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DOCTORAL THESIS

The Relationship between Saving and Micro Credit Program and Small Businesses in Eritrea: Evidence from Central Zone

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Abstract

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By Fiyori Afeworki Negash

It is universally accepted that Micro Finance Institutions (MFIs) have a significant contribution in supporting Small and Medium Enterprises (SMEs) and buttressing the economy of developing countries. This study has attempted to investigate the challenges that SMEs face in their efforts towards growth in Asmara, Eritrea. This study also attempted to measure the SME's awareness and attitudes towards microfinance. Moreover, the research set out to identify the risks and challenges facing the SMCP, the sole MFI operating in Eritrea. 145 SMEs, were selected and stratified as beneficiaries and non-beneficiaries of MFI. We collected data through questionnaires from 145 small business owners. To assess the risks posed to the SMCP, data was collected from 67 small business owners benefiting from MFI loans. For a fuller picture, data was also collected from the management of the MFI through interview. The findings have consolidated the conventionally accepted merits of MFI while at the same time making certain interesting new findings in the case of Eritrea. Although, there are some research findings that question the contribution of MFIs in alleviating poverty, MFI has overwhelmingly increased the capital of the limited SMEs benefiting from loans. However, the number of female beneficiaries is less than desired. A diversion of loans for other purposes has also been discovered. We additionally found that there is considerable lack of awareness about and positive attitude from the beneficiaries towards MFI. The study found that beneficiaries cite shortage of capital is the main challenge to MFI in the country. Findings also indicate that lack of diversified products offered by the SMCP is a weakness. These problems have caused dissatisfaction among the beneficiaries. Interestingly, the study found that the management of the MFI has divergent opinions on the challenges that their institution faces. The study concludes that there is a need to increase the amount of credit made available on top of a reduction of interest rates. These findings underline the need to ramp up sensitization efforts and to increase access to loans for SMEs by privatizing and proliferating MFIs in Eritrea. Finally, the study recommends that intervention at the government level in revamping the role of MFIs is critical for any progress in the future.

Key words: Eritrea, Small and Micro Enterprises (SMEs), Micro Financial Institutions (MFI), Savings and Micro Credit Program (SMCP), Impact, Awareness, Positive Attitude.

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Chapter 1 Introduction

1.1 Background of the Study

The important role of small business in the development of an economy is a well-founded fact. Small businesses have been the means through which accelerated growth and rapid industrialization have been achieved. However, SMEs continue to face multiple challenges according to a bulk of literature review on the subject. Luckily, Microfinance Institutions (MFIs) can play an important role as they have "evolved as an economic development approach intended to benefit low-income women and men". MFIs are key to helping alleviate those challenges faced by SMEs. As a matter of fact, microfinance is not a charity; it might have started for several reasons like to help poor people but today it's a real business. Microfinance is a way to extend the same rights and similar services to low-income households that are available to everyone else.

Nowadays Microfinance is gaining a general acceptance. It protects people against shocks, and allows the majority of the population to become part of a country's economic activity and can help to build markets. In general Microfinance contributes in Empowering the poor by supporting their income generating activities, ensuring sustainability through loans and paying financial service and fighting poverty by improving economic security and quality of life. However, microfinance is not as widespread as it should be. Most of the people in the world do not have access to financial services. In many countries, the financial sector reaches only a small fraction of the population, with very few people having even something as basic as a bank account.

Governments, public and private financial institutions, private businesses and others are recognizing the value of microfinance for poor individuals and for small- and medium-sized enterprises. The World Bank and the International Monetary Fund have embraced it as part of their strategy for alleviating poverty. The United Nations is making this a key issue in implementing the Monterrey Consensus on Financing for Development. The MFI industry has long viewed its primary role as delivering loans to poor clients.

Some recent researches showed that MFIs don't eradicate poverty. Kestern et al. (2017) found that a positive significant effect of SME finance on investments, firm performance and employment. On the other hand, in their findings poverty reduction efforts are scarcely addressed.

Surely, further research is needed whether this finding is applicable to places other than the place where the researches have been conducted. With Microfinances aiming to serve the poor, Sub Saharan Africa is an important region to consider when reviewing the impact of microfinance. Honohan and Beck (2007) report that enterprises in Sub Saharan Africa complain more about finance than in other regions. Those enterprises report that access to and the cost of finance are major constraints in the operation and growth of their firms than do enterprises in other regions.

For example, in Eritrea MFIs are also needed for reasons other than eradication of poverty. For many years the economy of Eritrea was dependent on Agriculture. With the expansion of the Sahara Desert, the rainy season has been shrinking to only two months and only a few days even in those months. And many Eritreans have been forced to change from agriculture to other means of income out of which small business is one. This hints Eritreans begin small businesses not only for the purpose of eradicating poverty but also to at least maintain the income they used to have from agriculture for their day to day living. Hence small business is still worthy of being encouraged. Putting the general economy of the nation, it can easily be noted that many individuals would never get finances from anywhere other than MFIs. Rena and Tesfay (2007) found that there is a fundamental linkage between

microfinance and poverty eradication in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources. For the resource poor Eritrea, survival often depends on subsistence agriculture and small income generating activities at the home or in the local marketplace. In many instances, microenterprises rather than formal employment create an informal economy that comprises as much as 75 per cent of the national economy. Yet the lack of saving and access to finances creates a state of perpetual scarcity, a poverty cycle that restricts people's potential to improve their livelihoods.

The current condition and general facts of the thesis

Eritrea in Tigrinya (ኤርትራ), officially the State of Eritrea, is a country in the Horn of Africa, with its capital at Asmara. It is bordered by Sudan in the west, Ethiopia in the south, and Djibouti in the southeast. The north eastern and eastern parts of Eritrea have an extensive coastline along the Red Sea. The name *Eritrea* is based on the Greek name for the Red Sea, which was first adopted for Italian Eritrea in 1890.

Eritrea is a multi-ethnic country, with nine recognized ethnic groups in its population of around 6 million. Most residents speak languages from the Afroasiatic family, either of the Ethiopian Semitic languages or Cushitic branches. Among these communities, the Tigrinyas make up about 55% of the population, with the Tigre people constituting around 30% of inhabitants. In addition, there are a number of Nilo-Saharan-speaking Nilotic ethnic minorities. Most people in the territory adhere to Christianity or Islam.

In the early 1950s, when Eritrea, despite the local population's aspirations for independence, was awarded to Ethiopia by the United Nations, it possessed a far more sophisticated urban and industrial infrastructure than Ethiopia. Eritrean critics said industrialization in the years since then focused on other parts of Ethiopia. Ethiopia nationalized Eritrea's 42 largest factories and systematically dismantled the Eritrean industrial sector during the protracted civil war. By the time of its independence from Ethiopia in 1991, Eritrea's economy had been destroyed by war and was dependent on income from ports and its small agricultural base. Like the economies of many African nations, Eritrean economy is largely based on agriculture.

Eritrea a young country was liberated from Ethiopia in 1991 after a bitter 30-year armed struggle and a referendum for independence in 1993. Even though it had faced the economic problems of a small, desperately poor country, the country started a new era of development in all aspects of life and it's during this time that the country's economy showed marked progress, specifically from 1993 to 1998.

Suddenly a devastating war broke out between Eritrea and Ethiopia due to border conflict, which lasted from 1998 to 2000. This war halted all bilateral trade, severely reducing port activity and hurt Eritrea's income and economy. This destructive war was followed by a tenuous no war-no peace situation which had a negative effect on the Eritrean economy. The economic growth went down to the ground and many families remain poor due to this political and economic unrest. Since the war ended, the government has maintained a firm grip on the economy, expanding the use of the military and party-owned businesses to complete Eritrea's development agenda. Erratic rainfall and the delayed demobilization of agriculturalists from the military kept cereal production well below normal, holding down growth in 2002. Eritrea's economic future depends upon its ability to master social problems such as illiteracy, unemployment, and low skills, and to open its economy to private enterprise so the diaspora's money and expertise can foster economic growth. *"Eritrea Economy GDP Currency Exports" Retrieved 11 June 2015.*

Against this backdrop, many individuals have tried their best to manage their livelihoods by engaging in different activities, such as by starting small businesses. To start a business is not an easy task in terms of finance and other related factors in developing countries like Eritrea. Many individuals

faced difficulties to start and those who started were challenged to survive. The SMCP was established in 1996 to help small business owners who do not have an access to banks and other financial institutions. The SMCP's mission is to foster small-scale business activities and thereby improve the livelihood of the beneficiaries and the economy at large. Microfinance allows people to safely take on reasonable small business loans in a manner that is consistent with ethical lending practices. Although they exist all around the world, the majority of microfinancing operations occur in developing nations. SMCP targets any citizen that has limited or no access to credit from a formal financial institution, provided they agree to comply with the required terms of credit.

Since the 1990s, Microfinance has gained considerable attention globally as a strategy to reduce poverty by promoting micro and small enterprises development (Berhane and Gardebroek, 2011). It is something that really brings the world together to cooperate for a better and sustainable future. According to Cooper (2012) Microfinance services had a strong positive impact on the growth of SMEs. And also, Akoto-Sampong (2011) finds that access to microcredit has an impact on the growth of small businesses and that people who had access to credit were able to increase their sales.

Providing funds to emerging micro and small scale enterprises has been the engine of growth. Sharma and Deshmukh (2013) studied about MFIs facilities and the awareness of people about MFIs. Even though MFIs are a solution to many small businesses, they are not without problems. Most MFIs face several challenges and risks when dealing with small businesses. According to various studies on the issue of challenges faced by MFIs, the main ones can be identified as: shortage of capital, lack of governmental support, and limited capacity. At the same time, MFIs face risks in providing loans to small businesses. The most prevalent risks are loan default and diversion of funds.

In Eritrea too, many researchers have focused their studies on the topic of microfinance. SMCP has significant effect on the livelihood of households in the rural areas. Rural livelihoods have the effect of reducing rural-urban migration and relieve the urban area's pressure. Microfinance resources in rural areas promote development and socio-economic justice in Eritrea and other developing countries according to Habte et al. (2017). Asgedom and Muturi (2014) focused on the repayment performance of the SMCP loans in Eritrea.

However, in the course of reviewing previous literature, it has been found that the gap is far wider than previously conceived. Researchers have tended to focus their studies on the limited MFI activities being undertaken, particularly the beneficiaries. It cannot be maintained that socio-economic justice and development are being promoted by MFIs Habte et al. (2017) while the majority of SMEs remain non-beneficiaries. Also, narrow research perspectives on the characteristics and behaviours of the beneficiaries or groups of beneficiaries fail to provide a fuller picture of the real situation (Asgedom and Muturi, 2014; Lensink and Mehrteab, 2003).

This thesis, therefore, attempted to fill a gap in research on the relationship of small business and MFIs in Eritrea. This gap pertained to the impact of SMCP in the growth of small businesses, levels of awareness and the attitudes of SMEs towards MFIs and to address issues of risks, challenges and capital of SMCP through assessment of data collected from small business owners, both beneficiaries and non-beneficiaries, as well as the SMCP management.

1.1.1 Importance/Significance of the Research

The ultimate purpose of the thesis is to study the relationship between SMCP and small businesses and help them succeed and grow by creating awareness and recognition. It will empower business owners and the society at large by tackling the lack of transparency and absence of research conducted by academicians and other individuals.

Raising the awareness and understanding among Eritrean small businesses on how to tap into the power of microfinance to grow their businesses, create jobs, and support economic recovery is the major importance of this research. This research is significant because it will:

❖ Make small business owners aware about the existence of SMCP, and its services.

This entails bringing both the existence of microfinance institution(s), and their importance to the attention of those who are launching and/or running small business. According to previous research, many of the small business owners and those who wanted to launch new small businesses either did not know whether there was a financial institution to help them or they did not properly understand what they can potentially benefit from such financial institutions.

❖ Identify the limitations of small business owners in benefiting from SMCP.

Identifying the limitations of the small business owners on how to avail themselves to access to and gain from such financial institutions. According to literature, even those who knew and understood still failed to adapt their business strategies to the prerequisites of the financial institutions. Every financial institution has its own set of regulations that every small business owner should fulfill in order to gain access to the institution's grace. Unfortunately, only few understand the meaning and significance of these sets of rules. Many however are either ignorant of them or perceive them negatively. Therefore, there is a serious need to fill that gap that both the financial institution and the small business owners might function and benefit to the maximum respectively.

❖ Help small business owners to develop the necessary business skills, including managerial, bookkeeping and accounting skills, which can also help them in properly utilizing loans from SMCP.

Helping small business owners to develop the necessary business skills. Another very critical issue is that the small business owners' ambition to launch and run a small business is far greater than their managerial skill and business ethics. For this, the likelihood of the business to fail is very high. This in effect, compels the financial institutions to act reluctantly. This would naturally happen because the financial institutions do not want to lend money to an entrepreneur with less chance of making a successful business.

Previous studies were focused on the activities of SMCP in relation to beneficiaries but this thesis discovered awareness about the availability and potential of microloans among small business owners and their challenges. The researcher focused on expanding the opportunities for small businesses to benefit from microloans.

Therefore, the expected results of the thesis and its implications on the society is to:

❖ Identify who and how people can become beneficiaries of MFIs

❖ Galvanize MFI operational strategies; in particular, strengthening cooperation with stakeholders at all levels of the community to ensure wider outreach in the population

❖ Introduce extensive sensitization programs on MFI activities and their benefits

❖ Co-opt successful beneficiaries in the sensitization program; sharing best practices

❖ Give suggestion to the government on why and how private MFIs should be expanded

❖ Creating future growth by expanding network of microfinance institution partners.

1.1.2 Statement of the Problem

Eritrea consists of mainly poor subsistence farmers. Increasing desertification coupled with unsustainable farming practices have compelled a not insignificant segment of the population to shift to small-scale commercial activities. These small businesses suffer from a lack of financing both in the launching phase as well as in their daily operations.

The Saving and Micro Credit Program (SMCP) established in 1996 is the sole Microfinance

Institution (MFI) in Eritrea. Studying about SMCP in Eritrea is one of the most interesting topics.

Important questions to be raised and discussed were: How does the SMCP accomplish its goal? How applicable and helpful is it in solving the existing problem of small businesses? Investigating the major challenges of small businesses and assessing how SMCP influenced the growth of small businesses through loan provision, assessing the level of awareness and the attitude of small businesses towards SMCP and discovering the challenges of the SMCP faces and their future plan are core problems raised in this research.

Therefore, the thesis intends to address and answer the following research questions:

1. What is the effect of the SMCP on growth and development of small business in Eritrea?
2. What are the difficulties of small businesses face in launching and financing and their level of awareness towards SMCP in Eritrea?
3. What are the risks and challenges of SMCP in Eritrea?

1.1.3 General Objectives of the Thesis

The main aim of the thesis is to study the relationship between SMCP and small businesses so as to build a Networking Platform by opening a consultancy office, which will build a sound working environment between them. Networking is important especially in a country like Eritrea where there is almost no internet access. Networking is the key to finding business and it will serve to facilitate relationships between MFI and small businesses, which often need professional services but are not willing or unable to hire full-time employees to meet the need. A consultancy is a full-time firm that specializes in facilitating relationships between businesses and financial institutions and other stakeholders.

The ultimate goal is therefore, to formulate policy recommendations that would enhance microfinancing and to launch a consultancy office for positive performance of small businesses.

1.1.4 Specific Objectives of this Thesis

- ✓ To find out the impact of SMCP in the growth and development of small businesses
- ✓ To investigate the challenges that SMEs face in starting and running their businesses.
- ✓ To study what is the level of awareness and attitude of the non-beneficiaries towards SMCP
- ✓ To assess the challenges and risks MFIs face in providing loans to small businesses.

1.2 Literature Review

The idea of creating Micro Finance Institution (MFIs) is to provide an easy accessibility of SMEs to finance/fund particularly those which cannot access formal bank loans. Microfinance banks serve as a means to empower the poor and provide valuable tools to assist the economic development process. The promotion of micro enterprises in developing countries is justified because of their abilities to foster economic development. Microfinance institutions target the poor who are considered risky but the repayment rate turns to be positive as compared with the regular commercial banks (Zeller and Sharma, 1998). The main objective of micro credit is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions. Access to finance is only key to SMEs growth globally. But provision of micro-credit without follow-up on the use of credit is like giving a child wheat flour to bake when he/she does not know how to bake. The literature chosen are those that are related with the area of this study, i.e., the role of Microfinance towards small

business.

1.2.1 The impact of Microfinance Institution

Impact of microfinance in Asia

Grameen Bank, a brain child of professor Mohammed Yunus, was started by the Bangladesh government in 1983 as a formal bank specializing in micro-credit where lending is done without the requirement of collateral. A lesson to be learnt from the emerging economies by Kaburi et al. (2013) an overview of the impact of microfinance in Bangladesh and Malaysia is as follows:

The studies done so far in Bangladesh show that living standards of the people has greatly improved through diversification and strengthening of their salaries, improved their security, increased their self-respect and given them independence. The poor have been able to undertake diversified economic activities which generate flow of income throughout the year. Micro-credit borrowers can now depend substantially on their own property to meet their financial obligations without depending on borrowing from expensive money lenders with unfriendly borrowing conditions like high interest rates and the requirement for the collateral. Micro-credit in Bangladesh has raised self-respect and empowered borrowers as well as raised their social standing and participation in activities like building community roads, running health programs and community schools.

In 2006 the Malaysian government gave a colossal sum of money to local financial institutions offering micro-credit to carry out micro-credit programs. The aim of microfinance institutions is giving loans to finance income generating activities to the poor households and eventually move out from the poverty group. A big percentage of the microfinance comes from the government with no interest for borrowers to undertake income generating projects. The advancing of loans follows Grameen Bank model where borrowers form groups who guarantee themselves. Malaysia has reached 80% of the targeted poor households. The government carries out screening of the poor before the loans are advanced. The loans are advanced through a special delivery system, no collateral, no legal action and no guarantors other than members of the group. What is striking is that the loans are delivered to the poor in the village. Besides, loans being given to the poor for income generating activities, there is close supervision by fields' staff at designated centers and business premises.

According to Hossain and Wadood (2020), the urban microfinance in Bangladesh has a statistically significant positive impact on some income/expenditure variables such as savings, educational expenditure, and transportation expenditure, but not with regards to all the income and expenditure variables. The probability of changing occupations of the microfinance borrowers is statistically significantly higher compared to the case of the non-microfinance borrowers. Microfinance also improved housing, utility usages, water and sanitation of the borrowers compared to the case of the non-borrowers. They also convey their encouraging message to the global microfinance institutions (MFIs) to expand their activities among the urban slum dwellers to obtain positive changes in the livelihood strategies of them. A study conducted by World Bank in 1999 showed that income of the poor had increased by 97-93% of the borrowers. Despite the merits of MFI, some researchers like Roodman and Morduch (2009) believed that reviewed studies on microcredit in Bangladesh and conclude that 30 years in to the MFI movement there is little solid evidence that it imoproves the lives of the poor clients in measurable ways.

Felix and Belo (2019) examines the impact of microcredit on poverty reduction, controlling for income and its distribution, employment, inflation rate and education, in the case of 11 developing countries in south-east Asia (Bangladesh, Cambodia, EastTimor, Indonesia, Malaysia, Myanmar, Nepal, Pakistan, Philippines, Thailand and Sri Lanka). The results indicate that microcredit reduces poverty

when it is measured by the head count index, poverty gap and squared poverty gap, as well as employment and education reducing poverty. They give their implications on governments of these countries to pursue policies that improve the granting of microcredit, and reminded not to forget the specificities of the populations they are addressing (against the contrary impact, already proven, of the level of inequality in reducing the level of poverty). They also believed that the governments should promote economic and financial development and growth policies, in so far as the latter (when controlling inequality levels)are expected to reduce the level of poverty. They believe that such type of policy will lead to greater access to a type of funding designed for their specificities and needs, allowing them to start and continue with their micro businesses and increase their level of income and financial stability. In addition, they believed that, it will lead to better levels of education and training, which contributes to better levels of employment, but also to the provision of skilled labour for improved SMEs.

And also, Noreen et al. (2011) found that MFI have a positive impact on the level of children, lead to improve housing conditions, increase consumption of the food items and increase household expenditure in Pakistan.

Impact of microfinance in Africa

Akoto-Sampong (2011) in Ghana finds that access to microcredit has an impact on the growth of small businesses and that people who had access to credit were able to increase their sales. However, beneficiaries of micro credit did not use it only for the business but on other things such as payment of school fees, wages and salaries of workers etc. The impulse of this is that, the beneficiary will have difficulty in paying back the loan; and it was established that gender was a factor that determined access to credit because the numbers were skewed towards women. The study also confirmed that most of the people who had access to credit were sole proprietors whose economic activities were that of trading but age was not a factor in considering one for credit. Quaye (2011) also reveals MFIs in Ghana have contributed enormously to the growth of SME sector through several activities like greater access to credit, enhanced saving habit, business, financial and managerial training, and general effects i.e., positive effect. SMEs face challenges in accessing credit like inability to provide collateral and high interest rates as well as MFIs have challenges, they face in granting credit like: problem of repayment of loans, lack of collateral security, poor records keeping, lack of transparency in the business accounts and related business information and lack of proper documentation of business registration and a permanent business address from the side of SMEs. Sometimes SME owners misuse the loan they got from MFI, at this time of misappropriation of the loans. Proper monitoring of client's business, thorough analysis of client's business information and strict assessment of client's creditworthiness before granting loan facilities should be provided by MFI.

Kenya witnessed emergence of NGOs, microfinance agencies in the 1990s using Grameen Bank group lending model and Savings of the members become security. Initially the pioneer microfinance was concerned with lending to existing enterprises and not starters just because of lack of capacity to train and provide technical assistance. A study by Mbithe (2010) shows among the financing offered by MFIs in Kenya, provision of suitable loan products to SMEs, follow up programs for the loans provided and favourable interest to open gates of opportunity for them to grow and expand. In all the assertions gauging the level of financial literacy of SMEs and the provision of the skills by MFIs, poor financial management skills among SMEs are a major obstacle towards their growth and development. Majority of them are unable to document their business operations and perform basic accounting. From the response given by SMEs the provision of the skills by MFIs has helped them manage their finances but not provided to the satisfactory to help most of the SMEs grow and develop. Based on the findings, the study concludes that the growth in sales is due to changes in microcredit, micro insurance and training provided by MFIs.

Nahamya et al. (2013) shows as all developing countries a considerable amount of multi and bilateral aid has been channeled into microfinance programs in Uganda with varying degrees of success. The SMEs sub-sector has realized tremendous growth in terms of employment, income and business stock size. The sub-sector has therefore attracted great attention of financial service providers to extend a range of financial offer to the poor. The findings indicate that although the MFIs have performed below a set standard on average due to some industry wide challenges, they have had a significant impact in linking SMEs and the poor to sources of credit and contributed to their growth in terms of growth of business capital and stock accumulation.

All the review agrees with the findings of Cooper (2012) that microfinance services had a strong positive impact on the growth of SMEs.

