 106 | 39.0 |
| Other | 126 | 46.3 |

4.2 The barriers encountered by entrepreneurs during business startup

Small and medium-sized entities (SMEs) play important roles in the economic growth and sustainable development of every nation, (Moore et al., 2008). In Ethiopia, small and micro enterprises (SME) sector is one of largest employment generating sector following agriculture (CSA, 2008). According to the CSA the sector contributes 3.4% of GDP. In spite of the enormous importance of SMEs sector to the national economy with regard to job creation and alleviation of poverty in the country, the sector is facing challenges which will impede its role in the economy (Kebede & Abera, 2014). The following paragraph discusses the major problems SMEs encountered during and at the time of business start up times. The major barriers encountered are broadly categorized into five broad headings.

4.2.1 Marketing factors

As shown in table 2 reveals that 84.2 % of respondents voiced that they lack the ability to diversify their products that can attract customers. 52 % of the respondents replied that they have difficulties to promote their products or services. Respondents also agree about 42 % that they lack ability to forecast the demand. Overall, 52 % of entrepreneurs agree they face marketing problems of making their business. The results are incongruent with scholars such as, Siropolis (1990) who states that the marketing factors that lead to business failure include lack of pricing setting, distribution and diversify their products or services rendered promotion and market links to customers (promotion). He also argued that small businesses fail because they are not prepared to handle increased managerial demands.

Table 2: Marketing factors

| Marketing factors | Disagree | | Neutral | | Agree | |
|---|----------|------|---------|-----|-------|------|
| | F | % | F | % | F | % |
| I lack skill to set price for the product | 181 | 66.5 | 6 | 2.2 | 85 | 31.2 |
| I lack ability to forecast demand | 145 | 53.3 | 14 | 5.1 | 113 | 41.5 |
| It is difficult to me to promote my product | 112 | 41.2 | 18 | 6.6 | 142 | 52.2 |
| Lack of product diversity constrain me to specific business | 34 | 11.0 | 8 | 2.9 | 229 | 84.2 |
| Total Marketing factor | 118 | 43 | 12 | 5 | 142 | 52 |

4.2.2 Management and experience:

As it is shown in table 3 the first problem they mentioned is a poor selection of business type where about more than 73 % agree on this issue. Respondents face difficulty choosing the type of business they want to engage in. 41 % of respondents declared that they lack training opportunities that has negative effect on their business development and for startup. About 40 % of the respondents confirmed that they lack management skills and work experience. They also mention poor organization and ineffective communication skills problems. Keasey and Watson (1993) stated that the small business management team often lacks experience and expertise, and these businesses frequently have to depend on a few individuals, often without the support of a formal management or career structure. Murphy (1996) also argued small business owners are displaying limited ability to manage financial resources, and have too much informal, fragmented and subjective managerial control.

Table 3: Management and experience Factors

| | Management and experience Factors | Disagree | | Neutral | | Agree | |
|---|---|----------|------|---------|------|-------|------|
| | | F | % | F | % | F | % |
| 1 | Poor organization and ineffective communication skill create problem to develop my business | 198 | 72.8 | 23 | 8.5 | 51 | 18.7 |
| 2 | I have limited experience to manage my business | 194 | 71.3 | 5 | 1.8 | 73 | 26.8 |
| 3 | Lack of accessible training facilities pose negative effect on my business development | 146 | 53.7 | 14 | 5.1 | 112 | 41.2 |
| 4 | Poor selection of business type create problem to attract customers | 59 | 21.7 | 14 | 5.1 | 199 | 73.1 |
| | Total Management and experience Factors | 150 | 54.8 | 14 | 5.14 | 109 | 40 |

4.2.3 Financial factors

Regardless of its nature, type, size and complexity Finance is the lifeblood of every business. According to the results in Table 4, more than 73% of the respondents agree that they face a shortage of working capital to run their business. The second major challenge mentioned by the entrepreneurs is high collateral required from lending institutions prohibit them from getting the required finance. The third problem out of the financial factors is the unplanned withdrawal of cash for personal use. This drains the amount of working capital available for business purpose. Respondents agree on this problem amount about 38.6 % High interest rate is also mentioned and the percentage agree on this issue is about 22.4 %.

The findings are incongruent with the result of The Small Business Advisor (1999) which it stated, Costly trial and error, poor financial management can be a serious obstacle when starting a business.

Poor understanding of tax, VAT, and bookkeeping, as well as difficulties in obtaining capital and the absence of guaranteed income also present serious problems in start-up businesses. Keasey and Watson (1993) also argued there is a need to understand how banks or financial institutions offer finance and how investors decide to invest in new ventures when the information they have is highly imperfect and incomplete. Another research finding, Baltic Sea Region, (2004) argued that most small businesses suffer from a shortage of capital that mainly reflects defecting in the supply of finance available to them through the market and in the methods of financing used. There are a number of reasons why financial markets do not work perfectly as far as small firms are concerned.

