

The role of micro and small enterprises (MSE) in local economic development (LED), with a focus on the wood-work MSE value chain

By

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Submitted in accordance with the requirements

for the degree of

DOCTOR OF PHILOSOPHY

in the subject

DEVELOPMENT STUDIES

at the

UNIVERSITY OF SOUTH AFRICA

SUPERVISOR: PROF T GEBRE-EGZIABHER

August 2014

Dedication

This dissertation is dedicated to

Elsa, Eden, and Nebyou

Acknowledgments

There are institutions and individuals that deserve recognition for their support and contribution towards the successful completion of this dissertation. First and foremost, three institutions, namely, the Ministry of Education (MOE), Addis Ababa University (AAU), and the University of South Africa (UNISA) deserve prime appreciation for the sponsorship and support of the entire program. My sincere gratitude goes to my supervisor Professor Tegegne Gebre-Egziabher, AAU, who has been willing to devote his precious time to serve as my advisor for this research endeavor. His support was immense right from the start to the final phase of the work.

I am indebted to Ato Mesert of the UNISA, Ethiopia Country Office, who was accessible, positive and consistently responsive for any request I had throughout the program. W/ro Tsegei (UNISA) also deserves appreciation. I am grateful to Professor Linda Cornwell and Professor FC de Beer of the department of Development Studies, with whom I had the initial contacts. I am thankful to the members of the Higher Degree Research Committee (HDGC) who diligently went through my proposal and allowed me to go ahead with the research work!

I would like to extend words of appreciation to the members of the Department of Public Administration and Development Management (PADM), AAU, in general and Hirut Kebede, secretary of the department, in particular. I would also like to take this opportunity to thank all members of the data collection team. I have to acknowledge many people, including those MSE and sawmill operators and timber traders who were willing and cooperative in providing information. My special thanks should go to Samuel Benti, Manager, Sheger Branch (Factory No. 1) Wood-Works Public Enterprise, Addis Ababa; Dr. Abayneh Derero and Mesfin Woji, Forestry Research Center, Addis Ababa; Ato Fuad Jemal, technical expert, 2RN Solomon Furniture and Wood Products; Alemayehu Negash, Ministry of Industry; Bantihun Gessese, PRO, Federal MESDA; Abebaye Assefa, Limenew Tadele and Wondwosen Ergete, AACG TIDB.

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List of Acronyms

| | |
|----------|---|
| AACG | Addis Ababa City Government |
| AATIDB | Addis Ababa Trade and Industry Development Bureau |
| ACDIVOCA | Agricultural Cooperative Development International / Volunteers in Overseas Cooperative Assistance |
| BA | Business Association |
| BDS | Business Development Services |
| BOP | Balance of Payment |
| CBO | Community Based Organizations |
| CSA | Central Statistical Authority |
| DP | Domestic Product |
| DVC | Domestic Value Chain |
| EEPCO | Ethiopian Electric Power Corporation |
| EPRDF | Ethiopian People's Revolutionary Democratic Front |
| FDI | Foreign Direct Investment |
| FDRE | Federal Democratic Republic of Ethiopia |
| FeMESDA | Federal Micro and Small Enterprise Development Agency |
| GCC | Global Commodity Chain |
| GDP | Gross Domestic Product |
| GS | Government Sector |
| GTP | Growth and Transformation Plan |
| GVC | Global Value Chain |
| IG | Imported Goods |
| ILO | International Labor Organization |
| LD | Local Development |
| LDC | Less Developed Countries |
| LED | Local Economic Development |
| LEDNA | Local Economic Development Network Africa |
| LG | Local Government |

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|------------|--|
| MFI | Micro Finance Institutions |
| MLE | Medium and Large Enterprises |
| MoFED | Ministry of Finance and Economic Development |
| MoUDC | Ministry of Urban Development and Construction |
| MOTI | Ministry of Trade and Industry (formerly) |
| MOI | Ministry of Industry (currently) |
| MSE | Micro and Small Enterprises |
| NGO | Non Governmental Organization |
| OECD | Organization for Economic Co-operation and Development |
| PS | Private Sector |
| SADC | Swiss Agency for Development and Cooperation |
| SME | Small and Medium Enterprises |
| SSA | Sub Saharan Africa |
| TIDB | Trade and Industry Development Bureau |
| UNDP | United Nations Development Program |
| UNECA | United Nations Economic Commission for Africa |
| UN-HABITAT | United Nations Human Settlements Program |
| UNIDO | United Nations Industrial Development Organization |
| USD | United States Dollar |
| VC | Value Chain |
| VCD | Value Chain Development |
| WB | World Bank |

Abstract

This research had an objective of exploring the role of MSEs in LED through analysis of wood-work MSE value chain. The basic research questions underscore what the domestic wood-work value chain looks like; what major weaknesses and challenges confront the operation of MSEs; what major areas of upgrading and inter-firm relations are evident in the sector; and what MSE value chains contribute to LED. The research exercise was based on review of related literature and a field survey, involving MSE operators drawn from the study area (Addis Ababa). Mixed method of analysis (quantitative and qualitative) was employed to deal with the data collected through questionnaires and interviews. Porter's model of VC (1985) and UNIDO's description of wood-work VC (2005) were used to provide conceptual framework. The wood-work sub-sector in Ethiopia has a domestic value chain since main inputs are from local sources, designs are by local producers, and products are for domestic markets. Domestic actors govern the allocation of resources and the distribution of benefits. Public enterprises control plantations hence primary inputs. Wholesalers in turn control inputs, which finally reach MSEs through retailers. Design, production and marketing decisions are made by MSE operators. Middlemen are minor as most of the products reach consumers directly. The value-chain's downstream is thus described by a short distribution-channel. Horizontal, non-market, linkages characterize inter-firm relations; whereas, arm's length market linkages dominate the supplier-MSE-buyer relations. In the absence of "lead firms", wood-work MSE value chains fail to qualify for the mainstream "buyer-driven" model. Without buyer-dominated quasi-hierarchical relationship, MSEs exercise "incremental upgrading" through learning-by-doing. Measures taken to upgrade the production process are considerably inclined to the physical (hardware) aspects of the firm. The MSE value-chain is restrained by internal and external problems. The current state of design marks underdeveloped links in the chain and delays entry into competitive markets. Despite the drawbacks, MSEs enable localities mobilize fragmented resources and create employment. MSEs contribute to LED through the value chain, right from input-sourcing to production and marketing. Inter-firm relations and upgrading efforts uphold the contributions.

Key terms: LED; MSE; Value-Chain; Input-Sourcing; Production; Marketing; Upgrading; Chain-Governance; Inter-Firm Relations

Chapter One

1. Background and Problem Statement

1.1. Introduction

This study has been inspired by the need to look into the role of micro and small scale enterprises (MSE) in local economic development (LED). Since it was very difficult and almost impractical to deal with as many different types of enterprises at a time, the approach was to concentrate on a specific sub-sector from the entire MSE sector. Consequently, the wood-work MSE sector was selected with an aim to applying a modest analysis of domestic value chain in order to broadly appreciate the role of micro and small enterprises in local economic development.

This first chapter provides the groundwork and prologue for the subsequent chapters of the dissertation. The chapter begins with a brief account of country context and proceeds into the fairly specific background of the study, which in turn provides handy context for the major statement of the problem. Following this, the chapter unfolds the research objectives and basic questions that would guide the main course of the research. The study has specified scope/boundary and will ultimately have certain importance for relevant stakeholders. The chapter briefly presents such inter-related subject matters consecutively.

1.2. Brief Account of Country Context

Ethiopia, an African country with a surface area of 1.12 million km², is the world's 27th largest nation. The country (the second most populous in sub-Saharan Africa¹) has a population of more than 80 million, exhibiting one of the highest rates of annual growth, i.e., 2.8 percent, with an estimated density of 114 persons per km² (CSA 2012). The country's average family size ranges between 4 and 5 persons. Fertility rate (births per woman) is about 5.4 and life expectancy is about 49 years (World Bank 2009c; World Bank 2010). One of the world's oldest

¹ Next to Nigeria

civilizations with magnificent historical heritages, Ethiopia, is also one of the world's poorest SSA countries (World Bank 2010). Not only poverty, regional disparity (in terms of development) is also among the most recognized problems of the country (Tegegne 2009a:16). According to MoFED (2008:05), terribly low level of income is "at the root of poverty in Ethiopia". Nearly half of the population is suffering from a substantial magnitude of food insecurity, hence forced to live below the absolute poverty line. Data for per capita income are not readily available; when available their validity is quite uncertain, however (Tegegne 2009a:16). Social services are marked by dire shortages and substandard qualities. Unemployment is an ever escalating phenomenon. At household level, dependency ratio is very high (about 95 percent). As indicated by the country's Central Statistical Agency (CSA), every 100 persons in the economically productive age often take care of themselves as well as additional 95 dependents.

Ethiopia is essentially an agrarian country whose rural population (mainly engaged in agriculture) is more than 83 percent (CSA 2012). The economy is based on agriculture, which accounts for half of the GDP, 60 percent of exports and more than 80 percent of total employment (MoFED 2008; Fund for Peace, 2009). Many other economic activities, including marketing and processing, fundamentally depend on agriculture. Production is overwhelmingly by small-scale farmers and enterprises and a large part of commodity exports are provided by the small agricultural cash-crop sector. Exports are almost entirely agricultural (primary) commodities, like coffee, *khat* (stimulant chewing leaf), oil seeds, flower, hide and skin, live animals, etc. The per capita domestic product is about \$779, which is below the average for SSA (UNDP 2009). The Ethiopian rural livelihood is dominated by subsistence agriculture, whereas the majority of the urban population is principally engaged in the informal MSE sector in one way or another.

Ethiopia has undergone notable political restructuring since 1991. Toppling the military socialist regime from power, the EPRDF has introduced and vigorously practiced a decentralization scheme based on ethno-linguistic criteria. Ethnic based federal structure was formed through what is termed as “devolution of power”. Accordingly, the nation has been divided into regional states with political authority vested in them through the federal constitution. Devolution takes away much of the traditional authorities of the central government to boost the role of regional states in terms of political, economic and administrative powers. Regional states are normally expected to discharge a range of responsibilities at all levels (local as well as regional). It would thus be imperative to appreciate issues of local development more than ever before. The agenda and issues of local economic development (LED) seem to be pronounced given the current political/economic order. Within regional jurisdictions, *woredas* (local governments at district levels) are entrusted with relatively robust economic/administrative duties. LED at all tiers involves local authorities (political/administrative agencies), the private sector² and the community.

To complement the political restructuring, the government has also introduced key reforms in the economic domain. The reforms include privatization of publicly owned enterprises, foreign trade liberalization, deregulation, devaluation, and allowing operation of private banks and insurance companies, which were non-existent for nearly two decades prior to 1991. Such reform measures revealed complete departures from the past and have been thought to be precursors conducive for the functioning of the private sector in the country.

² The private sector in our case is better characterized and represented by ever proliferating micro and small enterprises (MSE).

According to MoFED (2010a), the Ethiopian economy registers on average 2-digit growth of 11 per cent per annum³. Despite this striking growth, the country is still suffering from a number of economic as well as social problems. The Ethiopian foreign trade is overly dominated by the export of primary commodities, which is frequently affected by global price of exports and imports. Narrow industrial sector base, inflation and pressure on the balance of payments (BOP) are among the major challenges to the Ethiopian Economy (ibid). Moreover, the country suffers from escalating population pressure, declining per-head share of arable land, deterioration of the natural resource base, climate-induced hazards, lack of investment capital, underdeveloped entrepreneurship (legacy of poor business culture), increasing rate of unemployment, unstable political order marred by a long history of civil strife and war, inefficient civil service system, heavy brain drain, high level of rural-urban migration mainly in search of livelihood, ... and many more. The list is not exhaustive. But these are nearly unrelenting phenomena in the country's long history.

Given this appalling situation, one may not expect the country to have a relatively well-developed formal industrial sector, which can provide economic and employment opportunities for its already vast and rapidly increasing population. Subsistence agriculture is for rural life whereas micro and small enterprise (MSE) sector, the vast majority of which constitutes informal activities, is for urban life. It is this sector which may fairly accommodate the employment needs of urban population, particularly the youth, both the trained and untrained, the resource-poor, females and other marginalized sections of the population. On account of the current reality, the small and microenterprise sector deserves appropriate policy as well as institutional attention on the part of the government and its partners both at union and local levels. One indication of the presence of attention

³ Though this is the case since 2004, it is mainly due to favorable agro-climate, substantial inflow of foreign aid and remittance, huge expansion in the construction sector, and higher coffee prices than ever before (Alfenburg 2010). This means that, the growth is not ascribed to "competitiveness" of the sectors (ibid).

on the part of the government is the formulation of the strategy and establishment of the agency for MSE development and promotion.

1.3. Background

Globally there are emerging and persisting realities. To be more specific, thanks to the changes in the world economic landscape in the late 1970s through 1980s, micro and small businesses including firms in the informal sector grew in importance in many less-developed countries (LDC). The contribution of MSEs towards employment, poverty reduction, entrepreneurship and innovation is growing in importance. The sector “generates about 6.2 percent of the aggregate employment in the United States, 22.3 percent in China, about 80 percent in India, 67 percent in Japan and about 70 percent in EU countries” (Carter and Jones-Evans, cited in Tegegne and Meheret 2010). It has also been observed that all through the 1950s and 1960s the successful Asian economies have very much benefited from the growth of the MSE sector (Tegegne and Meheret 2010). Micro and small enterprises are noted for sizeable proportions of urban employment, and also considered as the “vital component of Africa’s urban economies” (Tokman, cited in Hyman 1989). The same argument pertains to the situations prevailing in Ethiopian towns and cities.

In Ethiopian towns and cities, MSEs and the informal sector in general are not only the predominant income generating activities but also the basic means of survival. The trend in this case seems to extend even at a faster pace into the future. As clearly indicated in the introductory part of the country’s Micro and Small Enterprise Development Strategy issued in 1997, the proportion of citizens earning livelihood from “the informal sector activities and small scale manufacturing industries is eight times larger than those engaged in the medium and large scale industrial establishments”, substantiating the ever increasing significance of the MSE sector in the economy of the country. The government has formulated the national MSE development strategy primarily because it has

recognized MSEs as “important vehicles to address the challenges of unemployment, economic growth and equity in the country”. The national strategy’s primary objective is “to create an enabling legal, institutional and other supportive environment for the growth and development of MSEs” (FDRE 1997: II). Currently, the 2010/11-2014/15 Growth and Transformation Plan (GTP) of FDRE dedicates especial emphasis to the development of micro and small enterprises sub-sector. As underscored in the GTP document, MSEs play a “significant role in the national development activities, particularly, in the creation of employment opportunities and poverty reduction” (MoFED 2010b). A new MSE development strategy was then formulated in 2011 by a task force led by MoUDC and FeMSDA, with an overall vision of creating a “competitive” MSE sector that sets the basis for industrial development in the country (UNDP 2011:42).

This research project aims by and large at looking into the role micro and small enterprises (MSEs) play in local economic development (LED). Toward this aim, the wood-work subsector is chosen from among the subsectors that have been identified by the GTP (2010/11-2014/15) as well as the new MSE development strategy (2011) as the key (target) areas in the manufacturing sector, which includes food processing, leather and foot-wear, textile, metal-works and agro-processing. The government has intentions to develop clusters of these subsectors in different regions of the country. Cluster development projects are already initiated in Addis Ababa (the capital) and the Tigray Regional State.

Globally, the wood furniture sub-sector is considered to be a big and expanding business⁴, as its trade worldwide is much faster than the world merchandise trade as a whole, including footwear and apparel (UNIDO 2003:1; Abonyi 2006: 2) .

⁴ In 2000, for instance, the furniture business, according to UNIDO (2003) “was the largest low-tech sector, with total global trade worth USD 57.4 billion, exceeding apparel (USD 51 billion) and footwear (USD 36.5 billion)”

In this research, the wood-work MSE sub-sector is studied within the broader perspective of its value chain. This sub-sector is essentially characterized by a domestic value chain (DVC) since the major inputs (raw materials) for the most part are acquired from domestic sources, designs are carried out by the local producers and, most important, forward linkages (via finished goods) are limited to domestic markets.

A value chain (VC) describes the full range of activities undertaken to produce goods and services. The essence of value chain lies in the fact that value is added to the product as it moves through the chain (LEDNA 2012). The discrete activities of design, input, production and marketing constitute the value chain of a given product or service. Likewise, the “resource-based, labor intensive” (UNIDO 2003:1; Abonyi 2006: 2) wood-work value chain is made up of furniture-design, input-supply, production, distribution and sales. Many key stakeholders including suppliers, producers, and buyers are involved in this overwhelmingly buyer-driven⁵ value chain. The firms and the whole range of activities involved at every segment and stage of the value chain contribute to employment creation, poverty alleviation and local economic development (LED).

According to UNIDO (2003), the wood-work sub-sector offers “opportunities for developing countries and their firms to participate effectively in the global economy”. The global wood furniture business is liberalized, entry barriers to the global value chains (GVC) are relatively low, hence can create export opportunities (Abonyi 2006:2). The growth potentials, contributions to LED, participations in the GVC, successes as well as failures of MSEs in general are all strongly linked to the overall performance of their value chains.

⁵ Gereffi (1999:1-2) distinguishes between “buyer-driven” and “producer-driven” value chains and this is adequately addressed in the chapter covering the literature.

1.4. Statement of the Problem

Existing literatures on LED (Blakely 1994; Helmesing 2001, 2005; Guimaraes 1998; Rogerson 2002; Rodriguez-Pose and Tijmstra 2009; Blakely and Nancy 2009; Swinburn and Yatta 2006; Tegegne 1999) remark that there are three major actors of local economic development: the government, the private and the community sectors. The private sector incorporates, among others, economic establishments of micro, small, medium, large and extra-large (heavy) industries. Among these, micro and small enterprises (MSEs) are taken in this study to represent the private sector. MSEs are exceptionally taken to represent the local private sector from among the diverse economic establishments basically because MSEs play pivotal role in economic (and also non-economic) life of localities. Issues like extensive unemployment, deficiency of the formal sector to absorb fairly sufficient level of labor, increasingly heavy capital shortages, the need for local resource mobilization and stimulation of the local economy and other points of concern made MSEs quite peculiar and relevant entities that deserve sufficient attention as well as policy focus in the local economic development initiatives of urban localities.

In Ethiopia, the private sector is substantially dominated by the MSE “operators” (Solomon 2004:27-36; Alfenburg 2010). As discovered by the CSA survey of 2003, MSEs in Ethiopia account for “the bulk of non-agricultural economic activities” and nearly for “95.6 per cent of total industrial employment”. The relative importance of MSEs is growing as a result of the urban population dynamics and the daunting urban poverty level. The urban population increases roughly by 8 % per annum (Zegeye, in Bikila 2011:76) and in Addis Ababa, in particular, the poverty level is about 60%, which means that more than 1.7 million people in the city are living below poverty line (Asmamaw, in Bikila 2011:76). Given the current rapid rural-urban migration and a crippling formal sector, MSEs have become important urban economic activities and hence major hosts of urban employment.

Local Economic Development (LED) is an essential tool for local employment creation and income generation through coordinated resource mobilization efforts (Blakeley 1994; Blakeley and Nancy 2009; Helmesing 2005a). Creation of “employment opportunities” and increased “economic growth” at the local level constitute the very and inseparable objectives of LED (LEDNA 2011). Though there are several strategies, MSEs remain to be the main players in local economic development. Enterprise (particularly, MSE) development is thus considered as the prime “entry point” of LED programs in Ethiopia (UNDP 2011:7). Yet, the ability of MSEs to contribute to LED heavily depends on the strength of their competitiveness. “Competitiveness” in this context is basically the result of the performance of the entire value chain in which such MSEs are situated. The entire value chain includes the series of activities operating until the end product reaches the ultimate users. Beyond that, better performance and competitiveness of local (domestic) value chains would help enterprises enter into global value chains.

MSEs are believed to contribute to the economy in many different ways . Though this is normally the case, there are different problems constraining their performance, competitiveness and ultimate contribution. The problems are either internal or externally induced. Internal problems are closely linked to the limitations and weaknesses of a particular firm, whereas external problems emanate from the broader environment. The external (broader) environment is bifurcated into two layers. The first layer is the immediate environment that principally constitutes the value chain. The second layer is the general environment, including, the economic, policy and institutional milieu that affects the MSE sector as a whole (Gebrehiwot and Wolday 2001; Tegegne and Mehret 2010).

The MSE sector constitutes a wide assortment of economic activities ranging from informal to formal micro and small enterprises. As indicated, the wood-work MSE sub-sector is selected for this research. The wood-work sub-sector in Ethiopia has been identified as one of the key MSE sub-sectors. This sub-sector is

studied within its broader value-chain context. The prospects for growth and the key problems emanate partly (and also basically) from each segment of the value-chain, including design, input-supply, production and marketing outlets. Other auxiliary activities may also have a stake in this regard.

In light of the arguments raised above, this study attempts to deal with issues related to: (i) the performance of the wood-work MSE value chain; (ii) the problems (both internal and external) affecting the survival and operation of MSEs and their value chain; and (iii) how the value chain influences and contributes to local economic development through the interrelated concerns of LED, including local resource mobilization, entrepreneurship, and employment creation.

Many writers have done important jobs to illustrate the nature, operation and contribution of MSEs at large and their contributions to LED in particular. However, such writings take the issues of MSEs with no or little focus on their value chains. For instance, Fitsum (2002), Gebrehiwot and Wolday (2001; 2006), Tsugeureda (2002), Solomon (2004), Tegegne and Mulat (2005), Elias (2005), Eshetu and Zeleke (2008), Eshetu and Mamo (2009) and Tegegne and Meheret (2010) have raised different issues on MSEs in the Ethiopian context. But none of these literatures see MSEs within their value chain perspective. Perhaps one possible reason for not capturing value chains could be that most of the writers have taken MSEs in general with no focus on a particular (specific) industry or sub-sector.

Taking the value chain perspective of enterprises has become the central concern of present-day researches in the field. Value chains are taken because single enterprises “[...] rarely turn raw materials into finished products and sell them to consumers” (Humphrey and Schmitz 2000:9). Various literatures address the essential issues of value chains particularly that of global value chains (GVC). Gereffi (1999); Gereffi, Humphrey and Sturgeon (2005); Humphrey and Schmitz

(2000, 2001); Morris (2001); Fleury and Fleury (2001); Kaplinsky (2000, 2001); McCormick (2001); Dolan and Tewari (2001), and at institutional level, UNIDO (2003), are among the important contributors to the literatures on the operation of global value chains. The mainstream and contemporary research outputs on value chains (importantly, by Gary Gereffi and colleagues) are used as theoretical basis for this study. Moreover, articles by Kuzilwa and Ngowi (2009), Itika (2009), Tegegne (2009b), McCormick, Kuzilwa and Tegegne (2009) are important and recent contributions to the literatures of MSEs operating in the apparel and footwear sectors in Africa. These articles tried to present issues within the relevant value chain systems of enterprises. More recently, the research by Tebarek (2011) also contributed a lot to the study of value chains in the Ethiopian leather and leather products sector. This one focuses on inter-firm relations and governance structures in the domestic value chains. Though Tegegne (2009b) and Tebarek (2011) have seriously taken the value chain perspective, they did not relate it to LED.

Therefore, this particular research attempts to feel the gaps existing in the literature, essentially in two interrelated areas:

- (i) MSEs and their domestic value chains, and
- (ii) The role of such MSE value chains in LED.

In other words, this research is initiated to study the role of micro and small enterprises (MSE) in local economic development (LED) through analysis of the wood-work MSE value chain in the Ethiopian context.

1.5. Research Objectives

This research aims by and large at exploring the role of micro and small enterprises (represented by the wood-work MSE domestic value-chain) in local economic development (LED). More specifically, this research is intended:

- To explore the domestic value chain of the wood-work MSEs;
- To identify the strengths and weaknesses of the value chain;
- To assess upgrading efforts and inter-firm relations;
- To describe the role of wood-work value chain in local economic development;
- To identify the major problems confronting MSEs in the locality; and
- To suggest some possible ways of improving the situation.

The broadly stated as well as the specified objectives call for the formulation of basic research questions. Therefore, the following basic and interrelated questions are raised in an attempt to meet the objectives and also guide the course of this research:

- 1) What does the wood-work MSE value chain look like in Ethiopia?
- 2) What are the major weaknesses/strengths (*internal*) of the (wood-work MSE) value chains?
- 3) What major challenges (*external*) confront the existence/operations of MSEs and their value chains?
- 4) What are the major areas of upgrading and forms of inter-firm relations in the wood-work MSE sector?
- 5) What do MSE value-chains contribute to local economic development?

1.6. Scope of the Study

Helmsing (2001:64) makes distinctions between three main categories of local economic development initiatives, namely, community based economic development, business (enterprise) development, and locality development. The second category (i.e., business/enterprise development) “consists of initiatives that target and involve (cluster of) enterprises”. The third category (locality development) is complementary to the first two categories (Rogerson 2002:6). This research is concerned with the second category (enterprise development) and attempts to look into the role of micro and small enterprises (MSE) in local development, within the context of their domestic value chains. While MSEs are engaged in a variety of businesses, pertinent local government institutions normally operate with the spirit of promoting and enabling the business environment for the MSEs. This is a precise expression of the prime relationship between the two entities. Ultimately, of course, both entities contribute their part to local development in general and creation of employment and stimulation of the local economy in particular.

Several problems are inherent in the nature of MSEs. The MSE sector, as “an assortment of highly heterogeneous business entity, including a variety of informal activities” (FDRE, 1997:2), has a range of characteristics that certainly pose difficulty in the process of selecting and classifying business activities. It is very difficult to consider all sorts of enterprises both in the formal and informal sectors. Partly because of this, only one type of business, i.e., wood-furniture production and sales, is considered for this study. Micro and small wood-work enterprises, which are likely to i) better mobilize local resources (i.e., finance, material inputs, and labor), ii) utilize labor intensive technologies, hence iii) generate employment opportunities for a minimum of 2 and a maximum of 30 persons are the focus of this research endeavor. On top of this, local wood-work enterprises serve as a fertile ground for entrepreneurial development particularly

for the large number of youth; and, to some extent, produce tradable goods that may enable localities and local people to generate more incomes.

LED takes place in a clearly defined local space. The locality selected for this study is the capital city of Ethiopia, Addis Ababa. The types of MSEs considered for the study include private enterprises engaged in wood-furniture production and related activities. The value chain also constitutes sawmill enterprises engaged in the acquisition and processing of logs and timber traders engaged in the distribution of basic inputs (mainly timbers) for the furniture manufacturing enterprises in the locality.

1.7. Importance of the Study

The practice of local economic development, particularly LED strategy, is at its novelty in the most parts of Africa. Exceptions, if any, are usually associated with the LED initiatives and practices of South Africa and few other nations (Rodriguez-Pose and Tijmstra 2009:5). LED initiatives for the most part are merely confused with the conventional local development practices (Ibid). The kind of LED which we may understand in its western context is not yet a full fledged practice in Africa. Nevertheless, LED is getting momentum from time to time. This study will be of some value to the development efforts (poverty alleviation, employment creation, economic growth, and generally local development) in Sub-Sahara Africa, in general and in Ethiopia, in particular.

As in most cases of SSA, the Ethiopian reality can not claim to have a well-established LED strategy and practice. In this respect, the exercise of this study could serve several purposes. The ongoing decentralization processes and the existing regional as well as local government arrangements in Ethiopia naturally call for substantial development efforts at the local level. Development efforts at the local level require concerted engagements of local actors with effective support of regional and federal governments. The prime local actors in this study

are local government institutions and micro and small scale enterprises (MSE) which typically represent the private sector in such an urban setting.

The outcome of this study serves primarily as an input for policy makers both at federal, regional and local levels. Government institutions at all tiers, including micro and small enterprise development agencies, and non-governmental development organizations can use the findings of this study to make reasonably sound policies and decisions in matters related to MSE development in general and creation of employment opportunities in particular. Institutions using this study may benefit from important information pertinent to the operation and vital needs of MSEs, the problems engulfing MSEs and their value chains, the nature and magnitude of relationships between MSEs and local government institutions, and so on.

At micro level, micro and small enterprises (wood-work MSEs and also MSEs engaged in other small-scale businesses that have more or less similar configuration of domestic value chains) can possibly benefit from the findings and recommendations of this study. Those MSEs that aspire to upgrade their operations and products and ultimately have the interest and aim of entering export markets can gain something from this material.

Local Economic Development (LED) is an emerging theory (Blakeley and Nancy 2009:76). Partly because of this, current LED practices for the most part take place in the context of theoretical limitations (Gumareas 1997). Rogerson (1995:vi) also adds that the existing literature on local economic development in the developing world, in particular, is “fragmentary and somewhat underdeveloped”. In this regard, this study attempts to make small contribution to the existing literary stock of LED, with a special focus on micro and small scale enterprises and their value chains in the context of less developed countries of Africa. This modest attempt may also encourage capable researchers to put more

and rigorous research efforts in the areas of LED and MSEs within the broader perspective of value chains.

1.8. Chapter Organization

Logical flow of the dissertation has been supported with coherent organization of the chapters. In chapter one, we have seen the research background, problem statement, research objectives, delimitation (scope) and significance of the study. The upcoming chapters start with the review of literature and wind up with the presentation of concluding remarks.