1.2.2 Awareness About MFIs

If potential customers are not familiar with MFI then they cannot consider it when they need a loan or want to save money. Several studies have found that awareness about MFIs and their activities stems from secondary sources rather than marketing initiatives taken by the MFIs themselves. For instance, according to Ahuja and Batra (2017) the awareness level about micro finance in a sample population from Delhi was 83.5%. However, the study also shows that poor people of Delhi have awareness about micro finance from various sources; 30.5% of the sample people were aware about micro finance from their relatives, friends and neighbours, 7.5% people from advertisements in radio, TV and newspapers, and 21.5% from other sources. Comparably, 16% were made aware of MFI activities through bank representatives. This only highlights the urgent need for the MFIs to spread financial literacy among the poor in different areas. They should establish direct communication with the people and this can be done by organizing awareness campaigns to make the people aware of the benefits of the services offered.

According to The Chartered Institute of Marketing (1926), Marketing is defined as “the management process that identifies, anticipates and satisfies customer requirements profitably.” Marketing is an organizational function and set a process for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and the stakeholders (American Marketing Association 2006). Private-sector marketing practices can significantly increase the rate at which organizations acquire new customers and reduce the number of customers they lose each year. The most important function of marketing in microfinance is in creating a customer-centric culture that strengthens the ties between the organization and the customer in numerous ways. Marketing helps organizations grow their customer base as they expand into new markets and work with new customer segments. Marketing also helps organizations achieve their social missions by making sure low-income clients are aware of the services available. In general marketing is intended to facilitate an exchange relationship between companies and customers. Marketers must communicate in order to inform, persuade and remind their potential customers (Kimmel 2010).

Microfinance allows people to safely take on reasonable small business loans in a manner that is consistent with ethical lending practices. Although they exist all around the world, the majority of microfinancing operations occur in developing nations. Micro lending starts in small villages where family and friends get together in money sharing groups. These have their own names. For example, in West Africa, they were called ‘‘tontines’’, in Bolivia, ‘‘pasanaku’’, in Latin America, ‘‘tandas,’’ in Africa and the Caribbean, ‘‘Susu’’ and in Eritrea, ‘‘Eukub.’’ While the concept has been used globally for centuries, The 2006 Nobel Prize winner Dr. Muhammad Yunus, the founder of the modern microfinance, has helped to push the industry further into the spotlight.

Ashamu (2014) noted that the operations of MFIs have grown in the recent years in Nigeria. Providing funds to emerging micro and small scale enterprises has been the engine of growth. In spite of challenges of different kinds regarding policy implementation framework and an urgent need for approval, the number of MFI branches and their employees increased five and ten folds respectively, whereas their asset base and clients increased six and sixty seven folds respectively. Growth is defined in relation to changes in micro credit, and training provided by MFIs assures that microfinance services had a strong positive impact on the growth of SMEs. The research was based on two hypotheses, namely whether there is a difference between beneficiaries and non-beneficiaries and also the effect of microfinance on poverty alleviation. Gulima (2016) added that training has a positive impact on quality of operators' work, working speed, productivity, motivation, and job satisfaction. However, still majority of the respondents were not satisfied with the available trainings. He advised that in order to create extra job opportunities using small capital investment, the operators should be provided continuously with need driven, gap filling and problem-solving capacity building trainings.

Mewl, which is equivalent to Bangladesh's Grameen Bank, was started six years after Eritrean independence, in 1996. At the beginning its purpose was to help interested Diaspora returnees, War veterans and women to launch their own businesses and also to help rebuild Eritrea's war-devastated infrastructure. Eritrean microfinance is called SMCP (Mehrteab 2005). The main aim of the SMCP or Mewl is to provide financial services to the vulnerable groups in both rural and urban areas of the country who have no access to commercial banks. A corollary to this would be the promotion of the private sector by encouraging the development and expansion of small business, assisting individuals to increase their income generating ability and to improve their earning and the prosperity of their communities and the nation as a whole.

To achieve its objectives SMCP has three operational strategies. The first strategy is to provide access to saving and credit to individuals. The second is to strengthen community representative structures, from village to higher levels, and to involve communities in the development and sustainability of the program. Lastly, to establish a legal, regulatory and judicial framework for the microfinance sector of Eritrea so that SMCP can be a sustainable autonomous financial institution. SMCP targets any citizen that has limited or no access to credit from a formal financial institution, provided they agree to comply with the required terms of credit. SMCP is grassroots-oriented; it is a group-based lending program that substitutes collateral with joint liability principles. Small business firms constitute the bulk of business activities in the country. Thus, it is no wonder that securing the well-being of these small business firms and financing them would be of great interest.

In Eritrea too, many researchers have focused their studies on the topic of microfinance. SMCP has a significant effect on the livelihood of households in the rural areas. Rural livelihoods have the effect of reducing rural-urban migration and relieves the urban area's pressure. Micro financial resources in rural areas promote development and socio-economic justice in Eritrea and other developing countries according to (Habte et al. 2017).

Asgedom and Muturi (2014) focused on the repayment performance of the SMCP loans in Eritrea. They found that there is no significant relationship between the socio-economic factors and the repayment performance. But in general there is a high level of repayment performance. Lensink and Mehrteab (2003) addressed Risk behavior and Group formation in Microcredit groups in Eritrea. And they find evidence that borrowers in large groups will take more risk than borrowers in smaller groups.

Yet, for SMEs to identify potential suppliers of financial services, there must be an information flow to small business owners. Information asymmetries are actually concerned with the two players in the financial market. Given two projects with equal expected value, the lender prefers the safest one

and the borrower the riskiest. This is because the borrowers know more about their business and find it easy to hide the true nature of their project to exploit the lender's lack of information.

Information asymmetries in finance markets should be minimized to increase market transparency, encourage greater investor participation and reduce financing costs for SMEs. Information infrastructures for credit risk assessment should aim to support an accurate evaluation of the risk in SME financing. To the extent possible and appropriate, credit risk information should be standardized and made accessible to relevant market participants and policy makers to foster both debt and non-debt SME financing instruments. Accessibility of this information at the international level should be supported to foster SMEs' cross-border activities and participation in global value chains (Vuković, 2015).

Sharma and Deshmukh (2013) studied MFIs facilities and the awareness of people about MFIs. Poor married women are the target consumers. Two hypotheses underpinned the data analysis of the research. First, Urban Poor people are aware of the concept of micro finance, and the second is that People of Nagpur city are Aware about various schemes under micro finance. The analysis yielded the following result.

They provide loans during their starting or existing business, for the purchase of commercial vehicles and personal two wheelers. In the study most of the poor people of Nagapur city are aware about micro saving schemes. Out of 552 respondents 473 respondents, which is 90.6% stated that they were aware about microfinance. Regarding the awareness about micro-credit, insurance, saving and employment schemes, 17.2%, 9.2%, 55% and 18.6% of the respondents have an awareness about the mentioned schemes respectively. The high level of awareness has been proved in the paper.

Most of the research on Eritrea focused on the roles and activities of Microfinance Institutions and their impact on small businesses. To mention some:

- Asgedom and Muturi (2014) focused on the repayment performance of the SMCP loans in Eritrea.
- Lensink and Mehrteab (2003) addressed Risk behavior and Group formation in Microcredit groups in Eritrea.
- Habte et al. (2017) studied the SMCP effect on the livelihood of households in the rural areas of Eritrea.

None of them has attempted to study the awareness of small business owners towards SMCP in Eritrea. Filling this gap is the ultimate purpose of this thesis.

1.2.3 Challenges of Microfinance

Since the 1990s, Microfinance has gained considerable attention globally as a strategy to reduce poverty by promoting micro and small enterprises development (Berhane and Gardebroek, 2011). It is something that really brings the world together to cooperate for a better and sustainable future.

Even though MFIs are a solution to many small businesses, they are not without problems. Most MFIs face several challenges and risks when dealing with small businesses. According to various studies on the issue of challenges faced by MFIs, the main ones can be identified as: shortage of capital, lack of governmental support, and limited capacity. At the same time, MFIs face risks in providing loans to small businesses. The most prevalent risks are: loan default and diversion of funds.

Challenges and Risks faced by MFIs

For the last couple of decades, the microfinance sector has been rapidly growing around the world and particularly in developing countries and regions; nonetheless, this progress has been met with challenges and risks in various aspects and forms.

According to Acha (2012), some challenges microfinance banks in Nigeria face are, regular changes in government policies, lack of requisite human capital, infrastructural inadequacies and socio-cultural misconceptions. And also, the banks are further inhibited by corruption, frauds and forgeries and poor corporate governance. One of the most recurrent challenges is the high transaction cost. An earlier study conducted in the same country by Asama and Oseki, (2007) highlighted the need for the recruitment of effective and appropriate manpower, addressing the lack of training opportunities and poor conditions of service that led to inefficiency and high level of frauds and forgeries.

In the Middle East, Hussein (2014), found that the challenges to the MFIs sector, among others, were improper regulations, lack of innovative and diversified products, limited management capacity of the borrowers and especially in Oman the preference of the youth for government jobs over SMEs. His study found out that loan repayment default was as result of non-management capacity of borrowers due to inadequate training of borrowers on utilization of loan funds before they received loans and also because of dependency of youth on government jobs. Micro finance is not a magic stick which can suddenly change the socio-economic scenario of the society. But no doubt it is an important tool which can be used to bring about social and economic changes gradually and durably.

Meanwhile, Alemayehu and Lemma (2014), have pointed to clientele factors as the biggest challenges to the performance of MFIs in Ethiopia. These factors are loan diversion to non-business activities, borrowing experience of clients, amount of money invested in income generating activities, factors related to loan repayment, absence of voluntary saving experience, and the business condition of the borrowers. Many other researchers have identified the risk posed by loan default and loan diversion to MFIs. Bichanga and Aseyo (2013) affirm that 64 percent of the clients interviewed in their study indicated that loans advanced to them were diverted to other uses. Borrowers are likely to misuse funds or use it for unprofitable activities therefore increasing chances of default. Borrowers are likely to misuse funds or use it for unprofitable activities therefore increasing chances of default. This can be reduced by actual visits to their premises and keen follow up on their business operations as confirmed by (Warue, 2012), (Kamanza, 2014) and Yegon et al., (2012). Boateng et al. (2015) affirm that Default rate is higher among those who did not receive any training, and they observed that loan given to group has less default rate than to individuals, because group pressure improves repayment rates.

To adequately support small enterprises, MFIs will need to better understand their unique needs and to tailor financial services and build appropriate infrastructure to meet them. Small business loans involve larger amounts and greater complexity, so risk assessment requires thorough analysis, due diligence, and number crunching. Credit rating and scoring tools can help MFIs manage the risk better, though they face a challenge where large samples are not available to construct a model. The MFI will also need to develop specific training for loan officers, moving from a “character only” lending judgment, as used for many micro finance lending decisions, to one that highlights first cash flow and second collateral or guarantor forms of repayment when making a small business lending decision Glisovic and Martinez (2012). In addition, proper utilization of mobility app in order to get essential information about potential borrower and MFI can use analytics insights at a macro and micro level as a marketing tool for increasing customer base (Mersland et al. 2011). At the top level, the government should carry out supervision at the level of disclosure of the MFIs to ensure transparency about the risks involved in the micro-credit portfolios. This will keep a vigil on the performance of staff of various MFIs and their recovery practices. This will also encourage MFIs to abide by a proper code of conduct and work more proficiently (Abuja and Batra 2017).

Sources of Capital

MFIs may generate capital from various sources according to previous studies. Predominantly, the capital seems to emanate from public funds or government agencies. Yet, a considerable amount of money has also been made available to MFIs by other donors/ investors.

Fehr and Hishigsuren (2004) have summarized the sources of capital for MFIs as (1) Donor and government grants and soft loans obtained from multilateral banks (e.g., the World Bank, Inter-American Development Bank alike), government aid agencies (e.g., United States Agency for International Development (USAID), UK Department for International Development (DFID), foundations (e.g., Ford Foundation) and apex organizations (e.g., Women's World Banking, ACCION, FINCA). (2) Savings: Deposits have been a primary source of funds for financial institutions. In most developing countries, especially in South, East and Central Asia, MFIs are not permitted to re-deploy depositor savings until they can meet certain minimum capital requirements mandated by regulatory authorities. (3) Private Sector Capital: Non-Governmental Organizations (NGOs) typically provide capital when they take an ownership position.

Similarly, according to a 2004 survey conducted by the Consultative Group to Assist the Poor (CGAP) and Appui au développement autonome (ADA) on microfinance investors around the world, close to 79 percent of all capital that goes to financing MFIs is dominated by socially motivated public funding consisting of government sponsored agencies such as the international financial institutions (IFIs). The remaining 21 percent is from other private capital sources mainly consisting of the private and institutional investors. Although grants are not included in the above sources of financing for MIFs, it is estimated that bilateral and multilateral donors and private foundations to MIFs contribute approximately $500 million to $1 billion in grants each year (Matu, 2008).

Microfinance in Eritrea

A Saving and Micro-credit Programme (SMCP) is a Microfinance in Eritrea that has been running in Eritrea since 1996. The general objective of the microfinance program is poverty alleviation through promoting micro and small enterprises development. SMCP gives loan to clients who satisfy certain criteria. Thus, by opening opportunity for accessing loans to a large portion of population, SMCP aims to contribute to local and rural development in Eritrea. SMCP has been running six loan product which target the specific purpose of clients' activities. These are Micro-Business Loan (MBL), Small scale agricultural loan (SSAL), Oxen loan (OL), Small business loan (SBL), Irrigated agricultural loan (IAL) and Employee loan (EL). The loan repayment term depends on the loan product and ranges from 6 to 24 months. (SMCP brochure)

In general, there is a scarcity of research on the activities of the SMCP and its impact on SMEs and the economy as a whole. Towards that end, Goto and Negash (2016) conducted a research about how SMCP influenced the growth of small business and the result was that beneficiaries showed growth in their capital after they got loans and have positive attitude towards them. Negash (2021) conducted another research to assess the awareness and attitude of small business owners towards microfinance in Eritrea. The result was somehow unique compared to other related studies of different countries in that there is low awareness and negative attitude from the non-beneficiaries among small business owners. Here we can see that there is severe lack of knowledge about MFIs in Eritrea (Negash, 2021).

This thesis, therefore, will attempt to fill the gaps in the literature on MFIs and their activities in Eritrea by addressing issues such as, risks, challenges, awareness, and capital through an assessment of data collected from SMEs as well as the SMCP management.

Chapter 2 Microfinance and Small Businesses

2.1. Microfinance

2.1.1. Overview of Microfinance

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. It is mostly used in developing economies where SMEs do not have access to other sources of financial assistance. No collateral is required contrary to formal banking practices. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral due to distance. It is due to this that the cost to lend a dollar will be very high and also there is no tangible security for the loan. Microcredit institutions spend billions of dollars fighting poverty by making small loans primarily to female entrepreneurs. Providing banking and other financial services to the poor presents a serious challenge because of poor credit risk. These compounds the problem of being a risk sector for lending. Proponents argue that microcredit mitigates market failures, spurs micro-enterprise growth, and boosts borrowers' well-being.

In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self-confidence and the training of members in that group on financial literacy and management. There are different providers of microfinance services and some of them are: Non-Governmental Organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non-bank financial institutions. The target group of MFIs are self-employed low-income entrepreneurs who are: traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans and blacksmiths.

2.1.2. Methods of Delivering Financial Services by MFIs

Credit Unions

Credit Unions are organizations that are formed on the basis of financial relation of savings and loans between its members. They accumulate savings from its members and provide short-term credit to the needed members. The demand for loans in general exceeds the supply of savings. In most rural areas credit unions are still the solitary source of deposit and credit services, besides the informal financial market. Because credit unions have social as well as commercial objectives, they may have a key role to play in offering pro-poor financial services.

Group Lending (Grameen Model)

Group lending is one of the most novel approaches of group-based lending small amounts of money to a large number of clients who cannot offer collateral. The size of the group can vary, but most groups have between four to eight members. The group self-selects its members before acquiring a loan. Loans are granted to selected member (s) of the group first and then to the rest of the members. Most MFIs require a percentage of the loan that is supposed to be saved in advance, which points out the

ability to make regular payments and serve as collateral. Group members are jointly accountable for the repayment of each other's loans and usually meet weekly to collect repayments. To ensure repayment, peer pressure and joint liability works very well. The entire group will be disqualified and will not be eligible for further loans, even if one member of the group becomes a defaulter. The creditworthiness of the borrower is therefore determined by the members rather than by the MFI.

Individual Lending

Individual lending is a straight forward credit lending model where micro loans are given directly to the borrower. It does not include the formation of groups or generating peer pressures to ensure repayment. The individual model is a part of a larger credit plus program where other socio-economic services such as skill development, education, and other outreach services are provided.

Self-help Groups (SHG)

SHG is common among women in the rural areas who are involved in one income generating activity or another. Making credit available to women through SHGs is a means to empower them. This group is an institution that helps its members sustainably with the necessary inputs to foster their lives. SHG provides its members not only the financial intermediation services but it also provides creating of awareness of health hazards, environmental problems, educating them etc. These SHGs are provided with support, whether financial, technical or other wise to enable them to engage in income generating activities such as; tailoring, bee keeping, hairdressing, weaving etc.

Village Banking

Village Banking are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings. The members are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000). The loans are baked by moral collateral; the promise that the group stands behind each loan (Global Development Research Centre, 2005).

2.2. Small Business

2.2.1. Overview of Small Business

In an economic view Small Business is defined as a firm that has relatively small share of their market place and is managed by owners in a personalized way and not through the medium of a formalized management structure and is independent in the sense of not forming part of a large enterprise.

In a statistical view SMEs is defined as: the size of the small firm sector and its contribution to GDP, employment, exports, the extent to which the small firm sector's economic contribution has changed over time.

A business is small in an industrial country with less than 500 employees and less than 100 employees in developing countries. SMEs in Eritrea are generally defined as firms which have minimum 5 and maximum 25 numbers of employees. This definition is established with the agreement of Ministry of Trade and Industry of Eritrea and United Nations Industrial Development Organization to fit the situation of least developed countries (Ogubazghi and Muturi, 2014).

2.2.2. Challenges of Small Business

Most small business owners don't have enough money saved up. Small business owners are needed to save up at least six months' worth of living expenses along with six months' worth of expenses for their business too. Poor record keeping is also a cause for start-up business failure. In most cases, this is not only due to the low priority attached by new and fresh entrepreneurs, but also a lack of the basic business management and skills. Business interest if not accompanied with business management skills in the end is an obvious business failure. Another common problem during the start-up period is that negative cash flows have been a common characteristic, mostly due to lack of sales, pricing problems, high competition, and most often, operation on a small scale combined with soaring costs of operation. After establishment, a firm faces problems in its operations. Poor market is one of the main problems that a firm face. Power costs are high in East Africa. It has the most expensive electricity on the continent. Therefore, challenges faced by small businesses striving to survive are very high compared to large firms. And last but not least, the lack of accessing credit from formal financial institutions like commercial banks poses a serious bottleneck. Nowadays access to finance represents one of the main challenges for SMEs entrepreneurs (Ramona, 2014).

2.3. Relationship between Microfinance and Growth and Development of SMEs

The purpose of any firm is to make profit and growth. A firm is defined as an administrative organization whose legal entity or frame work may expand in time with the accumulation of physical resources or tangible that are human in nature. The term growth can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements. The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state. The growth of a firm can be determined by supply of capital, labor and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources to the firm. Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augments income levels, increases employment and thereby alleviates poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production.

Microcredit and small and medium enterprise (SME) finance are often pitched as alternative strategies to create employment opportunities in low-income communities. The main objective of microcredit is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions. Insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME's risk-bearing abilities; improve risk coping strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor. MFIs that are financially sustainable with high outreach have a greater livelihood and also a positive impact on SME development because they guarantee sustainable access to credit by the poor.

Some recent research findings pointed out that MFIs in alleviating poverty is still in question. Westover (2008) did not deny the contribution of MFI towards low income clients. However, the question of the effectiveness and impact on the poor of MFI programs is still in question and not free from debate. He stressed that NGO leaders and government policy makers should refrain from

applying MFI approach universally as a means of alleviating poverty. Studies of MFI generally show no or minimal impact from providing microloans. That is the large promises of microfinance solving world poverty were not panning out (Dahal and Nathan, 2020).

Microfinance is seen as a key development tool, and despite the current deepening crisis within the industry, it continues to grow in sub-Saharan Africa. Van Rooyen et al. (2012) in their study, they considered impacts of microcredit on the poor people's income, savings and the outcome on Education and women's empowerment. And concluded the available evidence shows microfinance does harm, as well as good, to the livelihoods of the poor.

MFI has an important role to play in growth and development according to propenents of MFIs. As it helps very poor households to meet basic needs and protection against risk, it associates with household improvements in economic welfare and it helps to empower women by supporting that promotes gender equality. In the word of professor Yunus 2003, He emphasized that "Microfinace is not a miracle cure that can eliminate poverty in one time, but it can reduce poverty for many and end its severity on others, if it combined with other innovative programs that unleash people's potential, microcredit is an essential tool in our research for a poverty-free world."

The Factors that affect SME's access to credit

The type of population to be served and the activities that the target market is active in and also the level or stage in development of the business to be financed is determined by the MFIs. SMEs differ in the level in which they are and the products and services offered to them by the MFIs are towards meeting the demands of the market. SMEs are financed differently and the financing is determined by whether the firm is in the start-up phase or existing one and also whether it is stable, unstable, or growing. The type of activities that the business is involved in is also a determinant and this can be: production, commercial or services activities. Access to finance represents one of the most significant challenges for SMEs' entrepreneurs. To ensure SMEs creation, existence and growth it is vitally important to understand the financing needs of SMEs and entrepreneurs, the main obstacles to finance availability and accessibility in developing countries. (Ramona and Alessandro, 2015)

Start-up or existing SMEs

In identifying the market, MFIs consider whether to focus on already existing entrepreneurs or on potential entrepreneurs seeking for funds to start up a business venture. Working capital is the main hindrance in the development of already existing SMEs and to meet up, they borrow finance mostly from informal financial sources such as: families, friends, suppliers or moneylenders. The finances obtained from these informal financial services have high interest rates and services offered by the formal sector are not offered by these informal financial sources. MFIs see it less risky to work with existing microenterprises because they have a history of success.

Businesses that are financed by MFIs from scratch consider that they will create an impact in the society by alleviating poverty by increasing their level of income. An integrated approach lays down the foundation for start-up businesses to pick up since financial services alone will not help them. They need other services such as skills training and to equip them with all the necessary tools that can hinder them from obtaining loans. Existing businesses with part of their capital being equity is preferred by most MFIs to work with since the level of involvement is high and consequently lower risk.

Chapter 3 The Effect of Micro Finance Institutions in Growth and Development Small Business

3.1. Introduction

3.1.1. Background of the Study

Small businesses are generally regarded as the driving force of economic growth, job creation, and poverty reduction in developing countries. They have been the means through which accelerated growth and rapid industrialization have been achieved. Micro and Small Enterprises have been recognized as socioeconomic and political development catalysts in both developed and developing economies.