Table 4: Financial factors

| | Financial factors | Disagree | | Neutral | | Agree | |
|---|--|----------|------|---------|------|-------|------|
| | | F | % | F | % | F | % |
| 1 | Shortage of working capital constrain to run my business as planned | 53 | 19.5 | 19 | 7.0 | 200 | 73.5 |
| 2 | High collateral requirement from lending institutions make me unable to get the required finance | 31 | 11.4 | 50 | 18.4 | 191 | 70.2 |
| 3 | High interest rate charged by lending institutions make me unable to get the required finance | 158 | 58 | 53 | 19.5 | 61 | 22.4 |
| 4 | Unplanned withdrawal of cash for personal use drain cash for working capital | 154 | 56.7 | 13 | 4.8 | 105 | 38.6 |
| | Total | 99 | 36 | 34 | 13 | 139 | 51 |

4.2.4 Infrastructure factors

Depending on the nature of business, service or manufacturing the electric power is vitally important to operate their business successfully. According to the results in table 5, 46.7 % of the respondents reply they get a power interruption problem which makes serving customers difficult. Forty one percent of the respondents reply the insufficient and interrupted water supply adversely affects to run their business as expected. The Table 5 also shows that more than 46 % of the respondents agree that there are inadequate working premises to access and serve the customers, while about 42 %.

Pickle and Abrahamson (1990) argue that it is not unusual for a small business owner to select a location based primarily on convenience or cost. A location may be chosen because of the availability of a vacant building, proximity to the owner's residence or low rent. One of the reasons why small businesses fail is because they select a site for their business without first making a thorough analysis of the overall location's potential for the business's survival and growth. According to Siropolis (1990), the importance of location is determined by the type of the business, proximity of the business to its customers, i.e. must customers travel to the business or must the business owner travel to the customers. Other factors to be considered are whether the business offers a special product or service with little direct competition, and whether convenience is the key selling point in what the business offers to customers. According to Longenecker et al. (2003), the importance of the location decision is underscored by the costs and the impracticality of pulling up stakes and moving an established business if the decision on the location proves to be wrong. Based on this, if the choice of location is particularly poor, the business may never be able to get off the ground, even with adequate financing and superior managerial ability. In the article by All Business: Champions of Small Business (2004), to consider factors such as traffic (how many potential customers pass the business during the course of a day).

Table 5: Infrastructure factors

| | Infrastructure factors | Disagree | | Neutral | | Agree | |
|---|---|----------|------|---------|-----|-------|------|
| | | F | % | F | % | F | % |
| 1 | Power interruptions create problem to continuously serve customers | 140 | 51.5 | 5 | 1.8 | 127 | 46.7 |
| 2 | Insufficient and interrupted water supply affect to run my business as expected | 148 | 54.4 | 11 | 4.0 | 113 | 41.1 |
| | Total Infrastructure | 144 | 53 | 8 | 3 | 120 | 44 |

In general, as it is revealed in Table 6, the five categories of challenges that encountered in micro and small business start up are summarized in the following table 6 according to the rank given by the respondents. The first challenge is marketing problem which accounts 52 %; the second challenge is finance related problems (51%) and the third challenge as explained by them is an infrastructure problem mainly electric power and water. Workplace related problems are the fourth 43% and the last are management and experience problems.

Table 6: Summary of challenges encountered during business startup

| Rank | | Disagree | | Neutral | | Agree | |
|-----------------|---------------------------|----------|----|---------|----|-------|----|
| | | F | % | F | % | F | % |
| 1 st | Marketing factor | 118 | 43 | 12 | 5 | 142 | 52 |
| 2 nd | Finance | 99 | 36 | 34 | 13 | 139 | 51 |
| 3 rd | Infrastructure | 144 | 53 | 8 | 3 | 120 | 44 |
| 4 th | Work place | 149 | 55 | 5 | 2 | 118 | 43 |
| 5 th | Management and experience | 149 | 55 | 14 | 5 | 109 | 40 |

5. CONCLUSION

Small and medium-sized entities (SMEs) play important roles in the economic growth and sustainable development of every nation. The role of Micro and Small Enterprises (MSEs) in employment and income generation is increasingly recognized for the unemployed people and has become a major playing field for policymakers and donors with dual objectives of enhancing growth and alleviating poverty. Creating a new business is a process fraught with difficulty and failure and many businesses fail in the first twelve months of trading. Potential new business

Owners may not know how to establish or run a new venture when they conceive their business idea. In fact, it appears that the majority of those starting-up a new enterprise often have only vague ideas of how they are going to organize the business formation and its subsequent management.

Personal savings and family source and assistance of relatives are the major sources of finance to start up Capital. The majority of them had startup capital of about Ethiopian Birr 5,000 (250USD) and more than 90 % of them use is predominantly rent house and other means like using open air during market days or using containers or just use roadside and tents temporarily to make micro business. Challenge is marketing problem which accounts, finance related problem and infrastructure problem mainly electric power and water.

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