Chapter two imparts the relevant literature reviewed under three main themes: (1) local economic development, (2) micro and small enterprises, and (3) value chains. Mainstream scholarly works and a number of supplementary literatures are used to compose the central ideas, concepts, possible debates and issues under each theme. The major objective of the review is to see the role of MSEs in LED through the study of MSE value chain, and thereby assess and consolidate the information gathered from the field survey. Chapter three describes the methodology of this research. The research methodology is based on an extensive review of literature and a field survey supported with interviews to the key informants, personal observation, and secondary sources. The data analysis has been both quantitative and qualitative.

Chapter four and five are concerned with description of the profile of MSEs and MSE operators, respectively. The profiles in both cases are constructed on the basis of certain key factors, some of which as suggested (for instance, by Liedholm and Mead 1999) or used (for instance, by Tegegne 2009b; Tegegne and Meheret 2010) in the MSE literatures. Chapter five, in addition to the operators' profile, also presents the description and analysis of certain labor-related data in the sector. Chapter six and seven report the highly interrelated and successive functions of input-sourcing, production and marketing the products. Issues related

to products, product design, manufacturing and distribution are all discussed in these two consecutive chapters.

Chapter eight and nine, consecutively, discuss upgrading efforts and describe and analyze the possible relations among the key stakeholders, namely between and among MSEs (inter-firm relations), between MSEs and input suppliers (which is another version of inter-firm relations), MSEs and buyers and, finally, the nature of relations between MSEs and government institutions.

Chapter ten presents the role of MSE value chains in LED. The chapter maps the domestic wood-furniture value chain, and provides an account of the flow of value adding activities and directions of relationships starting from upstream through downstream segments till ultimately products reach final consumers. The weaknesses of the value chain would also be discussed in some detail. Chapter eleven, the final chapter, presents concluding remarks, including theoretical reflections (insights into the value chains and policy relevance of MSEs), summary and conclusions drawn, and some recommendations and research suggestions.

1.9. Summary

This research has an objective of exploring the role of micro and small enterprises (MSE) in local economic development (LED). The wood-work subsector is selected in this study. This sub-sector (wood-work) has been identified by the new MSE development strategy (2011) as one of the key (target) areas in the manufacturing sector together with food processing, leather and foot-wear, textile, metal-works and agro-processing. The wood-work MSE sub-sector has been studied within the broader perspective of its domestic value chains (DVC). This sub-sector has a domestic value chain mainly because most of the inputs are acquired from internal sources and forward linkages (via finished goods) are limited to domestic markets. The wood-furniture MSE domestic value chain is made up of furniture-design, input-supply, production, distribution and sales. In

view of this, the chapter has provided broader context, including brief account of country context and background for the study. The chapter then dealt with preliminary issues of the research including problem statement, objectives, scope and importance of the study.

Chapter Two

2. Literature

2.1. Introduction

This review of literature imparts the experiences and main issues related to the role of micro and small enterprises (MSE) and their value chains in local economic development (LED). It has been frequently noted that micro and small enterprises constitute significant component of the urban economies. In situations where large industries are underdeveloped or scarce, the role of MSEs in local development becomes an issue of particular relevance.

The discourse begins with presentation of the rationales for LED, different ideas/concepts and environmental context of LED and proceeds into the role of MSEs in local economic development. The part local government institutions play in promoting MSEs and enabling the environment for LED is also relevant. This part of the literature relies mainly on the works of Helmesing (2001, 2005), Blakeley (1994), Guimareas (1997, 1998), Rogerson (2002); Rodriguez-Pose and Tijmstra (2009), Swinburn and Yatta (2006), the World Bank (2009) and ILO (2001, 2005, 2007), among others.

The role of MSEs in LED is studied within the broader perspective of MSE value chains. The literature thus discusses the key concepts, dimensions and issues of global as well as domestic value chains, with particular emphasis to the wood-work (furniture MSE) value chains. The literature in this regard heavily relies on the works of prominent writers, including, among others, Porter (1985); Gereffi (1999); Gereffi, Humphrey and Sturgeon (2005); Humphrey and Schmitz (2000, 2001); Morris (2001); Kaplinsky (2000, 2001); and McCormick (2001).

2.2. The Rationales for Local Development

Development strategies are undergoing major changes and paradigm shifts⁶. The changes are quite frequent partly and may be because “there are clearly no sure-fire formulas for success” (Hoff and Stiglitz 2011: 389). Some development strategies work better for a while and in some countries and may not in others. What is right in one place may not be so somewhere else (ibid; Pat Caplan 1994:1). The rationales for local economic development could be diverse and complex. However, attempts are made here to capture the rationales under two broader themes: (1) from “development-from-above” to “development-from-below” and (2) globalization and localization.

From Development-from-Above to Development-from-Below: a paradigm shift

Many writers (including Swinburn and Yatta 2006; Birkholzer 2005; Rogerson 2002, Helmsing 2005; Rodriguez-Pose and Tijmstra 2009) have noted that there are shifts from traditional development strategies (mainly focusing on supply-side sectoral approach) to territorially based alternative development strategies, commonly known as local economic development, shortly expressed as LED. The conventional (highly centralized) development strategies and policies had so far little impact on the growth of the marginalized and developing regions (ILO 2001:4). Such policies have only contributed for the growth of “the most dynamic areas of a weak region, such as large cities or relevant urban centers”, merely exacerbating the existing regional imbalance (ibid). Swinburn and Yatta (2006:3) also indicated that sectoral (supply-side) development strategies could not achieve the “once hoped for results”. Conventional macro-economic policies are necessary, but not sufficient to achieve broad-based and sustainable economic growth in developing countries (ibid).

⁶ Changes of minor and modest magnitude are common trends in every facet of life. Paradigm shifts, however, transpire whenever a particular institution or model is regarded as “not doing well”. Consequently, new and hitherto untested institution/model will be sought hoping that it would work better under the current realities (Singh 1999:2).

Birkholzer (2005:2-3) gives an account of four scenarios that would help us appreciate the specific characters of economic development. The 1st scenario is “development from above”, in which case the main actor is the state that decides and works top-down from the center to local levels. The 2nd scenario is “development from outside”, which in several cases shares features of the first option. Under both options, local actors appear to believe that they can not stand on their own. “Development from outside” requires outside “investors” that can bring in money and other necessary resources. The 3rd scenario is “wait and see”, when the local actors remain more or less passive hence waiting for things to come and happen. This is a state of *fatalism*. The 4th scenario is “development from within”. In this scenario, the local actors play the key role and this is at the hub of LED.

Nations have experienced different models to realize economic development. Nelson (in Elias 2005) asserted that despite their variety, economic development models may be put in a nutshell under two principal “schools of thought”: *development-from-above Vs development-from-below*.

Development-from-above perceives development as essentially “emanating from the core and growth centers and trickling out to the peripheries and hinterlands” (ibid). According to Nelson, this approach draws its theoretical perspective from “the economic development and modernization theories of capitalism”. In order to achieve economic growth, development has to be “uneven both in functional and territorial space”. This model aims at achieving functional integration wherein leading regions expand into lagging regions and resources of lagging regions are made accessible to leading regions. Taken at the global scale, development-from-above means that development experiences and patterns should trickle down from the industrialized nations to the LDCs. Less developed nations often fall under tacit and at times explicit obligations to imitate things done in the west (or other high-income countries).

The development-from-below school, on the other hand, primarily argues for nations, regions or localities to take control of their own resource bases and institutions to initiate economic development and create strong ground for employment opportunities in the nation, region or locality (ibid). Helmesing (2005a:23) noted that the “endogenous” views of development-from-below, which emerged in reaction to the “exogenous” views of development-from-above, rely much on “local resources, enterprises and actors”⁷.

Experiences have demonstrated that top-down models have generally proved failures in many countries (including Ethiopia) mainly on account of incompatibilities between exogenous forces and internal (local) realities. Today, much is said about bottom-up rather than top-down, decentralization rather than center-down, and in LDCs, in particular, small and medium enterprises (that would use local resources) rather than attracting outside (mainly) heavy industries, i.e. *industrial boosterism* (Rogerson 1995: vii) and, of course, local development initiatives rather than nation-state controlled economic growth schemes.

Another relevant point to mention at this juncture is the decline of “Regional Planning”, whose key aim was to reduce regional disparities and spatial concentration (Tegegne 2009:3). Regional planning has been on decline since the early 1970s through 1980s essentially with emergence of LED as an alternative practice (ibid). The central cause for the decline of regional planning, according to De Mattos (in Guimaraes 1997:282), was the “disappointment it entails”: its inability to redress the spatial imbalances and bring about more balanced and fair national development processes. Even if the efforts of regional planning were in place, the root causes for regional disparities have not been deeply altered. The changes brought about by regional planning efforts, “in the most optimistic cases”, have only been “modest” (Guimaraes 1997:282). Such “disappointing” results are

⁷ As Nelson (in Elias 2005) puts it: “development-from-below, fundamentally aims to create regional autonomy through integration of all aspects of life within a territory defined by its culture, resources, landscape and climate”

not surprising given inadequate commitments and just few resources dedicated to regional planning efforts⁸ (ibid). Consequently, Gilbert (in Guimaraes 1997:282) remarked that, regional planning /policy has “[...] disappeared without a trace in most Third-World countries”.

The dissatisfaction with the “trickle down” premise has initiated ways for a more meaningful concept and practice of development (Hasan 1998:12). Consequently, LED topples the traditional top-down practice and replaces it with *local* bottom-up approach. The LED approach focuses on an endogenous development from below and development of a region or locality rather than an industrial sector (ibid). LED is a bottom up approach aimed at ensuring “equitable economic growth through unleashing the economic potentials of every territory” (LEDNA 2012). Pat Caplan (1994:2) also strongly argued that “development begins from below; it can not be imposed from above”. This does not, however, mean that nations (including localities) can not use external help, expertise and technology. The bottom-up (endogenous) development view has been increasingly taken as an “alternative development” line in recent years (Helmsing 2005a: 23; Rodriguez-Pose and Tijmstra 2009). The OECD (in ILO 2001:9) also firmly recognizes that,

“one of the most important trends in recent years, and one that is linked to the emergence of the local development approach itself, has been a reorientation of economic and social policy away from ‘top down’ sectoral instruments towards ‘bottom-up’ local development strategies. ‘Top-down’ instruments to create new physical infrastructure (such as transport and communications facilities and industrial sites and premises),

⁸ Partial explanation for the decline of regional planning and regional policy, according to Guimaraes (1998:23), is the widespread adoption of the “new” model of development by the developing countries. This new model is heavily backed by the international financial institutions like the World Bank and IMF. The new model is characterized by “reduced government intervention in the economy, liberalization of domestic markets, privatization, increased emphasis on the private sector as the engine of economic growth, lowering of barriers to foreign trade and the introduction of export incentives”. These new forces greatly cause the space of regional policy and planning to shrink and eventually vanish (ibid).

to implant externally-owned investments or to support declining sectors have often failed to lead to the anticipated trickle-down and growth in lagging areas. By contrast, [...] ‘bottom-up’ support for endogenous development can be highly effective in supporting long-term development through measures such as support for entrepreneurship, developing human capital, spreading innovation and building local institutions and firm networks [...]”

Globalization and Localization

Another perspective to grasp paradigm shifts is to look into the operation of two dominant forces: *globalization* and *localization*. Singh (1999:1) noted that development strategies of nation-states have been undergoing considerable paradigm shift due to, among other factors, two dominant forces: one of globalizing processes operating from outside, and the other internal (localization) forces operating indigenously from within.

Globalization, in sharp contrast to “state-centrism” (Sklair 2002:5-29), reflects the progressive integration and interdependence of the world’s economies. It calls for governments to seek international partners as the best way to manage changes affecting global business (flows of goods and services), financial flows, and the global environment (Gereffi *et al*, in McCormick, Kuzilwa and Tegegne 2009: 4; Singh 1999: 1). Globalization thus is becoming increasingly pervasive as more and more nations join the global production and market systems (Blakely and Nancy 2009: 7). Globalizing forces exert pressures on governments of nation-states to do more in terms of infrastructure and institution-building to create an “enabling environment” for growth and development (Singh 1999:1; World Bank, in Loop 2000:4). Globalization, as per the words of Helmsing (2005b: 314), is reducing the position of the state to the level of facilitation.

Localization (the internal) forces, on the other hand, necessitate decentralization, deconcentration and devolution of government and fiscal powers, as well as more and wider participation in decision-making and organizational processes. Localization (as opposed to globalization) suggests the rising aspiration of people

for greater voice in their government. Localization displays itself in the assertion of local and regional identities. It pushes national governments to reach down to regions and localities as the best way to manage changes affecting local politics and patterns of growth (Singh 1999:1; World Bank, in Loop 2000:4).

The two trends (globalization and localization) shouldn't be considered as mutually exclusive phenomena, however. The two should rather be taken as "reciprocally reinforcing" processes (ILO 2001:20). A new term, *glocalism*, has thus been emerging to express the "possible role of local economies in a global context" (ibid). In this regard, an important and recent theoretical development, as observed by Guimaraes (1998:25), is the link often made between LED and the global scene (globalization).

The national government plays an important role in local economic development planning (Blakely and Nancy 2009: 40). Nevertheless, in a world context characterized by escalating international competition and globalization, the nation state is surrendering much of its capacity to stir up and manage development processes (Swinburn and Yatta 2006:3). This loss, together with the fact that "economic development has become increasingly a *localized* phenomenon" (Rogerson, 1995:v) is leading to the emergence of the locality or region as "the economic space in and for which coordinated efforts to promote wealth-creating economic activities can be meaningfully undertaken" (Cook, in Guimaraes 1997: 283).

Advancing processes of globalization and (its antithesis) localization, the decline of regional planning and policy, the weakness and malfunctioning of the top-down models and approaches of development and other socio-political and economic changes may have caused paradigm shifts through which the need for locally-based development (LED) has been taking shape in different parts of the world through time.

2.3. Local Economic Development

Local Economic Development (LED), as per some writers (for instance, Rogerson 2002; Swinburn and Yatta 2006; Rodriguez-Pose and Tijmstra 2009), has an Anglo-Saxon origin and its practices have gradually spread to the other parts of Europe and the rest of the world. Rodriguez-Pose and Tijmstra (2009:5) noted that in comparison to the other parts of the world, practices and examples of LED in Africa are still relatively scarce.

LED, according to Guimaraes (1998:22-23), describes a practice without sufficient theoretical foundation. It lacks substantive, relatively comprehensive and applicable, theory. As a result, “local development planners are often forced to work with extremely scarce resources and to rely on partial and fragmented theories of some use but of limited and uncertain applicability” (ibid). Nevertheless, notable moves have been made by a number of prominent scholars (for instance, Blakely 1994; Helmsing 2001) and several others to define LED and describe its salient features.

Helmesing (2005a) defines LED as a “process in which partnerships between local government, community-based groups and the private sector are established to manage existing resources to create jobs and stimulate the economy of a well-defined territory.” LED initiatives, therefore, assume the presence of a certain minimum level of “institutional thickness”⁹ or density of public, private and civil society actors (Ibid). In the words of Blakeley (1994), LED is an endogenous development process that relies on the potential of local human, material, natural and institutional resources. Supporting Blakeley’s argument, Guimaraes (1998:24)

⁹ The idea of “institutional thickness” explains the presence and operation of institutional forces (and the social and cultural factors) in a given locality. “Institutional thickness” as a concept has been developed by Amin & Thrift (1993) in their attempt to “discuss the prospects of local development in a process of globalization” (Lathrop 1997: 100).

maintains that LED is fundamentally “based on variables controlled from inside the area”, not on the resources allocated from outside.

Various international agencies (for instance, the World Bank, ILO, UNDP, UN-HABITAT, ACDIVOCA and SADC) draw on tailored definitions of LED that suit their respective objective and mode of operation. In all cases, however, the LED definitions apparently demonstrate processes in which “local actors shape and share the future of their territory” (Canzanelli 2001, in Rodriguez-Pose and Tijmstra 2009:3; ILO 2001:9). At least five key assumptions can be derived from LED definitions: (1) LED is based on territorial approach; (2) LED is endogenous, i.e., heavily relies on local resources (variables controlled from inside the area) and locally owned ; (3) LED is a strategically planned process that provides “context-specific solutions” for local problems; (4) LED is best achieved through participation, social dialogue and partnership of all actors - private, public sector, people; and (5) LED is a process that focuses on enabling conducive local business environment for all actors (ILO 2005: 6-7; Swinburn and Yatta, 2006:5; Helmsing 2001:63; Hasan 1998: 2; Guimaraes 1998:24; Lathorp 1997:95; Blakeley 1994).

The prime objective of LED, sometimes the sole rationale for local development efforts, is “boosting local employment” (Blakeley and Nancy 2009:94). Though this is the case, it at the same time has the broader goals of stimulating sustainable “economic growth” (ILO 2010), achieving local economic stability, building diverse economic, hence employment, base (Blakeley 1994) and ultimately improving the “quality of life for every one, including the poor and the marginalized” (Cunningham and Mayer-Stammer 2005; Rodriguez-Pose and Tijmstra 2009). Successful LED strategies accompanied by productive use and effective management of local resources lead to an increase in the local economy’s capacity that generates wealth for local people (Bartik 2003).

LED takes place in a certain *local space*, which may be defined as “a geographical unit of intermediate scale, above the community and below the regional and national levels” (World Bank, in Wandscheider 2004: 1). In the urban setting (including hinterlands), *local* is described as “any urban area ranging from large cities to small towns and the rural areas linked to these urban centers” (Wandscheider 2004:2). Locality is understood as a part (sub-set or small-scale) of a larger whole (a region or a country). The term essentially stands for “specificity of areal content and something of uniqueness” (Singh 1999:3). Local systems are smaller in size than (and generally different from) national systems, but not less complex than the national systems (Guimareas 1998: 32).

LED presupposes the practices of *locality development* and *local economic base*. Locality development refers to the creation of enabling environment through improving the key factors, mainly *public goods*, which “determine the attractiveness of a locality for business expansion and investment” (UNDP 2011: 18). The key factors imply the “tangible” (hard) and “intangible” (soft) infrastructure of a locality. The tangible factors relate to the most basic economic infrastructure like transport and communication infrastructure, availability and cost of land and energy, etc. The intangible factors, on the other hand, relate to such qualities as “competence, efficiency and business-mindedness of public administration, economic climate and image of the locality (town or region), proximity of supporting industries, universities, research institutes, etc. (ibid). According to Helmsing (2001:71, 2005a: 301-303), locality development describes the comprehensive planning and management of the physical and economic development of a given area¹⁰.

¹⁰ It relates to the management of the whole local area, i.e., the “built up physical infrastructure and economic and social overhead capital of the locality, which minimizes negative externalities (pollution, congestion,) and maximizes positive externalities (agglomeration economies)” (2001:71, 2005a: 301-303).

One of the central interests of LED is its concern for the development of the “The Local Economic Base” of an area (Helmsing, 2001; 2005b). The local economic base refers to the set of activities involving the export of products and services to outside the area under consideration. For that reason it is also called the “export base” of an area or locality. The destination of these exports can be anywhere, in other parts of the same country (domestic markets) or abroad (foreign markets) (Helmsing, 2001:68; Helmsing 2005b:302). Bartik (2003:5) describes “exports” and “imports” in the LED context: Exports are “goods or services sold outside the local jurisdiction”, while imports are “goods or services purchased by local residents or businesses, but produced outside of the local jurisdiction”¹¹.

Pro-poor Vs Pro-growth LED

Davis and Rylance (2005:12) disclose that LED initiatives often encounter a “contradiction” between the aims to “foster economic empowerment” and to “eradicate poverty”. An economic empowerment approach might seek to encourage successful entrepreneurs who can provide employment to others. A poverty eradication approach, on the other hand, aims at reaching as many poor households as possible to enable them generate income and alleviate poverty. So these two approaches are either “entrepreneurial” (in the case of the former) or “welfarist” (in the case of the latter). This trend of contradiction between economic empowerment and poverty reduction is common in LED (ibid). However, writers like Meyer-Stammer (2010) are too critical and insist that LED is “about competitiveness” not “community development”. In other words, LED is entrepreneurial not welfarist.

Practices of local economic development in SSA, in particular, and in developing countries, in general, are at their very infant stage. A number of key factors,

¹¹ Bartik (2003:5) contends that economic development policies are likely to raise the total number of jobs in the local economy when these policies assist new businesses to emerge or existing businesses to expand that add to the local economy’s “export base” or substitute for local “imports”.

including, among others, weak governance structure, highly limited organizational capacity, and shortage of skills undermine the overall application and effectiveness of LED in these parts of the world (UN-HABITAT 2009:2). Writers in the area (for instance, Rodriguez-Pose and Tijmstra 2009:5) contend that LED experiences in SSA frequently tend to focus on the social (community) dimension of LED than its economic dimension. Thus it often becomes *local development* or community development than implying true/proper local economic development (LED) strategies. Other writers like Swinburn and Yatta (2006:3), Rogerson (2002:2), Hasan (1998: 2), Helmsing (2005) also share similar viewpoint. In this regard it is useful to see that the extensive writings of Bert Helmsing, in particular, are very much ingrained in the LED practices of the developing world (including Africa) than in the vibrant experiences of the North (Rogerson 2002:5).

LED experiences in SSA are usually identified with survival, self-reliance and poverty reduction than competitiveness and participation in the global commodity chains (Binns and Nel, in Rodriguez-Pose and Tijmstra 2009:5). The “narrowly-focused” pro-poor LED strategies are essentially about achieving social rather than economic goals (UN-HABITAT 2009:2). Such strategies address important problems, but leave many of the economic causes of underdevelopment intact (ibid). In Africa, the term has been used to name what is “one of the constituent parts of LED than the whole” (Rodriguez-Pose and Tijmstra 2009:5). This trend is creating confusion and giving the wrong impression that the goals of “growth” and “poverty reduction” are somehow mutually exclusive (ibid).

The proper LED approaches experienced in the West, Latin America and Asia are almost absent in SSA. Examples of LED strategies that may combine “pro-growth” and “pro-poor” components are rare in SSA and often confined to such countries like South Africa that already have better developed, urbanized and globally linked economy than the rest of the continent (Rodriguez-Pose and Tijmstra 2009:6; Swinburn and Yatta 2006:3). LED strategies in Africa generally

share the goals of poverty reduction and of a greater inclusion of previously marginalized and excluded groups in social and economic life (ILO 2010:14; Rodriguez-Pose and Tijmstra 2009:5).

To wind up, LED interventions can generally range from “pro-growth” (market-led) to “pro-poor” (market critical) approaches (Scott and Pawson, in Rogerson 2002: 3; UNDP 2011:16). Recently, however, as part of the millennium development goals, important distinction (of priority) has been made between economic growth as the “immediate goal” and poverty eradication as the “overall goal” of LED (Hindson and Mayer-Stamer 2007: 8-9). Nevertheless, Rogerson (2002:2) argues, pro-poor strategies cannot be “the defining axis in LED planning” in the developed world, while such strategies are at the heart of LED planning in the developing world. This is an issue giving rise to a policy “divergence”, in stead of “convergence”, in the international LED context, between the developed North and the developing South (ibid).

LED Generations

Local development practices could have existed for long. But the issue of LED was until recently not on the political agenda and also not sufficiently recognized in the conventional economic thinking (Birkholzer 2005:1). Two conventional approaches – microeconomics and macroeconomics – have existed so far (ibid). According to Nel, in Rodriguez-Pose and Tijmstra (2009:3) and also Birkholzer (2005:1), terms like “local economy” and “LED strategies” appeared on the political agenda, in development strategies and in the academic world firstly in some Anglo-Saxon countries¹² and spread out very slowly into other European countries and remain still unknown in a lot of others. Rogerson (1995:v) also stated that planning for local economic development has appeared as the main scholarly and policy research focus since the 1980s. LED strategies have

¹² High-income countries of the North

generally emerged as a response to the social and economic problems that resulted from the persistence of locally specific problems.

Since the 1960s, LED has passed through three broad stages or “waves” of development (World Bank 2009a). Each of the waves has its own spotlight and instruments. In each of these waves LED practitioners have developed a better understanding of LED (both effective and failed) programs. LED policy and practice is currently in its “third wave”. Although LED has moved through each of these waves, elements of each wave are still practiced today. The first wave of LED was experienced during the periods of 1960s to early 1980s; the second wave from 1980s to mid 1990s; and the third wave from late 1990s onwards (Ibid; Davis and Rylance 2005:3-4). (See Annex 4.2: LED generations)¹³

The third wave is the new generation of LED. According to Helmsing (2001:63; 2005a: 23), local economic development, in the new generation (the third wave), is described as: multi-actor, as its success depends on its ability to mobilize public, private, and non-profit/community-based actors; multi-sector, as it refers to the public, private and community sectors, and multi-level, as it operates locally within the context of national and global processes. Globalization, with its threats and opportunities, requires local initiatives to be framed through the analysis of global changes. LED increasingly presupposes a multi level mode of thinking globally and acting locally.

The Role of Local Government Institutions

Local development is increasingly regarded as a major local government responsibility (Bartik 2003:2). First, local governments are to provide “the right mix of local public goods”. Local governments are made more and more

¹³ Swinburn and Yatta (2006:8), instead of narrating the three waves consecutively, draw contrast between *traditional* and *modern* LED practices. The *modern* category perfectly corresponds to the third wave of LED generations. (See Appendix 4.2 LED Generations)

responsible for local needs in infrastructure facilities and services. However, in most countries (particularly in SSA) one cannot speak of sustainable availability and provision of such services due to financial, managerial, human resource, and regulatory constraints (Helmsing 2005b: 312-313). Second, local governments are expected to “facilitate or *enable* the other actors make their most productive contribution” (Helmsing 2001:63). Moreover, the success of the LED process is very much dependent on the “horizontal cooperation between the local government and other local stakeholders”, primarily including the private sector (Rodriguez-Pose and Tijmstra 2009:7). Local government takes a lead in playing a facilitative and coordinative role by creating an enabling environment to bring all the sectors together under a common objective of local development. It should be noted, however, that the other actors, namely, the PS and CBO, including NGO, in contrast to the public sector, are “far from the planning and policy formulation processes of local economic development” (Tegegne 1999:1). The public (government) sector is always responsible for public policy, planning and major decisions in the public domain.

Local governments (LGs) have important roles to play in the promotion of LED, as LED is among the most important tasks of local governments (Cunningham and Meyer-Stamer 2005:2). Though they have a lot of roles, the major ones can be recapitulated from the works of Blakley (1994), Helmsing (2005b), and also UN-HABITAT (2009) as follows.

(1) LGs are *entrepreneurs/developers*; LGs take responsibilities or share in the risks in the operation of economic activities by making resources available; LGs have a role through delivering services and streamlining local development, which potentially provide a source of economic opportunity; (2) LGs are *coordinators*, LGs ensure that all LED key actors focus their approaches and activities on common objectives and that limited resources are used in the most effective and efficient manner; LGs have the “capacity to convene” other social actors to define the local public interest and the broad direction of LED; thus LGs

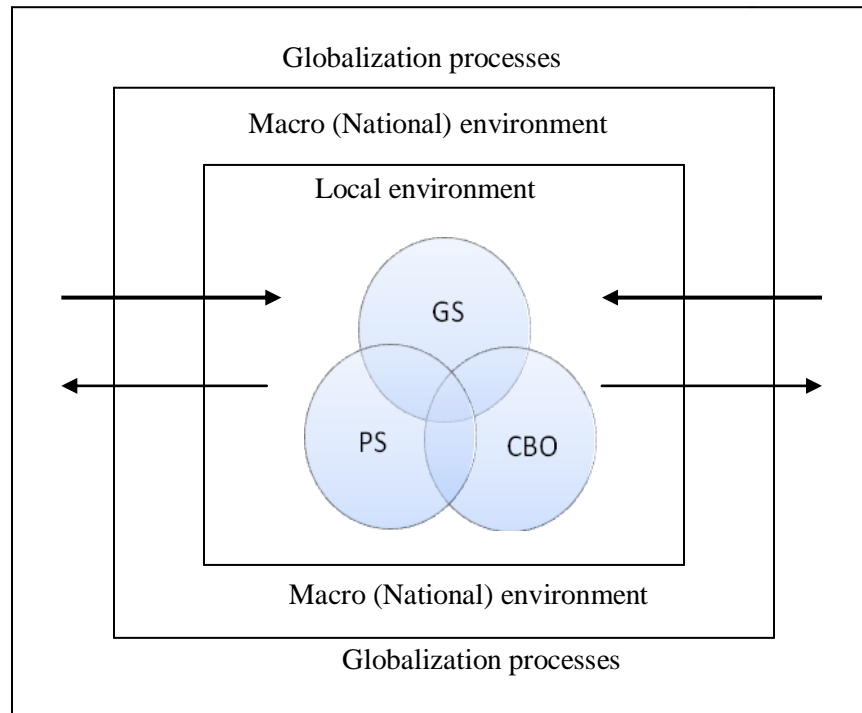
can enable the other actors to make effective contribution towards solving LED problems; (3) LGs are *facilitators/stimulators*; as facilitators, LGs provide the necessary enabling policy environment by reorganizing and updating the development process; as stimulators, LGs induce the creation and expansion of economic activities through a range of initiatives.