Globally, small to medium size enterprises are being hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development. SMEs have become more important in the economic matrixes in recent years across the globe through increased deliberate government policies and legislation aimed at nurturing SMEs as engines of economic growth and employment creation. It is estimated that SMEs constitute over 90 percent of total enterprises in most economies with a high rate of employment growth. They are also a vehicle for increased industrial production and exports.

Available evidence indicates that SMEs played a major role in the growth and development of all leading economies in Asia. The Asian countries such as India, Indonesia, China, Malaysia, Japan, and South Korea also have thriving SMEs sectors contributing between 70-90 percent in employment and an estimated 40 percent contribution to their respective GDPs. Small and medium-sized enterprises account for over 90% of Japanese enterprises, and support the Japanese economy in the manufacturing, commerce, and service industries throughout Japan. In Africa, economic powerhouses such as South Africa, Egypt, Nigeria and Kenya, the SME sector is estimated to contribute over 70% in employment and 40 % contribution to GDP, but contribute less than four percent to export earnings.

There is no doubt that most African countries depend on their Micro, Small and Medium Enterprise in driving their economies forward. However, most of these SMEs receive lukewarm support from their governments. Nevertheless, a few competitive SMEs are thriving and contributing to economic growth, employment creation and local development in combating poverty. For example, World Bank Enterprise Survey (2013), with a survey of 130,000 firms in 135 countries, found out that limited access to finance ranked at the top of the list of obstacles to growth and development of small and medium enterprises. The problem of accessing finance is much worse in the Sub-Sahara Africa Countries which constrained the development and growth of SMEs. The 1976 Economics Nobel Prize winner Milton Friedman quoted, “The poor stay poor not because they are lazy but because they have no access to capital”.

Eritrea is one of the African countries where SMEs is important. Eritrea’s small and medium enterprises (SME) sector holds great potential for generating employment, adapting technology, and creating an export base which is grounded in the country’s true comparative advantage of its ideal Red Sea location, abundant rich natural resources and its traditional history as a trade and business corridor to the country and its hinterland - Horn of Africa with the world.

The concept of micro-financing arose out of the need to provide to the low-income earners who

were left out by formal financial institutions. Micro-finance is generally an umbrella term that refers to the provision of a broad range of services such as deposits, loans, payment services, money transfers and insurance to poor and low-income households and their micro-enterprises. If we ask the key factors influencing small enterprise to become medium hence large enterprises are microfinance. Microfinance is an important tool to promote business development. Development of small business is subjects to access and received adequate finance and lucrative markets. Furthermore, microfinance improves business working capital. More than 10,000 firms in 80 countries, SMEs worldwide on average named financing constraints as the second most severe obstacle to their growth, while large firms on average placed finance only fourth. The practice of micro-credit dates back to as early as 1,700 and can be traced to Irish Loan Fund System which provided small loans to rural poor with no collateral. Over the years, the concept of micro-finance spread to Latin America, then to Asia and later to Africa. More than 7,000 microfinance institutions existed in developing countries with microloans amounting to about 16 million granted to poor borrowers.

Brazil was the pioneer country in Latin America to develop microfinance in the 1970s. Despite the difficulties, microfinance expanded throughout Latin America from 1980s onwards, creating new organizations and ways of working to address the problems in each country.

The formal microfinance began with the establishment of a private bank, Bank Dagang Bali (BDB) in Bali, Indonesia, in 1970 and in South Asia (Bangladesh, Pakistan, India and Nepal), while the informal sector financing can be traced back to the era of Kautilya in the fourth century B.C.E. The modern microfinance took shape after passing of Cooperative Credit Societies Act in 1904.

The modern microfinance movement is closely associated with the work of Dr. Muhammad Yunus, the US-educated Bangladeshi economist and future Nobel Peace Prize recipient in 2006. It was Yunus's work in the village of Jobra and the apparent success of the iconic Grameen Bank he established in 1983, that convinced him very early on that he had found the answer not just to Bangladesh's endemic poverty, but to global poverty in its entirety. Importantly, Yunus took great pains to portray microfinance as a vital way of legitimizing and promoting capitalism in developing countries, essentially 'bringing capitalism down to the poor' (Bateman, 2013). On a regional basis, the Asian programs reported 23.6 million clients at end-2000, of whom 10.5 million were classified as 'poorest.' From this it appears the center of gravity of the world microfinance movement is located in Asia.

Evidence suggests the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries, However, Susu, one of the microfinance schemes in Ghana, is thought to have originated from Nigeria in the early twentieth century. In Nigeria, informal financial institutions play their role and there may be only few Nigerians who are not a member of one or more of them (Seibel, 1970). Then it spread as far as Liberia, Congo and Zaire and later all over the continent. Moreover, Africa lags behind other regions of similar size and structure. Its gross domestic savings averaged 8 percent in the 1980s, while for the same period South East Asia and especially Newly Industrialized Economies (Republic of South Korea, Taiwan, and Singapore) reached respectively 23 and 35 percent. Up to 1998, the achieved average saving rate was far from the target (Calgagovski et al., 1991).

Based on the realization that small business firms are good opportunities to the majority groups of the people and demanded special attention, the ultimate goal of this research was aimed at SMEs in regard with MFI in Eritrea. It is really convincing that encouraging small business firms and proper financing of these firms can set Eritrea free from market monopoly. Micro-finance in Eritrea was introduced in 1994 to solve the problems of SMEs who have no access to formal banking services. Thus, the main focus of this study was to identify MFI activities towards SMEs and their growth in Eritrea.

3.1.2. Research Questions

1) What are the main challenges that SMEs face in starting and running their business in Eritrea?
2) Does microfinance contribute to entrepreneurial activities that can lead to sustainable growth of SMEs in Eritrea?
3) What are the challenges of SMEs in accessing credit?
4) Are credits effectively utilized by SMEs for business growth?
5) What are the main activities and the associated risks of Micro finance in Eritrea?

3.1.3. Research Objectives of the Study

This study has attempted to investigate the challenges that SMEs face in their efforts towards growth, with a particular interest in the role that micro-finance institutions play in the growth of SMEs. In addition to gaining an in-depth understanding of the challenges facing development SMEs, the study focuses on ascertaining a knowledge base on the resources needed for the development of SMEs and in what ways MFIs can contribute to ensure a sustainable growth and development of SMEs in Eritrea as well as setting up necessary model for MFIs.

The objective of this study focuses on how Savings and Microcredit influence financing Small Businesses. Therefore, the Specific Objectives are as follows:

1. To investigate the general challenges that SMEs face in starting and running their businesses.
2. To determine the contribution of MFIs on the entrepreneurial activities that lead to sustainable growth of SMEs in Asmara.
3. To assess the challenges SMEs face in accessing credit.
4. To examine the utilization of credit by SMEs for business growth.
5. To examine the association between age, gender, nature of business, background of the owner, Loan duration, percentage of loan granted, kind of credit, usage of loans for the right purpose, as well as effect and increase in capital gained from the loan.

3.1.4. Significance of the Study

It is worth mentioning that most researchers have found this area of study very important to the development of the socio-economic activities in developing countries like Eritrea.

Small Business is the backbone of the economy of a country. It plays a vital role as a contributor to economic growth and as a source of employment. The government has come to recognize the importance of the small business sectors and has taken numerous steps to support it by providing information, advice, and business planning; helping entrepreneurs find sources of finance; offering ways to improve; by providing continuous training on diverse skills to the employees and the managers; promoting technological innovation and making it easier for small businesses to sell to the government and to foreign markets.

Encouraging entrepreneurs or small business owners is among one of the most treatment of business area in the world. Studying such a topic is of a great interest and some of the significances are:

1. Providing and updating the government, organizations and individuals with necessary information about the problems of launching small business firms. ‘Knowing the problem is knowing

the solution,' thus, possible measures may also be recommended to avoid the identified bottlenecks in establishing small business firms in Eritrea.

2. The findings of the study are going to enable micro finance institutions to better understand their role in the growth of SMEs in Eritrea in order to implement better and effective programs. And it will act as feedback to microfinance institutions that provide financial solutions to SMEs.

3. The study will assist MFIs to adopt the necessary measures and models needed to ensure the desired growth in the SME industry as well. Providing guidance model on how to manage the activities of SMEs in order to control the misappropriation made by them.

4. To make unknowledgeable SME owners and managers aware of the services and products provided by micro finance institutions.

5. The study will serve as a source of reference for other researchers and more importantly, entrepreneurs of SMEs may find it useful in the successful operation of their enterprises as the study will unveil some of the reasons why some SMEs fail. It is also significant for scholars to understand the level of SMEs development in Eritrea which plays a significant role in providing ancillary services to multi-national corporations. Finally, this study contributes to the future development of this area of research, particularly in a developing country like Eritrea.

3.1.5. Statement of the Problem

Small business financing (also referred to as start-up financing) refers to the means by which an aspiring or current business owner obtains money to start a new small business, purchase an existing small business or bring money into an existing small business to finance current or future business activity. One of the main problems in small business is a matter of finance. There are many ways to finance a new or existing business, each of which features its own benefits and limitations. In the wake of the recent financial crisis, the availability of traditional types of small business financing has dramatically decreased. There has been a big problem in financing small business and in recent years even the biggest firms are not exceptions because of the world's financial crises.

In Eritrea, the history of small business has a continuous track of financial affliction resulting from different problems like all small businesses throughout the world. In addition to this, the political instability of Eritrea (i.e., colonialism) had a lion's share in suppressing Eritrean small business firms. Since the Eritrean economy was at its lowest level, there was no availability of financial sources especially for small firms. Owing to these problem and other external factors many individuals were hindered from starting their own business. Over the past 25 years of independence, however, the state of small businesses has not been as bad as the previous decades. Small businesses have been gearing forward as a development vehicle in providing job opportunities to the underprivileged such as women and the poor. Moreover, the government also encourages and provides funds to orphanages and post-war victim children and teenagers who are financially and economically bereft. Yet, there are many problems that have to be addressed. Challenges faced by SMEs from many studies may emanate from financial challenges, management or marketing limits in which many SMEs find themselves in. Small Businesses fail either from being started or at their early stage of operation. On the other hand, Ubom (2003) claims that Micro Finance Institutions offer business solutions to small and medium enterprises by providing savings and credit, payment services, social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Studies indicate that SMEs fail as a result of challenges such as inability to provide quality services, lack of adequate finances and poor management skills. This would sound ironical owing to the view that it is the same problems that microfinance institutions are

strategically focused on addressing. A gap in the reviewed literature exists as far as addressing the effect of micro finance institutions and growth and development of SMEs is concerned.

An informal discussion with entrepreneurs in the SME industry revealed that there is great reliance on credit as a tool for business growth and development. However, most entrepreneurs asserted to the fact that they are faced with the challenge of inadequate capital and this inhibits their growth. Some MFI institutions also believe that credit obtained by entrepreneurs are misappropriated. Another constraint of most SMEs is the lack managerial and business skills. There is the need to build these capacities in addition to financial resources in order to achieve growth.

The study has attempted to establish the effect of microfinance institutions on growth and development of SMEs with focus on Asmara, the capital city of Eritrea.

3.1.6. Current Condition of the Country

Across the globe, economic wellbeing of the people is the priority of any government of any developed nation in general and of any developing country in particular. So is true with the Government of Eritrea. The Government of Eritrea is exerting its full effort to help improve the well-being of the entire population. One way of doing it is through encouraging in launching and running of small business and financing them to cope with the market through the Savings and Micro Credit Program (SMCP). Besides this, nowadays, the government is paying more attention to small business. A good example of this is the conference recently held in January 2013, in Asmara, regarding the enhancement of small business in Eritrea (i.e., to encourage national private investors).

As part of the continuation of such national initiative in fostering small business, it was decided to conduct a study on how microfinance works in Eritrea and their contributions to SMEs during their launching, running and financing their business. The study is highly expected to contribute to and to guide Eritrean business innovators and initiatives: in having the right insight of the government's economic regulation control; in selecting projects that increase the value of the firm; and to have the awareness of the economic environment of a country to enhance their financial position of small firms.

Eritrea is not only geographically small but also economically not advanced. It got its independence in 1991 and is still one of the youngest nations in Africa with a population of approximately 6,000,000 people highly scattered in small towns and semi-cities. The majority of the people living in these places deals mostly in business area are small business undertakers.

There are only few fairly big business organizations owned either by the government or finger-counted individuals and/or organizations yet relatively many small business firms cover up the majority of the business activities of the country. So, no wonder that securing the wellbeing of these small business firms and financing them is a matter of great interest. These days, considerable numbers of small business firms are run by women which is another good side of the area of study. In the country, almost all the formal and informal economies are dominantly driven by women. If there were no small business firms many of these inspiring females would remain unemployed. Besides that, it can be said that several families are managing their daily life relying solely on these firms; nonetheless, the expectation has not been met so far. One notable example is the continuous financial support and encouragement being endowed to the orphanages and war-victims' families in rural and urban places of the country to help them be self-reliant by rehabilitating them through launching and running different small firms such as movable-kiosks, dressmaking, beauty salons, and small distribution depots etc.

Small businesses are mostly owned and operated by individuals who are socially and economically disadvantaged. Assistance and support are available from the government of Eritrea through micro credit companies for community development through loans to businesses for local development, construction, or modernization of buildings; for project servicing in low-income areas with

unemployment or areas that were stricken by natural disasters; or, for projects serving disadvantaged individuals. The only shelter for those small business financing is the Microfinance company. The smallness of loans and savings, the absence of asset-based collateral and the simplicity of operations are the three distinctive characteristics of the financial services provided by MFIs.

The Savings and Micro Credit Program (SMCP) is an MFI operating throughout the State of Eritrea. The majority of the Eritrean population does not have access to the conventional financial institutions basically due to lack of collateral and financial records. Moreover, the Eritrean financial sector is small and underdeveloped offering only a limited range of financial services. SMCP was, therefore, established in 1996 as part of the Eritrean Community Development Fund and it provides savings and micro credit services to the poor section of the population where the conventional financial institutions have failed to serve. The institution enables its beneficiaries to successfully deal with environmental hazards, economic failures as well as personal and family problems.

In Eritrea, there are two microfinance institutions; The Saving and Credit Program (SCP) 1996 and the Southern Zone Saving and Credit Scheme (SZSCS) 1994.

The saving and credit program (SCP): the government of Eritrea, the World Bank (IDA) and loans and grants from donors are the main sources of funds for SCP. The aim of the SCP is to provide financial services to the vulnerable group in the rural and urban areas who have no access to formal banking services. Grassroots-based solidarity groups owning and operating “Village Banks” will form the backbone of the program and charges 16% as a rate of interest. While its immediate objective is to provide access to credit and savings to people who are outside the orbit of the formal banking network, its long-term objective is to strengthen its institutional setting and together with SZSCS, establish the legal, regulatory and judicial framework for the microfinance sector of Eritrea.

The Southern Zone Saving and Credit Scheme (SZSCS) has been launched by the Agency for Co-operation and Research in Development. The main objective of the Scheme is to provide underprivileged people access to credit. In addition, it has the objective of strengthening the institutional capacity of the scheme. The scheme charges an interest rate of 14 % (Lensink et al. 2003).

3.2. Methodology

3.2.1. Study Area

The study area selected for the research work was Asmara the Capital of the Central Region in Eritrea. In Eritrea there are six district Regions.

3.2.2. A Brief Introduction about Asmara

Asmara is located in the Maekel Region near the centre of Eritrea. The population of Asmara is approximately 650,000 and is the largest city in Eritrea. Eritrea’s three official languages are Tigrinya, Arabic, and English. Tigre, Kunama, Afar, and other Cushitic languages are spoken in smaller populations throughout the country. Asmara is the capital city and largest settlement in Eritrea with a population of around 649,000 inhabitants making it the largest city in Eritrea. Although all ethnic groups are represented in the capital, the largest groups are the Tigrinya people (77%) and the Tigre people (15%). In Asmara, the main language is Tigrinya. However, Arabic, Italian and English are also widely spoken and understood.

The city lies at an elevation of 2,325 metres (7,628 feet) above sea level. It lies on north-south trending highlands known as the Eritrean Highlands, an extension of the Ethiopian Highlands. The temperate central portion, where Asmara lies, is situated on a rocky highland plateau, which separates the western lowlands from the eastern coastal plains. The lands that surround Asmara are very fertile, especially those to the south towards the Debub Region of Eritrea. The highlands that Asmara is located in fall away to reveal the eastern lowlands, characterised by the searing heat and humidity of the Eritrean salt pans, lapped by the Red Sea. To the west of the plateau stretches a vast semi-arid hilly terrain continuing all the way towards the border with Sudan through the Gash-Barka Region.

Asmara experiences warm summers and mild winters with subtle temperature changes between the two seasons. July and August are the rainiest months in which it rains a large portion of the annual rainfall within the two-month timeframe. Asmara is praised for its peaceful, crime-free environment, and for being one of the cleanest cities of Africa.

As the capital city and largest settlement of Eritrea, most Eritrean businesses have their headquarters in Asmara. The city was once a factory town. During the colonial period, it was an administrative and commercial centre of Italian East Africa. When the British entered the country in 1941, many businesses were closed down or relocated outside of the city. This trend continued under Ethiopian occupation. Textile clothing, footwear, processed meat, beer, soft drinks, and ceramics are Asmara's major industrial products. The city is a marketplace for agricultural products, and a centre for tanning hides.

The Eritrean economy is largely based on agriculture, which employs 80 percent of the population but contributes little percent to gross domestic product. Agricultural exports include cotton, fruits and vegetables, hides, and meat, but farmers are largely dependent on rain-fed agriculture, and growth in this and other sectors is hampered by lack of a dependable water supply.

Asmara is known for its well-preserved colonial Italian modernist architecture. The city is divided into thirteen districts or administrative areas: Acria, Abbashaul, Edaga Hamus, Arbaete Asmara, Mai Temenai, Paradizo, Sembel, Godaif, Maekel Ketema, Tiravolo, Gejeret, Tsetserat and Gheza Banda. The official currency of Eritrea is the Nakfa. In the city of Asmara there are many SMEs of all kind the poor and rich alike, compared to other cities and they can be a look to the SMEs in other cities.

3.2.3. Study Population

According to Cooper and Schindler (2003), a population is the total collection of elements about which we wish to make some inferences. Mugenda and Mugenda also define a population as the entire group of individuals, events or objects having a common observable characteristic.

The target population for the study comprised all registered small and Medium Scale Enterprises in Asmara. All formal SMEs from the 13 administrative zones of Asmara were selected to be the actual population of the study. According to the Canadian Federation of Independent Business (CFIB) SME is defined as "a firm that is independently owned and operated and not dominant in its field of endeavour." In developing countries, a small firm is a firm that owns five to nineteen employees. A firm that owns three to nine workers is called a small business according to the Eritrea Department of Macro Policy and International Economic Cooperation.

Inclusion Criteria: Private formal companies have been included in the study.

Exclusion Criteria: Governmental companies were not taken in the study.

3.2.4. Study Design

A cross-sectional quantitative design was conducted from July 2016 to August 2016, at Asmara, the capital city of Eritrea.

3.2.5. Sample Size

The number of SMEs included in the study was calculated statistically as follows.

$$n = \frac{Z^2 pq}{E^2} * Non\ responses$$

Where **n** is the sample size
Z (standardized score for 95% confidence level), 1.96
p (expected proportion of the factor under investigation), q=1- p
E (maximum error allowed), 0.05
Non responses, 5%

In this study, p was taken as 0.1 from past studies that had loans from MFI. The sample size using the above prescribed parameters and formula was 138. Increasing sample size when there is non-response and missing data helped to compensate for the resulting loss in precision. To address the unavoidable non-response, only 5% rate is suggested. Therefore, the final non-response compensated sample size calculated was 145.

3.2.6. Data Collection Tools and Sampling Technique

In order to draw the samples randomly, we intended to use stratified random sampling technique. The two strata are beneficiaries and non-beneficiaries of loans from MFIs. The sampling frame for SMEs was taken from the Ministry of Trade and Industry and SMCP in Asmara Eritrea. The number of businesses samples were taken proportionally according to the number of SMEs.

There were 14,300 eligible small businesses in Asmara of which 10.5% (1,500) were beneficiaries of MFIs and 89.5% (12,800) were non-beneficiaries. From the sample size of 145 small businesses, we would have 129 non-beneficiaries and only 16 beneficiaries if we just follow a strict stratified random sampling technique. Only 16 beneficiaries seemed to be too small because it would mean only 1 beneficiary from one district would be included as there are13 administrative districts in Asmara. Having only 1 representative from most of the districts have ultimately made stratified sampling impractical, not only because of the small sample size it would give but also some districts might not be represented if any error would happen. To tackle the issue, therefore, quota sampling technique was used to gather the final sample for the study. In order to obtain the participants, we contacted several businesses from each of the 13 districts in Asmara, with the help of SMCP.

With beneficiaries we conducted it in the MFI's office in a more centralized way, that is the office people will call them from each district and had to come for the interview. But for non-beneficiaries, we have to go to each district and interview them to fill the questionnaire. We approached as many businesses as possible until the quota was reached for each stratum. Accordingly, we obtained 40 (27.6%) beneficiaries and 105 (72.4%) non-beneficiaries to participate in our study.

3.2.7. Measures

Dependent Variable: The increase in capital as a result of the loan from the MFI was used as a dependent variable.
Independent Variables: The main independent variables which were used in the study are age, gender, educational level, nature of business, background of the owner, loan duration, percentage of loan granted, kind of credit and usage of loans for the right purpose.

3.2.8. Data Collection Tools

A pre-designed questionnaire was developed, pretested and distributed to these samples (small firms) that were eligible in the study. To avoid any bias, questionnaires were self-administered by each and every selected candidate to fill the questions themselves.

3.2.9. Data Analysis

Most of the survey variables were categorical and frequency distributions were used to describe variables of interest. Mean and standard deviation were also used to describe the continuous ones. Specifically, two-way tables with a Chi-square distribution were used to assess the associations between socio-economic and other independent variables with the increase in capital as a result of the loans. Fisher's exact tests was employed where table cells had expected counts of less than five. In order to find out the direction and magnitude of relationship, logistic regression was employed taking increase in capital as a result of the loans as dependent variable and various other independent variables. Data was entered and analyzed using PASW (SPSS statistical software version 22). All *p*-values were 2-tailed, and a *p*-value < 0.05 will be considered statistically significant.

3.3. Data Analysis

3.3.1. Findings and Discussions

The data collected for this study indicates that the majority of beneficiaries of Micro Finance Institutions (MFIs) are male (55%) as compared to females (45%). This seems contrary to the paradigm underpinning MFIs, which posits the idea of fighting poverty by making small loans primarily to female entrepreneurs. The study also found that the age of greater majority of beneficiaries was in the range of 46-60 (55%) followed by those in the age group 31-45 (35%). Meanwhile, young adults aged 18-30 were very few comprising 2.5%. This may be attributed to the fact that most of the eligible adults in Eritrea are enlisted in the national service for a prolonged period of time, especially, due to the prolonged military standoff with neighboring Ethiopia.

The study found that 15% of beneficiaries were post-war victims and 2.5% were orphanages, which may be commensurate with the policy behind the establishment of the Small Credit Program in Eritrea (1994). Another 35% of beneficiaries were farmers, while the rest 47.5% were ordinary citizens.

Glancing at the business activities, we find that the majority of beneficiaries were involved in commerce (33%) and services (43%). Manufacturing, which has a high potential to create more

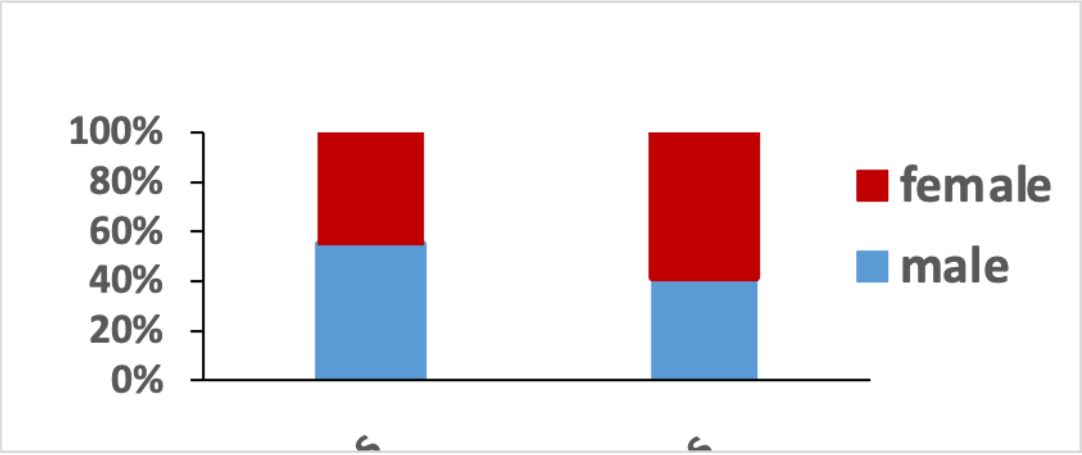

Figure 3.3.1. Gender Distribution, Note: *Data from* Goto and Negash (2016)

Table 3.3.1: Age Distribution of SMEs in Asmara, Eritrea

Years	Beneficiaries	Non-beneficiaries
18-30	2.5%	13.9%
31-45	35.0%	27.5%
46-60	55.0%	41.6%
>60	10.0%	16.8%

Note: *Data from* Goto and Negash (2016)

employment opportunities were lower in proportion at 7%.

On the contrary, the majority of non-beneficiaries of MFI were female (58.4%) as compared to males (41.6%), which indicates that more needs to be done to make credit available to female entrepreneurs for equitable development. When compared with the beneficiaries, the non-beneficiaries were also mostly between the age of 46 and 60 (41.6%), followed by the 31-45 age group (27.7%). The reasons for this phenomenon, of course, do not merit reiteration.

The study also found that the number of SMEs not benefiting from MFI and active in farming was very low at 4%. This is indicative of the need to focus more on increasing SMEs related to the agricultural sector. In that line, the study also found that the majority of non-beneficiaries were active in commerce (64.4%) and services (25.7%). The prevalence of SMEs active in commerce and services, notwithstanding whether they are beneficiaries or non-beneficiaries of MFI, indicates the need for action to make diversity of the types of business activities a criterion for access to credit.

In order to determine the efficacy of MFI in the business operations of SMEs, it is imperative to identify the main challenges that confront these enterprises from the start. All SME owners participating in the study, who constitute beneficiaries and non-beneficiaries of MFI, were queried on the challenges they faced in starting and running their business.

The data collected indicates that 72% of beneficiaries had faced financial challenges in starting or running their business. Meanwhile, 11% of the beneficiaries of MFI faced social challenges, 6% faced business location challenges, while 11% faced challenges related to rules and regulations. It is clear

Table 3.3.2: Socio-economic characteristics of the SME Beneficiaries in Asmara, Eritrea

Socio-economic variable		n (%)
Gender	Male	22 (55.0)
	Female	18 (45.0)
Age Category	18-30	1 (2.5)
	31-45	14 (35.0)
	46-60	21 (52.5)
	Above 60	4 (10.0)
Level of Education	Illiterate	1 (2.5)
	Elementary	8 (20.0)
	Junior and High School	26 (65.0)
	Diploma Level	4 (10.0)
	Degree Level	1 (2.5)
	Above Masters	-
Subject's Background	Farmer	14 (35.0)
	Orphanage	1 (2.5)
	Post-war victim	6 (15.0)
	Ordinary	19 (47.5)
Nature of Business	Manufacturing	3 (7.5)
	Commerce	13 (32.5)
	Service	17 (42.5)
	Others	7 (17.5)

Note: *Data from* Goto and Negash (2016)

that the challenges faced by SMEs are mainly financial in nature. This corroborates the existing literature on the challenges to SMEs. For example, World Bank Enterprise Survey (2013), with a survey of 130,000 firms in 135 countries, found out that limited access to finance ranked at the top of the list of obstacles to growth and development of small and medium enterprises.

Also, 37.5% of SMEs benefiting from MFI indicated that they started business through self-finance compared to 31.3% who commenced with credit from MFI. But, when queried on their means of acquiring capital, 75.5% of the beneficiaries stated that they obtained it from SMCP. This seems like sound evidence on the indispensability of MFI in helping small and micro businesses.

Similarly, non-beneficiaries of MFI were also faced with financial challenges-- a majority of 45% stated that the main challenge to starting and running an SME was financial. Social, business location, regulatory challenges accounted for 5%, 16% and 4% respectively. Another 13% of the respondents stated that they faced no challenges at all. The corpus of literature surveyed in this study has indicated that MFI has had significantly positive impact on SMEs in different parts of the world. The data collected for this study seems to be commensurate with the aforementioned fact.

Out of all the beneficiaries queried, 90% had a positive view of the contribution of MFI to the operation of SME's, while 10% indicated a negative view. At the time of the study, 60% of beneficiaries had been granted 100% or the full amount of the loan they requested, while 20% of the beneficiaries had been granted between 75% and 99% of their loans. Thus, the majority of beneficiaries participating in this study had been granted the greater part of their loans.

Moreover, 70% of beneficiaries stated that they got access to credit in less than two weeks (38% in two weeks; 32% in one week). 18% of beneficiaries took three weeks to access credit, while 13% took

Table 3.3.3: Socio-economic characteristics of the SME Non-beneficiaries in Asmara, Eritrea

Socio-economic variable		n (%)
Gender	Male	42 (41.6)
	Female	59 (58.4)
Age Category	18-30	14 (13.9)
	31-45	28 (27.7)
	46-60	42 (41.6)
	Above 60	17 (16.8)
Level of Education	Illiterate	2 (2.0)
	Elementary	22 (21.8)
	Junior and High School	60 (59.4)
	Diploma Level	9 (8.9)
	Degree Level	6 (5.9)
	Above Masters	2 (2.0)
Subject's Background	Farmer	4 (4.0)
	Orphanage	-
	Post-war victim	13 (12.9)
	Ordinary	84 (83.2)
Nature of Business	Manufacturing	9 (8.9)
	Commerce	65 (64.4)
	Service	26 (25.7)
	Others	1 (1.0)

Note: *Data from* Goto and Negash (2016)

four weeks. The data illustrates that the MFI credit was ready for utilization by the SMEs in less than two weeks for a majority of the beneficiaries.

Also, an overwhelming 95% of all beneficiaries stated that MFI fulfilled their expectations, while the rest (5%) found that the MFI did not meet their expectations. Similarly, 88% of respondents had a positive view on the influence of MFI in the operation of their businesses as compared to 13% who had a negative view. In terms of the challenges faced by SMEs in accessing credit, 45% of beneficiaries were of the view that the interest rates of MFI were high.

To the contrary, 55% of beneficiaries did not think that the interest rates were high. At the same time, 13% of all beneficiaries stated that they had to provide collateral security for credit, while the majority 87% did not provide any collateral. Only 25% of beneficiaries stated that the credit process was cumbersome and had bulky documentations as compared to 75% who had no negative views about the bureaucracy.

At the same time, 73% of beneficiaries stated that they always got the required collateral, while the remaining 27% stated otherwise.

In contrast, 70% of non-beneficiaries had no knowledge about MFI operations at all when compared to 30% who stated otherwise. Also, 99% of non-beneficiaries stated that they never applied for credit. When queried about the contribution of MFI to their enterprises, 77% of non-beneficiaries had negative views while 23% had positive views.

As mentioned above, 99% of non-beneficiaries had never applied for credit; therefore, it is safe to assume that the data is precise as 99% of non-beneficiaries stated that they did not need collateral. However, when asked if they thought that MFI had the potential to improve their business, 55% of

Table 3.3.4: Case-studies of the SME in Asmara, Eritrea

Variables		Statistic, n (%)
Challenges to Starting Business	Social	4 (11.1)
	Financial	26 (72.2)
	Location	2 (5.6)
	Rules and regulations	4 (11.1)
Objectives for establishing	Generate income	25 (65.8)
	Create employment opportunities	1 (2.6)
	Self-employment	6 (15.0)
	Serve Community	1 (2.6)
	Growth in Economy	5 (12.5)
Source of Finance at start	Self-finance	12 (37.5)
	Friends and relatives	7 (21.9)
	Partnership	2 (6.3)
	Loans from banks and finance institutions	1 (3.1)
	MFI	10 (31.3)
Requirements of getting loans from Bank	Collateral Security	21 (52.5)
	Good will	3 (7.5)
	License	10 (25.0)
	Others	6 (15.0)
Possession of Adequate Capital	Yes	14 (35.0)
	No	26 (65.0)
Means of acquiring capital	Bank	1 (2.5)
	Credit	3 (7.5)
	Family and Friends	1 (2.5)
	No where	1 (2.5)
	Self	3 (7.5)
	SMCP	32 (75.5)

Note: *Data from* Goto and Negash (2016)

non-beneficiaries had a positive view, while 45% were disinclined to believe that MFI could have an impact on their operations.

When asked if the existence of MFI had an influence on their business, 5 % of non-beneficiaries had negative views, 16% had positive views, 14 % had no idea about the influence MFI may have in any form, while a majority of 65 % stated that the existence of MFI effected no change in their businesses.

This study attempted to determine whether the credits are effectively utilized by SMEs for business growth, beneficiaries were queried if they saw an increase in their capital as a result of the loans. A large majority of beneficiaries (93%) stated that they saw an increase in their capital as a result of the loans compared to a meager 7% who observed no increase in capital. However, statistical analysis of the associations between increase in capital from loan and the selected socio-economic variables has been found to be non-significant (p-value > 0.05).

Meanwhile, when asked if they used the loans for other purposes, 83% of the beneficiaries responded negatively while 17% responded affirmatively admitting that they had used loans for other

Table 3.3.5. The Contribution of MFI's in the operations of SMEs' in Asmara, Eritrea

Variable		n (%)
Contribution of MFI	Yes	36 (90.0)
	No	4 (10.0)
Percentage of loan granted	10 to 19	2 (5.0)
	20 to 49	4 (10.0)
	50 to 74	2 (5.0)
	75 to 99	8 (20.0)
	100	24 (60.0)
Time to access credit (Weeks)	One	13 (32.5)
	Two	15 (37.5)
	Three	7 (17.5)
	Four	5 (12.5)
Expectation fulfillment	Yes	38 (95.0)
	No	2 (5.0)
Influence of MFI	Positive	35 (87.5)
	Negative	-
	Don't know	-
	Unchanged	5 (12.5)

Note: *Data from* Goto and Negash (2016)

Table 3.3.6: Challenges faced in accessing the credit from MFIs' in Asmara, Eritrea

Variable		Statistic, n (%)
Credit kind requested	Short term	10 (25.0)
	Medium term	29 (72.5)
	Long term	1 (2.5)
High interest rate	Yes	18 (45.0)
	No	22 (55.0)
Collateral Security	Yes	5 (12.5)
	No	35 (87.5)
Cumbersome and bulky documentations	Yes	10 (25.0)
	No	30 (75.0)
Always get collateral requested	Yes	29 (72.5)
	No	11 (27.5)

Note: *Data from* Goto and Negash (2016)

purposes. Of those who admitted to diverting loans for other purposes, 71.4% of the beneficiaries stated that they used loans to repay other loans while 28.6% either failed to answer or pointed to 'other' purposes.

It has already been discussed in an earlier chapter that businesses that are financed by MFIs should not only be given access to collateral-free credit. Instead, an integrated approach that offers other services such as skills training and better administration practices. Ubom (2003) claims that Micro

Table 3.3.7 The Contribution of MFI's in the operations of SMEs' in Asmara, Eritrea

Variable		n (%)
Knowledge of MFI operation	Yes	30 (29.7)
	No	71 (70.3)
Ever applied for credit	Yes	1 (1.0)
	No	100 (99.0)
Products of MFI benefited	Financial and Management training	2 (2.0)
	Others	99 (98.0)
Contribution of MFI	Yes	23 (22.8)
	No	78 (77.2)

Note: *Data from* Goto and Negash (2016)

Table 3.3.8. Rate of utilization of the credit by SMEs' in Asmara, Eritrea

Variable		n (%)
Loan used for other purpose	Yes	7 (17.5)
	No	33 (82.5)
Loans used for other purposes	Repay for other loans	5 (71.4)
	Others	2 (28.6)
Increase in capital from loan	Yes	37 (92.5)
	No	3 (7.5)

Note: *Data from* Goto and Negash (2016)

Finance Institutions offer business solutions to small and medium enterprises by providing savings and credit, payment services, social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group.

Thus, in order to avoid the detrimental diversion of loans for other purposes, more focus needs to be done by MFI on skills and management training.

3.3.2. Documents Obtained from the Small and Micro Credit Program (SMCP) of Eritrea Shed Abundant light on the Main Activities and Risks of Microfinance in Eritrea.

Core Objectives of SMCP

The core objective is to promote the private sector in Eritrea by encouraging the development and expansion of micro and small enterprises by assisting individuals to increase their income generating ability and helping them contribute their part in the food security strategy and overall economic development of Eritrea. The clients are the economically active poor who currently have no access to formal financial service provider. Special efforts, however, will be made to embrace the neediest strata, including returnees, deportees, demobilized combatants, vulnerable women groups, women headed households. SMCP provides five types of loans in three categories.

Group Loan

Group loan component, after the potential clients become organized by joining the SMCP sponsored solidarity groups to form their village banks. Each village bank should have between 35 to 105 members. The first loan cycle starts at ERN **6,000** while the ceiling is set at ERN **20,000** which is spread out in to five different loan cycles. The solidarity group configuration substitute for loan guarantee. Hence no need of collateral.

Individual Loan

Individual loan category will assist individuals engaged in any productive activities which generate profit and can cover the expected credit repayments. Any person in rural and semi-urban and small towns who agrees to comply with the requirements, or the terms of credit is eligible to apply for loans. The first loan cycle starts at ERN **30,000** while the ceiling is set at ERN **150,000** which is spread out in to different loan cycles and the minimum loan size should not be below ERN **7,000**. There is a special individual loan product targeting to purchase oxen for farming. The loan size ranges from **ERN 7,000 up to 15,000.**

Unrestricted Employees Loan (UEL)

The loan category was introduced in 2006 for governmental and private organizations employees. It is unrestricted on the subject of expending the money borrowed. The repayment is on monthly basis from their salary. The Loan term is for one or two years. Maximum loan size is employee's six months salaries but should not exceed 20,000 **Nakfa.**

Savings

Also, SMCP collects mandatory savings.

Group Loan Savings

10% of approved loan with initial deposit followed by **6%** to be deposited in installments over the agreed loan term.

Individual Loan Savings

To become eligible for borrowing, Individual borrowers will be first asked to deposit **5%** of the loan amount in advance and **6%** on-going savings. When clients need to withdraw from SMCP after repaying the entire loan amount, they get their savings with its interest earned.

Interest

The Interest rate has been set at **16%** for both Group and Individual loan categories. The Declining Balance Method is applied when calculating interest so as to have uniform installments (repayments). Due to declining balance method of interest calculation, at the end real interest does not exceed **10%** for clients who pay their loan regularly. **For Instant loan:** SMCP charges **7%** per annum at a flat rate interest, from which **1%** apply for loan risk coverage while the clients pass away.

Outreach

SMCP started its activities with 10 staff members with loan disbursements amounting 1.37 million in the year 1996. As of the end of 2015, there were 241 staffs at SMCP who served 53,832 active clients from of which, women clients comprised 52% (which is 28,025). During the same period there were 538 village banks in all six regions of the country spread over 56 out of 58 sub regions. Out of 2606 villages in the country, 1247 (which is 47%) get SMCP service. In the past 20 years, SMCP disbursed more than 2.75 Billion and loan outstanding balance remaining with clients is 241 million Nakfa at the

end of year 2015. SMCP has been showing improvements in its financial efficiency and sustainability from year to year. And, in the year 2015 Operational as well as Financial self-sufficiency were 312.5% and 170.6% respectively.

"No one to be idle from productive activity due to lack of access to credit."

Chapter 4 Small Businesses' Awareness, Experience and Attitude towards Microfinance in Asmara, Eritrea

4.1. Introduction

This research attempts to investigate the general awareness and attitude of small business owners towards MFI in Eritrea. Attitude in this context mean 'The belief of small businesses in the importance of MFIs to the growth of their Business.' The study is highly expected to contribute valuable information to the government and microfinance in Eritrea on how to develop awareness in SME owners about Microfinance in Eritrea and to make recommendations to allow and encourage private investors in Microfinance. Available evidence indicates that small businesses played a major role in the growth and development of all leading economies. And there is no doubt that most developing countries depend on their small businesses in driving their economies forward. However, most of these small businesses struggle with getting financing. Thanks to the modern microfinance's existence, small businesses can access and receive adequate finance and increase their working capital. However, in Eritrea most small businesses are not accessing MFI. One of the reasons is their lack of awareness of the existence of MFI and its services. However, even if they know about MFIs, they may not get the access due to several reasons.

In this study we incorporate a statistical regression analysis to identify the factors that affect small businesses' awareness of MFIs and whether they become beneficiaries.

Small businesses constitute the lifeblood of any growing economy. Not only do they boost the national economy, but they also allow a significant segment of the population, who would have remained idle or relatively less productive, to engage in the business world. In addition to that, many small businesses are the big business organizations of tomorrow.

However, despite the potential merits of small business both at the individual and national level, the reality of launching and running it presents its own challenges. One of the main problems is the lack of awareness among small business owners with regards to the existence and activities of financial institutions. In many corners of the globe, where MFIs are available, they are not properly utilized as expected. And usually the main reason for this is the lack of adequate knowledge about MFIs.

Entrepreneurs in the SME sector have revealed that there is great reliance on credit as a tool for business growth and development. However, most entrepreneurs asserted the fact that they are still faced with the challenge of inadequate capital in their businesses and this inhibits their growth. From another perspective, MFIs believe that credit obtained by entrepreneurs is misappropriated. Another constraint to most SMEs is the lack of managerial and business skills. There is a glaring need to build these capacities in addition to opening access to financial resources in order to achieve growth. The smallness of loans and savings, the absence of asset-based collateral and the simplicity of operations are the three distinctive characteristics of the financial services provided by MFIs.

Eritrea is a small country in the eastern part of Africa, along the Red Sea coast line. Despite the strategic importance of the country's geographic location and the business opportunities that this presents, extraordinarily little has been done. In Eritrea, the history of small business shows a track record of financial affliction resulting from different problems not unlike small businesses throughout the world. In addition to this, the political instability of Eritrea (i.e. colonialism) had a debilitating role in Eritrean small business firms. Since the Eritrean economy was at its lowest level there was no availability of financial sources especially for small firms. Owing to this problem and other external

factors many individuals were hindered from starting their own business.

The state of small business in Eritrea has not been as bad over the past 26 years of independence when compared to the previous decades. Small businesses have been gearing forward as a development vehicle in providing job opportunities to the underprivileged such as women and the poor. In Eritrea one way of encouraging small business has been through the Savings and Micro Credit Program (SMCP). The SMCP is an MFI operating throughout the State of Eritrea. Most of the Eritrean population does not have access to the conventional financial institutions basically due to lack of collateral and financial records. Moreover, the Eritrean financial sector is small and underdeveloped offering only a limited range of financial services. SMCP was, therefore, established in 1996 as part of the Eritrean Community Development Fund and it provides savings and micro credit services to the poor section of the population, which the conventional financial institutions have failed to serve. The institution enables its beneficiaries to successfully deal with environmental hazards, economic failures as well as personal and family problems. According to many studies, challenges faced by SMEs may emanate from financial challenges, management or marketing limits. Small Businesses fail either at the start-up stage or at their early phases of operation. Even after the SMCP is established, most of the small business owners' knowledge falls beneath expectations.

4.1.1. Importance of the Study

Small business has been the backbone of almost any economy, particularly in a small and young country like Eritrea, its importance remains to be contested. In Eritrea, a few decades ago, farming was the primary income of the nationals. Nowadays, however, it is no more, because the Sahara Desert keeps extending into the young nation. For this, small business has almost become the only option where people can turn. Consequently, there is an urgent need to understand the attitude of the people, who were initially immersed in traditional farming activities, towards small businesses and the microfinance institutions available. Secondly, the next critical focus to be addressed is the awareness of the society about the availability and operations of those microfinance institutions. Unfortunately, due to many confounding factors, these basic concepts had never been studied scientifically. The above-mentioned points became the purpose of my research.

Considering the current state of affairs in Eritrea, it is almost impossible to find adequate economic data. Therefore, this being the first scientific research to be conducted in this field, the study continues to be appreciated by all three stakeholders of small businesses in Eritrea, namely the society, the government, and the microfinance institutions. The research work dug out significant findings that would help both the government of the state of Eritrea and the microfinance institutions not only to amend their policies but also to come up with new strategies that would, in a way, tackle the problems identified in the research. On top of that, the study will inevitably be referenced by small business owners and microfinance institutions that might be launched subsequently in Eritrea.

In addition to the merits previously mentioned, the research work would ignite other researchers to conduct similar research in other parts of the country and in other related issues that need to be addressed scientifically. Besides, the work will serve as a pioneer reference to be used by other researchers in future studies.

Most importantly, the research revealed and clearly stated problems that small businesses face both in launching and running their business, especially in the line of finances. For this, the study came up with research-based recommendations that both the government of the state of Eritrea and microfinance institutions could use as alternative strategies to bring the general knowledge and awareness of the society up to the desired level.

4.1.2. Research Questions of the Study

1) What are the factors that determine the awareness of SMEs about MFIs?
2) What are the factors that determine an SME becoming a beneficiary?
3) Do MFI fulfill beneficiaries' expectations?
4) Do MFI increase beneficiaries' business capital?