2.4. Environmental Milieu: the Broader Framework for LED

Though LED is primarily driven by government, it requires the involvement of the other actors too (Cunningham and Meyer-Stamer 2005:7; Tegegne 1999). The actors involved in LED come under three categories, namely, public sector, private sector, and community based organizations (ibid). *Local government* or simply the government sector (GS) represents the public sector that does all political, legal, bureaucratic (administrative) and socio-economic activities at the local level. The *private sector* has considerable stake in LED as it generates investment, creates jobs, produces tradable goods and raises the local income. It also generates soft resources like management and technical skills. The *community sector* (CBO) includes a range of community-based and non-governmental organizations that would create accessibility to certain groups of the population in a locality.

Certain degree of convergence (partnership) in development planning, local resource allocation, investment programming and management of development processes is necessary to take place between public, private and community-based actors. Local economic development (LED), Helmsing (2001:61) believes, is an effective means to achieve this.

Figure 01: The Broader Framework for LED



Source: Own construct (2010)

A single sector is neither able nor willing to manage and effectively control the intricacy and risks involved in LED. A single sector may also fail to meet the resource requirements for LED promotion. Therefore, all of them should enter into partnership in order to bring about effective and sustainable local development. The center (the inner most intersection) defines the extent, kind and structure of relations between the three actors (GS, PS, CBO), and explains that the three entities interact to bringing about local development. The other three junctions represent interactions between any two entities. However, the three are not completely dependent on one another since each can still remain detached along some aspects of the relationship. The remaining areas thus represent the relative detachment or autonomy (Nelson, in Elias 2005) and the relative contribution of each sector to local economic development. According to UN-HABITAT (2009:5), an appropriate organizational setup is essential to coordinate the LED process. Nevertheless, we cannot expect a single organizational model

for LED, as it basically depends on the nature and pattern of partnership among the three actors. Relationships between actors can be viewed either as one of harmony or as conflicting (contradictory). Successful partnership between the development actors can be made “through dialogue, exchange of information, openness and clear definition of boundaries of interest and activities of partners” (Dejene and Yilma 2005:199).

Local economic development, though perceived to take place in a certain local space, it still takes place within the national (macro) framework and the broader global context. The global processes and the national environment are thus indispensable as no one can perceive local spaces as an “island” operating merely within local dimensions. Global processes have strong bearing over national as well as local conditions. National and local conditions could also have some degree of influence over the global process. The arrows (Figure 01) indicate continuous interaction between the global on one hand and the national/local on the other hand. Thicker arrows tell that influences coming from the global then to national and ultimately to local are stronger and influential than those coming from the opposite direction.

Figure 01 shows that there are three main layers (tiers) of environmental milieu. Going from the most immediate (relatively narrower) to the broader we find: local, national (macro) and global (globalization processes). Each layer of the environment is briefly described as follows.

Globalization is the international “practice and framework for analyzing the world in terms of the global system and processes” instead of restricting “issues within the jurisdiction of a particular nation-state” (Sklair 2002:5-29). The pivotal feature of the idea of globalization is that various contemporary issues cannot be sufficiently studied at the level of nation-states but need to be seen in terms of “transnational processes” (ibid). Globalization, according to Gerrefi and Memedovic (in UNIDO 2003:4), implies “functional integration between

internationally dispersed [economic] activities”. It also implies “the pervasive decline in barriers to the global flow” of main inputs (such as information, factors of production, technology, etc) necessary for the production of goods and services (Kaplinsky and Morris (2001:15). Globalization provides phenomena of two dimensions: *opportunities* and *threats* to local (as well as national) development. Local entities have the challenge of shaping their own “economic destinies” within this state of opposing forces. Localities are thus anticipated to exploit opportunities and also adjust to global changes in order to cope up with the threats. This is practically true for nearly all localities, poorest as well as wealthiest (Blakely and Nancy 2009:1).

The *macro (national) environment* encompasses several dimensions that would have strong influence over the survival and operation of any local unit of analysis. Localities do not exist in a vacuum, but exist and function within the broader macro (national) environment. The macro environment encompasses, among others, the political-legal, economic, technological, socio-cultural forces and national institutions which could have either enabling (conducive) or stifling impact on local conditions and development. The impact of institutions, in particular, is remarkable. As stated by Sturgeon (2001:9), business firms and industries at large are “profoundly influenced by the *local* and *national* (*italics added*) institutional environments in which they are situated”. Government¹⁴ provides policies, guidelines, regulatory frameworks, and public goods to enhance local development (Dejene and Yilma 2005:199). Government creates a *business climate* by virtue of its position in providing legal and regulatory frameworks,

¹⁴ Government intervention is also validated on “*efficiency* and *equity* grounds”. Government action is required principally in situations where the market is unable to function efficiently (market failure) due to “monopolistic behavior, risk/uncertainty, positive and negative externalities, free-riding” and so on. Therefore, the government is involved in the provision of public goods (for efficiency reason). On top of this, the government bears the duty to provide access to certain goods and services in spite of “people’s ability and willingness to pay” (for equity reasons) (Helmsing, in Elias 2005:104).

which may either encourage or discourage business development (White, in Hindson and Meyer-Stamer 2007: 3).

The *local environment* encompasses numerous factors, including: the local “institutional thickness”, mainly made up of local government institutions, the local private sector, community-based organizations, local entrepreneurship culture, operations of local markets, the local population and its demographic characteristics, local (indigenous) resources, local geography and climate and infrastructure. The local environment is made up of a crowd of variables and elements that describe the relative strength or weakness of a particular locality. The set of local variables explains the comparative and competitive advantages of the locality¹⁵.

In any local environment, the private sector is the one that generally creates jobs and generates investments by producing tradable goods. The private sector has a big stake in LED and also brings in a range of resources including management skills, technical knowledge and access to finance. The private sector operates within government policies and regulations, keeping in mind, however, that there are myriad of micro enterprises which operate in the informal (unregulated) sector (Elias 2005:104; Macharia 1997:39-40).

LED has broadly been defined as a process of partnership between three development actors. All the three actors play important role in managing resources for creating jobs and stimulating the local economy (Helmsing 2005a). Though this is the case, LED has in this research work been used with a focus on

¹⁵ According to Dijk (2000:2), comparative advantage is a “static indicator”, while competitive advantage is “dynamic and man-made”. Comparative advantage is “what the locality has”, while competitive advantage is “what the locality could achieve”. The competitive advantage is not inherited but can be enjoyed through relatively outstanding performance and innovation. This means that the source of the competitive advantage is “innovation; not just factor of endowments” (ibid).

the role of the private sector, particularly that of wood work MSEs and their value chains, in local economic development (LED). The partnership context is further rationalized as existing between MSEs and local government institutions.

2.5. Micro and Small Enterprises (MSE)

Enterprises occupy vital place in local development. The presence of small enterprises in large numbers increases the coping capacity of an area against economic trouble and disorder (Hasan 1998:12). Micro and small enterprises are prevalent in an economic landscape as they are comparatively simple to establish and manage. Such small-scale activities are characterized by very low entry and exit barriers and thus attract a sizeable number of entrepreneurs. On the contrary, business ventures that require huge capital, large working space, advanced managerial skill and longer time to breakeven are beyond the capacity of most local entrepreneurs (Wandscheider 2004:7).

The distinctions made as “micro”, “small”, “medium” and “large” are based on the scale/size of enterprises in terms of capital asset, size of employment (labor strength), market share, revenue, etc. (Harve, in Tegegne and Mehret 2010:8). It is hardly possible to come up with universally accepted definition of MSEs as different countries and agencies employ their own ways of classification and definition. Nevertheless, “size of employment” seems the most common criteria to distinguish between micro and small enterprises (see Annex 6 to note the distinctive features of MSEs).

The discourse in this paper centers on wood-work micro and small enterprises (MSEs) that have employed up to 30 workers. Within this range, “micro” and “small” are distinguished to have 1-5 and 6-30 workers, respectively. The capital ceiling is 1.5 million Birr.

Within the broader MSE sector, we can see distinctions between two sets of enterprises labeled as “survivalist” and “growth-oriented”. The “survivalist”

category hosts those micro enterprises basically engaged in myriad of livelihood activities. The “growth-oriented” category, on the other hand, hosts those enterprises engaged in economic activities whereby surpluses are reinvested for business expansion and development (Ibid; UN 2001:2). The micro enterprise sector is the largest private sector subgroup. This group is less entrepreneurial since it has prime interest in decent level of living than in maximizing profits and/or enterprise growth. From this group, few may be able to “graduate” to small, medium and large-scale enterprises (Helmsing 2005b:313-316).

The Role of MSEs

Liedholm and Mead (1999:1) closely observed that there are two opposing views over MSEs, some of them against and some others in favor. Those who are against argue that an increase in the number of people employed in this “marginal sector” of the economy is a sign of the economy’s failure to provide productive jobs; people are compelled to take part in activities that supply only petty subsistence income. As a result, many people are likely to think that “widespread micro entrepreneurship is simply a reflection of a low level of economic development” (Fitsum 2002:253). Those who are in favor, on the other hand, argue that MSEs are promising, as their contribution to employment and income is increasing over time. This is promising since markets are functioning and many people are finding opportunities to participate in economic activities.

In the 1950s and 1960s micro enterprises were viewed as marginal and unproductive sectors that evade tax and with little potential for growth or entrepreneurial capacity. In the 1980s, however, micro-enterprises secured better attention from donors and governments as sustainable ways of blending efficiency with equity in the long run. Micro enterprises may spur the local economy by increasing the overall demand and permit greater investment. Micro enterprises, by being particularly suitable to areas where it does not pay for medium and large firms, contribute to decentralized development and regionally balanced growth.

Micro-enterprises, which are also in the informal sector of the economy, have a significant contribution to local economic development (Tegegne and Mulat 2005:61). Moreover, Pederson (2000:136) has some points of clarification for the misunderstanding people often hold towards small and larger enterprises:

“The problem with the argument and most of the empirical studies of scale economies is that the small and large are assumed to be doing the same thing in direct competition. However, the small enterprises generally do not do the same as the large ones. They tend to find niches in the inputs or product markets where the large enterprises cannot exploit their scale economies and therefore cannot compete. Or they specialize in distribution to peripheral or low-income areas where the distribution costs of the large-scale sector are prohibitive”

MSEs could contribute to LED in the following ways (Dijk and Mkandawir, in Elias 2005:97; Dijk 2000:5-6; Loop 2000: 21, Elias 2005: 97): MSEs create *employment opportunities*; MSEs contribute to *poverty reduction*: poor people often find work in MSEs, hence the development of these enterprises helps the poor; MSEs enable *mobilization of local resources* (that could remain untapped); MSEs provide the ground for utilization of *labor-intensive technologies*; MSEs serve as a *training ground for entrepreneurship*; MSEs encourage local capital accumulation, hence help *balance regional disparities*; MSEs *stimulate and promote local development* through the use of appropriate technologies.

MSEs are the major feature of the economic landscape in all developing countries today. The contribution of these enterprises to the creation of jobs and to the alleviation of poverty has been recognized by many Third World governments. MSEs are given prominence in the development plans and strategies of many donors (Liedholm and Mead 1999:1). The policy relevance of MSEs, particularly small industries, may come under two major points (Loop 2000:21): (i) *the potential for employment creation* and (ii) *MSEs' competition with larger enterprises, and even in global markets, through clusters*. Growing trends in decentralization strategies increasingly justify the proliferation and importance of small enterprises.

Liedholm and Mead (1999:7-8) summarize the contribution of the sector to development as follows: contribution to household income and welfare; employment creation through business creation (new) and expansion (of existing enterprises); contribution to confidence/empowerment of the individual; contribution to social change and political stability; and contribution to developmental and distributional objectives. Moreover, MSEs provide new opportunities for the poor, women, and for those in rural and isolated (marginalized) locations; and contributions in the area of demographic change (for instance, through reduction in rural-urban migration).

The MSE development strategy of Ethiopia (FDRE 1997), articulates the role and contribution of the sector. As per this strategy, MSEs create employment (and equitable income distribution), stimulate economic growth, and encourage effective use of the skill (and talent) of people without demanding higher level (formal) training. MSEs are described as the “national home of entrepreneurship”. MSEs activate competition, exploit niches in markets, and enhance technological change and productivity. As per this document, the “labor absorption capacity” of the MSE sector is high; the “average capital cost per job created” is usually lower than the same in big businesses. The sector’s role in technical (and innovative) activities is vital for many of the problems challenging the country (Ethiopia). The new MSE development strategy (2011) also underscores that the MSE sector lays the foundation for industrial development (UNDP 2011:42).

MSEs need to graduate to SMEs. The growth-oriented SMEs then make significant contribution to economic growth and employment creation (UN 2001: IV). In the prevailing climate of globalization, developing countries need to own a critical mass of domestic enterprises, which are internationally competitive and capable of entering global chains of production (UN 2001:3).

As can be generalized from the works of several writers in the area, including Helmsing (2005), Dijk (2000), Hyman (1989), in Elias (2005), Todaro (1997),

Macharia (1997), Castelles and Portes (1989), Liedholm and Mead (1999), Blair (1995), Wandscheider (2004), Dewar and Watson (1991), Loop (2000), Pederson (2000) and the works of important institutions and agencies like ILO (1972), in Macharia (1997), UN (2001), UN-HABITAT (2009), LEDNA (2011), FDRE (1997), most micro and, to some extent, small scale enterprises are in the informal sector of the economy. Therefore, it becomes necessary to look into the informal dimension of micro and small enterprises.

The Informal Dimension of MSEs

Michael Todaro (1997:268-269), observes that the dualistic feature of the economy of the LDCs is explained by the existence of a modern and traditional sectors¹⁶. When the analysis of the dualistic feature is applied to the urban economy, it would be based on the dichotomy between the *formal* and *informal* sectors. According to Dewar and Watson (1991:181), the informal sector plays a vital role for “[...] those who either need or desire to generate an income outside the generally termed ‘formal sector’”. The majority of new comers into the urban labor stock often strive to establish their own employment or to work for small-scale family-owned enterprises, engaged in a vast assortment of activities. Some of the enterprises could ultimately graduate to the formal sector, where they may get registered, licensed, and operate under state regulations.

Macharia (1997:39) describes the informal sector as “[...] all those small scale business activities that operate without direct state regulation.” Wandscheider (2004:14) complements that “the more informal is the enterprise, the more interactions with government agencies are often kept to a minimum”. Assuming an “ideal market economy”, without any level of regulation, the difference between formal and informal would be totally meaningless as all business

¹⁶ The “modern” is characterized by essentially urban, capital intensive, large scale production sector whereas the “traditional” is characterized by subsistence, heavily rural, labor intensive and small-scale production sector.

activities become entirely “informal” (Castelles and Portes 1989:13). They added that, “the more a society institutionalizes its economic activities following collectively defined power relationships and the more individual actors try to escape this institutionalized logic, the sharper the divide between the two sectors” (ibid).

Large proportion of the urban population in SSA finds employment in the informal sector (Loop 2000:19). According to LEDNA (2011), the informal sector contributes to 77% of “non-agricultural employment” and 55% of the GDP in SSA. In view of this, [...] “any analysis of Africa’s economy that does not focus on informality” may thus be totally deficient (Macharia, cited in Elias 2005). In SSA, strategies developed for promoting informal sector enterprises not only serve employment creation purposes, but can also be taken as measures of “direct attack on poverty” (Dewar and Watson 1991:184). The role of the informal economy goes beyond providing employment opportunities for the poor; if properly “engaged”, it could enhance “the fiscal base of local governments” (UN-HABITAT 2009: 2). Unfortunately, macroeconomics tends to focus only on the formal sector activities and generally has little concern for the informal sector (Pederson 2000:131). For instance, in Zimbabwe, Pederson (2000:152) discloses, the formal manufacturing sector does not consider the informal sector as a business partner (subcontractor) but as an illegal competitor.

From a policy perspective, the conceptual difference of very small (informal) enterprises from larger (more formal ones) is often misleading. Micro, small, medium and larger enterprises do not function in totally disconnected “economic circuits”; in reality, all are “vitaly interrelated”. The concept of “informal sector” basically focuses on “the bottom end of a continuum” that ranges from very small (micro) to very large (heavy) industrial complexes (Dewar and Watson (1991:182-183). (See Appendix 6: hierarchy of enterprises).

Informality may possibly be seen under two conditions: (i) when enterprises fully operate in an informal setting and (ii) when enterprises operate formally but with some degree of informality. The first one is the case of what is often called “informal sector”, since enterprises operate without any formal registration, license, tax payment, and any form of state regulation. However, informality is not limited to the informal sector alone. In view of this, the second case is evident when enterprises (particularly MSEs) that are formally registered, licensed and pay taxes operate with some degree of informality. Though formally registered and licensed, enterprises in this case still have many aspects of informality in the areas of, for instance, labor administration (employment and layoff, minimum wage rate, working hours, pension and other employee rights and duties), accounts recording and keeping, source of financing (like using informal sources).

Clustering: to boost up the role of MSE in LED

Clustering is an important mechanism for the industrial performance of small enterprises. Several writers, for instance, Porter (1990), Helmesing (2005a), Dijk (2000), Visser (2000), Rogerson (1995), Sturgeon (2001), Ionescu (2005) and Mohering (2005), address the processes, practices and issues of clustering. In all cases, clustering is justified on the ground that MSEs in the cluster together do better than those that are not part of the cluster. A cluster is defined as a “spatial concentration of horizontally or vertically related enterprises and accompanying institutions in an area or region” (Mohering 2005:21). Helmsing (2005a) argues that disadvantages of micro/small enterprises can be compensated by advancing division of labor among them (and by creating supporting institutions) in a cluster. Cooperative inter-firm relationship makes individual firms less vulnerable to risks, promote exchange of information and know-how and create a rich pool of collective knowledge (UN 2001:2).

According to Schmitz, in Visser (2000: 78), “clustering opens up efficiency and flexibility gains which individual producers can rarely attain”¹⁷. In a well-developed cluster, economies of scale and scope are attained like those enjoyed by large-scale and leading businesses (Dijk 2000:3-7; World Bank 2009a; Harvard Business, in Distil 2010). This means that clustering helps MSEs to compensate for lack of scale. Clustering allows firms to specialize and increase productivity with which they can compete, nationally and globally (Harvard Business, in Distil 2010). Dijk (2000:3) also contends that urban MSEs can compete in a global economy through clustering and strong inter-firm relations.

Clusters or “industrial districts”¹⁸ are closely related to value chains as they depend on “[...] groups of spatially proximate firms that tend to specialize in a particular component, process or service required to bring a product to the market” (Sturgeon 2001:11). In the cluster setting, enterprises are inter-linked and connected in many ways. Some enterprises will be suppliers to others; some will be buyers from others; some will share labor or resources (Dijk 2000; World Bank 2009a; Harvard Business, in Distil 2010). Clusters/industrial districts play crucial role in upgrading and innovation (Porter 1990; Fuerst 2010:92).

Dijk (2000:7), Dijk and Sverrisson (2000: 183), Rogerson (1995:ix) and Visser (2000: 79) outline certain features of clusters, including, spatial proximity (or nearness) of the enterprises (the relevant distance varies from one km in the center

¹⁷ Two models of clustering processes, namely, “passive collective efficiency” and “active collective efficiency” are identified (Schmitz, in Visser 2000: 79-80). The difference between the two models is portrayed by the notion of “inter-firm cooperation”, which is not necessary for passive collective efficiency but critically important for active collective efficiency. Passive collective efficiency operates in “a top-down direction, from the cluster level to the micro-level of individual firms”. Active collective efficiency, on the other hand, operates in “a bottom-up direction, from the responses of individual firms to competition, through inter-firm linkages and business networks, and up to the cluster level” (Visser 2000: 80).

¹⁸ The term “industrial district” is an Italian equivalent to “cluster” (Tegegne 2009b:11). It is recognized that spatial clustering yields advantages for enterprises, not only in European industrial districts, but also in developing countries.

of a city to about 50 km in the case of some European industrial districts); a high density of economic activities; the presence of firms involved in the same (competing), similar, and subsidiary activities; the existence of inter-firm linkages (division of labor) between enterprises as a result of (vertical) subcontracting, and specific forms of (horizontal) cooperation; some degree of specialization; entrepreneurial dynamism; institutional development enhancing the supply of business support services; and socio-cultural embeddedness of economic transactions.

2.6. Micro and Small Enterprises (MSE): Empirical Literature

The available literatures on micro and small enterprises (MSE) in Ethiopia have different orientations and focus in addressing a wide range of issues related to the profile, structure, organization and operation of MSEs. The literatures may in one way or another be identified with or come under three broad categories: (1) Policy documents that provide policy framework and institutional setting for MSE operation and development; (2) Empirical literatures that deal with different assortments of MSEs in general, without a focus on a specific (single) sector; and (3) Empirical literatures that, unlike the previous ones, deal with specific sector.

In most of these “categories” of empirical literature, we may encounter cross-cutting issues related directly or indirectly to: (i) the role and contribution of MSEs in employment creation, income generation and poverty reduction; (ii) the constraints challenging the smooth operation and growth of the sector; and (iii) the degree of informality (informal economic activities) involved in the sector; and (iv) some constructive suggestions recommended to redress the major problems in the sector.

The *first category* consists of pertinent policy documents that provide broader as well as detailed policy framework and institutional setting for MSE operation and development in the country. The most apparent policy documents are: (i) the Growth and Transformation Plan (GTP 2010) formulated to cover the period

2010/11-2014/15; (ii) the FDRE MSE development strategy document (1997); and (iii) the FDRE MSE development strategy document (2011). These documents provide for and clearly reveal: (i) the emphasis given to the MSE sector (particularly the GTP 2010); (ii) the constraints challenging the sector and what measures should be taken to address the challenges (FDRE 1997, FDRE 2011); and (iii) the need for redefining (revising the definitions of) the MSE sector (FDRE 2011).

The highest national policy framework (the GTP) clearly states (on page 56) that micro and small enterprises constitute “the main strategic direction of industrial development” in the country. The GTP (see page 57) recognizes that “the expansion of MSEs in urban areas will result in large scale job creation and thereby poverty reduction”. Moreover, MSE development is considered to be “[...] critical for strengthening sustainable rural-urban and urban-to-urban functional and economic linkages”. The GTP identifies the main sectors and the sub-sectors that would come under each sector. Wood-work, under the manufacturing sector, is among the sub-sectors given emphasis by the GTP.

The revised MSE development strategy document (FDRE 2011¹⁹), in addition to pronouncing the emphasis given to the MSE development by the GTP, provides new definitions to the MSE sector based on: (i) identifying the gaps in the existing definitions; (ii) dividing the sector into two, namely, industry and service; and (iii) considering inflation and currency fluctuation (for the coming 5 years). The new MSE definition takes into account employment and capital size as criteria. Size of employment (human power) is similar for both industry and service sectors: up to 5 for micro enterprises and 6-10 for small enterprises. Size of capital is different in industry and service sectors. 100000 Birr (\$6000) and 50000 Birr (\$3000) are

¹⁹ The revised MSE development strategy document (FDRE 2011) takes on most of the issues incorporated in the MSE development strategy document of 1997 but revises certain issues that need revision and amendment. The revised document (2011) redefines the previous (1997) MSE definitions that had worked for more than 14 years.

the ceilings for micro enterprises operating in the industry and service sectors, respectively. On the other hand, 1.5 million Birr (\$9000) and 500000 Birr (\$30000) are the ceilings for small enterprises operating in the industry and service sectors, respectively.

The *second category* consists of the body of empirical literature that deal with different assortments of MSEs in Ethiopia, without focusing on a single (specific) sub-sector or business (for instance, Gebrehiwot and Wolday 2001; Solomon 2004; Andualem 2004, cited in Tegegne and Meheret 2010; Tegegne and Mulat 2005; Elias 2005; Mulu 2007; Eshetu and Zeleke 2008; Eshetu and Mamo 2009; Rahel and Paul 2010; Tegegne and Meheret 2010; MoUDC 2013).

In this broad category, we may find different orientations and areas of focus. Some of the literatures provide overview and nature of Ethiopian MSEs (for instance, Solomon 2004; Mulu 2007). Some of them deal with the role of MSEs as means for poverty alleviation, employment generation and economic growth (for instance, Tegegne and Meheret 2010; Elias 2005) and some of them are based on the distribution and performance of MSEs in regional towns of Ethiopia (for instance, Tegegne and Mulat 2005; Elias 2005; MoUDC 2013). Some materials in this group provide features that distinguish MSEs from medium and large enterprises (for instance, Elias 2005; Tegegne and Meheret 2010) while some of them include ‘medium-scale’ enterprises in their analysis (for instance, Eshetu and Zeleke 2008; Eshetu and Mamo 2009). Some of the literatures are gender-sensitive, focusing on the place of women in the operation of MSEs (for instance, Rahel and Paul 2010; Eshetu and Zeleke 2008).

Some of the literatures make attempts to identify the key constraints challenging the MSE sector at large (for instance, Gebrehiwot and Wolday 2001; Andualem 2004, cited in Tegegne and Meheret 2010) and the problems distinctly felt at start up and operation levels (for instance, CSA 2003 and also FDRE 1997). There is also a body of different literatures in this category, specifically concerned with

MSE finance and Business Development Services (BDS). This sub-group consists of literatures related to MSE finance, more of microfinance (for instance, Gebrehiwot and Wolday 2006; Itana 2002; Haftu et al 2009, cited in Tegegne and Mehert 2010) and business development support (for instance, Wolday 2002, cited in Tegegne and Mehret 2010; Fitsum 2002).

The *third category* consists of literatures that deal with different issues of a single sector. In other words, these are sector-specific (for instance, Tseguereda 2002; Tegegne 2009b; Loop and Tseguereda 2002; IIED 2009; Tebarek 2011). In this group, IIED includes “medium-scale” enterprises for analysis. The works of Tegegne (2009b) and Tebarek (2011) in particular are concerned with the value chains of the leather and footwear sector in Ethiopia. The first one focuses on the value chain perspective of small scale footwear production whereas the second one is more about inter-firm relations and governance structure of the leather products value chain.

It is hard to find organized literature on the wood-work sector in Ethiopia. It is more difficult to get literature related to the wood-work MSE value chain. Perhaps one very important empirical literature in the wood-work sector is the one that is conducted by UNIDO (2003a²⁰) in relation to the global wood furniture value chain, with special focus on the South African furniture sector.

When it comes to our specific study area (locality), information regarding the distribution of wood-work MSEs has been obtained from the City’s (Addis Ababa) Trade and Industry Development Bureau (TIDB). According to the data generated in 2012 from the TIDB, the wood-work MSE sector is roughly divided into six groups: (1) furniture production, (2) wood-sawing, (3) timber trading, (4) traditional wood-works, (5) wood-sculpture, and (6) wood-fuel. Only the first three groups, namely furniture, wood-sawing and timber trading, are relevant to

²⁰ The wood-work value chain part of the literature review relies mainly on this (UNIDO 2003a) empirical study

the value chain perspective of the MSE sector in this research. As per the data from TIDB (2012) all together there are 599 registered enterprises. Out of this aggregate, there are 360 furniture MSEs (60%) 45 sawing-mill enterprises (7.5%), and 108 timber trading stores (18%). The rest (14%) constitute traditional works, sculpture and fuel-wood.

So far, we have seen both theoretical and empirical literatures on MSEs. In the theoretical part we have seen that MSEs, operating both in the formal and informal sectors, occupy very important place in the economy of less developed countries. We have also seen that the role of MSEs in LED may possibly be boosted if MSEs were organized in a setting of enterprise clusters than operating in scattered manner. In the empirical part, we have seen that the available body of MSE literature in Ethiopia can be roughly grouped under three broad categories: major policy documents that provide broader framework and institutional setting for MSEs and empirical literature concerned with MSEs in general and MSEs in specific sector.

In this research, the role of MSEs will be studied not in isolation or at the production level *per se*; rather within the broader context and extended operation of value chains – *with a focus on the wood-work MSE domestic value chain*. Therefore, the upcoming sections are devoted to the discussions of value chains.

2.7. Value Chains

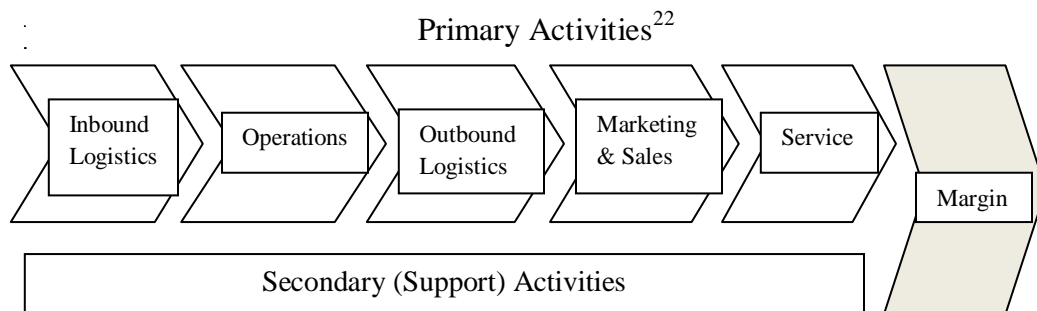
The concept of value chain²¹ has existed for about three decades since it was used (developed) in 1985 by M. Porter in his influential work titled “Competitive Advantage: Creating and Sustaining Superior Performance” (Feller, Shunk and Callerman 2006:1). In this original work of Porter, “value chain”, describes the activities an organization performs, which in turn are linked to the analysis of the

²¹ Earlier, a French term *filiere*, which means “chain”, was used to describe chain of activities. The *filiere* concept was used as an approach to study agricultural export-commodities (Raikes *et al*, in Gereffi and Kaplinsky 2001:3; UNIDO, in Tebarek 2011:10)

organization's competitive strength: i.e., better performance is the source of competitive advantages of an organization (Porter 1985; *ibid*).