4.1.3. Objectives of the Study

The general objective of the study is to make suggestions to the government regarding the policy of privatization of microfinance institutions in Eritrea.

Specific Objectives

1. To identify the difficulties small businesses, face when launching their business.
2. To evaluate the awareness of small business owners about micro finance institutions in Asmara, Eritrea.
3. To identify the relationship between small business owner's knowledge about and utilizations of microfinance institution in Asmara, Eritrea.
4. To assess the attitude of small business owners towards microfinance institutions in Asmara, Eritrea.
5. To identify the role/contribution of micro finance institutions on small business in Eritrea.

To achieve the above objectives, 4 research hypotheses were formulated:

1) The nature of the business, challenges faced during the start of the business, the objectives for establishment, method of financing, the type of loan requirements needed, and whether they have adequate capital for the business can significantly determine whether a small business becomes a beneficiary of an MFI.
2) The nature of the business, challenges faced during the start of the business, the objectives for establishment, method of financing, the type of loan requirements needed, and whether they have adequate capital for the business can significantly determine whether a small business will know about MFIs.
3) Beneficiaries of MFI do not believe MFIs fulfill their expectation (there is no positive attitudes)
4) Beneficiaries of MFI do not believe MFIs increase their business capital.

4.2. Methodology

4.2.1. Study Population

The target population for the study comprised all registered small and Medium Scale Enterprises in Asmara. Asmara is located in the Maekel Region near the center of Eritrea. Asmara is the capital city and largest settlement in Eritrea with a population of around 649,000 inhabitants making it the largest city in Eritrea. As the capital city and largest settlement of Eritrea, most Eritrean businesses have their headquarters in Asmara.

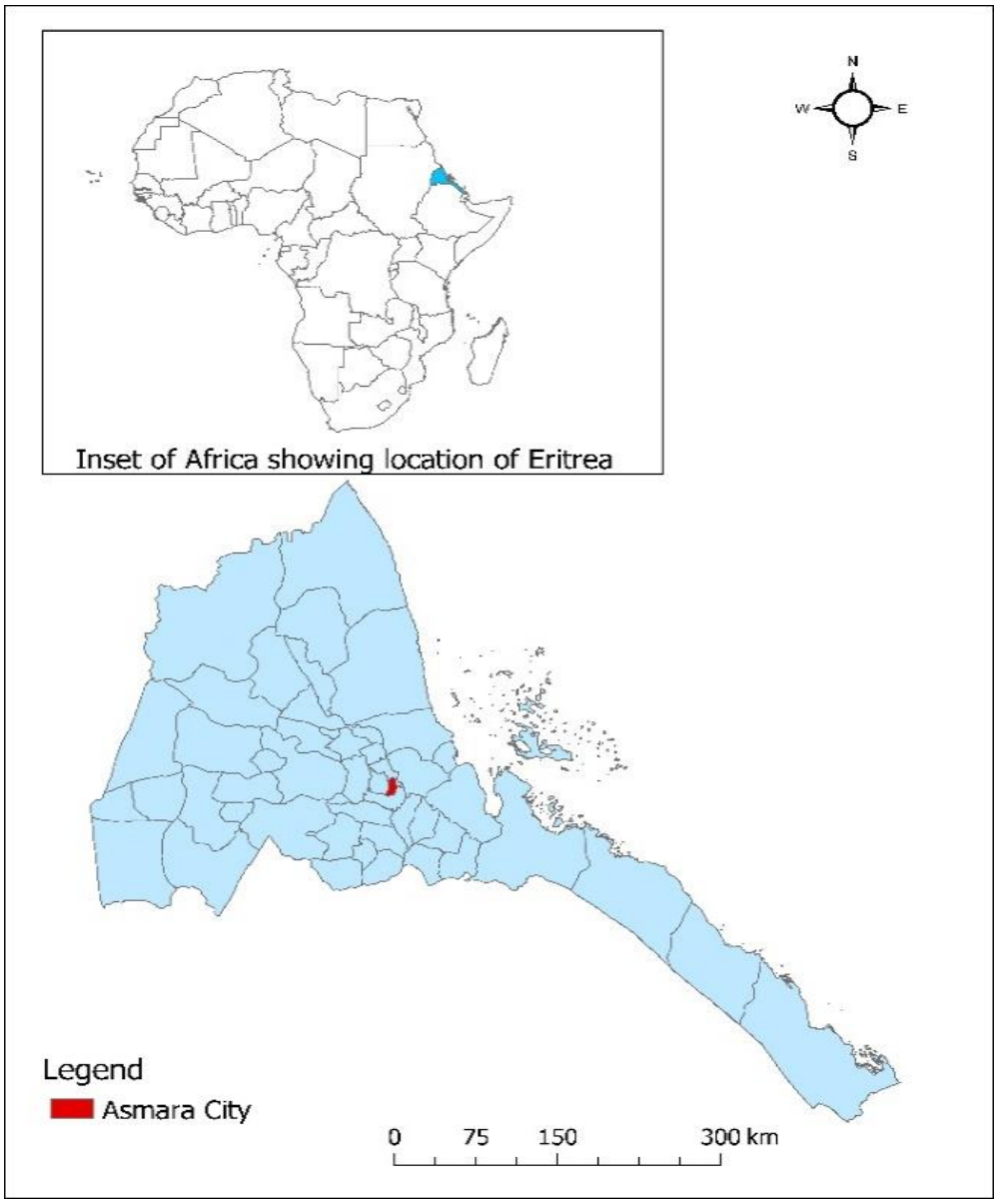

Figure 4.2.1. Map of Eritrea. *Map made on arc gis using open access GIS data.*

The city was once a factory town. During the colonial period, it was an administrative and commercial center of Italian East Africa. When the British entered the country in 1941, many businesses were closed down or relocated outside of the city. This trend continued under Ethiopian occupation. Textile clothing, footwear, processed meat, beer, soft drinks, and ceramics are Asmara's major industrial products. The city is a marketplace for agricultural products, and a center for tanning hides. The Eritrean economy is largely based on agriculture, which employs 80 percent of the population but contributes little percent to gross domestic product. Agricultural exports include cotton, fruits and vegetables, hides, and meat, but farmers are largely dependent on rain-fed agriculture, and growth in this and other sectors is hampered by lack of a dependable water supply. Asmara is known for its well-preserved colonial Italian modernist architecture. The official currency of Eritrea is the Nakfa. In the city of Asmara there are many SMEs of all kind the poor and rich alike, compared to other cities and they can be a look to the SMEs in other cities.

4.2.2. Data Collection Tools and Sampling Technique

After developing the research proposal and the reliable data-collecting tool that passed through rigorous statistical procedures, we successfully incorporated all the stakeholders, and data was collected firsthand. I traveled to Eritrea to collect the required data directly from the study participants. The data was collected at Asmara, which is the capital of Eritrea. The study participants were small business owners of various economic and social strata. These included experienced business owners, young people who just launched small businesses, and individuals who sold a few items on the streets of Asmara.

The main tool for collecting primary data in this study was questionnaire. In order to draw the samples randomly, we intended to use stratified random sampling technique. As some businesses were unable for participation, making strict stratified random sampling impractical. Therefore, quota sampling was used to gather the final sample for this study. The sampling frame for SMEs was taken from the Ministry of Trade and Industry and SMCP in Asmara Eritrea. The number of businesses samples were taken proportionally according to the number of SMEs. After compensating for non-responses, the final sample size calculated was 145. Out of 145 only 141 replied positively to our questionnaires and the rest 4 were not responsive.

4.2.3. Data Analysis

Most of the survey variables were categorical and frequency distributions were used to describe variables of interest. Chi-square goodness of Fit Test was used to calculate the attitude of the respondents, and its subsequent impact on utilization of loans from MFIs. To know the factors that determine whether being a beneficiary or not and whether non-beneficiaries know about MFI or not, this study made further use of two models of Logistic Regression Analysis:

$$\ln\left(\frac{p_i}{1-p_i}\right) = \beta_0 + \beta_1 x_{1,i} + \cdots + \beta_k x_{k,i},$$
$$p_i = \Pr\,(Y_i = 1),$$

where Y is the dependent variable indicating whether a respondent was a beneficiary or not (Beneficiary=1 / Non-Beneficiary=0 or whether non beneficiary was knowledgeable of MFI=1 or Not knowledgeable =0), β_k is a coefficient associated with the independent variable x_k.

In the first model, if the coefficient is positive (negative), the corresponding variable supports he is beneficiary (non-beneficiary). In the second model, if the coefficient is positive (negative), the corresponding variable supports that the non-beneficiary knows (does not know) MFI.

4.3. Data Presentation and Analysis

4.3.1. Socio-economic Characteristics of SMEs in Asmara, Eritrea

The data collected for this study indicates that the majority of beneficiaries of Microfinance are male (55%) as compared to females (45%). On the contrary, the majority of non-beneficiaries were female (58.4%) as compared to males (41.6%), which indicates that more needs to be done to make credit available to female entrepreneurs for equitable development.

Table 4.3.1. Socio-economic Characteristics of the SMEs in Asmara, Eritrea.

Socio-economic variable	Non-Beneficiaries n (%)	Beneficiaries n (%)
Gender		
Male	42(41.6)	22(55.0)
Female	59(58.4)	18(45.0)
Age Category		
18-30	14(13.9)	14(35.0)
31-45	28(27.7)	21(52.5)
46-60	42(41.6)	4(10.0)
Above 60	17(16.8)	22(55.0)
Level of Education		
Illiterate	2(2.0)	1(2.5)
Elementary	22(21.8)	8(20.0)
Junior and High School	60(59.4)	26(65.0)
Diploma Level	9(8.9)	4(10.0)
Degree Level	6(5.9)	1(2.5)
Above Masters	2(2.0)	-
Subject's Background		
Farmer	4(4.0)	14(35.0)
Orphanage	-	1(2.5)
Post-war victim	13(12.9)	6(15.0)
Ordinary	84(83.2)	19(47.5)
Nature of Business		
Manufacturing	9(8.9)	3(7.5)
Commerce	65(64.4)	13(32.5)
Service	26(25.7)	17(42.5)
Others	1(1.0)	7(17.5)

Note: *145 questionnaires distributed and 141 received. (101= Non-Beneficiaries and 40= Beneficiaries).*
Data from Negash (2021)

The study also found that the age of the greater majority of beneficiaries was in the range of 46-60 (55%) followed by those in the age group 31-45 (35%). Meanwhile, young adults aged 18-30 were very few comprising 2.5%. The non-beneficiaries were also mostly between the age of 46 and 60 (41.6%), followed by the 31-45 age group (27.7%).

The study found that 35% of beneficiaries were farmers, 47.5% were ordinary citizens, 15% were post-war victims while the rest 2.5% were orphanages.

Glancing at the business activities, we find that the majority of beneficiaries were involved in commerce (33%) and services (43%). Manufacturing, which has a high potential to create more employment opportunities was lower in proportion at 7%. The study found that the majority of non-beneficiaries were active in commerce (64.4%) and services (25.7%) and active in farming was very low at 4%.

Table 4.3.2. Case-studies of the SMEs in Asmara, Eritrea

Variables	Non-Beneficiaries, n (%)	Beneficiaries, n (%)
Challenges in starting business		
Social	10 (9.9)	5 (12.5)
Financial	62 (61.4)	30 (75.0)
Location	26 (25.7)	6 (15.0)
Rules and regulations	11 (10.9)	2 (5.0)
Others	13 (12.9)	4 (10.0)
Objectives for establishment		
Generate income	68(67.3)	26(65)
Create employment opportunities	9(8.9)	1(2.5)
Self-employment	21(20.8)	7(17.5)
Serve Community	2(2.0)	1(2.5)
Growth in Economy	21(20.8)	6(15)
Source of Finance at start		
Self-Finance	52(51.5)	14(35.0)
Family and Colleagues	45(44.6)	10(25.0)
Partnership	-	2(5.0)
Loans from banks and finance institutions	6(5.9)	2(5.0)
MFI	-	12(30.0)
Others	3(3.0)	4(10.0)
Requirements of getting loans from Bank		
Collateral Security	65(64.4)	21(52.5)
Good will	2(2.0)	3(7.5)
License	28(27.7)	10(25.0)
Others	10(9.9)	6(15.0)
Possession of Adequate Capital		
Yes	22(21.8)	14(35.0)
No	79(78.2)	26(65.0)

Note: *145 questionnaires distributed and 141 received. (101= Non-Beneficiaries and 40= Beneficiaries) Multiple response allowed and percentages represent a proportion of cases. Data from* (Negash,2021).

Table 4.3.3. The Contribution of MFIs in the operations of SMEs' in Asmara, Eritrea

Non-Beneficiaries Knowledge and Beneficiaries Expectation about MFI		
Variables	**Non-Beneficiaries, n (%)**	**Beneficiaries, n (%)**
Yes	30(29.7)	38(95.0)
No	71(70.3)	2(5.0)
Ever applied for credit (Non-Beneficiaries) and Increase in Capital from loan (Beneficiaries)		
Yes	1(1.0)	37(92.5)
No	100(99.0)	3(7.5)

Note: *145 questionnaires distributed and 141 received. (101= Non-Beneficiaries and 40= Beneficiaries). Data from* Negash (2021)

4.3.2. Case Studies of SMEs in Asmara, Eritrea

The data collected indicates that 75% of beneficiaries had faced financial challenges. Meanwhile, 12.5% of the beneficiaries of MFI faced social challenges, 15% faced business location challenges, while 5% faced challenges related to rules and regulations. It is clear that the challenges faced by SMEs are mainly financial in nature. Similarly, non-beneficiaries of MFI were also faced with financial challenges-- a majority of 61.4% stated that the main challenge to start their business was financial. Social, business location, regulatory challenges accounted for 9.9%, 25.7% and 10.9% respectively. Another 12.9% of the respondents stated that they faced no challenges at all.

Also, 35% of SMEs benefiting from MFI indicated that they started business through self-finance compared to 30% who commenced with credit from MFI. 51.5% and 44.6% of non-beneficiaries commenced their business from self-finance and family and Colleagues respectively.

65% of beneficiaries followed by 67.3% of non-beneficiaries started their business for the purpose of generating income to help their family. 52.5% of beneficiaries and 64.4% of non-beneficiaries said the requirements of getting loans from Bank is Collateral Security. This is very true and that is one of the main reasons MFI existed, to help those small businesses who could not provide collateral.

In contrast, 70.3% of non-beneficiaries had no knowledge about MFI operations at all when compared to 29.7% who stated otherwise. An overwhelming 95% of all beneficiaries stated that MFI fulfilled their expectations, while the rest (5%) found that the MFI did not meet their expectations.

Beneficiaries were queried if they saw an increase in their capital as a result of the loans and a large majority of beneficiaries (92.5%) stated that they saw an increase in their capital as a result of the loans compared to a meager 7.5% who observed no increase in capital.

4.3.3. Small Businesses Challenges at the Start-up and Factors that Determine Being a Beneficial or not

We conducted multivariable logistic regression analysis to estimate coefficients associated with MFI's socioeconomic profile and the answer of the case study, where the independent variable is whether a respondent was a beneficiary (1) or not (0). Table 4.3.4 shows the result of analysis (see Table 4.3.8 at the last page of this chapter for detail questionnaire). In order to avoid multicollinearity problem, we eliminated one variable of each pair that has over ± 0.4 correlation coefficient. As we can see McFadden's Pseudo $R^2 = 0.49855$, the result is rather effective.

In order to determine the efficacy of MFI in the business operations of SMEs, it is imperative to identify the main challenges that confront these enterprises from the start. All SME owners participating in the study, who constitute beneficiaries and non-beneficiaries of MFI, were queried on the challenges they faced in starting and running their business. According to the data collected from both beneficiaries and non-beneficiaries of MFI, four major factors have been identified as challenges during the setting up of their businesses. These variables are financial, social, location and regulatory.

Financial challenges mean the inability of the small businesses to have enough finance. This finding echoed what the World Bank Enterprise Survey (2013) stated that financial limitation as the primary barrier to the growth and development of small businesses. Next to the financial problem is the social problem. Moving from a traditional lifestyle such as farming that has been practiced for many centuries to business is not welcomed by many.

Table 4.3.4. Logistic Regression Analysis of factors associated with being a beneficiary or not. (In order to avoid multicollinearity problem, we eliminated one variable of each pair that has over ±0.4 correlation coefficient.)

Variable		Coefficient	Std. Error	Z-value	Pr(>|Z|)
Socioeconomic Profile					
B11	Manufacturing	1.31820	1.19679	1.101	0.27070
B13	Services	2.08664	0.76430	2.730	0.00633***
B2	Gender	0.99528	0.70638	1.409	0.15884
B31	Age (18-30)	-1.82834	1.36670	-1.338	0.18097
B33	Age (45-60)	-0.47479	0.75674	-0.627	0.53039
B41	Illiterate	0.07160	2.04715	0.035	0.97210
B42	Elementary	0.62567	0.94882	0.659	0.50963
B44	Diploma	1.15597	1.10074	1.050	0.29364
B45	Degree	-0.73637	1.50164	-0.490	0.62386
B51	Farmer	2.39825	1.22031	1.965	0.04938**
B52	Orphanage	20.32975	6522.63877	0.003	0.99751
B53	Post-war	0.21489	0.87286	0.246	0.80553
Case Study of Selected SMEs					
A1	Business duration	-0.01867	0.02419	-0.772	0.44028
A21	Societal challenges	0.20116	1.04279	0.193	0.84704
A23	Location challenges	-0.77097	0.86873	-0.887	0.37483
A24	Regulation challenges	0.02859	1.00748	0.028	0.97736
A25	Other challenges	-0.19443	0.99759	-0.195	0.84547
A31	Family	0.26085	0.74703	0.349	0.72695
A32	Employment	0.74606	1.21863	0.612	0.54040
A34	Community	0.80053	1.68059	0.476	0.63383
A4	People employed	-0.39264	0.21836	-1.798	0.07216*
A52	Friends and relatives	-0.75255	0.65769	-1.144	0.25253
A53	Partnership	18.78651	4153.08491	0.005	0.99639
A54	Banks	-0.63014	1.29610	-0.486	0.62684
A55	MFI	21.29206	1523.48593	0.014	0.98885
A62	Good will	1.70728	1.52973	1.116	0.26440
A63	License	-1.16889	1.01641	-1.150	0.25014
A64	Other requirements	0.33886	1.15054	0.295	0.76836
A7	Adequate capital	1.69144	0.71349	2.371	0.01776**
Criteria					
	Number of observations	141			
	AIC	144.34			
	McFadden's Pseudo R^2	0.49855			

*Significance codes: '***' 0.01 '**' 0.05 '*' 0.1,* Note: *145 questionnaires distributed and 141 received. (101= Non-Beneficiaries and 40= Beneficiaries). Data from* Negash (2021)

In societies like Eritrean where the approval of the family and the community at large has a great impact in every move an individual member, diverting from the traditional way of living to launching and running small business leaves many small businesses to social pressures such as rejection, discouragement, and so on. Another problem people face when they start their business is lack of getting a strategic business location; meaning that either by not having any place at all or a place that

doesn't suit the business type. In addition to that sometimes the government doesn't let some type of businesses to establish in a location where the owners preferred. Last but not least one of the identified challenges is regulatory obstacles. By regulatory obstacles means any sort of governmental regulations that somehow negatively affect the small business. These obstacles include prolonged time to get legal permit to start a business, and this is usually due to long bureaucratic procedures.

As we can see earlier the foremost challenge faced by both beneficiaries (75%) and non-beneficiaries (61.4%) of MFIs is financial. The data acquired found that 10.9% of non-beneficiaries found that rules and regulations was a challenge, while 5% of beneficiaries listed regulation as a challenge. Equally challenging to non-beneficiaries was the location of the business (25.7) but only 15% of beneficiaries identified this as a challenge. On the contrary, 12.5% of beneficiaries faced social challenges to starting their business compared to just 9.9% of non-beneficiaries.

While all challenges faced during the start of the business (A21-A25) are not statistically significant, we can find that some other factors have significant impact on whether a respondent was a beneficiary or not. As table 4.3.4 indicates, those who has background as a farmer (B51; β=2.39825**), whose business nature is service (B13; β=2.08664***) are more likely to be beneficiaries. Next, those who have more employee (A4; β=-0.39264*) are less likely to be beneficiaries, that is, those who have large employment seem not to have necessity for MFI's help. Lastly, those who have adequate capital for your business (A4; β=1.69144**) are more likely to be beneficiaries. This result echoes the existence of MFI to minimize the SMEs financial distress.

Hypothesis 1 was partially accepted because the results provide evidence that only background of the owner, nature of the business and having adequate funds for daily activities can determine whether a small business will become a beneficiary of an MFI, none of the other stated factors were statistically significant.

4.3.4. Awareness of Non-beneficiaries about MFI and Factors that Determine their Knowledge

Indeed, it would be obsolete to talk about the awareness of non-beneficiaries about MFIs. As we can see from table 4.3.2, they were asked whether they had knowledge about microfinance prior to the study. When we look at the figures regarding non-beneficiaries, we observe that the majority (n=71, 70.3%) have no awareness of MFIs when compared to those who do.

To determine the factors associated whether they significantly affect non-beneficiaries to know about MFI or not we incorporate logistic regression analysis in the same way as the previous section.

According to the result derived from Table 4.3.5, those whose nature of business is manufacturing (B11; β=2.36876*) and whose education is degree level (B45; β=3.38398**) are significantly more likely to know about MFI. So, the nature of the business could determine whether a small business knew about MFI. Next, those who had regulation challenges at the start of their business (A24; β=2.47246**) were significantly more likely to know about MFI. Those who started their business to serve growth economy (A35; β=-2.15635*) were less likely to know about MFI. The method of financing at the start of the business could determine whether a small business knew about MFI. Those who used banks (A54; β=3.29156*) were significantly more likely to know MFI. Lastly, those who had adequate capital (A7; β=2.09217**) were significantly more likely to know about MFI.

Hypothesis 2 was fully accepted except for the type of loan requirements needed because the results in each category provide evidence that is statistically significant. The nature of the business, the challenges faced during the start of the business, the objectives for establishment, method of financing, and whether they have adequate capital for the business are all factors that can significantly determine

Table 4.3.5. Logistic Regression Analysis of factors associated with whether non-beneficiaries know about MFI or not. (In order to avoid multicollinearity problem, we eliminated one variable of each pair that has over ±0.4 correlation coefficient.)

Variable		Coefficient	Std. Error	Z-value	Pr(>|Z|)
Socioeconomic Profile					
B11	Manufacturing	2.36876	1.26456	1.873	0.06104*
B13	Services	0.10487	0.91738	0.114	0.90899
B2	Gender	0.18783	0.80920	0.232	0.81644
B31	Age (18-30)	0.02211	1.23295	0.018	0.98569
B33	Age (45-60)	0.54889	0.81956	0.670	0.50303
B41	Illiterate	-15.75758	1546.29763	-0.010	0.99187
B43	Junior high	1.00209	1.04573	0.958	0.33793
B44	Diploma	-0.34995	1.92391	-0.182	0.85567
B45	Degree	3.38398	1.68552	2.008	0.04468**
B51	Farmer	1.19571	2.65400	0.451	0.65233
Case Study of Selected SMEs					
A1	Business duration	0.04493	0.02432	1.847	0.06471*
A21	Societal challenges	-4.30483	4.55128	-0.946	0.34422
A23	Location challenges	-0.46727	0.91814	-0.509	0.61080
A24	Regulation challenges	2.47246	1.03768	2.383	0.01719**
A25	Other challenges	0.31363	1.06194	0.295	0.76774
A32	Employment	1.04354	1.20707	0.865	0.38730
A33	Self employed	0.03061	1.14328	0.027	0.97864
A34	Community	1.43228	4.62153	0.310	0.75663
A35	Growth of economy	-2.15635	1.13088	-1.907	0.05655*
A4	People employed	0.45891	0.24613	1.864	0.06225*
A52	Friends and relatives	0.31664	0.78670	0.402	0.68732
A54	Banks	3.29156	1.68443	1.954	0.05069*
A56	Others	-0.05296	1.26576	-0.042	0.96662
A62	Good will	-0.22678	3.76780	-0.060	0.95200
A63	License	0.75234	0.88830	0.847	0.39703
A64	Other requirements	-2.21374	1.59639	-1.387	0.16553
A7	Adequate capital	2.09217	0.98357	2.127	0.03341**
Criteria					
		Number of observations	101		
		AIC	125.1		
		McFadden's Pseudo R^2	0.43768		

*Significance codes: '***' 0.01 '**' 0.05 '*' 0.1,* Note: *145 questionnaires distributed and 141 received. (101= Non-Beneficiaries and 40= Beneficiaries). Data from* Negash (2021)

a small business' awareness about MFI.

4.3.5. Attitude towards MFIs

We have already seen that the level of awareness about MFIs among non-beneficiaries is

Table 4.3.6. Chi-Square Test of goodness fit to measure beneficiaries' expectation

Variables	Observed	Expected	$(O-E)^2/E$
High expectation	38	20	16.2
No expectation	2	20	16.2
Total	40	40	32.4

Note: *Number of samples: 40=Beneficiaries. Data from* Negash (2021)

Table 4.3.7. Chi-Square Test of goodness fit to measure the Impact MFI made to Beneficiaries

Variables	Observed	Expected	$(O-E)^2/E$
Yes	37	20	14.45
No	3	20	14.45
Total	40	40	28.9

Note: *Number of samples: 40=Beneficiaries. Chi Square test results are unreliable because not all observed frequencies were greater than 5. Data from* Negash (2021)

comparatively low. But it can be said that the attitude of non-beneficiaries about the impact of prospective loans on their businesses was relatively proportional with 55.4% of respondents having a positive attitude and 44.6% giving negative responses. On the other hand, the majority of beneficiaries (95%) said that MFIs fulfilled their expectations. Contextual meaning of attitude is 'The belief of small businesses towards the importance of MFIs to the growth of their business. And when we say positive attitude it means when beneficiaries are satisfied with the services and products of MFI.

To know the attitude of SMEs towards MFIs different questions were asked to beneficiaries and non-beneficiaries. Beneficiaries were asked whether MFIs fulfilled their expectations and non-beneficiaries were asked whether their business would be improved if they had loan from SMCP.

To further gauge the significance of attitudes towards MFIs among beneficiaries, a chi-square test of goodness fit was conducted. The results have nullified the hypothesis that there is no positive attitude on expectations from MFIs. The test value (χ^2c) 32.4> Table value of chi-square (χ^2t) 3.84. This indicates that MFIs indeed helped those who benefited from them. Therefore, reject Hypothesis 3. See Table 4.3.6 for detail.

4.3.6. Impact of MFI Loans on Business Capital

To identify the role/contribution of micro finance institutions on small business in Eritrea, the beneficiaries were asked whether the loans acquired from the MFIs led to an increase in their capital. To this, 37 beneficiaries (92.5%) responded positively while a minority of 3 beneficiaries responded negatively. Beneficiaries were asked whether the loans acquired lead to increase in their capital. This is shown in Table 4.3.7.

This hypothesis is specific to beneficiaries who already use fund for their business from MFI. Apart from the descriptive statistics that indicate a majority of beneficiaries witnessing an increase in their capital as a result of MFI loans, a chi-square test of goodness fit has also shown that the impact of MFI loans is statistically significant as can be seen in table 4.3.7. calculated value (χ^2c) 28.9> Table value (χ^2t) 3.84, then Hypothesis 4 is rejected.

4.4. Discussion

The results revealed profoundly important findings that would serve as useful information to small business owners and help them connect with the microfinance institutions. Additionally, this would also help the microfinance institutions to improve their activities.

The predominant challenge for both beneficiaries and non-beneficiaries of MFI in Asmara is financial constraint. And it is precisely for this reason that the beneficiaries sought funds from MFIs. Not surprisingly, the vast majority of these beneficiaries (92.5%) reported a positive impact on their businesses and an increase in their capital as a consequence of the credit from MFI. This would inevitably lead us to question why the non-beneficiaries did not follow suit to address their financial problems.

Those who had financial challenges at the start up were significantly less likely to know about MFI and those who have adequate capital were significantly more likely to know about MFI. The result may look contradictory, but it suggests that there are other, possibly more pressing reasons, why a non-beneficial would remain a non-beneficiary despite having financial challenges.

It seems that the non-beneficiaries' lack of awareness about MFIs. The fact that more than two-thirds of the non-beneficiaries who participated in this study were not aware about MFIs and their activities compels us to look at the concept of information asymmetry from a different perspective. Asymmetry of information is the inability of financial institutions to determine whether the businesses are able to repay their loans. Asymmetric information is when a borrower once in possession of borrowed funds, may divert them (misappropriate) to other personal purposes other than the business activities. However, this study has found that it is not the lack of readily available detailed information about the performance and operations of small businesses that has been a bottleneck to the provision or offering of credit to the non-beneficiaries. On the contrary, it is the total lack of awareness of the majority of non-beneficiaries about the very existence of the MFIs that has denied them the much-needed funds for the growth of their business and augmentation of their capital.

The reason why information asymmetry with regards to MFIs is heavily skewed towards the non-beneficiaries may be attributed to various factors upon deeper study. However, the evidence at hand points inevitably to the inability of the SMCP, the primary and only MFI in Eritrea, to sufficiently reach out to its intended beneficiaries. Indeed, as mentioned earlier, the SMCP, at least on paper, targets a vast portion of the Eritrean population, particularly focusing on disadvantaged segments like war veterans, returnees from the diaspora and women. One of the three operational strategies that are supposed to realize this mission is the strengthening of representative structures across all administrative levels in the country. However, the empirical findings of this study suggest that there may be a certain measure of complacency on the part of the SMCP in its implementation of this strategy. After all, you cannot blame the non-beneficiaries for not knowing about the SMCP if it does not make efforts to advertise its services and reach out to potential clients.

This lack of awareness in business owners in Asmara, Eritrea is in stark contrast to the level of awareness described in other studies. For instance, Sharma and Deshmukh (2013), has found that awareness about MFIs was rather high at 90.6% among the poor of Nagapur city in India. Not only had that but her study showed that the awareness extended to the different activities and offers of MFIs in varying degrees.

If businesses in Eritrea, which are already operating despite challenges, have such a low level of awareness about MFI, one can assume how a lack of knowledge in the general population is precluding many disadvantaged individuals from starting their own SMEs and contributing to the growth and development of the economy.

Would the non-beneficiaries have utilized loans of MFIs had they been aware? This is not a hypothetical question. The study found that 0.99% of non-beneficiaries had ever applied for a loan

from SMCP. In plain terms, two-thirds of the non-beneficiaries did not know about the MFI and thus they never requested loans. Also, it has been found that the awareness about MFIs has a strong statistical relationship with the utilization of loans.

However, another factor that requires consideration is the skepticism of approximately 45% of non-beneficiaries towards loans. This does not mean that these beneficiaries were only averse to loans from MFIs as opposed to other financial institutions; rather, data indicates that 53.4% of non-beneficiaries cited banks as their primary source for additional capital. This leads us to surmise that non-beneficiaries could have made use of loans from MFIs if they had been aware of its availability, its ease of access and potential rewards.

The research findings clearly show that MFIs help SMEs to solve their financial challenges and to increase their capital. This is important because most SMEs indicate that their main challenges are financial in nature. However, the fact remains that most SMEs are still unaware about MFIs and the services they provide. Also, a considerable number of SMEs have a negative attitude towards loans. This indicates that the MFI in Eritrea should do more to contribute to development and growth of SMEs and the economy in general. Thus, more research is needed to address, and we decided to study the challenges and opportunities of SMCP in Asmara, Eritrea.

Table 4.3.8. Detail questionnaire

Socioeconomic Profile		
B1	What is the nature of your Business?	
	B11	Manufacturing
	B12	Commerce
	B13	Services
	B14	Others
B2	Kindly indicate your gender. (Male:1, Female: 0)	
B3	Kindly tell us your age.	
	B31	18-30
	B32	31-45
	B33	45-60
	B34	Above 60
B4	What is the level of your Education?	
	B41	Illiterate
	B42	Elementary
	B43	Junior high school
	B44	Diploma level
	B45	Degree level
	B46	Above master’s level
B5	Background of the owner.	
	B51	Farmer
	B52	Orphanage
	B53	Post-war victim
	B54	Ordinary

Case Study of Selected MFIs		
A1	How long have you kept your business?	
A2	The challenges you face when you start your busines.	
	A21	Societal
	A22	Financial
	A23	Location
	A24	Rules and regulation
	A25	Other challenges
A3	What was the objective for establishing your business?	
	A31	To generate income to support their family
	A32	To create employment opportunities for others
	A33	To be self employed
	A34	To serve the community
	A35	For better growth of economy
A4	How many people have you employed?	
A5	How did you finance when you start your business?	
	A51	Self
	A52	Friends & relatives
	A53	Partnership
	A54	Loans from banks & finance institutions
	A56	Others
A6	To get loan from bank what are the requirements?	
	A61	Collateral security
	A62	Good will
	A63	License
	A64	Others
A7	Do you have adequate capital for your business?	

Chapter 5 Challenges and Risks of the SMCP in Eritrea: Perspectives of the Beneficiaries and SMCP Management

5.1. Introduction

Microfinance refers to the supply of financial services to clients of low income, including consumers, and those who run their own business, who usually lack access to big financial institutions. It is a movement with the objective of creating an opportunity of permanent access to an appropriate range of high-quality financial services to as many poor and near poor households as possible. Those who support microfinance believe that such access will help poor people by providing new and additional financial resources. Indeed, the emergence of MFI, which is a brainchild of Muhammad Yunus, a Bangladeshi professor in economics, in 1974 has brought prospects of a bright future to the world.

Clearly, microfinance is much more important in developing countries as compared to developed ones. The important role of small business in the development of an economy is a well-founded fact. Small businesses have been the means through which accelerated growth and rapid industrialization have been achieved (Koech, 2011). However, a survey of 130,000 small and medium firms in 135 countries, found out that limited access to finance ranked at the top of the list of obstacles to growth and development especially in Sub-Saharan countries (Kuntchev et al.,2013). Luckily, MFIs can play an important role as they have "evolved as an economic development approach intended to benefit low income women and men" (Ledgerwood, 1999). Nonetheless, the utilization of MFI services is curtailed because of information asymmetries leading to lack of timely, accurate, qualitative, quantitative, and complete information regarding the ability of the applicants to access financial products from the banking institutions and to repay back the loan (Bazibu, 2005a).

In a more localized context, Eritrea is a young East African country with a population of 6,000,000, consisting of mainly poor subsistence farmers, where increasing desertification and unsustainable farming practices have compelled a not insignificant segment of the population to shift to small-scale commercial activities. These small businesses suffer from a lack of financing both in the launching phase as well as in their daily operations. Thus far, in Eritrea, the research has focused on the behaviour of microcredit groups and the repayment performance of borrowers (Asgedom and Mturi, 2014). Hence, Goto and Negash (2016) tried to address the research gap in a study titled 'The Impact of MFIs on Growth and Development of Small Business in Eritrea'. The researcher found that financial constraints greatly inhibit the launching and operations of small businesses. However, the relatively small number of small businesses benefiting from MFI loans overwhelmingly increased their capital although there was still a measure of loan diversion for other purposes. Most importantly, they found that non-beneficiaries from loans outnumber the beneficiaries to a great extent. To find the reasons behind this, Negash (2020) conducted another research on small business owners' *awareness of* and *attitude towards* MFIs and their services. Her study found that there is very little awareness about MFIs among the non-beneficiary small businesses and, approximately half of respondents have a negative attitude towards loans, which prevents them from acquiring much needed financing for their cash- starved businesses.

As mentioned above, research in the domain of MFIs has focused on their impact on small businesses and, thereby, the economy at large. Other research, has investigated the socioeconomic characteristics of business owners and their loan repayment. This research departs from the existing

studies as it attempts to identify the risks, challenges, and shortcomings of the sole MFI in Eritrea, SMCP, by utilizing data collected from (1) the small business owners and (2) the MFI management.

5.2.1. Objectives of the Study

The ultimate purpose of the project is to help other businesses succeed and grow by creating awareness and recognition. It will empower business owners and the society at large by tackling the lack of transparency and absence of research conducted by academicians or non-state entities. Previous study revealed that awareness about the availability and potential of microloans remains low among small business owners. The researcher focuses on expanding the opportunities for small businesses to benefit from microloans.

- ✓ Awareness: Raising the awareness and understanding among Eritrean small businesses on how to tap into the power of microfinance to grow their businesses, create jobs and support economic recovery.
- ✓ Future Growth: Expanding network of microfinance institution partners.
- ✓ Research: Commissioning a study on the challenges and opportunities of microfinance for small businesses.

5.2.2. Specific Objectives

Therefore, the specific objectives of this research are:

1. Assessing the challenges and risks MFIs face in providing loans to small businesses.
2. Gauging awareness on MFIs and suggested ways of improving outreach
3. Identifying Sources of Capital and their sufficiency
4. Assessing the Need for Private MFIs

5.2. Methodology

5.2.1. Study Population

The study population comprised of the registered beneficiaries' small businesses in SMCP of Zoba Maekel, Eritrea. In total, there were 2105 small business in zoba Maekel of Eritrea, constituting the population of this study.

5.2.2. Data Collection and Sampling Technique

Semi-structured questionnaire was prepared to achieve the study objectives. Primary data was collected from the selected beneficiary small businesses through the designed questionnaire by face-to-face interview. The questionnaire had three main components: questions that assess awareness and suggested ways of improvement, weaknesses and challenges, and perceived capital availability of SMCP in the country. The two basic demographic characteristics, namely, gender and level of education of the beneficiaries were also collected. In order to make the samples representative of the population, stratified random sampling technique was used to select 67 beneficiaries from urban and

rural areas. For collecting data from the SMCP, a structured questionnaire was prepared for the management of the SMCP. The responses to the questions were given in percentages (20%, 40%, 60%, 80%, and 100%).

5.2.3. Statistical Analysis

Data entry was done in Excel data sheet and then exported to Statistical Package of Social Sciences (Version 23). After data entry, cleaning was performed. Descriptive analysis was mainly done for the qualitative variables using frequency and percentage. Tables and graphs were used to organize and present the data. Binomial test was used to investigate the significant weaknesses and challenges. Opinions were collected in a 6-point Likert scale as 20%, 40%, 50%, 60%, 80%, and 100%. Opinions which are 50% or more were aggregated to represent occurrence of more challenges. The aggregated percent are tested whether they are significantly greater than 0.5 or not using binomial test. If the aggregated percent is significantly greater than 0.5, using binomial test, it is considered as having more weakness/challenges. If the aggregated percent is significantly less than 0.5, it is considered as showing less weakness/challenges, otherwise it is considered as moderate weakness/challenges.

Moreover, chi-square test and Fisher's exact test were used to perform categorical data analysis. Associations that were found significant using chi-square test were further analyzed using logistic regression to determine the strength and direction of association. P-values less than 0.05 were considered as significant throughout the analysis.

5.3. Data Presentation and Analysis

5.3.1. Demographic Characteristics of MFI Beneficiaries

Of the selected 67 small businesses benefiting from MFI services, an almost even distribution of males (52.2%) and females (47.8%) was observed. With regards to their educational level, the majority (31.3%) of beneficiaries were at secondary level, followed by junior (25.4%), elementary (22.4%), tertiary (13.4%), and illiterate (7.5%).

5.3.2. Beneficiaries' Perspectives on Weaknesses and Challenges MFIs Face

The data collected from the beneficiaries with regards to the cardinal issue of MFI weaknesses yielded some important results. Accordingly, the beneficiaries' pointed to 'lack of diversified new products' (71.7%, p=0.001) as the main significant weakness. Moderate weakness was obtained with regards to MFI products (51%, p=0.464), and enough capital (48%, p=0.807). As can be seen from Figure 5.3.1, the beneficiaries did not consider the SMCP as having any problems with qualified staff and specialized departments (4%, p<0.001), continuous and effective follow up (37%, p=0.049), and proper information to the public (34%, p=0.014).

On the Moderate challenge was observed from beneficiaries on default risk (49%, p=1.000). Misappropriation (24%, p<0.001) and adequate client information (16%, p<0.001) were not rated as challenges to SMCP (figure 5.3.2).

Table 5.3.1: Demographic Characteristics of the study participants, n=67

Variable	Frequency	Percent
Gender		
Male	35	52.2
Female	32	47.8
Level of Education		
Illiterate	5	7.5
Elementary	15	22.4
Junior	17	25.4
Secondary	21	31.3
Tertiary	9	13.4

Note: *Data from* Negash (2020)

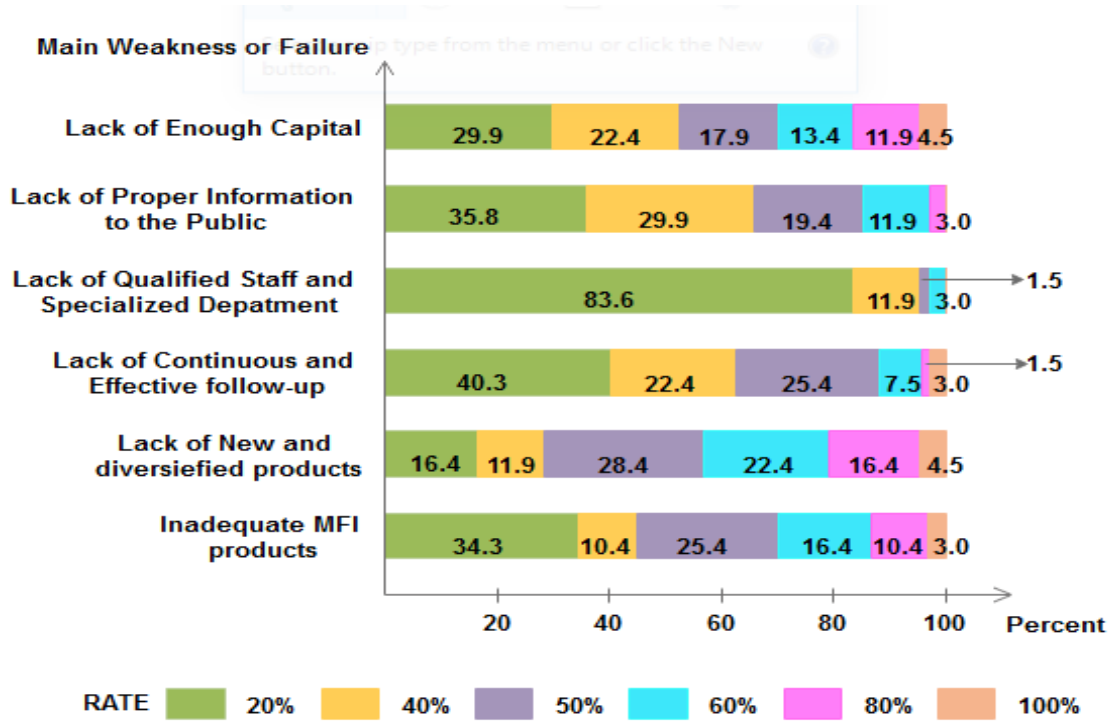

Figure 5.3.1: Main weakness or failure in SMCP as per the observation of beneficiaries, n=67.
Note: *Data from* Negash (2020)

5.3.3. Awareness and Suggested ways of its Improvement

The data overwhelmingly indicated that the majority of beneficiaries were made aware of SMCP and its services by word of mouth, whether it be from neighbors, relatives or friends (Table 5.3.2). The proportion of beneficiaries which reported Neighbor/relative/friends (46.3%) as initial source of information were significantly higher than those who responded TV/radio/newspaper (28.4%, p=0.049), and seminar/meetings (25.4%, p=0.019).

The results showed that the proportion of males and females who accessed initial information from media were 37.1% and 18.8% respectively. Half (50%) of females accessed initial information from

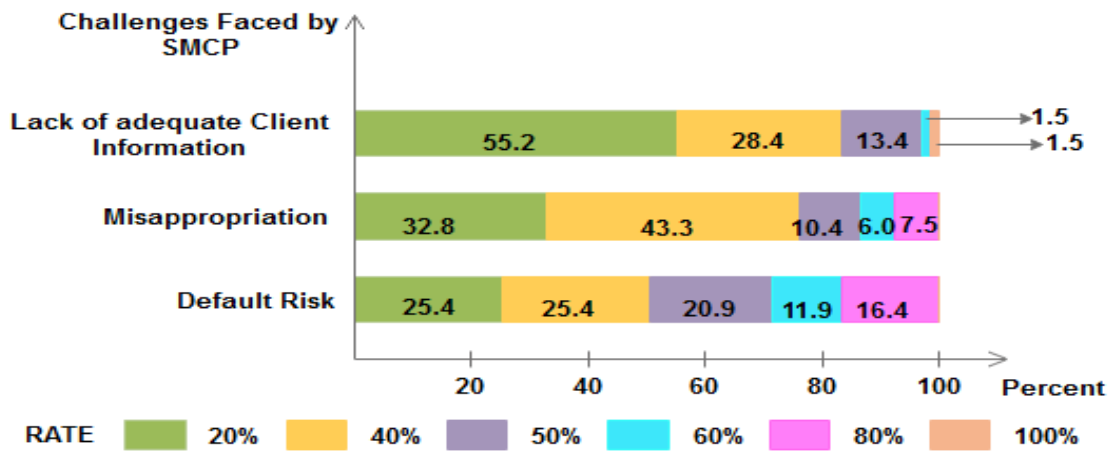

Figure 5.3.2: Challenges faced by SMCP as per the observation of beneficiaries, n=67.
Note: *Data from* Negash (2020)

Table 5.3.2: Initial source of information regarding SMCP, n=67.