The Porter's value chain is bifurcated into primary and secondary activities. The primary activities, which are involved in the creation of a product/service, would come under five key areas: inbound logistics, operations, outbound logistics, marketing and sales and services. Secondary activities are support activities that include procurement, technology development, human resources management, and infrastructure (Porter 1985:38).

Figure 02: Porter's Model of Value Chain



Source: adapted from the works of Porter (1985)

Support activities are linked to each of the primary activities in a manner to upgrade/improve their efficiency and effectiveness. "Margin" denotes a profit margin, which an organization secures when it delivers a product or service for which the customer is willing to pay more than the sum total of the cost of each

²² Primary activities are generic activities whose details may vary by industry. "Inbound logistics" refers to the receiving, warehousing, material handling, transport and inventory control of inputs; "operations" include the value-creating functions of transforming the inputs into the final product; "outbound logistics" involves the activities required to deliver and transfer the final product to the end user, including warehousing, order processing, transport operations, etc; "marketing and sales" includes those activities related to getting buyers purchase the product, including channel selection, advertising, promotion, pricing, etc.; "service" activities are those that maintain and enhance the product's value, including customer support, installation, spare-parts supply, repair services, etc. (Porter 1985:39-40).

activity. This would entail that the organization should better manage the linkages between all activities in the chain (ibid).

Porter has made an original as well as seminal contribution to the study of value chains. Then after, however, many prominent scholars, including Gery Gereffi (1999, 2001, 2005), John Humphrey (2000, 2001, 2005), Hubert Schmitz (2000, 2001), Timothy Sturgeon (2001, 2005) Raphael Kaplinsky (2000, 2001), Dorthey McCormick (2001), Michael Morris (2001), ...) have explored the subject further and provided us with definitions, descriptions and analysis of the salient features and important dimensions of value chains.

A value chain refers to the entire sequence of activities required to bring a product or service to the end use (Gereffi 1991:1; Sturgeon 2001:11; Ribit, in Itika 2009:211). The chain includes the discrete yet interrelated activities of design, input-sourcing, production, marketing, distribution, and support to the final consumer (Kaplinsky, in Barrintos 2001:84; McCormick 2001:106; Sturgeon 2001:11)²³.

In this paper value chain is operationally defined as the wood-work MSE value chain consisting of a series of value adding activities from input-sourcing to production and marketing till furniture products reach the final buyer.

One very important point to note at this juncture is that the value chain perspective shifts the focus of researchers from “production” to the sequence of activities that range from design to distribution (Gereffi and Kaplinsky 2001:2). Production, as Kaplinsky and Morris (2001:4) pointed out, is only one of a series of value added links in the process. The fundamental contribution of value chain analysis is thus its capability to embrace the entire aspects of “the process of production, distribution and retailing” across the chain (Barrientos 2001:83).

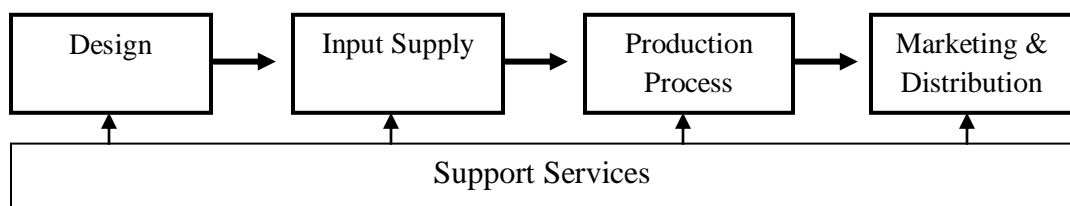
²³ Terms like *supply chain*, *commodity chain*, *production chain*, *activity chain* and *product pipeline* can be used to describe the same idea with different focus and context (Sturgeon 2001).

Value chain analysis imparts the key dimensions of value chains, namely, input-output structure, geographic spread and chain governance (McCormick 2001). The upcoming few pages will present brief discussions on the key dimensions and related issues of value chains.

Input-Output Structure

The input-output structure is an important feature of the value chain (McCormick, 2001:106). As suggested in the definition, the configuration of a value chain generally has four key components (stages): design, input-supply, production process, and distribution. Support services would accompany each of these components (ibid; ILO 2007:5). If a value chain is an array of “products and services linked together in a sequence of value adding economic activities” (McCormick 2001:106), then the value of a product increases as it passes through each stage of the chain (ILO 2007:5; ACDIVOCA 2010).

Figure 03: A Simplified Model of Input-Output Structure



Source: Adapted from the works of McCormick (2001)

In this linear progression of activities, any given product must first be designed; the raw materials and subsidiary inputs must be procured; the production (transformation) process must take place; and the product must be distributed to the final users directly or via wholesalers and retailers. At each and, in some cases, different stages of the chain, services like finance, warehousing, transport may be injected to keep the process running. Support services will do this. More importantly, a value chain has “less visible” input-output structure made up of the “flow of knowledge and expertise” needed to keep the physical input-output

structure functioning. This means that the flow of knowledge and expertise parallels the physical flows. However, the intensity of the flow of knowledge and expertise differs from one segment of the chain to the other. For instance, the amount of knowledge and expertise required at the design stage could generally be greater than the amount required at the production stage, which may only be “standard or routine knowledge” (McCormick 2001:106).

The Wood-Work Value Chain

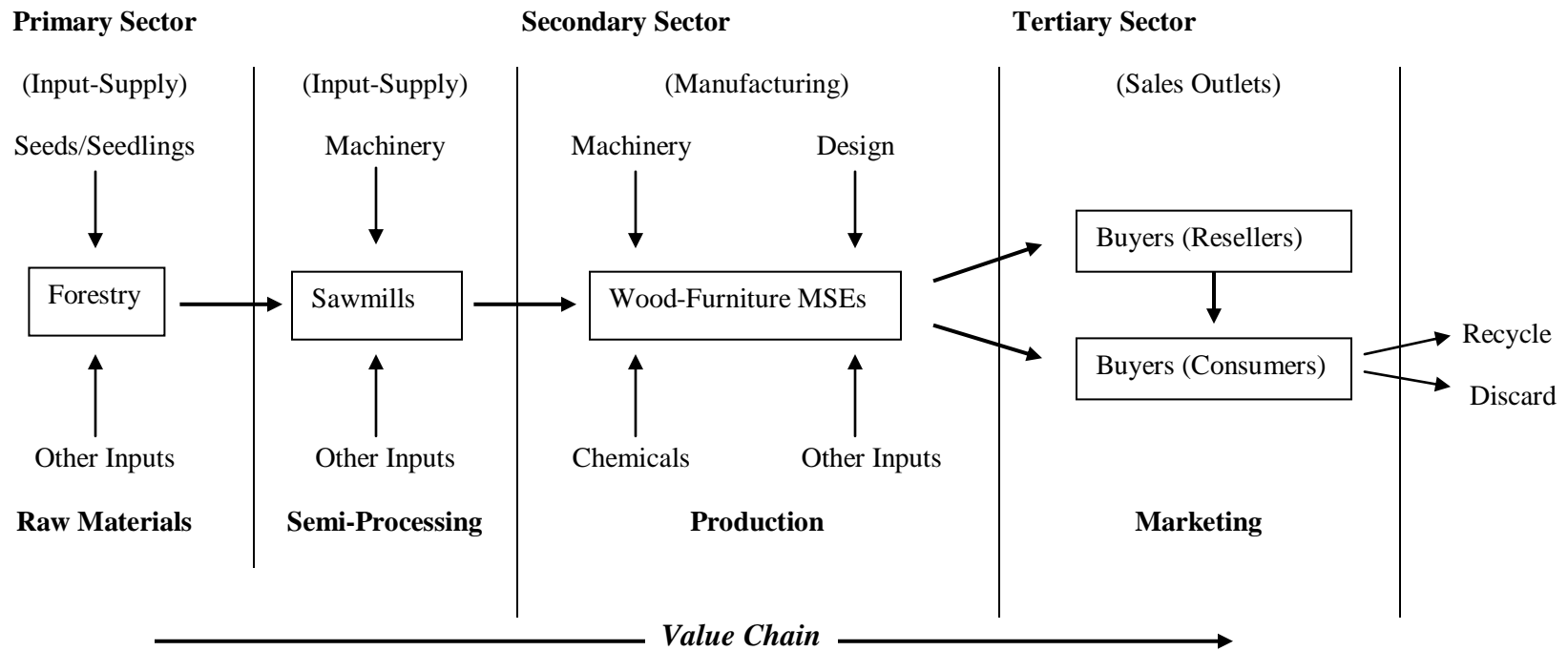
The wood-work value chain constitutes a range of activities that take raw materials and other inputs through the production process to marketing and distribution till the product reaches final consumers. All activities (both primary and secondary) at each segment of the chain involve a number of micro and small enterprises (MSEs) and such MSEs, in turn, contribute their part to local economic development (LED) in different ways, including, employment creation, production of tradable goods, income generation, promotion of entrepreneurship, and mobilization and utilization of local resources, etc.

The entire value chain involves three key sectors (Kuzilwa and Ngowi 2009:189): (i) the “extractive sector”, i.e., the primary sector, engaged in extracting cut logs; (ii) the “industrial sector”, the secondary sector, engaged in manufacturing, i.e., producing and assembling furniture; and (iii) the “service sector”, the tertiary sector, engaged in marketing and distribution, including retail and whole-sale outlets for furniture and related commodities.

The wood-work MSE value chain could be illustrated using a simplified chart (see Figure 04). As can be seen, the wood work (furniture) MSE value chain involves the provision of seeds/seedlings and other important inputs (including water, equipment, labor, chemicals, etc) to the forestry (primary) sector, which forms the base of raw materials. Cut logs from the forestry move to sawmills, which in turn get the basic inputs from the machinery industry and other inputs from different sectors. Sawn woods (i.e., timbers) then pass to the furniture manufacturers (in the

secondary sector). Furniture manufacturers get inputs from machinery, chemical (like paints, adhesives, etc) and other sectors in order to run production operations. They are also engaged in design and branding decisions and might draw such skills from the service sector. Finished goods (furniture) then flow to the resellers and retail outlets (in the tertiary sector) or to direct consumers, as the case may be. Ultimately consumers may, after use, recycle or discard old furniture (Kaplinsky and Morris 2001:4).

Figure 04: The Wood-Work MSE Value Chain



Source: Modified from the works of UNIDO (2003)

Geographic Spread

The other important dimension of a value chain is its geographic spread and spatial scale of operation. Value chains could be global, regional, national or local. According to McCormick (2001:1006), some value chains are quite global as their economic activities take place in many countries of the world. Since the 1970s many countries become deeply interdependent through the flows of goods, services and financial capital (Gerffi *et al* 2001:1). The literature on capitalism indicates that economic activities are not only “international in scope, but also global in organization”²⁴ (ibid). The emergence of global value chains (GVC) is among the key reasons for accelerating and widely intensifying globalization processes (Dicken, in Gereffi *et al* 2001:1-2; OECD 2007:1). The entire process of production, from raw materials to finished goods, “has been “sliced” and each process can now be carried out wherever the necessary skills and materials are available at competitive cost” (ibid). The value chain approach is therefore a handy device of exploring the form functional integration takes (Gerffi *et al* 2001:2) and this is all about looking into value chains formerly at the “international” and more recently at the “global” scale.

Nevertheless, the study of value chains is not confined to the global scale alone, as it is also possible to look at value chains at national, regional, or local levels. National, regional or local value chains operate the way global chains do. However, the geographic scope or “reach” of the former is by far limited than the latter (McCormick 2001:106). Even within national boundaries, local value chains cover much more limited geographic scope than regional or national value chains, but such value chains generally operate the same way regional or national value chains operate.

²⁴ “Internationalization” refers to the geographic spread of economic activities across national boundaries; whereas, “globalization” is more about the “functional integration of internationally dispersed economic activities” (Dicken, in Gereffi *et al* 2001:1-2; OECD 2007:1).

Chain Governance

The power relations imbedded in value chains, i.e., *governance*, is fundamental to the analysis of global value chains (Gereffi *et al* 2001:4; Humphrey and Schmitz 2001:20; Kaplinsky and Morris 2001:8). According to Humphrey and Schmitz (2001:22), governance is defined as “the inter-firm relationships and institutional mechanisms through which non-market coordination of activities in the chain is achieved”. The idea of governance implies the distribution of resources, the power of making such decisions, and exercise of control along the value chain (Bain 2010:4; Humphrey and Schmitz 2001:21, Morrison, Peifrobelli and Robelloti n.d.). The governance structure, pattern and practices generate “divisions of labor” within the chain hence significantly influence the allocation of resources and redistribution of benefits (Ponte and Gobbon, in Bain 2010:4). Value chain analysis, in this regard, as Morris (2001:127) has precisely put it, is “based on the realities of where global markets are dominated and where the greatest rents are extracted”.

The question of governance comes up when some enterprises start to function as per the parameters set by others in the chain. At the global scale, chains are basically governed by lead firms (Gereffi 1994; Humphrey and Schmitz 2000; Sturgeon 2000, in McCormick 2001:106). Governance structure develops to transmit pertinent information about the parameters, thereby enforce compliance and exercise control. Lead firms specify “what is to be produced by whom” and also strongly monitor the performance of component suppliers (producing firms). Humphrey and Schmitz (2001:21-22) outline four basic parameters to be observed by producers: (i) What is to be produced (the product); (ii) How it is to be produced (defining the production process); (iii) When it is to be produced (time); and (iv) How much is to be produced (quantity). The first two are considered as crucial for the chain governance and are often specified by the buyers. Humphrey and Schmitz (*ibid*) also add a fifth parameter, i.e., price (in which case suppliers

are required to design products and processes that meet target (projected) price levels).

Lead firms need to govern the chain very much at least for two basic reasons (Humphrey and Schmitz 2001:23; Gereffi *et al* 2001:4): (i) when the buyer/lead firm “has better understanding of the demands of the market than the supplier. The buyer then interprets the needs of the market and informs the supplier of what is required”. In this case the companies (buyers) are involved in specifying, hence coordinating and monitoring activities of the suppliers; and (ii) when there are potential risks “arising from a failure to meet commitments”. The more buyers/companies are exposed to risks from supplier failures, the more such companies are engaged in monitoring/controlling the value chain.

Terms like “governance”, “lead firms”, “buyer-driven”, “producer-driven” are all seem to mean the same thing as each is used to describe “the governing role of non-market connectedness between firms” (Morris 2001:127). Beyond this, however, governance can also be exerted by agents external to the chain. This is evident when parameters (for product and process, in terms of design, safety, standard weights, sizes and technical norms) are set by government agencies and international organizations (Keplinsky, in Humphrey and Schmitz 2001:22; Gereffi *et al* 2001:4). Government agencies, in particular, set parameters which are legally binding and forceful. Governance, both internally exercised and externally exerted, is generally meant to ensure the organization, coordination and control of all important aspects of the value chain.

Producer-driven/ Buyer-driven Value Chains

An important concept akin to the notion of global value chain is “global commodity chain”. Global commodity chain (GCC) is a framework developed in the 1990s by Gereffi and others in order to link “the concept of value-added chain directly to the global organization of industries” (Gereffi, Humphrey and Sturgeon (2005:82). According to Gereffi (1999:1), global value chains (GVC)

can be identified either as “producer-driven” (prominently during 1950s-1960s) or “buyer-driven” (prominently during 1970s -1980s) models²⁵.

Producer-driven value chains refer to those industries in which heavy (mainly) transnational manufacturers play the key roles in coordinating global production networks and controlling their backward and forward linkages (ibid; Gereffi and Memedovic, in UNIDO 2003b:5). Producer-driven value chains are often the characteristic features of technology- and capital-intensive industries. Air-crafts, automobile, heavy machinery and computer manufacturers are among those industries that fall within this category (ibid).

In the buyer-driven value chains, “large retailers, marketers and branded manufacturers play the pivotal roles in setting up decentralized production networks in a variety of exporting countries, typically located in the third world” (Gereffi and Memedovic, in UNIDO 2003b:5). Buyer-driven chains, according to Gereffi and Memedovic, characterize the “trade-led” labor-intensive industries engaged in the business of consumer goods such as apparel, wood-furniture, footwear, handicrafts and house-wares. In this case, large-scale retailers propose order specifications, which the “tiered-networks of third-world contractors” would observe in manufacturing goods for foreign buyers. Large retail firms generally design and market branded product, but do not manufacture the products they order. For this reason, such firms are referred to as “manufacturers without factories”, as the point of physical manufacturing (typically located in developing countries) is distinct from the point of design and marketing (typically

²⁵ Beyond the two models (buyer-driven/producer driven), Gereffi (2001) also identifies a third form of value chain which he refers to it as “internet-oriented value chain” (prominently during 1990s-2000s). In the internet-oriented value chains, brands are “linked to the internet infomediaries that channel information to web-based consumers”. Moreover, Gereffi (2001:37) observed that the internet-oriented value chain extends the “logic of buyer-driven chains as both information and power continue to shift inexorably from producers and retailers to consumers”.

located in developed countries) (ibid). See Annex 8.1 for more details of the features of producer-driven and buyer-driven models (commodity chains).

Major Forms of Governance

Many writers indicate that governance may take place through either arms-length market relations or non-market linkages. In this regard, Humphrey and Schmitz (2000:4) identify three major forms of non-market governance, namely, network, quasi-hierarchy and hierarchy. Network refers to “cooperation among more or less equals”. Quasi-hierarchy describes “a high degree of control from buyers over suppliers”, whereas hierarchy refers to the “direct ownership of local producers by buyers”. In networks, enterprises enjoy equal powers. In the quasi-hierarchy, suppliers are independent but subordinate to the buyers. In hierarchy, “vertical integration” comes within enterprises (ibid).

A more complete and elaborate typology of value chain governance has been proposed by Gereffi, Humphrey and Sturgeon in their seminal work titled “the governance of global value chains” (2005). Gereffi and his research associates identify five basic types of value chain governance. These are: (1) *markets*, (2) *modular value chains*, (3) *relational value chains*, (4) *captive value chains* and (5) *hierarchy*. Markets and Hierarchies form extreme poles of the continuum of “explicit coordination” Gereffi *et al* (2005:83). In between we find the three intermediate modes of the network category, namely, modular, relational and captive value chains (ibid)²⁶. (See also Annex 8.2, an illustration of global value chain governance)

²⁶ Markets fundamentally represent “market-based relationships among firms”. Market-based relationships are mainly “transitory” in nature but at times can also persist over prolonged time of period depending on the frequency of transactions. In market modes, “the costs of switching to new partners are low for both parties”. Modular value chains represent circumstances in which suppliers “make products to a customer’s specifications”. Nevertheless, the major suppliers (who provide the “turn-key services”) assume responsibilities for competencies in the production process, technology and use of machinery. Relational value chains represent networks of intricate relations and dealings between buyers

Power imbalance (asymmetry) is fundamental to chain governance as there are major actors (lead firms) who assume key responsibilities for the inter-firm relations in general and division of labor in particular (Kaplinsky and Morris 2001: 29). The governance structure (Gereffi, in Itika 2009:212) strongly shapes the way “resources are allocated and flow in the chain”. Generally, the producer-driven value chains are decisively governed and controlled at the point of manufacturing, whereas, the buyer-driven chains are basically governed and controlled at the point of design, distribution and retail outlets (Gereffi 1999:2). Nevertheless, the trend seems that there is momentous shift from producer-driven to buyer-driven chains (Gereffi *et al*, in Bain 2010:4). Lead retail firms and marketers play dominant role in “making and enforcing decisions about production practices” without owning manufacturing facilities themselves (*ibid*).

Buyer-driven chains of labor-intensive industries (than producer-driven chains of technology/capital intensive industries) are more relevant to the developing countries of Asia, Latin America and Africa. Nevertheless, highly skewed power concentration characterizes the global business (economic) relationship in general. Under either versions of governance (i.e., producer-driven / buyer-driven), producers/buyers from developed countries often dominate producers of developing countries in key aspects of decision-making in the value chain.

and sellers whose relations are based on mutual dependence. Relational value chains are coordinated and managed through “trust, reputations, family relations and ethnic ties”. Captive value chains represent networks in which “small suppliers” depend on “much larger buyers”. For the small suppliers, the costs of shifting to other buyers are quite high. As a result, they would always remain “captive” in the transaction. The large buyers often exercise higher degree of monitoring and control over the captive suppliers. Hierarchy represents a mode of governance in a value chain of “vertically integrated firms”. Vertical integration or hierarchical governance is exercised predominantly through “managerial control”, streaming down from executives and supervisors to subordinates, or from headquarters to branches and subsidiaries (Gereffi *et al* 2005:83-84).

Upgrading

So far we have scrutinized the key dimensions of a value chain. Still another very important consideration in the discourse of value chains is the notion of upgrading. Enterprises or clusters of enterprises should exert efforts to recurrently improve their competitive standing in the global value chain. Such efforts are realized through what is termed in the value chain literature as *upgrading* (Gereffi 2001; Humphrey and Schmitz 2000; Fleury and Fleury 2001).

Upgrading involves the process of organizational learning to improve the competitive position of firms in global value chains. In specific terms, upgrading involves “making better products more efficiently and moving into more skilled activities along the value chain” (Fuerst 2010:90). In this sense, upgrading can be seen as a notion of “innovating” to boost the value added along the chain (ibid). Enterprises need to make use of upgrading (as a “dynamic element”) in their response to the frequent changes in the value chain and the environment at large (ACDIVOCA 2010). Upgrading thus demands “innovating faster than competitors” (Fleury and Fleury 2001:117). The practice is not limited to efforts of individual firms; it also extends to the efforts of nations to improve their competitive positions in the international trade networks (Gereffi *et al* 2001:5; Gereffi, in Fleury and Fleury 2001:117). In relation to this, Porter (1990:73) also noted that the competitive advantage of nations relies on “the capacity of its industry to innovate and upgrade”. According to Dolan and Tewari (2001:94), “upgrading of local capabilities is critical to sustain existing markets and offset the impact of new competitors as well as to expand into new market niches”.

How can firms achieve objectives of upgrading? Humphrey and Schmitz (2000); Fleury and Fleury (2001:118); and Morris (2001:132) suggest three possible trajectories for upgrading: (i) product upgrading, which involves the development of new product lines; (ii) process upgrading, which involves the “efficient transformation of inputs into outputs by introducing superior technology or re-

organizing production systems”; and (iii) functional upgrading, which involves moving into new functions like “design or marketing”. Succinctly stated, upgrading can be realized through improvement/development of products, transformation processes and functions (ACDIVOCA 2010; Morrison, Peifrobelli and Robelloti, n.d.). Finally, Fleury and Fleury (2001:118) highlight that there would be upgrading if: (i) it (upgrading) improves the “competitive position of the firm” relative to its earlier position as well as its competitors; (ii) the changes are the result of genuine improvement in the competence of the firm; and (iii) it (upgrading) raises the “discretionary power” of the firm vis-à-vis other firms.

Value Chain Implications to LED

LED is a bottom-up approach to development. It generates employment opportunities and equitable economic growth through judicious utilization of the resource potentials of every locality. LED is firmly founded on the premise that every locality has own comparative advantages, which should be better exploited and managed (LEDNA 2012). The aim is to make the targeted local sectors (for instance, micro and small enterprises engaged in specialized economic activities) “more competitive and ensure local value chain operators obtain maximum benefits” (ibid) and ultimately contribute to local economic development, primarily, in terms of interrelated objectives of employment generation, poverty alleviation and economic growth.

Taking the value chain approach to local economic development means addressing the major constraints and opportunities faced by micro and small business enterprises at multiple levels of the value chain (ACDIVOCA 2010). According to ILO (2007:1-6), the idea of value chain is brought to local economic development (LED) in order to reinforce competitiveness and bring small enterprises into markets. Value chain development (VCD) is basically a market-oriented approach, as all activities of a given value chain are directed towards market. The value chain approach to local economic development (LED)

examines enterprises in a market chain that runs from “input-suppliers to final buyers” and also the “relationships among them” (ACDIVOCA 2010). Enterprises operating along a given value chain need to have effective cooperation and coordination of activities. Any case of “weak link” in the chain would jeopardize the competitiveness of the entire value chain. Inefficiency in production and marketing at any segment of the chain leads to economic standstill and ultimately to poverty (ibid; ILO 2007:6).

Michael Porter, for instance, focuses on the concept of value chains (1985) and demonstrates how the VC approach can be used as a vital tool for enhancing the competitive advantage of enterprises. He also focuses on the core issues of innovation and upgrading as mechanisms of achieving the nation’s competitive advantages (1990). Disaggregating the activities involved in the value chain and identifying the linkages among the activities, and pursuing continuous innovation and upgrading are vital to competitive advantages, both at the firm and, ultimately, at the national (including local/regional) level.

The value chain approach/perspective underscores that “... as much as the value chain model is global, it is quite possible to find national, regional or local value chains” (McCormick, in McCormick, Kuzilwa and Tegenge 2009b: 6). As per this logic, we may find domestic value chains (DVC) functioning within “limited geographical reach” and serving local and national markets. Domestic value chains operate “in the same way as global chains”. Both models involve design, input-supply, production and marketing. Nevertheless, we also observe important differences. Global value chains are generally superior to domestic value chains, in terms of, for instance, scale of operation, stretch, efficiency and productivity (ibid). Finally, Kuzilwa and Ngowi (2009:189) highlight that global value chains interface with local value chains. This would lead to a conclusion that successful performance of enterprises in the local chain could determine their entry into the global value chain (ibid). Effective participation in the global value chain stands as a key precursor of national economic growth and development.

2.8. Summary

The review of literature has been composed under three basic themes: LED, MSE and Value chains. Under the first theme, LED, we have seen the rationales for local development, the definitions and features of local economic development, the environmental milieu, pro-poor Vs pro-growth LED, LED generations, and the role of local government institutions in LED. Under the second theme, MSE, we have seen definitions of MSEs, the role (contribution) of MSEs in LED, the informal dimensions of LED, and clustering. We have seen that MSEs, operating both in the formal and informal sectors, occupy very important–place in the economy of less developed countries. We have also seen that even those working in the formal sector operate with some degree of informality (i.e., partial informality). The role of MSEs in LED may possibly be boosted if MSEs were organized in a setting of enterprise clusters than operating in scattered manner. The available body of empirical literature in Ethiopia can be grouped under three categories: major policy documents that provide broader framework and institutional setting for MSEs and empirical literature concerned with MSEs in general and MSEs in specific sector.

In this research, the role of MSEs is studied not in isolation or at the production level alone; rather within the broader context of the value chains – *with a focus on the wood-work MSE domestic value chains*. The third theme, value chains, has thus been the key point of discourse in this paper. The definitions and analysis of value chains impart its key dimensions, including input-output structure (in which we have also seen the wood-work value chain), geographic spread (spatial scale of operation), chain governance (inter-firm networks, quasi-hierarchy and hierarchy), producer-driven/ buyer-driven models of value chains, upgrading, which involves the process of organizational learning to improve the competitive position of firms through three possible trajectories: (i) product upgrading, (ii) process upgrading, and (iii) functional upgrading. Finally, we have seen briefly the value chain implications to LED.

Chapter Three

3. Research Methodology

3.1. Introduction

This research exercise aims primarily at interrelated areas of local economic development (LED), micro and small enterprises (MSE), and the role of MSEs in LED through modest analysis of the wood-work MSE domestic value chain. Micro and small enterprises exist and operate either in “scattered manner” or as “enterprise clusters”. Institutional support can be extended to both individual (scattered) enterprises and/or enterprise clusters. But it (institutional support) would be more viable and effective when it is extended to enterprise clusters (Rogerson 2002:6). In the Ethiopian case, however, enterprise clusters are hard to find, and if exist in any sub-sector (for instance, in the footwear sub-sector), they are not yet well developed. This research, therefore, builds on the operation of individual (scattered) enterprises; not on enterprise clusters. Though the research is built on scattered enterprises (MSEs), such enterprises are studied in terms of their value chains.

Chapter three presents the research methodology designed for this study. The methodology is based on a combination of broad review of literature (related to LED, MSE and Value Chains) and primary data collection pertinent to the wood work (the wood-furniture) MSE domestic value chain. The sources of data (both primary and secondary data), the locality of this research (a brief description of the study area), sampling methods and the sample size, the nature of the principal data collection tool (the questionnaire) and methods of data analysis, mainly quantitative supported with simple and descriptive data analysis, are briefly addressed and presented. Interviews were administered to collect data from selected MSEs, sawmill operators and timber traders in order to support the data gathered through the questionnaires.

3.2. Methodology

According to Creswell (2009:6-11), a research effort is guided by some “worldviews” or methodologies, which could in some way or another be influenced by the views and distinct assumptions of *post-positivism, social constructivism, advocacy and participatory, or pragmatism*:

“Post-positivism” is a traditional worldview based on empirical observation, measurement and quantitative research. It is interested in determining cause-and-effect relations and theory verification, hence deductive in its approach. “Social constructivism” is based on qualitative research and subjective analysis aimed at understanding the views of others. It is interested in theory generation, hence inductive in its approach. “Advocacy and participatory” worldview has come as a paradigm during the 1980s and 1990s, in reaction to the post-positivist views. It advocates social justice for the marginalized; hence it is more of political and change-oriented. It is more of qualitative and collaborative in its research procedures. “Pragmatism” is a result of “actions, situations and consequences”. It, unlike post-positivism, is not based on “antecedent conditions”. Pragmatist researchers, instead of devoting attention to methods, directly focus on “the research problem and use all approaches available” to look into the problem. Pragmatism is based on mixed (both quantitative and qualitative) methods (ibid).

This very research is not aimed at verifying (testing) theories through rigorous quantitative measurements and analysis (purely positivist) or is not intended to generating new theories through qualitative data collection and subjective analysis (purely constructivist). Nor it is participatory or political in nature driven by defined interest of advocacy for some marginalized group. It is not participatory since it does not involve respondent groups in all phases of the research. This research is guided by a pragmatist epistemology²⁷ that mixes qualitative and quantitative methods of data collection and analysis. This research, as Creswell

²⁷ A term preferred and used by some writers like Crotty (Creswell 2009:6)

(2009) noted, is more of “problem-centered” and “real-world practice oriented”. It is profoundly interested in exploring the role of MSEs in LED. The research tries to explore how MSEs are functioning and what internal and external problems are challenging the entire value chain. It also attempts to look for some alternative approaches or solutions (Patton 1990; Morgan 2007, in Creswell 2009: 10) that may help redress some of the problems. Therefore, this study draws on a pragmatist (essentially mixed) approach that blends quantitative and qualitative research methods. Accordingly, the data collected through the questionnaire and interviews are analyzed using quantitative and qualitative techniques.

The research exercise involves an extensive review of literature and a survey whereby questionnaires are served to collect data from MSEs at one point in time (Creswell 2009:146; Babbie 1989:89). The survey design²⁸ is effective to collect data from the sample (aimed at making generalization) of a population distributed over a large area with a relatively less cost and rapid return of responses (Easterby-Smith, Thorpe and Lowe 2002: 135; Creswell 2003:153; Fowler 2002, Babbie 1990, in Creswell 2009:146). The method is appropriate for using quantitative analysis and “particularly useful in describing the characteristics of large population” (Babbie 1989:254). Though questionnaires are the most important, interviews and observations are also methods often used to collect a survey data (Gay and Airasian 2003:277). In this study, questionnaire is the key instrument to collect data. However, interviews, consultations and personal observations are also used to augment the data acquired through the questionnaires. The literature review forms the context and background for the field research, which in turn enriches the stock of knowledge in LED, MSE development, value chains and, to some extent, role of government (particularly, local government) institutions in light of the situations of less developed countries

²⁸ Some people, according to Gay and Airasian (2003), refer to the survey research approach as a “descriptive research” approach. Many studies rely on survey and “are descriptive in nature” (ibid).

like Ethiopia. The research exercise helps to see to some extent the gap/divergence between what is said in the literature and what is actually the reality in less developed countries.

Attempts are made to explore the topic and provide familiarity (Babbie 1989:80-82) with the issues of LED and the key actors involved in LED. The research describes and analyzes observed realities (ibid) in the domain of micro and small enterprises (MSE), their value chains and the problems such MSEs often face across the value chain, right from the point of input-sourcing, product design, throughout the production process, to marketing and distribution. The research exercise also attempts to explain the way how MSEs could contribute to LED through analysis of the wood-work value chain, look into the relationships that prevail in the sector, and provide some explanations as to why the prominent problems in the sector exist and persist (ibid).

3.3. Sources of data

The research is based primarily on collecting, compiling and analyzing primary data. Furniture manufacturing MSEs operating within the wood-work value chain are the major sources for the collection of primary data. Sawmill operators and timber traders also serve as supplementary sources of information. All these sources of primary data (namely, furniture production MSEs, sawmills, and timber trading firms) are located in and distributed over the sub cities of Addis Ababa, which is the study area. Besides, secondary data are compiled to provide background for and complement the data collected from the primary sources. The basic secondary data on wood-work MSEs in Addis Ababa (and the MSE distribution over the sub-cities) was secured from Trade and Industry Development Bureau of the city Government (AACG).

The Locality: the Study Area

The locality selected for this study is the city of Addis Ababa, which is the largest (more or less primate) and capital city of Ethiopia. Addis Ababa is located approximately at the very heart (central highlands) of the country with an average elevation of 2500 meters above sea level. The highest peak is 2800 meters, in the northern part of the city, whereas the lowest peak is 2200 meters in its southern part. As a result of its location, Addis Ababa experiences an “Afro-Alpine climate” with an average temperature of 16 C° (AACG Strategic Plan 2005/6 – 2009/10).

Addis Ababa is one of the largest cities in Sub-Saharan Africa, with an estimated population of more than 4 million. It has political and diplomatic significance at continental as well as international levels. The city, like many African primate cities, is the political, industrial, commercial and service metropolis of the country. The city is the center of heavy concentration of diverse micro and small enterprises, including wood-work MSEs.

The city of Addis Ababa, as a typical SSA city, also suffers from a multitude of economic and social problems. Acute poverty, ever exacerbated by demographic pressures and extensive levels of unemployment, is perhaps at the top of the core problems of the city. Well articulated LED programs and MSE development strategies, supported with effective local government role in enabling the entire business environment, could serve as instrument to remit the pressures of unemployment and poverty.

The country’s recent decentralization process has an overall impact on whatever is generally taking place in the political, economic and social aspects of the city of Addis Ababa. As per Proclamation No. 1/2003 (Sub-cities and *Qebeles* Establishment Proclamation) the city of Addis Ababa has been sub divided into ten sub-cities (see Table 1). Sub-city means the “second administrative stratum of

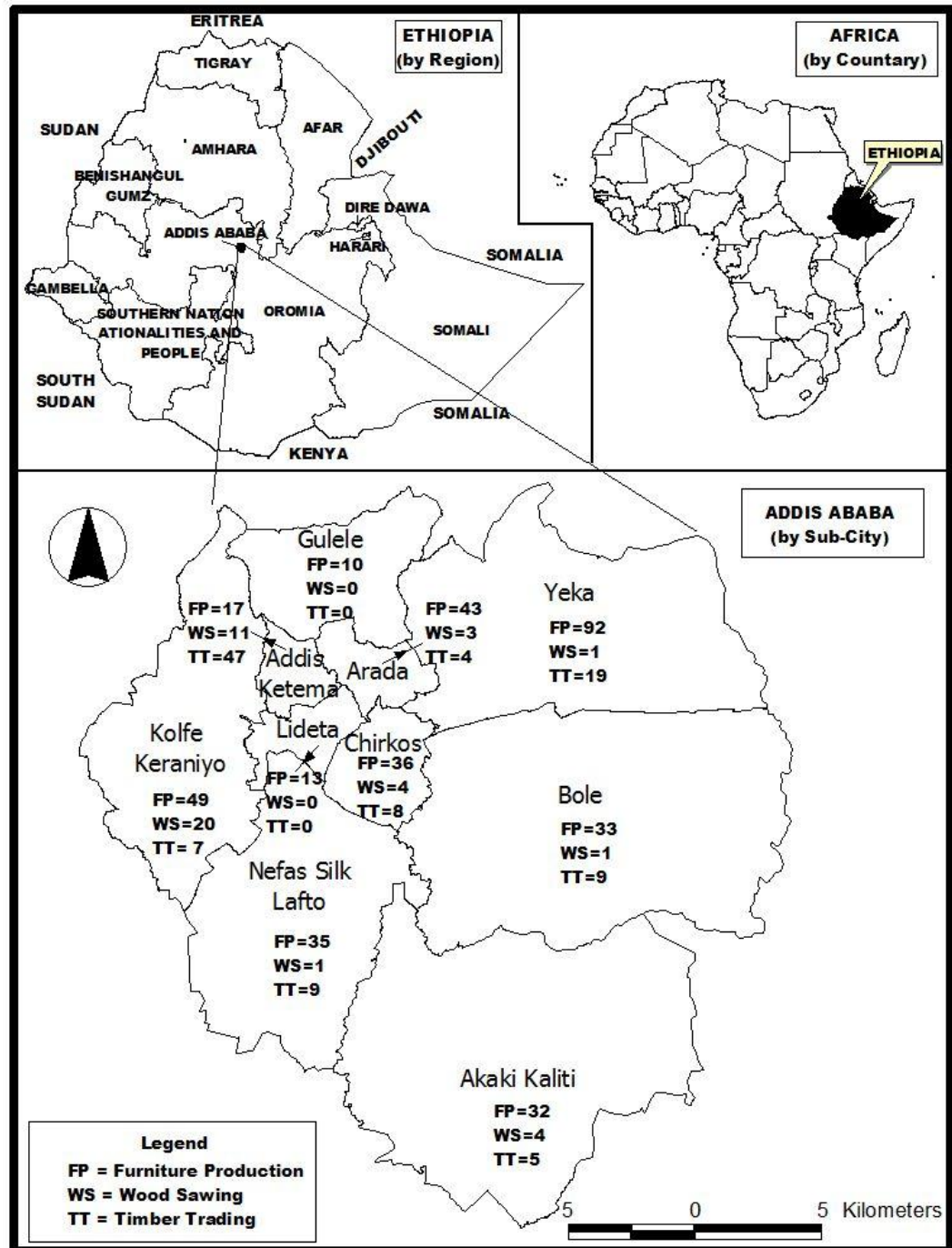
the city” just above the lower stratum (*Qebele*²⁹, which is currently upgraded and referred to as *Woreda*³⁰).

Figure 05 portrays the map of the locality (the geographic location of the city of Addis Ababa) and the distribution of wood-work MSEs in the ten sub-cities. The MSEs are particularly engaged in the three interrelated business lines of furniture production, wood sawing, and timber trading.

²⁹ The lowest administrative tier (just below the *Woreda* level) in Ethiopia

³⁰ The second lowest administrative tier (just above the *Qebele* level) in Ethiopia

Figure 05: Map of the Locality and Distribution of Wood-Work MSEs



Source of data: Table 02 (Chapter 4)

3.4. Sampling

Micro and small enterprises (MSEs) engaged in the manufacturing of furniture constitute the principal source of data for this research. On top of this, sawmill operators and timber traders are considered to provide information aimed at supplementing the data collected from the first set of enterprises (i.e., furniture manufacturing MSEs³¹).

According to the Trade and Industry Development Bureau (TIDB), there are 599 registered (hence licensed) wood-work and related micro and small enterprises in Addis Ababa (see Table 02, Ch. 4). Out of this aggregate, only 360 are purely engaged in the business of furniture production and sales. These 360 enterprises, therefore, serve as the population from which the 200 sample MSEs are taken for this research. It would have of course been exhaustive to take all of the 360 furniture MSEs operating in the locality. Nevertheless, due to resource constraints and other considerations, the researcher could not take this option but decided to consider at least half of them and design a sample size of 200 MSEs engaged in the production of furniture in Addis Ababa.

In Ethiopia, until recently (2011), two types of definitions have been employed to classify micro and small enterprises. One of the definitions was provided by the former Ministry of Trade and Industry (MOTI) and the other by the Central Statistical Authority (CSA) (Tegegne and Meheret 2010:13).

Ministry of Trade and Industry used to apply “paid-up capital” criteria to classify MSEs (FDRE 1997). Accordingly, the paid-up capital ceiling for micro-enterprises was fixed at 20000 Birr (local currency). On the other hand, those

³¹ The other types of wood-work enterprises that are engaged in the business of, for instance, wood-fuel, tooth-pick, sculpture, traditional wood-works, etc are completely left out from being considered as the focus of this study. These particular types of MSEs are left out since they do not normally come within the wood-furniture value chain proper.

business enterprises with paid-up capital of 20000-500000 Birr were categorized as small business enterprises (FDRE 1997: 3). However, taking the inflation after 1997 and contemporary prices into account, the paid-up capital brackets were becoming progressively irrelevant. Costs of raw materials, related supplies, rents and labor are not as before. In all spheres, the costs have escalated sharply.

The Central Statistical Agency, on the other hand, though not giving strictly separate criteria to distinguish between micro and small enterprises, it provides a labor criterion of “less than ten persons” to refer to small (micro) enterprises, including informal sector activities.

Since March 2011 the revised MSE development strategy has provided new criteria to define micro and small enterprises. As per the new strategy, micro enterprises are those enterprises that have 5 workers (including family labor) and total asset of not more than 100,000 Birr (for manufacturing enterprises³²). Small enterprises, on the other hand, are those enterprises that have 6-30 workers and asset of not more than 1.5 million Birr (for manufacturing enterprises) (FDRE 2011).

The revised (2011) criteria is therefore the basis for identifying and defining micro and small enterprises. Accordingly, out of the 360 wood-furniture enterprises registered by the TIDB, more than 55 percent are taken to constitute the sample; hence forming a sample size of 200 registered MSEs (see table 01). The 200 sample enterprises are proportionally drawn from different sub-cities as indicated in the following table. The researcher believes that the sample size is quite sufficient as it is taken from a highly homogeneous group of enterprises, in terms of factors such as economic sector (wood-work), product types, production

³² The 2011 MSE development strategy classifies MSEs in terms of products (manufacturing enterprises) and services (service providing enterprises). The capital ceiling for service giving micro enterprises is 50,000 Birr, whereas the ceiling for small enterprises is 500,000 Birr.

process and level of technology, scale of operation (all are MSEs), the markets they serve (domestic markets), the locality in which they operate, etc.

Wood-furniture enterprises indeed occupy the central place in the domestic wood-work value chain. The furniture MSEs are venues that link the key actors of the value chain, including input suppliers, designers, the producers and buyers. The linking role of furniture MSEs is relatively strong in the domestic value chain (DVC). This is partly because the DVC is likely to have a shorter distribution channel when compared to the global commodity chain (GCC). Though furniture MSEs occupy a key position, the role of sawmill enterprises and timber trading stores is also very important in the wood-work value chain. Sawmills are engaged in the operation of wood-sawing and service of supplying sawn-woods and chip-woods to the timber trading stores and furniture enterprises.

In the locality (Addis Ababa), there are about 45 registered MSEs specifically engaged in wood-sawing and 108 retail shops engaged in timber trading. Most of the sawmill enterprises (about 69 percent) concentrate in two neighboring sub-cities³³ of Kolfe-Keranio (20) and Addis Ketama (11). Most of the timber retail shops, on the other hand, concentrate in Addis Ketema sub-city (more than 43 percent), followed by Yeka sub-city (about 17 percent). (See table 02). 10 from sawmill MSEs and 24 from timber traders (22 percent in both cases) have been contacted for interviews and discussions. The sample sizes are considered to be quite sufficient since enterprises in each case are engaged in narrow (limited-scope) as well as highly homogenous functions. Sawmills are engaged in acquiring logs, processing and transferring timber to the buyers (users). And timber traders are engaged in buying and selling timbers.

³³ There could be some historical reason for the concentration of sawmill enterprises in these two sub-cities, which are located in the vicinity of the largest open market of the city and country at large (known as *Merkato*). As a matter of convenience and usual practice, trucks unload and distribute cut-logs and timbers in these neighboring sub-cities.

It could be possible to produce the list of all elements (MSEs) for sampling purposes. However, it is not realistic or practical to bring this to the ground and draw and then deal with sample MSEs on probability basis. This is primarily because MSEs are not clustered in one place but highly scattered across the city (and the sub-cities). It is very difficult to trace their exact physical location. Some are found in and around business areas; whereas others are dispersed in residential zones and hard-to-find places. Besides, the finance and the time-span requirements for this are quite beyond the researcher's capacity and condition to afford. Therefore, the feasible way of getting samples was on "encounter" (or availability) basis. When enterprises were randomly encountered within the selected sub-cities, for which relative proportions have already been determined, the data collectors had to be sure of at least two things: (i) the firm has labor size of not more than 30 (to define the scale of the enterprise) and (ii) the owner³⁴ should be available to impart pertinent information as per the broad-range items provided in the questionnaire.

³⁴ Owners are most preferred to provide responses since they are more relevant and also supposed to be familiar with the items provided in the questionnaire.

Table 01: Sample Plan: *furniture MSEs, sawmills, and timber traders*

| SN | Sub-City | Furniture MSEs | % | Sample Size | Sawmill MSEs | Sample Size | Timber Traders | Sample Size |
|----|---------------|----------------|------|-------------|--------------|-------------|----------------|-------------|
| 1 | Arada | 43 | 11.9 | 24 | 3 | - | 4 | - |
| 2 | Addis Ketema | 17 | 4.7 | 9 | 11 | 4 | 47 | 17 |
| 3 | Lideta | 13 | 3.6 | 7 | - | - | - | - |
| 4 | Chirkos | 36 | 10 | 20 | 4 | - | 8 | - |
| 5 | Yeka | 92 | 25.6 | 51 | 1 | - | 19 | 7 |
| 6 | Bole | 33 | 9 | 18 | 1 | - | 9 | - |
| 7 | Akaki-Kaliti | 32 | 8.9 | 18 | 4 | - | 5 | - |
| 8 | Kolfe-Keranio | 49 | 13.6 | 27 | 20 | 6 | 7 | - |
| 9 | Nifas Silk | 35 | 9.7 | 20 | 1 | - | 9 | - |
| 10 | Gulele | 10 | 3 | 6 | - | - | - | - |
| | Total | 360 | 100 | 200 | 45 | 10 | 108 | 24 |

Source: Table 02 (compiled form data obtained from Addis Ababa Trade and Industry Development Bureau, 2012)

Furthermore, it has to be underlined that the table does not impart data on informal wood-work businesses since such enterprises are not officially registered by the Bureau of Trade and Industry Development. Therefore, the number and distribution of MSEs across the city could be beyond the actual figures provided on the table. At this juncture, it should be very clear that being and operating absolutely in the informal sector or operating with some degree of informality doesn't mean that a given MSE is kept out of the value chain, as long as it does more or less similar things (design, input-sourcing, production-processing and selling) within the chain.

Recently, after the start of this research work, the government has been making sweeping efforts to alter the business landscape across the nation, particularly in terms of registration and licensing. Accordingly, the drastic move of the city government may have supposedly repositioned as many MSEs from the informal to the “formal” (registered) sector. Nevertheless, it should be remarked that even though MSEs are registered, hence compelled to pay taxes, certain elements of informality may still prevail in their operations, in terms of, for instance, employment and labor management, compensation management, financing and accounting, and business dealings and transactions. Apart from the formal registration, it would thus be very difficult to differentiate between formality and informality in the operations of MSEs.

3.5. Primary Data Collection Tools

The principal data collection instrument for this study has been a standardized (mainly closed-ended³⁵) questionnaire. The questionnaire is divided into 11 headings, which provide a wider range of items, including: personal data of operators, profile of the enterprise, the product, design and production, input supply, marketing and distribution, competition and competitiveness, upgrading, MSE labor structure, inter-firm relations, operators’ perceptions about government institutions and, finally, possible problems in the business (in the sector). The questionnaire is quite broad with substantial amount of information, which is relatively exhaustive, that has made the data collection process closer to a situation of case study on 200 sample enterprises in the wood-work micro and small enterprise sub-sector in the locality (Addis Ababa). (See Annex 1: the Questionnaire).

Information about strengths, weaknesses/deficiencies of the questionnaire and suggestions for its improvement are provided by pre-testing (Gay and Airasian

³⁵ Gay and Airasian (2003) contend that “Questionnaires rarely contain large number of free response items”.

2003:288). Accordingly, the questionnaire was put under a pilot test that provided an excellent opportunity to learn from the process, take advantage of the strengths and correct the deficiencies. Redundant, vague, and less relevant items have been reviewed, removed; missing, new points have been incorporated and necessary adjustments made to come up with the final version of the questionnaire. The entire process was based on the: (i) manner of the responses from twenty MSE operators, (ii) feed-back obtained from the data collectors, (iii) new ideas from more resources (i.e., other data collection instruments), and (iv) critical comments from the supervisor. This pre-testing process has been used as a means to ascertain the validity, “the extent to which the instrument measures what it is supposed to measure” (Leedy and Ormrod 2001:98; Gay and Airasian 2003:288) and reliability, “internal consistency” (Creswell 2003:158; Leedy and Ormrod 2001:99) of the questionnaire.

Respondents have mainly been owners/operators of MSEs. In very few cases, however, managers/ representatives/relatives were required to provide responses as they were available at the time of survey. When managers or representatives were not confident enough to provide information, either the sample enterprise was changed or the session was postponed until the owner appears. This means that only one questionnaire was delivered for one enterprise. The questionnaires were filled in by trained interviewers.

Interviews have been used to collect data from MSE operators, sawmill operators and timber traders (see Annex 2: Interview Checklist 01 and Annex 3: Interview Checklist 02). The data collected through interviews have served primarily as additional information to support and verify the data collected through the questionnaire. The interview checklist for the MSE operators has also served as an input to compose cases (or profile) of selected MSEs (see end of Chapter Four: Profile of MSEs). Moreover, consultations and detailed discussions have been made with relevant sources such as government officials and MSE employees.

Careful observation of premises and workshops (accompanied by discussions with the owners and workers) has been made on some of the enterprises to enhance the information acquired through questionnaires and interviews. This has been very important means of acquiring visible information on the overall situation and appearance of working premises, including, workshops, machines, tools, stores, input types, sales outlets and product types.

3.6. The Data Collection Process

As it was mentioned, the data collection process was started with a pilot test on twenty wood-work MSEs. In this process, the data collectors have been involved from the outset; hence trained to the extent they can fairly acquaint themselves with the operation of the value-chain in the wood-work MSE sector.

Seven data collectors (including the principal researcher) have been involved in the ultimate data collection process. All of the data collectors were Masters and final year undergraduate students from Addis Ababa University. At the end of each day of data collection, the principal researcher has closely verified and received the filled-in questionnaires. When there are cases of defective returns, the concerned data collectors have been instructed to repeat the process and redress the defects.

The interviews have been entirely carried out by the researcher, in some cases with an assistant. Moreover, useful discussions at different times in the course of this study have been made with pertinent bodies like sawmills operators, timber distributors and concerned government officials. The information acquired this way has served to support, complement and verify the data collected through the principal data collection instrument.

3.7. Data Analysis

The principal data was collected through a standardized, mainly closed-ended, questionnaire distributed to 200 MSE operators sampled from the ten sub-cities of

Addis Ababa. The data is presented using tabular statistical summaries, graphs and charts. Data analysis has been quantitative as well as qualitative. The quantitative analysis has been substantially based on simple analysis of the data collected through the questionnaire. The qualitative analysis was based on the information gathered through the interview checklists (01 and 02) and open (unstructured) discussions made with sawmill operators and distributors of timber and related inputs. Simple quantitative analysis was sufficient to an elaborate description and analysis of the overall functioning of the value chain of the wood-furniture MSE sub-sector. Secondary sources and physical observations have also been strong backings for the qualitative analysis and description of issues in the value chain in general and in the workshops (and related workplaces) in particular.

3.8. Ethical Considerations

All the sources (published literature, documents, web-based sources, secondary data from government institutions and other materials) used in this research work are duly acknowledged. Besides, certain ethical considerations have been sufficiently observed while collecting the data through the questionnaires and interviews. In this case:

- Participants have been properly informed of the purpose of the study and thus responses to the questionnaires or the interviews have all been based on “informed consent” (Leedy and Ormrod 2001: 107). Data gathering sessions have been voluntary;
- Much care has been taken to avoid psychological discomfort on the part of participants during data collection;
- Preferences of participants have been respected regarding how the sessions should proceed;

- Responses provided by the participants have been confidential in order to respect their “right to privacy” (ibid) or, in other words, “protect anonymity” (Creswell 2003:67). Moreover,
- Utmost care has been taken not to distort or misinterpret the information provided by the respondents;
- No wrong promises or deceptive information have been given to the participants as they might sometimes happen to expect immediate solutions (recommendations) to their firm level problems.

3.9. Summary

The research exercise involved an extensive review of literature and a field survey. The literature provides the context and background for the field research, which in turn contributes to the stock of knowledge in LED, MSE development and value chains. The research is based primarily on collecting, compiling and analyzing primary data. Micro and small enterprises operating within the wood-work value chain are the key sources for primary data. Besides, secondary data are searched for to provide background for and complement the data collected from the primary sources. The basic secondary data on wood-work MSEs in Addis Ababa (and the MSE distribution over the sub-cities) have been secured from Trade and Industry Development Bureau of the city Government (AACG) of the study area, i.e., Addis Ababa.

This research considers micro and small enterprises engaged in the wood-works business and related firms in the wood-work value chain. However, the focus was on the wood-furniture MSE sub-sector. Out of the 360 wood-furniture MSEs, more than 55 percent are taken to constitute the sample; hence forming a sample size of 200 registered MSEs. The 200 sample enterprises have been proportionally drawn from the ten sub cities of Addis Ababa.

The principal data collection instrument in this study has been a standardized (mainly closed-ended), an 11-pp, questionnaire. Prior to the launching of the overall data collection, the questionnaire was put under a pilot test on twenty wood-furniture MSEs. The pilot test provided an excellent opportunity to learn from the process, improve and assure the validity and reliability of the questionnaire.

The data collected through interviews (for sawmill operators and timber traders) have served as additional information to support the data collected through the questionnaire. The interview checklist for the MSE operators also served as an input to compose the cases (profile of MSEs). Moreover, consultations and detailed discussions have been made with relevant sources such as government officials, sawmills operators, MSE employees, and timber sellers.

Data analysis has been quantitative as well as qualitative. The quantitative analysis was based on the questionnaire, whereas the qualitative was based on information gathered through the interviews made to sawmill operators and distributors of timbers. Discussions with different officials and employees of MSEs have also served to enrich the information collected through the questionnaires and interviews. Secondary sources and physical observations have also been strong backings for the qualitative analysis and description of issues in the value chain in general and in the workshops (and related workplaces) in particular.

Chapter Four

4. Profile of MSEs

4.1. Introduction

According to Liedholm and Mead (1999:20-21), there are a number of factors that would “influence patterns of enterprise dynamics”. These factors belong either to the enterprises or the operators of such enterprises. The practice of identifying and analyzing the possible factors in both cases can serve at least two important purposes. First, the practice would help to identify the nature of the majority of MSEs and the characteristic features of those who are engaged in this economic sub-sector. Second, it may help policy makers in formulating appropriate policy instruments which in turn would direct government and donor interventions aimed at effectively supporting and developing the MSE sector. Therefore, we need to compile and analyze precise profile of micro and small enterprises engaged in the production of wood furniture. This chapter presents, first, empirical data on the distribution of MSEs in the study area (Addis Ababa) and, second, the profile of MSEs generated and compiled from the field survey.

4.2. Distribution of Wood-Work MSEs in Addis Ababa: Empirical Data

As official documents (data) of Trade and Industry Development Bureau of the locality demonstrate micro and small enterprises engaged in wood-related activities can be classified under six business types: furniture production, wood-sawing, timber trading³⁶, traditional wood-works, wood sculpture and wood fuel (see Table 02). Among these, the first three are interrelated in the value chain as wood sawing firms and timber traders appear to supply sawn woods (timbers) to the furniture manufacturing firms. Furniture production/manufacturing accounts approximately for more than 60 percent of the overall activity in the wood-work

³⁶ Timber trading is included in the list since it serves as input sourcing channel in the wood-work value chain

MSE sector in the locality. Wood-sawing and timber trading account for about 7.5 and 18 percent, respectively. Together, the three lines of business constitute more than 85 percent of the business in the sector. Traditional wood-works (0.8 percent) and wood sculpture (3.5 percent) are relatively insignificant. Wood-fuel accounts for about 10 percent, perhaps indicating the importance of wood fuel in the households of the city.

Three sub cities, namely Yeka (123), Kolfe-Keranio (100) and Addis Ketema (95) host more than 50 percent of the registered wood-work MSEs engaged in nearly all sorts of wood-related business activities in Addis Ababa. On the other hand, Lideta and Gulele sub-cities host relatively small number of MSEs. When we look at the highest and the lowest figures, Yeka (123) and Gulele/Lideta (17 each) sub cities come into the two extremes. Considered only in terms of wood-furniture MSEs, about 92 MSEs (25.5 percent) and 10 MSEs (2.7) percent are found in Yeka and Gulele sub cities, respectively, with a range of nearly 83.

Out of the 360 furniture production MSEs, some 14 run wood furniture and metal works together under one license and one working premise. Such MSEs are taken as part of the furniture production though they also are engaged in the business of metal (iron) works. The furniture production process, in some cases, involves both wood and iron materials.

Most of the saw-mills are found in the neighboring sub-cities of Kolfe-Keranio and Addis Ketama (about 69%). Sawmills located in these two sub-cities are physically close to the largest market place (*Mercato*) of the city and the country at large. Trucks carrying cut-logs enter mainly through the south and southwestern part of the city and unload the logs in these two sub-cities. On top of this, these two sub-cities host relatively most of the wood fuel MSEs in the locality. Most of the timber-trading shops are found in Addis Ketema and Yeka sub-cities, 43.5 percent and 17.6 percent, respectively.