Variable		**TV/ Radio/ Newspaper n (%)**	**Neighbor/ relative/ friends n (%)**	**Seminar/ meetings n (%)**
Gender				
	Male	13 (37.1)	15 (42.9)	7 (20.0)
	Female	6 (18.8)	16 (50.0)	10 (31.3)
p-value*		0.095	0.558	0.290
Level of Education				
	Illiterate	1 (20.0)	1 (20.0)	3 (60.0)
	Elementary	2 (13.3)	7 (46.7)	6 (40.0)
	Junior	1 (5.9)	11 (64.7)	5 (29.4)
	Secondary	9 (42.9)	9 (42.9)	3 (14.3)
	Tertiary	6 (66.7)	3 (33.3)	0 (0)
p-value*		0.001	0.580	0.189
OR (95% CI)	Secondary	6.19 (1.60, 23.88)	†	†
Referent=Junior Or below	Tertiary	16.50 (2.92, 93.19)		

**p-value was computed using chi-square test. †Cannot be computed because p-value was not significant*, Note: *Data from* Negash (2020)

neighbor/relative/friends and 42.9% of males used the same access. One fifth (20%) and 31.3% of males and females accessed information from seminars/meetings.

The potential difference in source of information regarding SMCP by gender and level of education was investigated. The results revealed no significant difference about access of information through TV/Radio/Newspaper among males (37.1%) and females (18.8%). Moreover, no significant difference about access of information through neighbor/relative /friends by gender (p=0.558) and seminar meetings (p=0.290) was found.

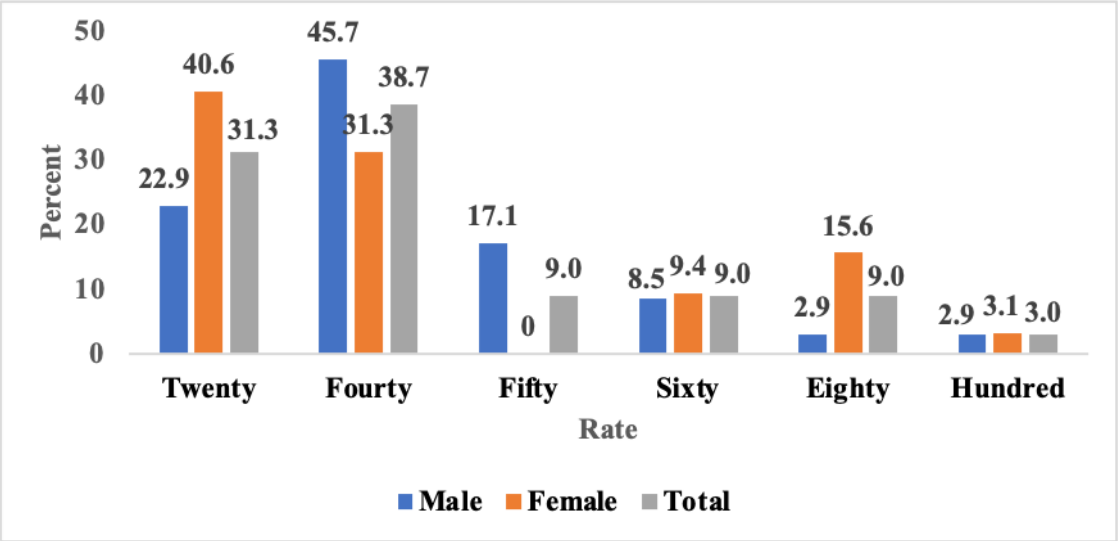

Figure 5.3.3: Opinion of beneficiaries on having enough information to reach MFI by gender, n=67. Note: *Data from* Negash (2020)

Table 5.3.3: Opinion of beneficiaries on having enough information to reach MFI by educational level, n=67.

	Educational Level				
Rate (%)	**Illiterate**	**Elementary**	**Junior**	**Secondary**	**Tertiary**
Twenty	5 (100)	5 (33.3)	8 (47.1)	3 (14.3)	0 (0)
Forty	0 (0)	7 (46.7)	7 (41.2)	9 (42.9)	3 (33.3)
Fifty	0 (0)	1 (6.7)	1 (5.9)	2 (9.5)	3 (33.3)
Sixty	0 (0)	2 (13.3)	1 (5.9)	1 (4.8)	2 (22.2)
Eighty	0 (0)	0 (0)	0 (0)	4 (19.0)	1 (11.1)
Hundred	0 (0)	0 (0)	0 (0)	2 (9.5)	0 (0)

Note: *Data from* Negash (2020)

The five categories of level of education were reduced into three to perform chi-square test on initial source of information by level of education. The three categories are junior or below (Illiterate, elementary, and junior), secondary, and tertiary. Beneficiaries at secondary level of education used media 6.19 times more (95% CI: 1.60, 23.88) than junior or below. Similarly, those at tertiary level used media 16.50 times more (95% CI: 2.92, 93.19) as compared to junior or below. No significant difference in initial source of information through neighbor/relative/friends or seminal/meetings by level of education was observed.

In addition, a breakdown by education level showed that: two third (66.7%), 42.9%, 5.9%, 13.3%, and 20% of the tertiary, secondary, junior, elementary, and illiterate beneficiaries accessed the initial information from TV/Radio/Newspaper, respectively. It must be noted that only 5 of the beneficiaries in this study were illiterate.

An operational definition in figure 5.3.3 is that beneficiaries with enough information are those who rated more or equal to 50%. On the other hand, those who rated less than 50% are considered as not having enough information.

The percentage of beneficiaries who had enough information (30%) to reach MFI was significantly less (p=0.001) than those who had not enough information (70%).

Table 5.3.4: Beneficiaries suggestions on mechanisms of promotion to create awareness by gender and education level, n=67.

Variable		TV/ Radio/ Newspaper n (%)	Seminar/ meetings n (%)	Special Program by SMCP n (%)
Gender				
	Male	20 (57.1)	9 (25.7)	6 (17.1)
	Female	10 (31.3)	11 (34.4)	11 (34.4)
p-value*		0.033	0.439	0.105
OR (95% CI)				
Referent=Females	Male	2.93 (1.08, 8.00)	†	†
Level of Education				
	Illiterate	1 (20.0)	3 (60.0)	1 (20.0)
	Elementary	1 (6.7)	6 (40.0)	8 (53.3)
	Junior	7 (41.2)	8 (47.1)	2 (11.8)
	Secondary	14 (66.7)	3 (14.3)	4 (19.0)
	Tertiary	7 (77.8)	0 (0)	2 (22.2)
p-value‡		0.001	0.004	0.650
OR (95% CI)	Secondary	6.22 (1.92, 20.21)	0.20 (0.05, 0.78)	†
Referent=Junior				
Or below	Tertiary	10.89 (1.91, 62.14)	©	†

**Chi-square test was used to compute the p-value, †Cannot be computed because p-value was not significant, ‡Illiterate, elementary, and Junior are merged to form junior or below so as to use chi-square test effectively, ©one cell was found to be zero and hence OR cannot be computed.* Note: *Data from* Negash (2020)

On the other hand, there was no significant difference of having enough information among males and females (Chi-square value=11.29, p=0.032). A small minority of beneficiaries believe that there is enough information about MFIs (Figure 5.3.3). Approximately 70% of all beneficiaries queried feel that they do not have enough information about the MFI. In this regard, the discrepancies between males and females are too trivial to merit any highlighting.

In Table 5.3.3, we can see that opinions on the adequacy of information about MFI do not show any meaningful variations when beneficiaries are categorized by their education levels. Indeed, for each educational category, an overwhelming majority of beneficiaries put the adequacy of information at 40% or below.

Generally, the beneficiaries suggested TV/Radio/Newspaper and seminar/meetings as mechanisms of promotion to create awareness. Significantly higher (p=0.029) proportion of beneficiaries suggested TV/Radio/Newspaper (44.8%) as compared to special program by SMCP (25.4%). However, the beneficiaries preferred TV/radio/newspaper (44.8%) as equal as (p=0.107) seminar/meetings (29.9%) on mechanisms of promotion to create awareness.

Males suggested TV/Radio/Newspaper 2.93 (95% CI: 1.08, 8.00) times more as compared to females as a mechanism of promotion to create awareness. However, there was no statistically significant difference in mechanism of promotion to create awareness by seminar/meetings (p=0.439), and special program by SMCP (0.105).

In order to make comparisons on mechanism of suggestion by educational level, illiterate, elementary, and junior were merged and called ‘junior or below’ to increase the sample size and perform chi-square test. The result revealed that beneficiaries at secondary level suggested TV/Radio/Newspaper 6.22

Table 5.3.5: Opinion of the beneficiaries on what type of information is needed to increase the awareness of the mass by gender and educational level, n=67.

Variable		What SMCP is? n (%)	Activities of SMCP n (%)	Benefits of SMCP n (%)	How SMCP works? n (%)
Gender					
	Male	19 (54.3)	2 (5.7)	8 (22.9)	7 (20.0)
	Female	9 (28.1)	4 (12.5)	12 (37.5)	5 (15.6)
Level of Education					
	Illiterate	3 (60.0)	0 (0)	1 (20.0)	1 (20.0)
	Elementary	4 (26.7)	0 (0)	4 (26.7)	6 (40.0)
	Junior	6 (35.3)	1 (5.9)	7 (41.2)	3 (17.6)
	Secondary	9 (42.9)	4 (19.0)	6 (28.6)	2 (9.5)
	Tertiary	6 (66.7)	1 (11.1)	2 (22.2)	0 (0)

Note: *Data from* Negash (2020)

(95% CI: 1.92, 20.21) times more as compared to those junior or below. Those who were at tertiary also suggested TV/Radio/Newspaper more than junior or below (OR=10.89, 95% CI: 1.91, 62.14). On the other hand, beneficiaries at secondary level suggested seminars/meetings 80% less as compared to junior or below (OR=0.20, 95% CI: 0.05, 0.78). However, no significant difference among the categories of educational level was observed for special program as SMCP as a suggestion of promoting to create awareness.

The beneficiaries were also asked to suggest their preferred means for disseminating information and awareness about the SMCP. A greater number of males (57.1%) indicated that more media outreach is needed while females gravitated towards seminar meetings (34.4%) and special programs by the SMCP (34.4%). Understandably, when seen from an educational level perspective, illiterates and those with an elementary level of education preferred personal engagements through meetings and special SMCP programs, while those with higher education preferred media as a source of information (Table 5.3.4).

Despite already benefiting from SMCP services, approximately half of the respondents stated that they needed more information on 'What is SMCP?' (Table 5.3.5). About a tenth of beneficiaries (n=6) would like to know about the activities of SMCP, a third (n=20) want more information about the benefits of SMCP, and others (n=12) need to know more about how SMCP works (Table 5.3.5).

5.3.4. Capital Availability of SMCP in the Country

According to the data presented in Table 5.3.6, a little over half of the respondents said that the amount of loans provided were *moderate* to *sufficient.* Still, a significant proportion of beneficiaries, both male and female, are of the opinion that the loans are either insufficient or dependent on the level of business purpose for which they are intended.

We can also notice from Table 5.3.6 that those beneficiaries with a higher educational level are skewed towards the insufficiency of loans axis while the converse is true for those with lower levels of education. The result also showed that there was no significant association between gender and sufficiency on the amount of loan (p=0.842), and level of education and sufficiency on the amount of loan from SMCP (*p*=0.058).

Table 5.3.6: Perceived sufficiency on the amount of loan from SMCP by gender and level of education, n=67.

Variable		Sufficient n (%)	Moderate n (%)	Not Sufficient n (%)	Depends on Level n (%)	P-value
Gender						
	Male	9 (25.7)	12 (34.3)	7 (20.0)	7 (20.0)	0.842
	Female	11 (34.4)	9 (28.1)	7 (21.9)	5 (15.6)	
Level of Education						
	Illiterate	1 (20.0)	3 (60.0)	1 (20.0)	0 (0)	0.058
	Elementary	8 (53.3)	2 (13.3)	3 (20.0)	2 (13.3)	
	Junior	7 (41.2)	5 (29.4)	3 (17.6)	2 (11.8)	
	Secondary	2 (9.5)	7 (33.3)	7 (33.3)	5 (23.8)	
	Tertiary	2 (22.2)	4 (44.4)	0 (0)	3 (33.3)	

Note: *Data from* Negash (2020)

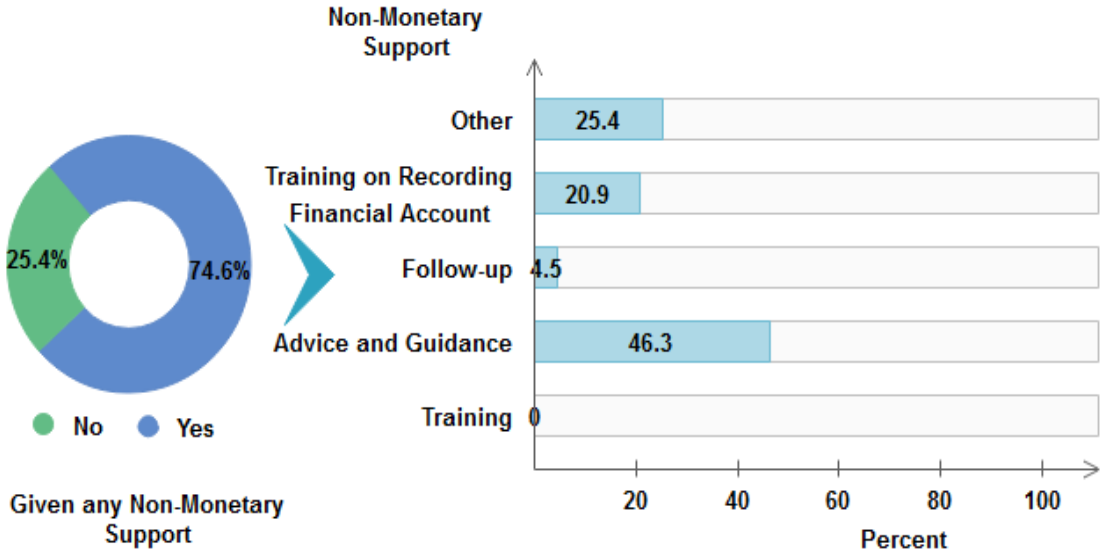

Figure 5.3.4: Non-monetary supports given by SMCP to the beneficiaries, n=67 (Sum of percent on the right might exceed percent who had non-monetary support, because of possibility of multiple response). Note: *Data from* Negash (2020)

5.3.5. Non-Monetary Support for Beneficiaries

A large proportion (74.6%) of beneficiaries attested to receiving non-monetary support from the SMCP. This non-monetary support comes, primarily, in the form of advice and guidance (46.3%) followed by training on recording financial accounts (20.9%) and other unspecified forms of support (25.4%) as seen in Figure 5.3.4.

Table 5.3.7: Sufficiency of the existing SMCP in Eritrea to meet the need of customers, n=67

Variable		Yes n (%)	No n (%)	*p*-value
Gender				
	Male	13 (37.1)	22 (62.9)	0.420
	Female	15 (46.9)	17 (53.1)	
Level of Education				
	Illiterate	3 (60.0)	2 (40.0)	0.069
	Elementary	11 (73.3)	4 (26.7)	
	Junior	6 (35.3)	11 (64.7)	
	Secondary	5 (23.8)	16 (76.2)	
	Tertiary	3 (33.3)	6 (66.7)	

Note: *Data from* Negash (2020)

Table 5.3.8: Level of agreement on launching many private micro credit programs in Eritrea by beneficiaries, n=67.

Variable		No Need n (%)	Twenty n (%)	Forty n (%)	Fifty n (%)	Sixty n (%)	Eighty n (%)	Hundred n (%)
Gender								
	Male	2 (5.7)	0 (0)	1 (2.9)	1 (2.9)	4 (11.4)	6 (17.1)	21 (60.0)
	Female	0 (0)	1 (3.1)	2 (6.3)	1 (3.1)	3 (9.4)	9 (28.1)	16 (50.0)
Level of Education								
	Illiterate	0 (0)	0 (0)	1 (20.0)	1 (20.0)	1 (20.0)	0 (0)	2 (40.0)
	Elementary	1 (6.7)	0 (0)	2 (13.3)	0 (0)	0 (0)	2 (13.3)	10 (66.7)
	Junior	0 (0)	0 (0)	0 (0)	0 (0)	2 (11.8)	5 (29.4)	10 (58.8)
	Secondary	1 (4.8)	1 (4.8)	0 (0)	0 (0)	2 (9.5)	7 (33.3)	10 (47.6)
	Tertiary	0 (0)	0 (0)	0 (0)	1 (11.1)	2 (22.2)	1 (11.1)	5 (55.6)

Note: *Data from* Negash (2020)

5.3.6 Need for Private MFIs in Eritrea

On sufficiency of the existing SMCP in Eritrea to meet the need of customers, 28 (42%) responded 'yes' and the remaining 39 (58%) 'no'. The proportion of respondents who admitted the sufficiency of the existing was not significantly different from their counterparts (p=0.222).

The results also showed that males and females alike agree on the inadequacy of the SMCP and its services (p=0.420). At the same time, though the illiterate and elementary groups seem to state that they are satisfied with the SMCP and its services, there is no significant difference with those of the secondary and tertiary (p=0.069).

To remedy the shortcomings of the SMCP, a vast majority of the beneficiaries support the establishment of private micro credit programs (Table 5.3.7). In this regard, there seems to be no

glaring discrepancies of opinion when seen from the perspectives of gender or educational level (Table 5.3.8).

5.3.7. SMCP Management's Perspectives

Data collected from the SMCP management is presented in the form of percentiles with regards to the various variables, including: strengths, performance indicators, challenges, monitoring procedures, and creating awareness. The results of the interview can be seen below.

SMCP Strengths and Performance Indicators

The management maintains (100%) that SMCP promotes all kinds of businesses, including manufacturing, services, and agriculture. Moreover, the SMCP is portrayed as being effective in alleviating poverty (80%) and promoting economic growth (100%). However, the management conceded that SMCP does not really lend assistance to businesses in crisis (50%).

The main indicators on which SMCP relies for measuring the success of its performance are the number of beneficiaries (100%), the repayment rate (100%), enhancements in borrowers' welfare (100%) and enhancements in borrowers' income (80%). However, the management did not provide any response to queries on the jobs created in the market as a result of SMCP activities.

Source of Capital and Challenges of SMCP

The management clarified that 80% of the funds available originate from government grants while 20% comes from savings and profits.

When it comes to challenges, the management indicated that they are at a 20% level. In other words, there are almost no serious challenges facing the SMCP that may hinder its day-to-day activities.

Monitoring Procedures and Sensitization

SMCP management feels that there may be room for increased monitoring as they are now implementing procedures at a level of 80%. Further efforts in needs assessment and impact assessment are some of the additional procedures that need to be incorporated.

The SMCP management also maintains that awareness programs are being conducted at 50-60% levels. This may seem commensurate with the findings from the beneficiaries which will be discussed in the next section.

5.4. Discussion

Overall, the results of this research paint an interesting picture that juxtaposes the different perceptions of beneficiaries and those of the SMCP management on a wide variety of issues. To start with, a considerable proportion of the business owners assert that the SMCP lacks diversified new products, while those products that are already being offered are inadequate. This seems commensurate with findings from the Middle East (M. Hussein, 2014). However, the SMCP management seems confident in the products and services provided, both in their diversity as well as impact on economic growth. The study finds that this divergence of perceptions between the beneficiaries and the SMCP is an obstacle unto itself.

Moreover, the amount of capital made available to small businesses is insufficient. This can be seen from two dimensions. First, this study has found that a significant proportion of beneficiaries are of the opinion that the loans are insufficient. This is in line with previous research on Eritrea Goto and Negash (2016). Second, it must be noted that the number of beneficiaries represent a minority of small

business owners in Eritrea. Thus, if SMCP is going to play an important role in alleviating poverty and developing the economy, increasing the amount of capital must take into account the non-beneficiary businesses which represent for the majority. The SMCP management has indicated that 100 % of funds are acquired from the government in the form of grants. This is clearly not enough. In fact, a previous study has noted that no additional funds have been injected either from the Government of the State of Eritrea or NGOs since 2006 (Mengistu, 2017). To address the shortage of capital therefore will require increased funding from the government. In the same vein, the government also needs to revise its policy on allowing private financial institutions that can help to fill the gap.

When taking the perspectives of the beneficiaries into account, one finds it interesting that the SMCP management perceives no challenges to its operations and activities. Clearly, this is a serious issue and, if anything, it shows that the drive for augmenting MFIs in Eritrea would be very hard to come from the SMCP itself. However, this should not be about enlightening the SMCP management. Rather, the core issue remains helping small businesses get access to capital.

Indeed, default risk seems to be very little in Eritrea. This has been corroborated by Goto and Negash (2016), where their study found that default and diversion of funds for other purposes was minimal. The SMCP also uses repayment of loans as one of its performance indicators, and the data clearly shows that the management considers it highly successful. These findings give further momentum to the argument that more capital is needed for as many MFIs as possible.

With regards to awareness and sensitization, there seems to be accordance in the findings from the beneficiaries and the SMCP. In other words, the beneficiaries have indicated that they need more information through as many mediums as possible, while the SMCP admits that it is working at 50% capacity on sensitization efforts. Worth mentioning is the fact that the proportion of illiterates and those with elementary education is not insignificant, which underlines the need for more seminars and special SMCP programs.

Chapter 6 Conclusion

6.1. Summary

The thesis revealed the important role of microfinance institution towards small business finance.

This thesis has validated the globally prevailing tried and tested precept that Micro Finance Institutions help to alleviate poverty, stimulate growth and create employment by increasing SMEs' growth and size through the provision of dearly needed resources.

In chapter 3, We addressed the effect of microfinance institution on growth and development of small businesses in Eritrea. Indeed, the figures presented in this study leave no room for doubt as to this fact: 93% of SMEs benefiting from access to MFI credit have seen an increase in their capital. It confirms that, even in Eritrea, MFI help to stimulate growth of their beneficiaries through the provision of dearly needed resources. A proportionate number of SME owners are also satisfied with MFI and their expectations have been met. Yet, it has been found that the number of female beneficiaries remains low when compared to males. Moreover, the types of businesses that are benefiting from the MFI in Asmara, Eritrea seem to be concentrated in the commerce and service sectors.

Financial challenges remain the foremost challenge in the starting of business, followed by problems related to rules and regulations. This is a compelling reason for the expansion of MFI services in Eritrea, not only by making credit available to SMEs but also the provision of training in skills, administration and management. The need for training services by MFI is also consolidated by the findings which indicate that a considerable proportion of SMEs have been diverting the loans for other purposes. A worrying revelation is the fact that many SMEs (70%) had no prior knowledge about MFI prior to this study.

By investigating both beneficiaries and non-beneficiaries, this thesis has been able to bring forth conclusive evidence that, when accessed, MFI loans have a significant positive impact on the growth of SMEs. However, it has also found that there is a big lack of awareness about MFIs and the services that they provide. It is this lack of awareness that has prevented the non-beneficiaries from utilizing loans from MFIs. On top of this, the negative attitude towards loans presents an additional challenge in helping SMEs to address financial shortages and problems in running their businesses. This clearly indicates that not only the non-beneficiaries but also people in general need to be made aware about the MFIs to increase the role of SMEs in the development of the Eritrean economy. Nonetheless, a worrying revelation is the fact that the awareness about the existence of MFI is exceptionally low in the case of Eritrea.