Table 02: Distribution of Wood-Work and Timber Trading Enterprises (Addis Ababa)

| SN | Sub City | Furniture Production | Wood Sawing | Timber Trading | Traditional Wood Work | Wood Sculpture | Wood Fuel | Total |
|----|------------------|----------------------|-------------|----------------|-----------------------|----------------|-----------|-------|
| 1 | Arada | 43 | 3 | 4 | 1 | 2 | 6 | 59 |
| 2 | Addis Ketema | 17 | 11 | 47 | 1 | 8 | 11 | 95 |
| 3 | Lideta | 13 | - | - | - | 3 | 1 | 17 |
| 4 | Chirkos | 36 | 4 | 8 | 2 | 1 | 2 | 53 |
| 5 | Yeka | 92 | 1 | 19 | - | 2 | 9 | 123 |
| 6 | Bole | 33 | 1 | 9 | - | 3 | 2 | 48 |
| 7 | Akaki-Kaliti | 32 | 4 | 5 | - | - | 1 | 42 |
| 8 | Kolfe-Keranio | 49 | 20 | 7 | - | 1 | 23 | 100 |
| 9 | Nifas Silk-Lafto | 35 | 1 | 9 | - | - | - | 45 |
| 10 | Gulele | 10 | - | - | 1 | - | 6 | 17 |
| | Total | 360 | 45 | 108 | 5 | 21 | 61 | 599 |

Source: Compiled from the data base of Trade and Industry Development Bureau (Addis Ababa, 2012)

4.3. Registered Capital Sizes of Wood-Work MSEs: Empirical Data

The table given below presents the data on registered capital sizes of micro and small enterprises engaged in the wood work businesses (furniture, wood-sawmills, timber trading, wood-fuel, etc) in Addis Ababa. Wood-work MSEs with registered highest capital investments (i.e., above 200000 Birr) seem to concentrate in five sub-cities, namely, Bole (9), Kolfe-Keranio (8), Nifas-silk (7), Arada (6), and Akaki-Kaliti (6); Nevertheless, MSEs with still more and highest capital investments of more than 500000 Birr concentrate in three sub-cities, namely, Bole (6), Arada (5) and Nifas-silk (5). There are about 18 MSEs with capital investments of more than 1 million Birr. More than half of the MSEs in this group are found in Bole and Arada sub-cities. MSEs with lowest capital investments (both below 10000 and 20000) seem to concentrate in three sub-cities, namely, Yeka, Addis Ketema and Kolfe-Keranio. As has already been seen, these three sub-cities together host more than half (53 percent) of the MSEs in the city.

In terms of business types, the highest capital sizes (in hundreds of thousands and millions) are associated with furniture production, which involves relatively heavy investment in workshops, machinery, tools, labor, component parts and other auxiliary inputs. The lowest capitals (below 10 thousands) are mainly associated with wood-fuel, sculpture, and traditional wood-work businesses. Wood-fuel constitutes about 10 percent of wood-work MSEs in Addis. Individual enterprises in this business have registered capital amount of not exceeding 5000 birr in almost all cases. Their function is limited to acquiring woods and preparing such woods for house-hold fuel consumption. This is in any measure a highly traditional and backward way of utilizing wood for fuel. The number of informal enterprises engaged in this practice can possibly be very high as the capital, skill, technology and working premise requirements are quite low (characterized by lower entry barrier) relative to the other forms of the business in the sector.

Table 03: Registered Capital Sizes of Wood-Work Enterprises (Addis Ababa)

| SN | Sub-City | No of MSEs in the City with Registered Capital (in <i>Millions of Birr</i>) of: | | | | | | | | | |
|----|---------------|--|-----------|----------|-----------|-----------|-----------|-----------|-----------|------------|-------|
| | | Below.005 | .005-.009 | .01-.020 | .021-.050 | .051-.100 | .101-.200 | .201-.500 | .501-1.00 | Above 1.00 | Total |
| 1 | Arada | 3 | 23 | 13 | 10 | 2 | 2 | 1 | 1 | 4 | 59 |
| 2 | Addis Ketema | 9 | 69 | 6 | 8 | 2 | - | - | - | 1 | 95 |
| 3 | Lideta | 2 | 5 | 3 | 4 | 1 | 1 | 1 | - | - | 17 |
| 4 | Chirkos | 5 | 28 | 11 | - | 2 | 5 | - | 1 | 1 | 53 |
| 5 | Yeka | 8 | 68 | 29 | 11 | 6 | - | - | 1 | - | 123 |
| 6 | Bole | - | 22 | 6 | 6 | 3 | 2 | 3 | - | 6 | 48 |
| 7 | Akaki-Kaliti | 4 | 21 | 6 | 3 | 2 | - | 3 | 1 | 2 | 42 |
| 8 | Kolfe-Keranio | 13 | 47 | 19 | 8 | 3 | 2 | 6 | 1 | 1 | 100 |
| 9 | Nifas Silk | 4 | 20 | 5 | 5 | 1 | 3 | 2 | 2 | 3 | 45 |
| 10 | Gulele | 3 | 9 | 4 | - | - | 1 | - | - | - | 17 |

Source: Adapted from the data base of Trade and Industry Development Bureau (Addis Ababa, 2012)

4.4. Profile of MSEs

The profile of the sample MSEs may be described and analyzed in line of some important factors, including: line of business (sector) and product type, enterprise age, enterprise size (in terms of both labor strength and size of capital), enterprise location (location of working premises), legal status, ownership form, and the nature of enterprise management.

Most of the micro and small enterprises (48 percent) have attained age of 6-10 years since establishment; of course, cumulatively, about 72 percent of the enterprises have age of below 10 years. It is also true that about 24 percent of the enterprises have age of less than 5 years, indicating their recent entry into and relatively speaking short experience with the business. Short experience can mean inadequate experience with the whole process of production and production techniques, labor management, customer handling, marketing and distribution, financial management and related business activities. Recent entry might also crudely indicate that enterprises may have not been in a position to accumulate sufficient capital for business expansion and upgrading. Those MSEs that might have benefited (if they really have benefited) from longer stay in the business (for more than 15 years) are not beyond 12 percent.

Table 04: Enterprise Age

| Enterprise age (since establishment): | Number of MSE ³⁷ (Percent) | Cumulative (Cumulative Percent) |
|--|--|------------------------------------|
| < a year | 4 (2) | 4 (2) |
| 1 – 5 years | 44 (22) | 48 (24) |
| 6 – 10 years | 96 (48) | 144 (72) |
| 11 – 15 years | 31 (15.5) | 175 (87.5) |
| 16 – 20 years | 7 (3.5) | 182 (91) |
| > 20 years | 15 (7.5) | 197 (98.5) |
| No response | 3 (1.5) | 200 (100) |
| Total | 200 | |

Source: field data

All of the MSEs considered for this study are licensed, meaning all are operating formally and thus pay business taxes (see Table 05). This is the result of the recent move of the government to bring business operations into the legal framework. Consequently, the MSEs have been duly registered and thus operate under a license. But still several aspects of their operations could be informal as well. An informal way of operation could be a point of discussion basically because there is a formal one. As Castelles and Portes (1989:13) observed before a couple of decades, we safely speak about an “informal” sector primarily because there is a “formal” one which operates within the broader institutional framework. Though MSEs are formally registered and licensed there still could be some

³⁷ Terms like “No of MSE”, “No of cases”, and “Frequency of responses” are used under different circumstances. The first one (No of MSE) is used when the subject under discussion is pertinent to or seen from the perspective of the MSE itself. The second one (No of cases) is used when the subject is more pertinent to or seen from the perspective of the owners/the operators or when the case is somehow external to the enterprise. The third one is used when the frequency of responses turns out to be greater than the sample size (i.e., 200) due to the possibility of multiple responses.

elements of informality in many aspects of their operations. It is unrealistic to put definite demarcation between the informal and formal economic activities. Kaplinsky and Morris (in LEDNA 2012) also noted that economic activities are not rigidly separated in real life.

Well established enterprises naturally have their own business (sometimes, brand) names and even trade marks to maintain identity among others. In this study, it has been seen that about 62 percent of the enterprises do have own “names”, perhaps, which could be a partial indication of the move of firms from the informal to the formal sector. Yet many of the firms (38 percent) do not have business names, in which case firm names are often identified with the name of the very owner/operator. This is often the main feature of the micro and highly survivalist (informal) firms. When firms grow bigger they tend to assume formal business names and, at latter and still higher stages, even brand names. Such names would give them identity, both within the business community and in their relations with government agencies (for registration, licensing, tax, statistics, or any other purpose).

Sole proprietorship is the dominant mode of ownership in the MSE sector in general. In the wood-furniture production and sales MSE sector, sole proprietorship overwhelmingly dominates (88.5 percent) over partnerships, which is only 11.5 percent. Both forms have their own (inherent) strengths and weaknesses. Sole proprietorships are dominant partly because startup capitals are comparatively small hence barriers to entry are relatively low. Generally speaking, some aspects subject to weaknesses in one form can be strengths in the other. Sole proprietorships have the advantages of making and passing prompt business decisions, high degree of flexibility and freedom of operation. Being free from personal disagreements, as often is the case in partnerships; sole proprietorships may enjoy relatively longer life of existence than partnerships. Sole proprietorships also enjoy more engagement and commitment from their owners. Partnerships, on the other hand, have the advantages of pooling and combining

essential business inputs from the partners. In partnerships, some people could have capital whereas others have essential skills and abilities. Partnerships can also benefit from new business ideas and expertise as people are likely to think in different dimensions. We can crudely generalize that partnerships are preferred when the partners wanted to compensate for the limitations of sole proprietorships.

In most of the MSEs (more than 88 percent), sole proprietors (the single owners) make critical decisions pertinent to the operation of the business. Decisions like investment, organizing business, employment and labor management, purchase of inputs, product design, selecting techniques of production, quantity and quality of outputs, logistics, distribution and marketing, revenue and expense administration, including accounts keeping and looking for credit possibilities, even decisions for liquidation and alteration of business are all undertaken by the sole owner. As formerly stated, this freedom could have its own advantages and disadvantages.

Table 05: Legal Status and Form of Ownership

| Description | No of MSE (Percent) | Description | No of MSE (Percent) |
|---------------------|------------------------|------------------------|------------------------|
| Legal status: | | MSEs with: | |
| Licensed | 200 (100) | Business name | 124 (62) |
| Not licensed | 0 | No business name | 76 (38) |
| Total | 200 | Total | 200 |
| MSE ownership form: | | The MSE is managed by: | |
| Sole proprietorship | 177 (88.5) | The owner | 179 (89.5) |
| Partnership | 23 (11.5) | Hired manager | 20 (10) |
| Total | 200 | Relative/Friend | 1 (0.5) |
| | | Total | 200 |

Source: field data

Enterprise management is an important aspect of portraying the profile of enterprises. It is clear that the more we move up the hierarchy of enterprises, we are likely to find relatively adequate composition (and team) of management personnel (see the hierarchy of enterprises, Annex 7). The reverse is true as we move down the hierarchy. We hardly find independent (hired) management in most of the micro and even small enterprises. In this study, too, most of the enterprises (close to 90 percent) are managed by their very owners. Only 10 percent of the enterprises have hired (independently appointed) managers. Some of the MSEs have relatively better organization, labor and capital size, machinery and tools, working premises, products, wider market access and sufficient revenue. These could be the ones that have managers hired to run the day to day business affairs of the firm. The real involvement and scope of responsibility of such managers in making important decisions relies, among others, heavily on the scale of the business, the behavior, interest, business tradition and capacity of the owner (s) and experience of the managers themselves.

Another important aspect of MSE profile is the nature of working premises. In relation to this, we can identify two categories of enterprises: those working in an independent working premise and those operating within the home premise. Though most (83.5 percent) of the enterprises operate in independent working premises, still there are some (16.5 percent) operating within home premises (see Table 06). Working premises can be acquired either through rent or otherwise. As can be seen from the table, most (78 percent) of the premises are acquired through rent. Nevertheless, we should also note that all independent working premises, even those acquired through rent, are not necessarily located in commercial (business) districts, as some of them could be located in quite residential areas (which in many aspects could be less suitable for such businesses). Moreover, continuity is often an issue when premises are acquired through rents from residences. The owners of such residences can at any time force the operators to terminate business and leave the premise.

Survival and business growth could be challenging for those operating within the home premises. According to Liedholm and Mead (1999:20-21), enterprises operating in business districts are more likely to survive and grow than those operating in home premises. As MSEs grow and graduate to medium and large scales, they are likely to find more access to working premises in commercial districts, particularly for their sales outlets and product display.

Table 06: Working Premises

| Enterprises operate in: | No of MSE (Percent) | The working premise was acquired : | No of MSE (Percent) |
|-----------------------------|---------------------|------------------------------------|---------------------|
| Independent working premise | 167 (83.5) | Through rent | 156 (78) |
| Within the home premise | 33 (16.5) | Without rent | 44 (22) |
| Total | 200 | Total | 200 |

Source: field data

One important way of studying the profile of MSEs is the description of size and source of capital. Table 07 displays the data assembled on capital sizes of enterprises, in terms of initial and current capital. Business people can often be willing to tell about their initial capitals; nevertheless, some of them could for whatever reason decline to disclose the current capital. Even when they disclose, they are likely to underestimate. Some of them are not totally willing to provide data for both initial and current capital³⁸.

About half (54 percent) of the enterprises had initial capital of less than 10,000 Birr, which is less than 600 USD. Every other thing being constant, low level of initial capital means low entry barrier to the business. Cumulatively, about 64 percent had initial capital of less than 20000 Birr, which is less than 1200 USD.

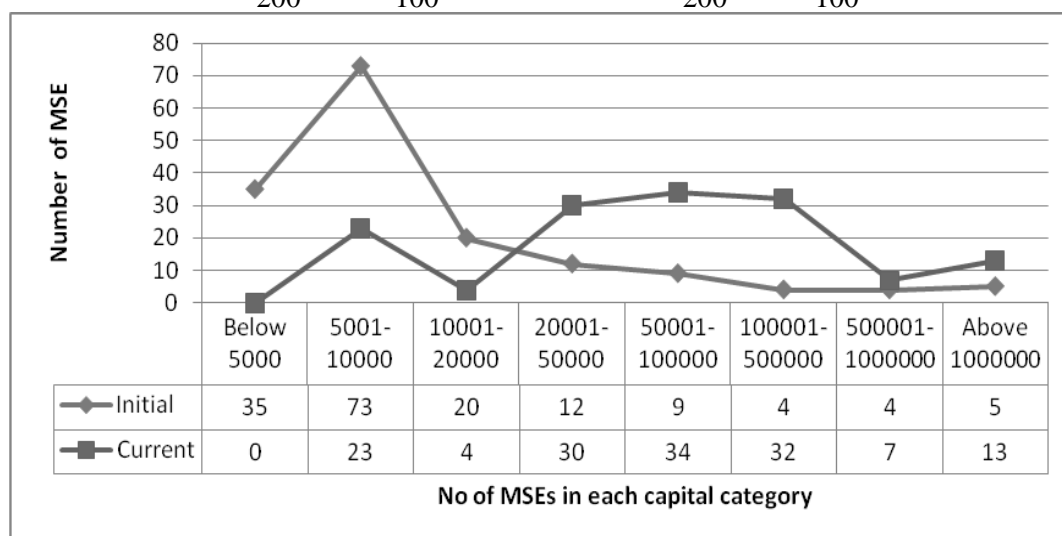
³⁸ About 38 (19 percent) and 57 (28.5 percent) of the respondents did not provide information relating to initial and current capital sizes, respectively.

Initial capital sizes of most of the enterprises (more than 36 percent) cluster within capital category of 5000-10000 Birr (approximately within 300-600 USD). Generally, in terms of initial capital, the bigger frequencies tend to concentrate around the lower capital categories, apparently below 20000 Birr (see the chart under table 07). Today, initial capitals (for beginners) couldn't be as before since costs of workshops, machines and tools, materials, rents and labor are mounting (exacerbated by the rapidly rising inflation) hence reinforcing entry barriers to the wood-work (furniture) business.

Currently, about 17 percent of the MSEs reported to have capital sizes that fall within the range of 50000-100000 Birr, which is roughly between 1100 and 2900 USD. In terms of current capital, the bigger frequencies concentrate within the capital ranges of 20000-500000 Birr. Some (6.5 percent) of the MSEs have capital size of more than one million Birr. There is some contrast between initial capital and current capital sizes. Through time, enterprises are normally expected to grow and accumulate more capital in terms of finance, material and human assets.

Table 07: Size of Capital: *initial, current*

| Capital Category | Initial Capital | | | | Current Capital | | | |
|------------------|-----------------|------|------|------|-----------------|------|------|------|
| | No of MSE | % | Cum. | % | No of MSE | % | Cum. | % |
| Below 5000 | 35 | 17.5 | 35 | 17.5 | 0 | 0 | 0 | 0 |
| 5001-10000 | 73 | 36.5 | 108 | 54 | 23 | 11.5 | 23 | 11.5 |
| 10001-20000 | 20 | 10 | 128 | 64 | 4 | 2 | 27 | 13.5 |
| 20001-50000 | 12 | 6 | 140 | 70 | 30 | 15 | 57 | 28.5 |
| 50001-100000 | 9 | 4.5 | 149 | 74.5 | 34 | 17 | 91 | 45.5 |
| 100001-500000 | 4 | 2 | 153 | 76.5 | 32 | 16 | 123 | 61.5 |
| 500001-1000000 | 4 | 2 | 157 | 78.5 | 7 | 3.5 | 130 | 65 |
| Above 1000000 | 5 | 2.5 | 162 | 81 | 13 | 6.5 | 143 | 71.5 |
| No response | 38 | 19 | 200 | 100 | 57 | 28.5 | 200 | 100 |
| | 200 | 100 | | | 200 | 100 | | |



Source: field data (Note: Cum. = Cumulative)

Entrepreneurs need some amount of money and other forms of capital (like machines, tools, working premises, etc) to start business. They might get the initial money from different sources, including own savings, family transfers, and credits. In this study, own savings (46.8 percent) stood first as a source of initial capital followed by family transfers, which accounts close to 40 percent. Micro credits account only for 3 percent. This indicates that not only personal (own) sources and savings but also family sources and transfers serve as a major source

of initial capital to start business in the MSE sector. Own savings become critical source of current financial needs once the business is started and going on (see Table 08). Bank loans could also be alternative sources for those who seek to get sufficient money to finance business. However, there are a number of personal reasons and external hurdles for not taking bank loans. Lack of collateral, absence of effective need for bank loans and fear of interest rates perhaps are the major reasons for not resorting to bank loans.

Table 08: Source of Finance: *initial, current*

| Sources of initial capital: | Frequency of responses (Percent) | Sources of finance for meeting current needs: | Frequency of responses (Percent) | Reasons for not taking bank loans | No of MSE (Percent) |
|--------------------------------|----------------------------------|---|----------------------------------|-----------------------------------|---------------------|
| Own savings | 104 (46.8) | Own savings | 166 (63.4) | No need | 56 (28) |
| Family transfers | 88 (39.6) | Borrowing from formal sources | 20 (7.6) | The enterprise is informal | 0 |
| Credits from friends/relatives | 23 (10.4) | Borrowing from informal sources | 31(11.8) | Lack of collateral | 69 (34.5) |
| Micro credits | 7 (3) | Supplier credits | 8 (3.05) | Fear of interest rates | 35 (17.5) |
| Other sources | 0 | Cash advance from clients | 37 (14.2) | Other reasons | 3 (1.5) |
| | | | | No response | 37 (18.5) |
| Total ³⁹ | 222 (100) | Total ⁴⁰ | 262 (100) | Total | 200 (100) |

Source: field data

³⁹ The total count exceeds sample size (200) because of multiple responses

⁴⁰ The total count exceeds sample size (200) because of multiple responses

4.5. Cases (profile) of Selected MSEs

Firm A

Enterprise Size: Small (16 Employees, minimum excluding casual workers)

Firm A is a young but relatively successful enterprise managed by a young entrepreneur, owner and operator. He himself was an employee of different furniture enterprises at different places for about 15 years before he started his own business. For nearly 7 years he used to work in Adwa, Tigray region. Before 4 years he came back to Addis and was able to start his own enterprise on a rented working premise with some tools and saving and initial capital of 17000 Birr.

The business was quite tough at the beginning. Working hard day and night, he managed to purchase a China-made machine with a cost of 23000 Birr, additional tools and other necessary inputs. He started the business with very few workers. However, in the last 3 years he became in a position to create employment opportunities for about 16 workers, minimum.

The firm is small and engaged in the production of house hold furniture. It does not accept large orders, usually office furniture, due to capacity limitations. In case large orders are received, the owner wants the customers settle for at least 50% down payment. This is a strategy to avoid financial shortage and to compensate for the time spent on this project and to make sure that this

would be carried out without impairing other orders. Now he is planning to buy heavy-duty machine worth of 250000 Birr, with which he would boost the firm's capacity thereby enter into large contracts including the production of office furniture.

The firm currently uses main inputs like pine woods, timbers, plywood and other inputs, which for the most part are purchased from Mercato (the biggest market) area. Pine woods and timbers are local whereas plywood, ready-made (well-designed) components like *décor complsato* (as locally termed) and other chemical inputs are imported (mainly from China). The owner/operator also uses own designs for certain furniture products.

The owner discloses that the enterprise is "busy and successful" ... worked hard for the last 4 years (since establishment) and was able to possess own pickup vehicle. All together, the current capital is nearly half a million. "Though we are successful and the market is promising", added the owner, "we are facing serious problems related to working premises, machines and labor turn-over". The current working premise has limited space, which is a bottleneck for scaling-up the

business. Changing the working place at this time means starting the business afresh and losing current customers. The second problem can be redressed by purchasing heavy-duty machines. Regarding labor, the owner says: “we are accustomed to high labor turn-over; the sector is like that! The good part of it is that

we immediately get new workers. But we also lose well-trained and experienced workers”. Amidst this, the owner has intent to expand the business. With spacious working premise, heavy-duty machines and additional workers, the firm is likely to enjoy a more successful business and prosperous future.

Firm B

Enterprise Size: Micro (4 employees)

This one is a micro enterprise of informal status (not yet having license and formal name) and operating just with 4 workers. The firm was established by the current owner (40) who was a regular student at a vocational college in Addis Ababa. He graduated with diploma in “wood-technology”. Upon graduation, he got 1000 Birr from his family. With this money he bought basic tools (like hammer and cutter) and started working with friends who already have started a very small wood-work business, where he was considered as “partner”. Having worked for some time, he has started running his own on a rented premise. He has worked for one year and now thinking to get registered and licensed.

The business is very small operating with only basic tools. We can not find the common (China-made) machine at this enterprise, which is of course engaged in the production of limited assortments of house-hold furniture. When the need arises, he turns to the nearby enterprises for machines and other services. He uses pinewoods, plywood and chip-wood boards as inputs, which he frequently buys from Piassa and Mercato markets. He designs himself on the basis of customer specifications. Though he has some amount of money now, “lack of finance” is still the single most important problem for his business. He could not get credits due to lack of collateral. In any case, his urgent and most pressing objective is buying the most necessary machine for his workshop.

Firm C

Enterprise Size: Small (8 Employees)

Firm C is a small-enterprise of 8 workers, established and managed by a young owner (38). Before starting

this business, the owner was a wood-work student at Misrak Comprehensive School, Addis

Ababa, and he is a 12 grade complete. Upon completion, he planned to start a wood-work business and fortunately managed to get 20000 Birr from his family. He started his business on a rented premise with this amount of initial capital, with very few workers and tools. Now the owner has gone through 5 solid years since he started the business. He is not that clear about the size of his current capital, but assumes it is closer to 80000 Birr.

The enterprise is currently engaged in the production of house hold furniture, including, doors, windows, cupboards, kitchen cabinets, beds and bed-sides. Firm C has already created employment opportunities for about 8 workers. The major inputs are pine woods, timbers and plywood boards. All such inputs are

often purchased from retailers operating in and around the Merkato area. The owner uses catalogues as sources for designs.

The owner says, “The demand is fine but the work is quite challenging”. He discloses that his enterprise operates under heavy constraint of finance and shortage of machines. The enterprise has one machine originally imported from China. The machine is not that strong to function to the satisfaction of the operators. To solve this problem, the firm has recently introduced a “*modific*” (locally made) machine worth more than 23000 Birr. The *modific* is not only affordable but also reliable and relatively heave-duty when compared to the common machines imported from China.

Firm D

Enterprise Size: Micro (5 Employees)

This one is located at a place where we come across a small concentration of MSEs engaged in the production and sales of furniture. We also find sales outlets for locally produced furniture whose workshops are located somewhere else, retail stores of imported furniture, and few MDF, ply wood retail shops.

The enterprise under discussion was established before 16 years with an initial capital of 18000 Birr that was raised through own savings. The owner (50) had no advanced formal

education or any special technical training. He used to dropout from grade 8. But through experience, he could manage to run the business for nearly 2 decades.

The business is run on a rented working premise that has a spacious display room and workshop and store at the back. The enterprise has 5 permanent workers, including a sales lady. The number of workers fluctuates along with the scale of business; hence, rising business

entails more temporary and contract workers.

The enterprise is engaged in the production and sales of household furniture made entirely out of local/domestic raw-materials (timbers and sawn woods, traditionally and informally termed as *Shashemene*, after the locality where pine woods and timbers mainly come from). The owner/operator is not interested in imported inputs as he believes that his enterprise is specialized in manufacturing domestic products made from local raw-materials. Operators use own and catalogue-based designs.

The owner asserts that his products are more strong/durable and relatively expensive than similar and “cheaper” Chinese products. He at the same time admits that imported inputs and products are embellished in design and finishing thus are quite attractive than his domestic ones. Otherwise (i.e., in material

quality/strength), the two are incomparable.

“The business”, says the owner “is not as before due mainly to imported alternatives”. Importers and MSEs making use of imported inputs – like MDF – have been mushrooming these days. Having been asked whether he has intentions to turn to imported inputs (MDF), the operator says, “we might use imported raw-materials (MDF) in the future. Currently, however, we are comfortable with our products and thus no need for change”.

The enterprise is operating in a place where we find a small cluster of similar MSEs. Inter-firm relations are relatively strong in this area though such relations are highly confined to information exchange, borrowing tools and, at times, machines.

Finally, labor turn-over is reported to be the major problem for this particular enterprise.

Firm E

Enterprise Size: Small (10-15 Employees)

This small enterprise was established before 4 years by the owner (40), who previously was engaged in another occupation. He could save and raise more than 1.5 million Birr and started wood-furniture business. Later on he could generate more money and purchased latest as well as heavy-duty machines imported

from Germany and enhanced the business on a rented premise. The enterprise is engaged in the production of both house-hold and office furniture. Product designs are catalogue-based. At the moment this data was collected, there were eight uniform-dressed, permanent and

well-trained workers, including foreigners.

The owner has strong dissatisfaction with the working environment in general. The most acute one for him, however, is the condition of the working premise, which in turn has a couple of problems: (1) lack of space, because of which 2 of the heavy-duty machines are not operational since the business has been started. The internal organization is quite messy; and (2) the physical appearance of the premise. The working premise is unattractive, substandard for the amount of capital invested! Customers are also likely to consider the firm as inferior.

The owner has always been keen to improve the condition of the working premise by spending money from

own pocket. Nevertheless, the requirements, processes and administrative procedures on the part of the government are nearly intolerable. In other words, government regulations and the bureaucracy are big bottlenecks to upgrade the entire appearance of the workshop. Moreover, if things were simple and smooth the owner wants to establish attractive display room on the premise. According to the owner, leave alone upgrading the premise, license renewal is becoming difficult due to demanding procedures and detailed requirements. Currently, the owner discloses, "the firm is working nearly at lose!" In order to get out of this, he needs either to improve the working premise or resort to a better (but expensive) working premise somewhere else.

Table 09: Cases (profile) of selected MSEs: *précis*

| MSE | Firm Age | Firm Size | Capital Size | | Products | Major Problems |
|--------|----------|---------------|--------------------------|----------------------------|------------------------------|---|
| | | | <i>Initial</i> | <i>Current</i> | | |
| Firm A | 4 years | Small (16) | 17000 Birr | 500000 Birr | House hold (HH) furniture | <ul style="list-style-type: none"> • Working premise • Lack of machinery • Labor turn-over |
| Firm B | 2 years | Micro (4) | - | - | House hold (HH) furniture | <ul style="list-style-type: none"> • Shortage of capital • Lack of credit |
| Firm C | 5 years | Small (8) | 20000 Birr | 80000 Birr | House hold (HH) furniture | <ul style="list-style-type: none"> • Shortage of capital • Lack of machines |
| Firm D | 16 years | Micro (5) | 18000 Birr | - | House hold (HH) furniture | <ul style="list-style-type: none"> • Labor turn-over |
| Firm E | 4 years | Small (10-15) | More than 1 million Birr | More than 1.5 million Birr | Both HH and office furniture | <ul style="list-style-type: none"> • Working premise |

Source: Cases (profile) of selected MSEs

4.6. Summary

This chapter disclosed that micro and small enterprises engaged in wood-works can be classified under five business types. Among these, MSEs engaged in furniture production and wood sawing are the concerns of this study as both are the major segments of the furniture value chain. The profile of MSEs, in

particular, has been captured using some important factors, including enterprise-age, size (in terms of labor and capital), enterprise location (location of working premises), legal status (whether an MSE operates formally or informally), ownership form (whether an MSE is sole- proprietor or partnership) and the nature of enterprise management.

Most of the MSEs are relatively young (less than 10 years), indicating their recent entry into and limited experience with the business. Though the MSEs are registered, licensed and pay taxes, still there are many elements of informality in their operations. Sole-proprietorship is the dominant form of business ownership in the wood-work MSE sector. About 90 percent of the MSEs are managed by the owners themselves. Another important aspect of the profile of MSEs is the location of the working premise. In this regard, most (83.5 percent) of the wood-work MSEs operate in independent working premises and the rest operate from home premises.

Most of the MSEs had initial capital of less than 10000 Birr, which is a partial indication of the relative ease of entry into the business. In terms of initial capital, the bigger frequencies tend to concentrate around the lower capital categories, apparently below 20000 Birr. In terms of current capital, bigger frequencies concentrate within 20000 and 500000 Birr. Some (6.5 percent) of the MSEs have capital size of more than one million Birr. The highest capitals (in hundreds of thousands and millions) are associated with furniture production, which involves heavy investments compared to the other forms of wood works. Own savings followed by family transfers constitute the main sources of initial capital.

Finally, case studies providing the profile of five wood-work MSEs (i.e., two micro and three small-scale enterprises) have been presented as detailed description and précis.

Chapter Five

5. Profile of MSE Operators and Labor

5.1. Introduction

This chapter presents, first, the profile of MSE owners and, second, the profile of labor. Terms like small producers, owners, workers, operators, etc. can be used by different writers (may be interchangeably) to name the persons engaged in the MSE business. On the other hand, terms like manufacturer, industrialist, investor, capitalist, factory owner, company owner, etc. are often associated with those engaged in the business of large and heavy establishments. The term entrepreneur seems pervasive though it is mainly used to refer to those who initiate business ideas at higher levels than micro and survivalist levels. As we move down the hierarchy of business establishments, we find small, micro and very micro (survivalist) enterprises, where we also find the bulk of the informal economies (see Annex 7). Whether firms at this level are informal or formal, the people engaged in the business as small producers can be conventionally termed as operators. See Solomon (2004); Liedhlo and Mead (1999); Tegegne and Meheret (2010); Tegegne (2009b); FDRE, MOTI (1997).

The role of MSEs is of particular importance in creating employment opportunities. This is one of the most important ways through which micro and small enterprises contribute to local economic development (LED) and poverty alleviation. Poor people, with meager resource possession and lower skills levels, often find business and employment opportunities in the MSE sector as entry barriers are relatively low both for the small entrepreneurs as well as the job seekers. It is not only the poor, but also entrepreneurs with strong finance and material capital and even sufficient technical and business skills who invest and run business in the MSE sector. Moreover, people with better technical skills (for instance, highly experienced workers and college graduates) also find

employment and work for micro and small enterprises. Under the labor profile, we will deal with such issues as labor strength, wage, and labor related problems.

5.2. Profile of Operators

The distinction between ‘operator’ and ‘owner’ becomes quite vague as we move down the hierarchy. Writers like Yu (in Tegegne 2009b: 160) use a composite term, *owner-operator*, in order to describe most of the producers engaged in the MSE sector. In most of the micro (and even small) enterprises where we find very small labor strength, owners themselves are among the operators. The term *operator* (in ordinary dictionaries) denotes any person who operates machines or equipments. This seems narrow and very specific in application. In this paper, we use the term operator by extending its application a bit beyond “operating machines” to represent an individual engaged in the business and operation of micro and small enterprises.

The profile of operators is composed by taking into account such key elements as owner’s occupation – whether the business is owner’s sole or additional occupation, the actual role of the owner in his/her enterprise, owner’s gender, age and ethnic origin and level of human capital (formal education and technical training). The intention for taking ‘ethnic origin’ as one element in the profile of operators mainly arises because ethnic and some other social factors in a given society are powerful forces to influence entry and create entry barriers to the MSE sector (the informal sector in particular) (see Macharia 1997).

We observe an overwhelming male dominance (close to 90 percent) over female in the ownership of wood-work MSE business. However, there are some entrepreneurial and prominent women owning and running the business in this sector though their number is quite small. These few women could be taken as pioneers. The trend in the spread of vocational education and training, changing propensity and increasing interest on the part of women could bring more of them to the business and thus alter the ownership composition to some extent. In terms

of age distribution, young ages seem to dominate in the business ownership. If taken cumulatively, about 86 percent of the owners/operators are below the age of 45. The modal class is 26-35, as 55 percent of the owners fall within this age group (see Table 10).

Another important element in the profile of MSEs is the owner's ethnic origin. Some studies indicate that some business lines are more frequently taken by certain ethnic groups or communities that would stand as entry opportunities/facilitators (for individuals from their own ethnic groups) or entry barriers (against individuals from other ethnic groups). Entries to business may be inspired and become easier at the same time barriers to entry are created as a result of social dynamics, where ethnic factors are very important (Macharia, 1997; Tegegne 2009b). Consequently, some types of micro and small businesses seem to be associated with and reserved for a particular community of ethnic origin. The idea of "ease of entry" (ILO 1972) into the MSE (mainly the informal) sector is considered with due care (Macharia 1997: 37). There are other social and political variables like ethnicity, friendship, and state activities and orientations which can constrain the entry to informal businesses. This means that it is not only "capital size" that determines the ease of entry, but also the social and political dynamics in a given country.

More elaborate analysis is provided by Tebarek (2011), whose analytical framework is based on the operation of socio-cultural factors of ethnicity, religion, political issues and informal relations in value chains. Tebarek (2011) forwards critical comments against the "functionalistic" approach of most of the research and literature that fail to address socio-cultural (non-functionalistic) considerations of value chains. He concludes that networking based on ethnicity and religion plays an important role in inter-firm linkages. However, Tebarek's conclusion should be taken with due care. At least three things must be taken into account:

- (i) Sub-sector or type of business under consideration. Tebarek's study was conducted in the leather industry; hence conclusions could be somehow confined to this particular or few other businesses;
- (ii) Scale of operation. The intensity of socio-cultural factors is likely to diminish as we move up the hierarchy of enterprises. Socio-cultural forces are quite strong in inter-firm relations of survivalist, informal, micro and very small enterprises than in the case of medium, large and heavy establishments;
- (iii) Spatial concentration of MSEs. The intensity of socio-cultural factors could be different when MSEs are in clusters or scattered. Socio-cultural forces are likely to be relatively strong in clusters than when MSEs are scattered. Small clusters of footwear operators constitute sizable proportion of Tebarke's source of data.

In any case, the footwear MSE sector in Ethiopia is dominated by operators from the *Gurage* community (see Tegegne 2009b: 160). In this sector, about 89.4 percent of the owners/operators are from the *Gurage* ethnic group (ibid). Tebarek (2011:33) adds that the *Gurages* "overwhelmingly" dominate in the Ethiopian leather and leather products value chain. Generally speaking, the *Gurages* are highly associated with the business sector and are said to have the "higher rate of business ownership than other major ethnic groups" in Ethiopia (Taye, in Tegegne 2009b:160). Traditionally, the *Gurages* have been frequently cited as dominating the business landscape in general. Nevertheless, things are noticeably changing and persons from other ethnic groups, too, are being heavily attracted and rapidly joining the business circle. For instance, in Addis Ababa, the survivalist (highly micro, one-man) shoe-shining business was previously dominated by the *Gurages*. Currently, however, it has become very common to see members of other ethnic groups (like *Hadiya and Woliyta*) dominating this particular survivalist business.

In this study, however, on the basis of 200 sample enterprises, some major ethnic groups, not only the Gurages, take part in the business of wood-furniture production. Accordingly, divers ethnic groups, including the Amharas (25 percent), the Oromos (13 percent) followed, of course, by the Gurages (11 percent) and other ethnic groups, participate in the business. Therefore, we may generalize that the wood-furniture sector, unlike many other small businesses, is not dominated by one ethnic group, namely, the Gurages.

In the wood-furniture MSE sector, the business is just sole occupation for most of the owners (88 percent). Only 11.3 percent of the owners have the business as additional occupation. For most of the operators the business could thus be the sole or major source of livelihood and occupation with which their career line is best identified. The business is “sole occupation” means that the operators would, under normal circumstances, exert their utmost efforts to the operation and growth of the enterprise. Involvement and commitment under such settings could be greater than under the settings given otherwise. Closer follow up, prompt decisions and corrective measures are also possible. Generally, the business benefits from the closeness and regular presence of the owner. Nevertheless, “sole occupation” could also be source of frustration when business gets down and is likely to lead to bankruptcy.

Table 10: Owners’/Operators’ Profile

| Owner’s gender: | No of cases (Percent) | Owner’s age : | No of cases (Percent) | Owner’s ethnic origin: | No of cases (Percent) |
|-------------------------------------|-----------------------|---|-----------------------|---------------------------|-----------------------|
| Male | 179 (89.5) | below 25 | 5 (2.5) | Amhara | 49 (24.5) |
| Female | 21 (10.5) | 26 – 35 | 110 (55) | Oromo | 26 (13) |
| Total | 200 | 36 – 45 | 56 (28) | Tigre | 5 (2.5) |
| | | above 45 | 27 (13.5) | Gurage | 22 (11) |
| | | No response | 2 (1) | Others ⁴¹ | 15 (7.5) |
| | | Total | 200 | No response ⁴² | 83 (41.5) |
| | | | | Total | 200 |
| The business (the firm) is owner’s: | No of cases (Percent) | Owner’s role in the business (in the firm): | No of cases (Percent) | | |
| Sole occupation | 176 (88) | Owner, operator, manager | 91 (45.5) | | |
| Additional occupation | 23 (11.3) | Owner, manager | 83 (41.5) | | |
| No response | 1 (.67) | Owner, operator | 12 (6) | | |
| Total | 200 | Only owner | 14 (7) | | |
| | | Total | 200 | | |

Source: field data

Owners may assume different roles in the actual operation of the enterprise. Some could be just owners, others could be owners and managers, and others could play every major role as operator, manager as well as owner. In the wood-work MSE sector, most of the owners (close to 46 percent) have the role to play as owner,

⁴¹ Include such ethnic minority groups as *Silte, Hadiya* ... mainly from the southern region of the country

⁴² As can be seen from the “No response” row many are not willing or reluctant to respond to this particular inquiry.

manager and operator. Some of the owners (41.5 percent) have roles as owner and manger; means do not take part in the actual (technical) operation of the production process. On the other extreme, some (7 percent) have a role as an owner alone; the license is in their name, they endorse or disapprove critical decisions (like purchase of materials in bulk, opening of branches, acquisition of major machines and tools, major sub-contracting, etc). In this case, the mangers seem to play important role in the day to day operation of the business and make decisions within “authorized boundary”. There are also few cases (6 percent) in which owners are also operators but hire managers to take certain administrative (managerial) responsibilities. This could happen when the owners lack and thus require the expertise of others in management duties. However, this kind of arrangement is likely to create management problem since disagreements frequently arise between the owner and the manager.

The role of the owner in the enterprise can be described as: quite limited, moderate or all-inclusive. This could depend on many grounds. But we need to ponder over one important ground, i.e., size of the enterprise. The role becomes all-inclusive as we move down the hierarchy of enterprises and could be quite limited as we move up the hierarchy. The role of the owner of those enterprises with huge capital, large labor sizes (say, 20 or 30), bulky operations with several branches, could be quite limited as there are hired personnel for every point of responsibility (ranging from technical operation to management). On the other hand, the role of the owner appears to be all-inclusive when the firm is very small and micro. In this regard, we can think of micro enterprises of small labor size (say, 2-3) with very small amount of capital and scale of operation. Between these two extremes, we may have owners with moderately ranging responsibilities.

Educational qualification can be a measure of entrepreneurial talent for MSE operators (Yu, in Tegegne 2009b). The more educated and trained, the more capable they are in dealing with the essential business requirements of measurements, calculations, designs, collecting and summarizing business data,

etc. As can be seen from the table, only 2 percent are illiterate and another 2 percent can only read and write. According to an official publication, CSA 2003 (in Tegegne 2009b), only 74.5 percent of the operators in the small scale manufacturing sector have been ascertained to be literate. In contrast, the current proportion of literate operators in the wood-furniture MSE sub-sector (which is not less than 98 percent) exceeds the official figure reported by the country's Central Statistical Authority (CSA) in 2003. Most of the operators (64 percent) are high-school completers, followed by diploma holders (15 percent) and elementary/junior level education completers (14 percent). Not only the proportion of literate operators, but also the proportion of operators with higher level of education is likely to increase very much in the years to come given the proliferation of both public and private vocational training and educational institutions in the country.

Table 11: Owners/Operators' Education, Specialized Training

| Owner's education level: | No of cases (Percent) | Cumulative percent | Specialized training: | No of cases (Percent) |
|--------------------------|-----------------------|--------------------|-----------------------------|-----------------------|
| Illiterate | 4 (2) | | Related to the business | 71 (35.5) |
| Read & write only | 4 (2) | 2 | Not related to the business | 53 (26.5) |
| Elementary/junior | 28 (14) | 16 | No specialized training | 76 (38) |
| High school complete | 128 (64) | 80 | Total | 200 |
| Diploma | 29 (14.5) | 94.5 | | |
| Bachelor Degree | 7 (3.5) | 98 ⁴³ | | |
| Total | 200 | | | |

Source: field data

On top of formal education, specialized training increases the business capacity in terms of technical know-how, managerial and book-keeping ability of operators.

⁴³ The cumulative percentages exclude illiterate operators

More than 60 percent of the operators in this study reported to have some kind of specialized training. Out of this, only 35.5 percent have trainings related to their current business; and the rest 26.5 percent have specialized training but unrelated to their business. About 38 percent of the operators do not have specialized training at all.

5.3. Profile of Labor

The profile of labor is composed by taking different aspects of labor and labor-related issues, including labor strength (both initial and current), terms of employment and skills levels, wage levels, and labor problems.

Labor Strength

The labor strength of MSEs is presented in terms of *initial* and *current* labor sizes. In both cases, initial and current, the size of each MSE is expected to range between 1 and 30. At the initial stage, most of the MSEs (71 percent) had labor size of 1-5. At the initial stage, only 4.5 percent of the MSEs had labor size of 11-20, and none of them had more than 20. Cumulatively, about 78 percent of the MSEs started business with labor sizes of less than 10 (see Table 12). The average and modal class for the initial labor size were 3.6 and 1-5, respectively.

Those micro and small enterprises started with relatively higher labor size may have been started by entrepreneurs having strong financial and material resources. This is a crude statement, however. In this regard, we find some MSEs that started business with initial labor size of 6 - 10 (about 7 percent) and 11- 20 (about 4.5 percent). Enterprises are graduating (perhaps gradually) from micro to small - in terms of labor size. The data provided on the table is also portrayed on a chart in order to illustrate the difference between initial and current labor strength. The number of MSEs steadily decline in the higher classes of labor size.

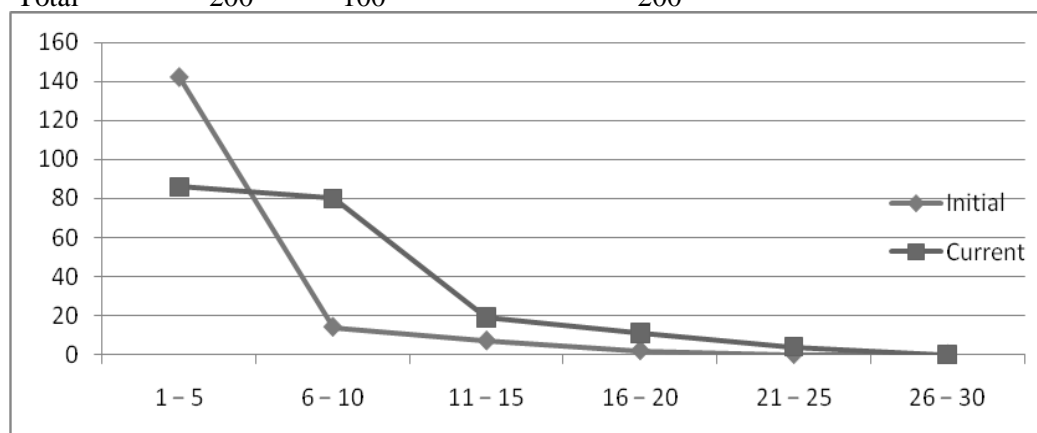
Currently, on the other hand, about 43 percent and 40 percent of the MSEs fall within the labor categories of 1-5 and 6-10, respectively. Moreover, about 9.5

percent and some 5.5 percent of the MSEs have labor sizes of 11-15 and 16-20, respectively. Only 2 percent of the MSEs have labor size of above 20. In the wood furniture MSE sector the reported lowest labor size is 2 whereas the highest is 25. The average for the current labor distribution is around 7.4 (see Annex 9). Taking the fact that 43 percent of the MSEs have labor sizes that fall within the range of 1-5, and the fact that 40 percent of the MSEs have labor sizes that fall within the range of 6-10, we may judge that most of the enterprises still operate at micro scale or found in the margin separating micro and small enterprises. Cumulatively, about 83 percent of the MSEs have labor size of less than 10, reinforcing the fact that micro enterprises form the bulk of the MSE sector. As per the previous (before 2011) definitions, those MSEs that have labor sizes of 6-10 were considered as “micro” enterprises. But currently, following the 2011 revised MSE development strategy, such MSEs are considered as “small” enterprises. This shift is evident not because of real graduation from micro to small scale, but because of revisions made to the definition⁴⁴ of MSEs.

⁴⁴ According to the revised (2011) MSE development strategy, those MSEs with more than 5 (i.e., 6-30) workers are considered as “small” enterprises.

Table 12: Labor strength: *Initial, Current*

| Labor Size | Initial | | | Current | | | | |
|-------------|-----------|------|------|---------|-----------|-----|------|------|
| | No of MSE | % | Cum. | % | No of MSE | % | Cum. | % |
| 1 – 5 | 142 | 71 | 142 | 71 | 86 | 43 | 86 | 43 |
| 6 – 10 | 14 | 7 | 156 | 78 | 80 | 40 | 166 | 83 |
| 11 – 15 | 7 | 3.5 | 163 | 81.5 | 19 | 9.5 | 185 | 92.5 |
| 16 – 20 | 2 | 1 | 165 | 82.5 | 11 | 5.5 | 196 | 98 |
| 21 – 25 | 0 | 0 | 165 | 82.5 | 4 | 2 | 200 | 100 |
| 25 – 30 | 0 | 0 | 165 | 82.5 | 0 | 0 | 200 | 100 |
| No response | 35 | 17.5 | 200 | 100 | 0 | 100 | 200 | |
| Total | 200 | 100 | | | 200 | | | |



Source: field data (Note: Cum. = Cumulative)

Micro and small enterprises can make use of different terms of employment. The basic terms can be expressed as permanent, contract and temporary (see Table 13). We can not see formal agreements between the owner and the employee. Things are often done informally and based on mutual trust. In most of the MSEs employees are hired, administered and finally laid off without concrete formality; this is perhaps the most important manifestation of informality in the sector. If employees have worked for relatively longer years, the owners are likely to consider them as permanent employees of the firm. Approximately, about 58 percent (i.e., 116) of the MSEs have permanent workers of 1 to 5 and about 30

percent (i.e., 60 MSEs) have permanent workers of 6 to 10. MSEs also use temporary workers when businesses are in state of boom and there are relatively large orders. The degree of informality is likely to diminish as the government is currently taking certain measures, more importantly in the areas of: (1) registration and licensing of MSEs and (2) bringing MSEs into the pension (retirement fund) scheme.

Table 13: Terms of Employment and Skill Levels

| Description | Terms of Employment | | | Skill Levels | | |
|-------------------|---------------------|----------------|----------------|----------------|----------------|----------------|
| | Permanent | Contract | Temporary | Skilled | Semi-Skilled | Unskilled |
| Number of workers | Number of MSEs | Number of MSEs | Number of MSEs | Number of MSEs | Number of MSEs | Number of MSEs |
| 1-5 | 116 | 86 | 72 | 115 | 112 | 56 |
| 6-10 | 60 | 11 | 13 | 30 | 27 | 12 |
| 11-20 | 13 | 0 | 0 | 6 | 14 | 0 |
| 21-30 | 0 | 0 | 0 | 0 | 0 | 0 |

Source: field data

The Wage Structure

The wage in the wood-work MSE sector is not based on specified scale. Employment is often concluded on negotiations, which may be influenced by a number of factors like the type of the job, experience and skill of the candidate, demand for labor and the wage rate in the local labor market, the immediate need and the capacity of the employer (the MSE) to pay, etc.

The modal wage bracket for the wood-furniture MSEs sector is approximately 500-1000 Birr. About 59 percent of the employees fall within this income bracket. Earning 500 Birr per month means subsisting on less than one dollar a day. Earning 1000 Birr, the highest rate in the modal class, means nearly equivalent to

earning 57 USD⁴⁵, i.e., less than 2 dollars a day. Thus, the wage rate can generally be considered as one of the lowest. The next most important wage bracket is 1001-2000, where we find about 24 percent of the employees. Even within this category, the highest rate (2000 Birr) is approximately equivalent to 114 USD. Taken together, most of the workers (about 83 percent) fall within the wage bracket of 500-2000 Birr. The number of workers earning more than 2000 Birr is just less than 6 percent; whereas, the number of workers earning about 500 Birr is more than 10 percent (which is less than 30 USD).

Table 14: Wage Levels

| Income Brackets (in Birr) | No of Workers (Percent) | Cumulative No (Percent) |
|---------------------------|----------------------------|----------------------------|
| Below 500 | 140 (11) | 140 (11) |
| 500-1000 | 756 (59) | 896 (70) |
| 1001-2000 | 308 (24) | 1204 (94) |
| 2001-3000 | 45 (3.5) | 1249 (97.7) |
| Above 3000 | 29 (2.3) | 1278 (100) |
| Total | 1278 ⁴⁶ | |

Source: field data

Informality is also inherent in the administration of working hours. There is no unanimous standard as such since MSEs use variable working hours. Employees earn the wages for working for 7 to 10 hours a day. It was seen that the most accepted and relatively common working hour is 8 hours a day. In some cases employees are required to work for 12 hours and may sometimes get overtime payments.

⁴⁵ Taking an approximate exchange rate at the time (1USD =17.55 Birr)

⁴⁶ This figure falls short of the total number of workers in the sample of 200 MSEs since some of the respondents fail (or are not willing) to provide data on monthly earnings of workers.

Labor Problems

Micro and small enterprises, like any other form and scale of organization, are confronted with various types of labor problems. Three most important types of labor related problems were identified in this study; namely, absenteeism, high labor turn-over, and misconduct. The third one is an aggregate term intended to represent all sorts of misbehaviors on the part of the employees in the workplace. Enterprise operators feel that all are problems confronting them to the extent of disturbing the normal functioning of the business. Nevertheless, labor turn over is felt (by 78 percent of the MSE operators) to be relatively most significant problem, followed by absenteeism (74 percent). Then comes, in the third place, misconduct often manifested by misuse of resources, dishonesty, theft and other similar behaviors.

Table 15: Labor Problems

| Labor Problem ⁴⁷ | No of MSEs | Rated as 1 st (Percent) | Rated as 2 nd (Percent) | Rated as 3 rd (Percent) |
|---|------------|------------------------------------|------------------------------------|------------------------------------|
| Absenteeism | 192 | 74 (38.54) | 66 (34.38) | 52 (27.08) |
| High labor turn-over | 192 | 78 (40.63) | 89 (46.35) | 25 (13.04) |
| Misconduct: misuse of resources, dishonesty, theft, etc | 192 | 50 (26.04) | 46 (23.96) | 96 (50.0) |
| No response | 8 | | | |
| Total | 200 | | | |

Source: field data

⁴⁷ As indicated, the respondents were asked to rank the three problems as 1st, 2nd, and 3rd on the basis of perceived significance. If inverse weights (3-1) were assigned, rank orders could have been established based on the weighted scores: absenteeism (2.11), high labor turn over (2.28), and misconduct (1.76). Then, labor turn over would come as the most important labor problem in the wood-furniture MSE sub-sector.

Possible reasons for high level labor turn-over can be mentioned to include: (1) dissatisfaction with the working environment; (2) dissatisfaction with the level of pay; (3) dissatisfaction with the amount of work relative to the pay (exploitative); (4) dissatisfaction with other fringe benefits (ex. absence of training opportunities); (5) dissatisfaction with the nature of labor management and relations within the firm; (6) possibility of getting employment in other firms (Note: MSEs are proliferating, both in the wood-works and other economic activities); (7) age of employees (young age); (8) inability to cope up with the requirements of the job mainly due to lack of experience and skill; etc.

Enterprise operators may have several methods of solving some of the problems. Lack of experience and skill, for instance, can be solved to some extent through provision of skills training related to the job. However, the experience of MSEs in providing or getting training opportunities for the workers is not that significant. MSEs in this respect seem to be more concerned about immediate performance and financial returns than long term growth and development. The MSEs that assert to provide training for their workers are well below 15 percent (only 27 MSEs). The trainings in all cases seem to be conducted on the job, whereby the owners, skilled managers, and skilled (senior) operators provide.

5.4. Summary

This chapter presented the profile of MSE operators and labor. The profile of MSE operators was compiled on the basis of important factors including the owner's occupation (whether the business is sole or additional occupation), the actual role of the owner in the business, owners' age, gender, and ethnic origin and level of education (formal education and technical training). About 55 percent of the owners fall within the age group of 25-35, indicating the dominance of young ages in the MSE business ownership. We observe an overwhelming male dominance (90 percent) over female in the ownership of wood-work MSE business. About 64 percent of the owners are high-school completers. The role of

the owner in the business could be limited, moderate or all-inclusive depending mainly on the size of the enterprise. The role is likely to be all-inclusive if the enterprise is very small. The role generally becomes modest and quite limited as we move up in the hierarchy of enterprises. In the wood-furniture MSE sector, the business is just sole occupation for most of the owners (88 percent). Only 11.3 percent of the owners have the business as additional occupation.

Social variables (such as ethnicity, religion, and informal relations) are seen in some studies as important factors that influence entry into the business circle. This is, however, more likely as we move down the hierarchy of enterprises and in some types of businesses. Ethnic origin, for instance, doesn't appear as an important entry factor in the wood-furniture MSE sector. This is against the reality in many other cases where people from the *Gurage* minority dominate MSE businesses.

The other important issue considered in this chapter is the profile of labor, which has been studied in terms of labor strength (both initial and current), terms of employment, wage structure and labor-related problems. In this sector, the labor size ranges between 2 and 30. The average is around 8, which is twofold of the average observed at the initial stage (i.e., 4.06). High labor turn-over is among the key labor-related problems in the sector.

Chapter Six

6. Products, Production and Input Sourcing

6.1. Introduction

Important points related to products, product design, production and input sourcing are raised in this chapter. In what is referred to as the “marketing mix”, we have four major elements (the 4P’s) of marketing, namely, the product, place (placing products through the distribution channel), promotion and price (Kotler and Armstrong 1992). In the marketing mix what comes first is the product, which in this study refers to the assortment of furniture products by micro and small-scale enterprises. Conceptually, an important part of the product is the “product design”, under which a couple of different but interrelated points, namely, “who designs the product” and “the way product design is carried out” are considered.

Another important matter intimate to the product is the “production” process. The discussion on “production” deals with how production takes place (whether it is horizontally or vertically integrated) and whether the process is basically labor-intensive or machine-intensive and the condition of the machines for furniture production. At this juncture, the chapter also presents the major problems identified in the MSE sector.

Latter on, the chapter discusses issues of input sourcing by micro and small wood-furniture enterprises: the major (raw materials) and subsidiary inputs required for furniture production. Then follows modest analysis of the data pertinent to input suppliers presented in terms of wholesalers and retailers as well as local producers and importers. The chapter finally provides some information on supplier evaluation, modes and major problems of input acquisition.

6.2. Product Types and Product Design

One can make a list of many types of products in the furniture industry. The global furniture industry is divided into four major product groups (UNIDO 2003:2-3), namely, (1) office furniture, (2) kitchen furniture, (3) bed-room furniture, and (4) living/dining and shop furniture. Each of these product groups has its own distinct market segments (ibid). In this study, however, we can have two major categories of furniture products for the micro and small enterprises, namely:

- (1) House-hold furniture, and
- (2) Office furniture.

House-hold furniture products may include major items like beds, bed-sides, tables (dining tables, dressing tables, etc), chairs and armchairs, normal cupboards, built-in cupboards, walk-in closet, kitchen cabinets, TV-stands, doors and windows and wooden floor (parquet), wooden ceilings (perline), wooden stairs and hand rills (particularly for newly constructed houses). Office furniture products mainly include such items like tables, chairs and armchairs, cupboards, shelves, school desks, doors and windows. Engagement in the production of office furniture requires more capital and large labor size as the orders are usually in bulk. Therefore, relatively, small rather than micro enterprises seem to be fit for the production of office furniture. Micro enterprises are more comfortable with the production of house-hold than office furniture. They are constrained by lack of capital, labor size and, perhaps, experience to receive and deliver large orders. Customers from the office-furniture market segment also consider the size, physical appearance and reputation of the firm before they propose large orders. Generally speaking, given the entire (both internal and external) range of constraints within which they operate most of the micro and small enterprises (MSE) are engaged in the production and sales of furniture products for the house-hold than for the office market segment.