Based on the aforementioned result, we decided to conduct further detailed study about awareness and experience of small businesses towards microfinance in Eritrea.

In chapter 4, the statistical logistic regression analysis reveals that those who has farmer background and whose nature of business is service are significantly more likely to be beneficiaries, on the other hand those who have more employees are less likely to be beneficiaries, that is, those who have large employment seem not to have necessity for MFI's help. On top of that the study found out that those who had adequate capital were more likely to be beneficiaries. This supports the proponents of MFI who argue that MFI can be a real solution to small business finance constraints.

The thesis also found out that those who had regulation challenges at the start of their business were significantly more likely to know about MFI. And also, those whose nature of business manufacturing, those whose education is degree level and those who had adequate capital are significantly more likely to know about MFI. But those who started their business to serve growth

economy were less likely to know about MFI. This result suggests the need for research into the possible reasons for these observations.

At the outset, this thesis attempted to fill a gap in research on MFIs in general. This gap pertained to the levels of awareness and the attitudes of SMEs towards MFIs. However, while reviewing previous literature, it has been found that the gap is far wider than previously conceived. Researchers have tended to focus their studies on the limited MFI activities being undertaken, particularly the beneficiaries. It cannot be maintained that socio-economic justice and development are being promoted by MFIs Habte et al. (2017) while the majority of SMEs remain non-beneficiaries. Also, narrow research perspectives on the characteristics and behaviors of the beneficiaries or groups of beneficiaries fail to provide a fuller picture of the real situation (Asgedom and Muturi. 2014; Lensink and Mehrteab. 2003). Therefore, future research on the domain of SMEs and MFIs needs to follow a more holistic approach. Depend on this result we also conducted another study to find the challenges microfinance face in Eritrea.

Furthermore, in chapter 5, the SMCP proved to create different new product services such as; training and advising to small business owners on how to manage their financial activities through follow ups and control. However, the findings of this study revealed that the scarcity of capital is the main bottleneck to MFI activities in Eritrea. It not only limits the products and services offered by the SMCP but also restricts the number of businesses that could benefit from small loans. Obviously, the Eritrean economy stands to benefit immensely if the number of beneficiaries multiplies.

Overall, the evidences suggest that, the only one governmental MFI could not reach the needs of the potential customers as Eritrea is a fast-growing developing country. This clearly indicates that not only the non-beneficiaries but also people in general need to be made aware about the MFIs so as to increase the role of SMEs in the development of the Eritrean economy. Therefore, the MFI in Eritrea should do more to contribute to development and growth of SMEs and the economy in general.
To achieve this, the following recommendations are put forward:

6.2. Recommendation

This thesis has found evidence to consolidate on the merits of MFI while at the same time making certain interesting new findings. Solving the problem of lack of awareness about MFIs and the negative attitude towards loans rests primarily on the shoulders of the SMCP. Thus, to make MFI in Eritrea more effective the following recommendations should be taken into consideration:

1. Increasing the number of SMEs benefiting from MFI to bring about more robust economic progress
2. Offering training services in skills and management to help SMEs operate their businesses smoothly and to maintain liquidity
3. Diversifying the types of business activities that are getting access to credit; particular focus may be given to agriculture as it is critical to food security
4. Increasing the number of female beneficiaries of SMEs
5. Introducing extensive sensitization programs on MFI activities and their benefits to SMEs. To conduct an awareness program to inform SMEs about the benefits of MFI
6. Galvanizing SMCP operational strategies; in particular, strengthening cooperation with stakeholders at all levels of the community to ensure wider outreach in the population
7. Co-opting successful beneficiaries in the sensitization programs and encouraging them to share their practices
8. Increasing government funds for SMCP
9. Finding alternative sources for capital

10. Allowing the establishment of private MFIs, which will necessarily require policy initiatives
11. Increasing the number of beneficiaries, which means setting new benchmarks for the SMCP in terms of both performance and outreach
12. Conducting awareness programs at higher capacity, with a special focus on communities lacking access to information

At the same time, the government must promulgate policies and create conducive grounds for the privatization and proliferation of MFIs in Eritrea. Above all the government has to allow and encourage private investors to start private MFIs in Eritrea.

Researchers can also contribute positively to these efforts by making studies to identify who and how more people can become beneficiaries of MFIs. And also, more studies are needed to identify challenges to SMEs on a broader scale and how they can be tackled.

Appendices

Appendix A. Questionnaires

A.1. Questionnaires for chapter 3 the effect of microfinance institutions in growth and development small businesses

A.1.1. Questionnaires to Beneficiaries.

SOCIOECONOMIC PROFILE

1. What is the nature of your Business?

a. Manufacturing b. Commerce c. Services d. Others(Please specify)

2. Kindly indicate your gender a. Male b. Female

3. Kindly tell us your age. ---------- a. 18-30 b. 31-45 c. 45-60 d. above 60

4. What is the level of your Education? a. Illiterate b. elementary c. Junior high school d. diploma level e. degree level f. above masters level

5. Background of the owner. a. farmer b. orphanage c. post-war victim d. ordinary

CASE STUDY OF SELECTED SMEs IN THE CITY OF ASMARA.

1. When did you start your business?

2. The challenges you face when you start your business

a. Societal b. Financial c. location d. rules and regulation

3. What was the objective for establishing your business?

a. To generate income to support their family

b. To create employment opportunities for others

c. To be self employed

d. To serve the community

e. For better growth of the economy

4. How many people have you employed? ---------

5. How did you finance when you start your business?

a. Self b. Friends &Relatives c. Partnership

d. loans from banks & finance institutions e. MFI f. Others (Please specify)

6. To get loan from bank what are the requirements

a. collateral security b. good will c. License d. others (please specify)

7. Do you have adequate capital for your business? a. Yes b. No

8. In time of need in what ways do you intend to acquire additional capital for your business? ----------

THE CONTRIBUTION OF MFIs IN THE OPERATIONS OF SMEs

9. Do you know about the operations of Micro Finance Institutions? a. Yes b. No

10. Have you ever applied for credit facility from MFI? a. Yes b. No

11. Have you ever benefited from any services of Micro Finance Institution?

a. Yes b. No

12. Which products of Micro Finance Institutions have you benefited from?

a. Credits b. Financial & Management training c. Others (please specify)

13. Has the availability of MFIs contributed to the enhancement of your managerial skill, financial management skill and overall business knowledge? a. Yes b. No

14. What percentage of loan applied was granted?

a. 100% b. 75-99% c. 50-74% d. 49-20% d. 21-10%

15. How many weeks does it take to access credit from MFI?

16. Does MFIs fulfill your expectations? a. Yes b. No

17. In general, how has the existence of MFIs affected your business?

a. Don't know b. Positive c. Negative d. Unchanged

THE CHALLENGES FACED IN ACCESSING CREDITS (to those who are beneficiaries of MFIs)

18. What kind of credit do you normally request from MFIs?

a. Short term(less than 1 year) b. Medium term (1-3) c. Long term (above 3 years)

19. How many times have you applied for loans from MFIs? -------

20. Out of the number of times you applied, how many times were you successful in getting the loan?

21. Do you find the following criteria for accessing loans from MFIs cumbersome?

a. High interest rate a. yes b. no

b. Collateral security a. yes b. no

c. Cumbersome and bulky documentations before credit a. yes b. no

d. Others (please specify)

22. Do you always get the collateral requested? a. Yes b. No

THE RATE OF UTILIZATION OF CREDITS BY SMEs

23. Have you ever used loans for other purposes apart from business purposes?

a. Yes b. No

24. Apart from your business, what other purposes do you use your loans for?

a. To repay for other loans

b. To solve unexpected family issues

c. To pay for ceremonies like wedding, graduation…

d. To pay for medical bills

e. Others (please specify)

25. Do the loans acquired lead to increase in your capital? a. Yes b. No

26. Kindly suggest how credit misappropriation can be avoided.

27. What comment can you give the MFI in Eritrea to be improved? or

What would you recommend that needs to be done to improve accessibility of microcredit by SMEs?

A.1.2. Questionnaires Non-Beneficiaries

SOCIOECONOMIC PROFILE

1. What is the nature of your Business?

b. Manufacturing b. Commerce c. Services d. Others (Please specify)

2. Kindly indicate your gender a. Male b. Female

3. Kindly tell us your age. ---------- a. 18-30 b. 31-45 c. 45-60 d. above 60

4. What is the level of your Education? a. Illiterate b. elementary c. Junior high school d. diploma level e. degree level f. above masters level

5. Background of the owner. a. farmer b. orphanage c. post-war victim d. ordinary

CASE STUDY OF SELECTED SMEs IN THE CITY OF ASMARA.

1. When did you start your business?

2. The challenges you face when you start your business

a. Societal b. Financial c. location d. rules and regulation

3. What was the objective for establishing your business?

f. To generate income to support their family

g. To create employment opportunities for others

h. To be self employed

i. To serve the community

j. For better growth of the economy

4. How many people have you employed? ---------

5. How did you finance when you start your business?

a. Self b. Friends &Relatives c. Partnership

d. loans from banks & finance institutions e. MFI f. Others (Please specify)

6. To get loan from bank what are the requirements

a. collateral security b. good will c. License d. others (please specify)

7. Do you have adequate capital for your business? a. Yes b. No

8. In time of need in what ways do you intend to acquire additional capital for your business? ----------

THE CONTRIBUTION OF MFIs IN THE OPERATIONS OF SMEs

9. Do you know about the operations of Micro Finance Institutions? a. Yes b. No

10. Have you ever applied for credit facility from MFI? a. Yes b. No

11. Have you ever benefited from any services of Micro Finance Institution?

a. Yes b. No

12. Which products of Micro Finance Institutions have you benefited from?

a. Credits b. Financial & Management training c. Others (please specify)

13. Has the availability of MFIs contributed to the enhancement of your managerial skill, financial management skill and overall business knowledge? a. Yes b. No

14. Do you find the following criteria for accessing loans from MFIs cumbersome?

e. High interest rate a. yes b. no

f. Collateral security a. yes b. no

g. Cumbersome and bulky documentations before credit a. yes b. no

h. Others (please specify)

15. Do you always get the collateral requested? a. Yes b. No

16. If you had loan from SMCP do you think your business would be improved than your current status.

a. Yes b. No

17. In general, how has the existence of MFIs affected your business?

a. Don't know b. Positive c. Negative d. Unchanged

18. What do you think the greatest challenge of Small business in Eritrea? ------

19. In Eritrea do you think it is easy to start a business? Why?

20. What comment can you give the MFI in Eritrea to be improved?

A.2. Questionnaires to chapter 4 for small business awareness, experience and attitude towards microfinance

Socioeconomic Profile		
B1	What is the nature of your Business?	
	B11	Manufacturing
	B12	Commerce
	B13	Services
	B14	Others
B2	Kindly indicate your gender. (Male:1, Female: 0)	
B3	Kindly tell us your age.	
	B31	18-30
	B32	31-45
	B33	45-60
	B34	Above 60
B4	What is the level of your Education?	
	B41	Illiterate
	B42	Elementary
	B43	Junior high school
	B44	Diploma level
	B45	Degree level
	B46	Above master's level
B5	Background of the owner.	
	B51	Farmer
	B52	Orphanage
	B53	Post-war victim
	B54	Ordinary

Case Study of Selected MFIs		
A1	How long have you kept your business?	
A2	The challenges you face when you start your business.	
	A21	Societal
	A22	Financial
	A23	Location
	A24	Rules and regulation
	A25	Other challenges
A3	What was the objective for establishing your business?	
	A31	To generate income to support their family
	A32	To create employment opportunities for others
	A33	To be self employed
	A34	To serve the community
	A35	For better growth of economy
A4	How many people have you employed?	
A5	How did you finance when you start your business?	
	A51	Self
	A52	Friends & relatives

	A53	Partnership
	A54	Loans from banks & finance institutions
	A56	Others
A6	To get loan from bank what are the requirements?	
	A61	Collateral security
	A62	Good will
	A63	License
	A64	Others
A7	Do you have adequate capital for your business?	

A.3. Questionnaires asked to answer chapter 5 that is challenges and risks of the SMCP in Eritrea

A.3.1. Questionnaire for Small Business

1.Kindly indicate your gender a. Male b. Female

2. Level of Education?

a. Below elementary

b. Elementary

c. Junior school

d. High school

e.BA degree

f. MA degree and above

3. How did you know about SMCP?

a. Announcement through tv/radio/newspaper

b. Neighbor/relatives/friends

c. seminars/meetings

d. Special program by SMCP

e. Others

4. Did you have enough information to reach MFI? 20%. 40%. 50%. 60%. 80%. 100%

5. In what ways do you think SMCP can promote to create awareness.

a. Announcement through tv/radio/newspaper

b. Neighbor/relatives/friends

c. seminars/meetings

d. Special program by SMCP

e. Others please specify

6. In your opinion what type of information is needed to increase awareness of the mass about SMCP.

a. What SMCP is

b. What are the activities of SMCP

c. Benefits of SMCP

d. How SMCP works

e. Others please specify

7. Did you get enough amount of loan from SMCP?

a, Sufficient

b. Moderate

c Not sufficient.

d. There is levels that increases from time to time

e. Others please specify…….

8. Did you get any non-material support from any services of SMCP?

a. Training,

b. Advice and guidance,

c. Follow up,

d. Only loan,

e. Basic training on how to record financial account

f. Others please specify

9. Do you think the existing SMCP in Eritrea is enough to meet the need of customers? A. Yes b, No

10. In your opinion what level of agreement would you rate if many private micro credit programs launches in Eritrea. 20%. 40%. 50%. 60%. 80%. 100%

11. In your observation what do you think is the main weakness or failure of SMCP.

a. Inadequate MFI products (supply) 20%. 40%. 50%. 60%. 80%. 100%

b. Lack of new and diversified products 20%. 40%. 50%. 60%. 80%. 100%

c. Lack of continuous and effective follow up 20%. 40%. 50%. 60%. 80%. 100%

d. Lack of qualified staff and specialized department 20%. 40%. 50%. 60%. 80%. 100%

e. Lack of proper information to the public 20%. 40%. 50%. 60%. 80%. 100%

f. Others please specify

12. In your observation what do you think is the main challenges faced by SMCP.

a. Default risk

b. Shortages of skilled human resource 20%. 40%. 50%. 60%. 80%. 100%

c. Misappropriation (Loan diversion) 20%. 40%. 50%. 60%. 80%. 100%

d. Lack of adequate client information 20%. 40%. 50%. 60%. 80%. 100%

e. Lack of enough capital 20%. 40%. 50%. 60%. 80%. 100%

f. Others ……please specify.

A.3.2. Questionnaire for SMCP management

Potential Strength of SMCP

1. How do you rate the principal strengths of SMCP?

a. MFI promote all kinds of business 20%. 40%. 50%. 60%. 80%. 100%

b. MFI is most effective against poverty 20%. 40%. 50%. 60%. 80%. 100%

c. In crisis MFIs role is high 20%. 40%. 50%. 60%. 80%. 100%

d. MFI promote economic growth 20%. 40%. 50%. 60%. 80%. 100%

e. Others please specify……..

2. What are the performance indicators used to assess the effectiveness of your microcredit programs?

a. Number of beneficiaries 20%. 40%. 50%. 60%. 80%. 100%

b. Repayment rate 20%. 40%. 50%. 60%. 80%. 100%

c. Jobs created in the market 20%. 40%. 50%. 60%. 80%. 100%

d. Enhancements in borrower's income 20%. 40%. 50%. 60%. 80%. 100%

e. Enhancements in borrower's welfare 20%. 40%. 50%. 60%. 80%. 100%

f. Others (Please mention) ……..

3. What are your main sources of finance for SMCP?

a. Grants and donations from donors 20%. 40%. 50%. 60%. 80%. 100%

b. Grants from the government 20%. 40%. 50%. 60%. 80%. 100%

c. Savings 20%. 40%. 50%. 60%. 80%. 100%

d. Profits 20%. 40%. 50%. 60%. 80%. 100%

e. Loans from banks 20%. 40%. 50%. 60%. 80%. 100%

f. Others (Please mention) ……..

Challenges and Risks faced by SMCP

4. Indicate the percentage level of agreement of the following challenges

a. Lack of qualified staff and specialized department 20%. 40%. 50%. 60%. 80%. 100%

b. Lack of management capacity in the branches 20%. 40%. 50%. 60%. 80%. 100%

c. Shortages of human resource capital 20%. 40%. 50%. 60%. 80%. 100%

d. Lack of qualified research team 20%. 40%. 50%. 60%. 80%. 100%

e. Inadequate MFI products (supply) 20%. 40%. 50%. 60%. 80%. 100%

f. Lack of new and diversified products 20%. 40%. 50%. 60%. 80%. 100%

g. Low profitability of SMCP 20%. 40%. 50%. 60%. 80%. 100%

h. Lack of vehicles for transportation 20%. 40%. 50%. 60%. 80%. 100%

i. Higher communication cost 20%. 40%. 50%. 60%. 80%. 100%

j. Higher information technology cost 20%. 40%. 50%. 60%. 80%. 100%

k. High utility cost 20%. 40%. 50%. 60%. 80%. 100%

l. Lack of adequate client information 20%. 40%. 50%. 60%. 80%. 100%

m. Unwillingness of clients to provide personal information 20%. 40%. 50%. 60%. 80%. 100%

n. Lack of continuous and effective follow up 20%. 40%. 50%. 60%. 80%. 100%

o. Others please specify…….

5. Could you rate the potential risks of SMCP?

a. Lack of appropriate risk assessment methodologies 20%. 40%. 50%. 60%. 80%. 100%

b. Uncertain source of capital 20%. 40%. 50%. 60%. 80%. 100%

c. Default risk/ Credit risk 20%. 40%. 50%. 60%. 80%. 100%

d. Weak portfolio management and data analysis 20%. 40%. 50%. 60%. 80%. 100%

e. Lack of solid credit risk management policy 20%. 40%. 50%. 60%. 80%. 100%

f. Misappropriation (Loan diversion) 20%. 40%. 50%. 60%. 80%. 100%

g. Other (please specify)

6. Could you rate the potential threats to SMCP mission and strategies?

a. Lack of effective alliances. 20%. 40%. 50%. 60%. 80%. 100%

b. Government rules and regulations 20%. 40%. 50%. 60%. 80%. 100%

b. Quality human resources 20%. 40%. 50%. 60%. 80%. 100%

c. Potential customers. 20%. 40%. 50%. 60%. 80%. 100%

d. Inadequate flow of cheap funds. 20%. 40%. 50%. 60%. 80%. 100%

e. Mitigate risk factors 20%. 40%. 50%. 60%. 80%. 100%

f. Potential competitors 20%. 40%. 50%. 60%. 80%. 100%

g. Others please specify

Systems of services provision by SMCP

7. Do you provide sufficient fund as per the demand of your clients?

a, Sufficient b. Moderate c. Not sufficient. d. There is levels that increases from time to time

e. Others please specify…….…….

8. What is your plan to increase the amount of loan for faithful customers? ……

9. Do you provide services other than loan?

a. Training,

b. Advice and guidance,

c. Follow up,

d. Only loan,

e. Basic training on how to record financial account

f. Others please specify ……

10. Kindly provide suggestions on how non-financial services provided for SMEs can be improved or the plan you have for the future?……

11. Are there any procedures to monitor the usage of the loans you provided? (Yes/No)

12. what are the monitoring procedures?

a. Regular visits to the borrowers in their places to monitor the usage of the loans and provide assistance in case needed. 20%. 40%. 50%. 60%. 80%. 100%

b. Revising documents presented by the borrowers on their project's activities

20%. 40%. 50%. 60%. 80%. 100%

c. Monitoring clients satisfactions and opinions on their loan repayment procedures

20%. 40%. 50%. 60%. 80%. 100%

d. Regular measurement to clients satisfaction about the loans amount and repayment procedures

20%. 40%. 50%. 60%. 80%. 100%

e. Others (Please mention)

How to promote awareness of SMCP

13. How do you promote awareness? What mechanisms do you use to create an awareness.

a. Announcement through tv/radio/newspaper. 20%. 40%. 50%. 60%. 80%. 100%

b. Encouraging beneficiaries to spread the information. 20%. 40%. 50%. 60%. 80%. 100%

c. seminars/meetings 20%. 40%. 50%. 60%. 80%. 100%

d. Special program by SMCP 20%. 40%. 50%. 60%. 80%. 100%

e. Others please specify …….

14. What is your plan to increase the number of beneficiaries?

15. What plans do you have in order to increase the awareness of the public about SMCP.

B. Program

```
install.packages('openxlsx')
library(openxlsx)
install.packages('DescTools')
library(DescTools)
df <- read.xlsx("dummy.xlsx",sheet=1)
df <- read.xlsx("C:/Users/selih/Downloads/dummy.xlsx",sheet=1)
cor1 <- cor(df)
write.csv(cor1,"clipboard.csv")
Beneficiaries <- Bene ~
B11+B13+B2+B31+B33+B41+B42+B44+B45+B51+B52+B53+A1+A21+A23+A24+A25+A31+A32
+A34+A4+A52+A53+A54+A55+A62+A63+A64+A7
ans1s   <- glm(formula = beneficiaries, data = df,family=binomial)
summary(ans1s)
PseudoR2(ans1s)
ans1s <- glm(formula = Beneficiaries, data = df,family=binomial)
summary(ans1s)
PseudoR2(ans1s)
Knowledge <- Know ~
B11+B13+B2+B31+B33+B41+B43+B44+B45+B51+A1+A21+A23+A24+A25+A32+A33+A34+A35
+A4+A52+A54+A56+A62+A63+A64+A7
ans2s <- glm(formula = Knowledge, data = df,family=binomial)
summary(ans2s)
PseudoR2(ans2s)
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df)
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use='all')
cor1 <- cor(df,use='all')
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df)
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use="all")
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use ="all")
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use ="all")
write.csv(cor1,"clipboard.csv")
```

```
cor1 <- cor(df,use ="all")
cor1 <- cor(df,use ="all")
write.csv(cor1,"clipboard.csv")
cor1 <- cor(df,use ="all")
write.csv(cor1,"clipboard.2csv")
cor1 <- cor(df)
write.csv(cor1,"clipboard.2csv")
cor1 <- cor(df,use ="all")
write.csv(cor1,"clipboard.2csv")
View(df)
View(cor1)
View(ans2s)
View(ans1s)
View(df)
cor1 <- cor(df,use ="all")
write.csv(as.matrix(cor1)),"clipboard.csv")
cor1 <- cor(df)
write.csv(as.matrix(cor1)),"clipboard.csv")
cor1 <- cor(df)
write.csv(as.matrix(cor1)),"clipboard.csv")
View(ans1s)
View(cor1)
View(ans1s)
View(df)
View(cor1)
View(ans2s)
View(ans1s)
savehistory("~/R Program.Rhistory")
```

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