Nearly all of the producers (more than 94 percent) are engaged in the production of multiple types of products (see Table 16). Specialization in the production and sales of single product is unlikely for a number of reasons. For the enterprises it is not feasible hence unrealistic to produce and sale single products, for which they may not find sufficient market. Moreover, enterprises are micro and small with limited financial capacity and labor strength severely constraining their capacity to mass-produce and cover wider market sphere with a single product. Even if enterprises are able to offer a single product, they naturally prefer to produce multiple products and thus avert possible risks generated by having just a single product type.

Table 16: Products and Product Design

| MSEs are engaged in the production of: | No of MSE (Percent) | Products are: | No of MSE (Percent) |
|--|----------------------------------|--------------------------------------|---------------------|
| Single type of product | 4 (2) | Finished goods | 187 (93.5) |
| Multiple types of products | 189 (94.5) | Component parts | 0 |
| No response | 7 (3.5) | Both | 13 (6.5) |
| Total | 200 | Total | 200 |
| Who designs the product? | Frequency of responses (Percent) | Designs are carried out by: | No of MSE (Percent) |
| Freelance designers | 5 (1.12) | Manual methods | 152 (76) |
| Owners/Operators | 171 (38.2) | Advanced design technology (machine) | 8 (4) |
| Hired (professional) designers | 0 | Both | 40 (20) |
| Customer specifications | 172 (38.39) | Total | 200 |
| Copying published designs | 100 (22.32) | | |
| Total ⁴⁸ | 448 | | |

Source: field data

Currently, competition is strong in nearly all areas (indeed stringent in some cases) of business unless the business is run by few producers/distributors or at the extreme it is a monopoly of some sort. Products/commodities can compete in a number of ways, among which comes the product design. In one of his articles related to the leather sector, Tegegne (2009b:164) noted that “design capacity is critical in the Ethiopian shoe industry” as imported shoes (particularly from China) outshine local products predominantly in terms of superior design. Likewise,

⁴⁸The total count exceeds the sample size (200) because of multiple responses

capacity to design appears very important in the wood-furniture sector since similar commodities are flooding from the far-east exporters including Malaysia, Philippines, China, Indonesia, etc. No doubt, furniture commodities coming from the far-east are fine-looking and thus attractive as compared to domestic products. This is chiefly because of superior designs marked by elegant “finishing”.

In the wood-furniture MSE sector, designs are mainly done by the owners/operators themselves (38 percent) based to some extent (38.4 percent) on customer specifications. Customer specifications usually come as major or minor modification over existing product designs on the display. In fact, customers can also bring new designs that they have seen somewhere else. Besides, some of the MSEs resort to copying from published materials or catalogues (22.3 percent). Catalogue-based designs are thus the second most important means of designing products in the furniture MSE sector. The practice of using freelance designers is at a very infant stage (only 1.2 percent). Moreover, it is unlikely to find wood-furniture MSEs making use of hired professional designers. Micro and small enterprises operate within this underdeveloped state of product design practices. The mechanisms of carrying out designs are not that better as most of the MSEs (76 percent) use manual, mainly traditional, methods. Only 4 percent of the MSEs employ advanced design technology, and some 20 percent use both manual methods and advanced design technology.

6.3. Production

The production process is the key component (segment) of the wood-furniture MSE domestic value chain in the sense that it serves as a linking point for upstream and downstream activities of the entire chain. “Production” represents the whole process of manufacturing wood-furniture. The production process can be based on three alternatives on its input side: (1) entirely local/domestic inputs; (2) entirely imported inputs; or (3) a combination of both local and imported

inputs. The approximate proportion of these in the MSE sector will be discussed under “mode of input acquisition”.

Enterprises in this sector are naturally characterized by producing and selling finished goods. No enterprise is found to produce and sale component parts in the real sense. If there are elements of this, it could only be the production and supply of sawn-woods (timbers). Beyond this, all of the MSEs are normally engaged in the design, production and sales of furniture products right from the beginning to the end product. The system of production is thus said to be relatively vertically integrated. Inputs (raw materials and subsidiary inputs, local as well as imported inputs) flow into the system, manufacturing then takes place in the workshop, ultimately furniture products of different kinds flow out to the market.

If this business system were made up of a good number of enterprises specialized in the production and supply of component parts, we can imagine how the value chain could have been not only advanced but also intricate. A network of subsidiary value chains could emerge, branch out, join, enlarge and enrich the main value chain of the furniture sector.

In a relatively better and highly specialized business where we find elaborate division of labor, production and sales are often separate business activities under separate but chained business entities. In such circumstances, producers manufacture and supply their products to the wholesalers and retailers. In our case, however, virtually all of the MSEs are engaged in both practices of production and sales. This is a practice which effectively shortens the distribution channel between the producers and the final users (the only actors in the distribution channel).

Operators (85 percent) perceive that most of their operations are manual, in other words, labor- than machine-intensive (see Table 17). Only 15 percent of them are of the opinion that their production operations are machine-intensive. Machines are of course a requirement in every wood-furniture MSE. Nevertheless, the scale

of using such machines varies from one MSE to the other greatly, and thus few are machine-intensive whereas most of them are labor-intensive (with highly manual operations). Most of the MSEs generally have limited and still some of them have only basic machines and tools for the production process. Old machineries and tools are very common in the untidy and seemingly disorganized workshops of the micro and small enterprises.

Table 17: Production and Production Machines

| Description | No of MSE (Percent) | Description | No of MSE (Percent) |
|-----------------------------|---------------------|--------------------------------|---------------------|
| Enterprises are engaged in: | | Production machines are: | |
| Production only | 0 | Locally-modified ⁴⁹ | 27 (13.5) |
| Production and Sales | 200 (100) | Imported | 63 (31.5) |
| Total | 200 | Both | 110 (55) |
| The production process is: | | Total | 200 |
| Labor-intensive (manual) | 170 (85) | Production machines are: | |
| Machine-intensive | 30 (15) | Own machines | 105 (52.5) |
| Total | 200 | Hired machines | 52 (26) |
| | | Both | 43 (21.5) |
| | | Total | 200 |

Source: field data

⁴⁹Locally modified machines (also termed by the operators as *modific*), in our case, are those equipments made by taking an important component(s) from imported machines when such machines get older, become dysfunctional, some of their parts are damaged, or, in some cases, they were meant for some other purposes before. The idea of locally modified machines also includes those equipments that are locally produced but their designs are forged from imported equipments.

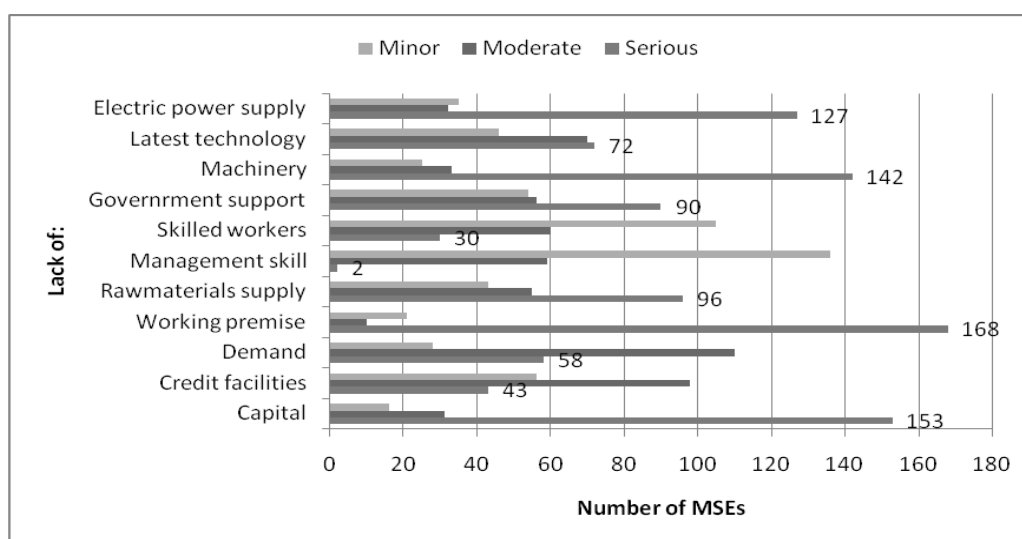
Production machines can be imported from abroad, locally modified or produced. Well organized enterprises with better capital investment can afford to own imported machineries, workshop tools and the necessary accessories from the outset. Or else, they may acquire and accumulate these equipments over some period of time. The period of time, of course, prolongs depending on a number of factors emanating from both internal (firm-specific) and external circumstances. Thriving MSEs manage to possess in the shortest time possible. Machineries are normally imported from abroad, and their costs are escalating. Therefore, those MSEs short of capital and limited volume of sales are often forced to resort to locally modified machines in their efforts to acquire machinery. We can see that about 13.3 percent of the MSEs depend mainly on locally modified machines and tools, and most of the MSEs (55 percent) depend both on locally modified and imported machineries.

Production machines (whether imported or locally-modified) can be owned or hired. Most of the MSEs (52.7 percent) operate with their own machines, whereas 26 percent of them operate with hired machines. Those enterprises that have both own and hired machines are nearly 22 percent. It might be generalized that, in most of the cases, the ones likely to use hired machines frequently are those micro enterprises severely constrained by financial scarcity. Some times, such enterprises also suffer from shortages of money to renew the rents. These are the micro enterprises operating and surviving within unfavorable business situation. If things do not improve, they are likely to close down for some time or withdraw from the business for good.

6.4. Identifying the Major Problems

Attempt is made to provide a list of possible problems in the MSE sector (see Figure 06). Nevertheless, it should not be considered as an exhaustive list since there could be a multitude of firm specific problems unaddressed here. With this limitation, some eleven well known items were provided. The respondents were asked to rate (identify) them in the order of their seriousness, as serious, moderate or minor.

Figure 06: Possible MSE Problems



Source: field data

The three most serious problems, in the order of their importance (on the basis of percentage), are:

1st Lack of working premise (identified as a serious problem by 84 percent of the MSE operators)

2nd Lack of capital, mainly finance (identified as a serious problem by 76.5 percent of the MSE operators); and

3rd Lack of machinery (identified as a serious problem by 71 percent of the MSE operators).

All these three problems can be described as internal problems specific to individual MSE. The next three (4-6) problems are: 4th Lack of electric power supply; 5th Lack of raw materials supply; and 6th Lack of government support. These problems can be described as external (general) problems, affecting all MSEs (as a sector) from outside.

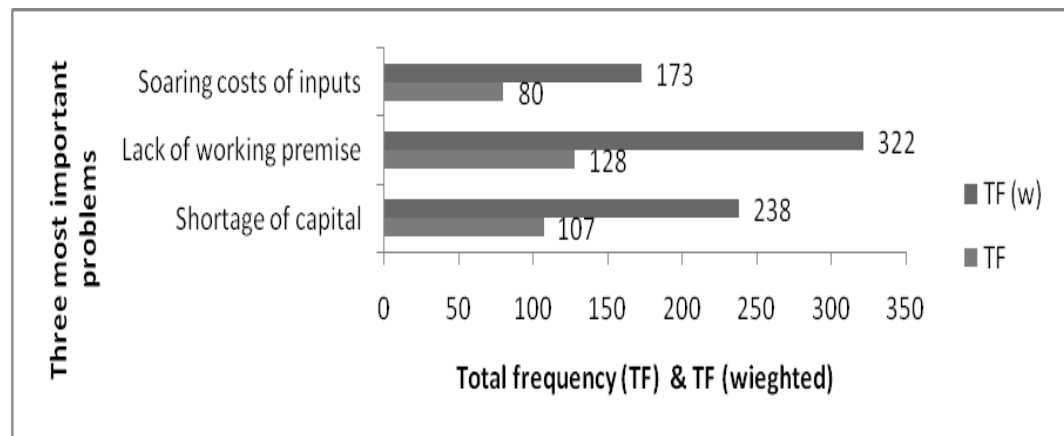
Shortage of electric power supply is indicted as the 4th major MSE problem and as the 1st external problem. This is true as business men, in particular, and citizens, in general, are frequently heard bitterly complaining about shortage and regular interruption of power supply in this country. Recently (June 2012), the City's businessmen had a meeting with the Parliament's Standing Committee for Industry Affairs and the State Minister of Industry. In this meeting, shortage of supply and regular power interruption was mentioned as one of the major bottlenecks in the business environment. The power supply problem has exposed businessmen for unnecessary expenses. It has gravely impaired the production process at firm level and seriously affected the foreign trade at national level (Source: Addis Admas, a local newspaper, Issue No 12 No 647, June 2012).

The Federal MSE development strategy document (FDRE 1997:6) remarked that "lack of smooth supply of raw materials and lack of working premises were the major bottlenecks for small scale manufacturing industries", whereas "lack of sufficient capital and working premises were the leading problems facing the informal sector operators from the start". Lack of raw materials, capital (both startup and working), working premises, and marketing problems are mentioned as the major problems hindering the growth and expansion of small scale enterprises. Shortage of electric power supply is not mentioned as one of the problems confronting the MSE sector both in the MSE development strategy documents of 1997 and 2011. The problem was not mentioned as one of the problems in the 1997 strategy document perhaps because power supply was not among the leading problems then. But the problem has been a recent phenomenon, increasingly becoming incompatible with the recent urban and industrial (and

business) expansion in the country. However, the 2011 strategy document also does not indicate shortage and interruptions of power supply as one of the problems challenging the MSE business.

MSE operators have been asked to identify and mention three most important problems they often face in the order of their significance (as 1st, 2nd, and 3rd), irrespective of the items given on Figure 06. So many problems have been identified and mentioned (see Annex 10). But three of them stood as the most important and given here in the order of their significance as: lack of working premise, shortage of capital and soaring costs of inputs (see Figure 07).

Figure 07: The three most important problems



Source: field data (provided on Annex 10)

The first two most important problems (i.e., lack of working premise and capital) match up the findings pointed out on Figure 06. The third one (i.e., soaring costs of inputs) is a new addition to the list. Furthermore, we can see from the data worked out and presented on Annex 9 that, “lack of machinery and tools” and “shortage of raw materials” consecutively come in the 4th and 5th place.

6.5. Input Sourcing

Timbers, sawn-woods, fabricated boards (like MDF and HDF⁵⁰, chip-wood boards, and ply woods serve as the major inputs (raw material) for the furniture industry⁵¹. There are also several types of subsidiary inputs, including chemicals (adhesives and paints), nails, plastics, textile materials, metals, irons, etc. The major inputs like timbers, chip-wood boards and sawn woods are for the most part acquired locally and to some extent imported from abroad. Inputs like plywood sheets, laminated HDF, MDF and *décor complsato* (as referred to as in local markets) are mainly imported from abroad. The imported inputs are said to be more processed, well-designed and fine-looking as compared to the local ones.

In the early days, cut-logs⁵² (raw-logs, or locally termed as “gindilla”) come from the original/ indigenous forest trees of the country, locally (or *scientifically*⁵³) named as “Weyera” (*Olea Africana/Europa*), “Kerero” (*Angeria Aldolfderic*), “Zigba” (*Podocarpus Ficatus*), “Wanza” (*Cordia Africana*), “Koso” (*Hayginia Abyssinica*), “Yabesha Tsid” (*Juniprus Procera*), “Bisana” (*Croton Microsthus*), “Girara” (*Acacia Abyssinica*). Most of such forests were mainly and densely available at the South Western part (the rain-forest regions) of Ethiopia, including Jima, Tepi, Bebeke, Wolega and Illubabor. Some of the forests have also been

⁵⁰ Medium Density Fabricated-board and High Density Fabricated-board. Relatively, the former is widely available in the supply market than the latter (Source: Fuad Jemal, technical expert, 2RN Solomon Furniture and Wood Products, Addis Ababa). However, other sources (including, MSE operators and HDF/MDF sellers) indicate that the latter (HDF, which is much stronger than MDF) is in scarce supply; hence only economically strong MSEs would have access to it.

⁵¹ Sources: MSE operators; sawmills operators; timber and fabricated-board sellers

⁵² Composed mainly from the interviews made to Samuel Benti, Manager, Sheger Branch (Factory No.1) Wood-Works Public Enterprise (December 2011) and Dr. Abayneh Derero, EARO (September 2012).

⁵³ Source: Ethiopian Agricultural Research Organization (EARO), Forestry Research Center. Contact person: Mesfin Woji (August 2012); Resource person (and interviewed expert): Dr Abayneh Derero (September 2012).

available in some areas of the Shewa (Woliso, Ambo, Shashemene-Langano, etc.) and Bale (Dolo-Mena) regions. And some of the wood-land forest trees (like acacia), though not useful for furniture purposes, are relatively widespread in the dry wood-lands of the country (for instance, along the long stretch of the Ethiopian border with the Sudan, the rift valley and other low land areas of the country). Nevertheless, it is now very difficult to get raw-logs from the indigenous forests at least for two basic reasons:

(1) The density of the forests has these days been tremendously diminished as a result of human action⁵⁴; and

(2) Cutting is strictly forbidden through forest and wild life development authorities.

Sometimes, however, raw-logs from the indigenous forest trees can be obtained rarely as a result of forest clearing for highways, roads, camps and other construction purposes and when wild fires hit the forest area. Public forestry authorities and wood-work enterprises supply such logs for purposes of electric and telephone poles⁵⁵, building and bridges construction since the logs are very strong and reliable. In few cases, it is also possible that some private enterprises might illegally acquire raw logs from these species mainly through contraband. Traditional wooden products (mainly furniture) made out of the trees of indigenous forests (mainly from *Cordia Africana* trees, locally termed as “Wanza”) often illegally flow from the South-Western parts of the country, particularly from Jima area. Currently the original indigenous forests are rarely used for furniture production purposes; even if available they are quite expensive

⁵⁴ “The forest resources in Ethiopia are depleting due to the unabated deforestation and forest degradation. The bulk of the tree plantings are not successful either due to technical and other constraints” (Institute of Biodiversity Conservation 2012). Ethiopia is said to have about 3.65 percent of forest cover so far; currently, however, the figure is extended to 11 percent “owing to the accounting of high woodland areas into forest areas”. The country has 12.3 million ha of forests consisting of three major categories of forest coverage: “high forests, planted forests, high woodland areas” (ibid).

⁵⁵ Eucalyptus trees are widely used for electric and telephone poles.

and thus are beyond the acquisition capacity of most of the micro and small enterprises.

Instead of the original species, now planted pine trees (forests) of *Cupressus Lusitanica* and *Pinus Patula* serve as the major source of cut-logs, woods and timber supply⁵⁶ for the furniture industry in general and the MSE sector in particular. Public enterprises plant, cultivate and harvest cupressus lusitanica and pinus patula in some areas of the country and supply raw-logs and timbers to the market. Cupressus lusitanica⁵⁷ is relatively abundant and widespread than, but inferior in quality to, pinus patula. Public enterprises often strive to acquire raw-logs from these trees within 330 Km radius. Pine forests are planted and well known around Jima (Kafa), Shashemene-Munesa, Ambo, Wollega, Borena, Bale, and Illubabor. Not only physical distance, but also long time span is the problem as it takes many years (25-30 years) to grow and harvest the trees. Since it is also increasingly becoming very difficult to get such forests from nearby localities, some enterprises, both public and private (well established private enterprises, of course), are using mobile saw-mills to acquire cut logs from the very area (for instance, Illubabor) where such forests are available.

Mode of Input Acquisition

The cut-logs from *cupressus lusitanica* and *pinus patula* species flow into the saw-mills (both public and private) enterprises to produce timbers and different forms of sawn woods, which constitute the major raw-material inputs for the furniture enterprises. The timbers from the public enterprises would be transferred

⁵⁶In addition to cupressus lusitanica and pinus patula, eucalyptus trees also serve as sources of cut-logs and timbers. However, the cut-logs and timbers from eucalyptus trees are primarily for construction and other purposes, not for furniture production. (Source: sawmills operators and timber retailers 2012).

⁵⁷ Locally known as *Yeferenge Tsid*

to major distributors (wholesalers) who in turn would distribute the same to the timber retail stores and furniture MSEs in the city.

Sawmill MSEs

There are five main categories of sawmills identified on the basis of mode of ownership: (i) public (government-owned) sawmills, commonly known as “factories”, which for the most part are located at or near the pine plantations; (ii) sawmills in “industry villages” (these are the ones that belong to government-supported, but privately owned MSEs); (iii) private sawmill MSEs, engaged only in sawing and providing related services; (iv) sawmills owned by timber traders; and (v) sawmills owned by furniture manufacturing MSEs.

Merchants bring cut-logs and distribute to the private wood-sawing enterprises (there are about 45 registered sawmill enterprises in the city⁵⁸). Most of these (69 percent) are found in two neighboring sub-cities namely, Kolfe-Qeranio and Addis Ketema, which are adjacent to the main and largest market of the city (*Merkato*). The wood-sawing enterprises are engaged in two main types of functions: (i) processing logs into timbers, and (ii) sawing rough timbers into smooth timbers of different forms and sizes. Their customers include furniture MSEs (particularly, micro enterprises), timber retailers and others for the chip-woods and fire-woods (see the summary matrix provided below).

Trucks loaded with cut-logs enter the city through different directions (principally through Debre Ziet and Jimma roads, which connect the city with the main regions of cultivated pine-trees and large scale sawmills outside the city). In most of the cases, it was reported, the cut-logs would not be taken to warehouses and stores as all are sold right from the trucks. This is due to the shortages of raw materials supply. Not only the sawmill enterprises, some of the furniture MSEs

⁵⁸ As per the data secured from the TIDB of the city in 2012

also have their own machines and hence regularly purchase and process the logs for own consumption and sales.

The process of acquisition of cut-logs is not that simple and linear, it is rather intricate. There are a number of middlemen (brokers) in between, for instance. The role of the brokers is significant in several ways. To mention some, they help in passing on vital information, communicating sellers and buyers, setting prices and expediting the process of distribution and acquisition. Of course, some of the owners/operators of sawmills are frequently heard complaining about the brokers for they deliberately complicate the process in general and, more importantly, causing the prices to go up and the relations (between buyers and sellers) sour up. The operators often exchange information mainly related to input acquisition and some times are forced to practice joint purchase of logs. Shortage and decreasing quality of logs, escalating costs of inputs, lack of storage and safety, shortage of latest machines, frequent power interruption, and are among the key problems mentioned by the sawmill owners/operators. Input sourcing is tightened by serious competition brought about by other buyers (furniture-MSEs), consequently, sawmill enterprises are often compelled to procure “inferior quality” logs.

Table 18: Sawmill MSEs: *information summary*

| Factors | Major | Others | Remarks |
|---------------------------------|---|---|---|
| Product types | Timber products of different types and forms | Chip-wood, wooden ceiling (<i>purlin</i>); wooden floor (<i>parquet</i>); fire-woods | Sometimes engaged in renting machines and selling spare logs |
| Inputs | Cut-Logs; rough timbers | Costs of labor; working premises; machines and hand-tools electric power, and others | Sometimes acquire used timbers (both from indigenous and pine trees) for reprocessing |
| Input sources | Wholesalers (cut-log distributors who use trucks) | Retailers and other sawmill owners (in few cases) | <ul style="list-style-type: none"> • Trucks loaded with logs unload and sale in <i>Merkato (Addis Ketema and Kolfe-Qeranio)</i> • Brokers heavily involved in the process |
| Customers (main buyers) | Micro and small enterprises | Timber retailers; others | |
| Problems in the business | <ul style="list-style-type: none"> • Short supply and poor quality of inputs (logs) • Cost of inputs • Broker-induced problems • Frequent power interruption | <ul style="list-style-type: none"> • Lack of storage and safety • Lack of latest machines | Also confronted with: <ul style="list-style-type: none"> • Business slowdown • Lack of W premises • Rising rents of W premises • Lack of spare-parts • Lack of capital |

Source: interviews with the sawmills operators

The sawmill MSEs (the 45 sawmills) located in the city are not well (strategically) positioned as suppliers of timbers in the value chain. As a result of the problems mentioned above, production (output) scale is quite small; hence sales are mostly for those highly survivalist or micro level furniture producers. This means that

financially as well as operationally strong MSEs would have their own sawmills or resort to other sources, including (i) government-owned sawmills and factories, (ii) the “industry villages”, and (iii) the private timber traders.

Wholesalers and Retailers

Timber traders (wholesalers and retailers) play very important role in supplying timber, solid-woods of different shapes and related inputs for furniture manufacturing MSEs. Most of the timber traders in Addis Ababa are found in Addis Ketema sub-city, which is located in the vicinity of the grand market place (*Merkato*). Out of the total of 108 registered timber trading businesses, 47 (about 43.5 percent) are located in this sub-city, followed by Yeka sub-city, which hosts another 19 (about 17.6 percent) of the same. Interviews have been made with the timber traders in these two sub-cities and the results are summarized in line with five key factors: items traded, business status, supply sources, customers, and problems often encountered in the business (see Table 19).

Timber distributors, both wholesales and retailers, sell both local and imported timbers and different forms of solid-woods. The local items come mainly from pine trees and to some extent from eucalyptus⁵⁹ and (rarely) from other indigenous trees. According to the timber traders and MSE operators, the imported ones come from Austria⁶⁰. The local timbers are competitive in terms of material strength and price; whereas the imported ones are more competitive in terms of material smoothness and nice-looks. Obviously, imported timbers and solid-woods are expensive than the local ones. The fine-looking imported timbers and solid-woods are much preferred for exterior and finishing purposes.

⁵⁹ Eucalyptus products are for construction purposes; not for furniture

⁶⁰ Though the timbers are imported from Austria, the same are habitually termed in the market as “Australia”. Imported timbers are marked by green color to distinguish them from domestic pine timbers.

Table 19: Timber Trading: *information summary*

| Factors | Major | Others | Remarks |
|---------------------------------|--|--|---|
| Items traded | Pine timbers and solid-woods of different forms | Chip-wood boards; eucalyptus timbers for construction purposes | Some are engaged in selling imported timbers (known as “Austria”, after the country from where the items are imported) |
| Business status | Mainly retailing | Wholesaling and retailing | Some are engaged in importing and distributing timbers |
| Supply sources | Wholesalers | <ul style="list-style-type: none"> • Industry villages⁶¹ • Government factories • Private sawmills | Some of the timber traders have own sawmills (purchase logs in bulk from state-owned plantations) |
| Customers (main buyers) | <ul style="list-style-type: none"> • Contractors (building construction) • Furniture MSEs | <ul style="list-style-type: none"> • Small-scale retailers | Some of the timber traders have own furniture MSEs |
| Problems in the business | <ul style="list-style-type: none"> • Shortage of supply • Escalating cost of inputs • Declining quality of timbers • Rising rents of shops | <ul style="list-style-type: none"> • Competition for supplies (unfair) • Business slowdown | Also confronted with: <ul style="list-style-type: none"> • (Sometimes) unfair tax assessment practices • VAT-related problems (there could be some traders who do not apply VAT; hence those who strictly use VAT would face declining sales) |

Source: interviews with timber traders

⁶¹ Industry villages represent concentration of government-supported MSEs. The industry villages acquire logs and timbers from public enterprises. Timber traders and furniture manufacturing MSEs, on the other hand, can acquire timbers from such industry villages.

Furniture manufacturing MSEs acquire the required inputs from wholesalers, retailers or directly from own shops. Most (65.24 percent) of the MSEs acquire timbers from retailers, however. Some of the MSEs (32.09 percent) acquire the same from wholesalers. Own shops are relatively insignificant (only 2.67 percent) as a source of input (see Table 20). The fact that most of the MSEs acquire inputs from retailers means that production and sales are at small scale. MSEs that source from wholesalers are those that are relatively better in their capital and business standing.

Table 20: Input suppliers: *wholesalers, retailers, own shops*

| | Wholesalers | Retailers | Own shops | Total |
|-------------------------------------|----------------------------------|----------------------------------|----------------------------------|-------------------|
| Inputs: | Frequency of Responses (Percent) | Frequency of Responses (Percent) | Frequency of Responses (Percent) | |
| Timbers (and related materials) | 79 (32.09) | 162 (65.24) | 7 (2.67) | 248 ⁶² |
| Component parts (if any) | 18 (12.5) | 123 (83.04) | 7 (4.46) | 148 |
| Equipment (machines and tools) | 22 (13.39) | 140 (84.25) | 4 (2.36) | 166 |
| Chemicals (paints, adhesives, etc) | 11 (6.4) | 153 (92.8) | 1 (.8) | 165 |
| Other inputs (nails, plastics, etc) | 28 (14.89) | 160 (85.11) | 0 | 188 |

Source: field data

Retailers are important sources not only for timbers and other related raw materials but for the other inputs too. The relative importance of wholesalers (32.09 percent) is seen in the same domain of inputs (i.e., timbers) than any other types of inputs (for instance, machines and tools, chemicals, etc). In all forms of inputs (raw materials, component parts, equipment, chemicals and other inputs) retailers are by far important than both wholesalers and own shops. Own shops

⁶² Figure exceeds the sample size (200) because of multiple responses, as MSE can acquire inputs both from wholesalers and retailers.

are of some importance only in the case of acquisition of component parts (4.46 percent).

Input sources could be either local or import markets, or both. In the wood-work MSE sector, most (75 percent) of the enterprises acquire or use inputs from both sources. About 26 percent of the enterprises use inputs from local sources only. And none of the MSEs claim to use imported inputs only (see Table 21). The basic raw materials, timbers and sawn woods, and to some extent, chip-woods are for the most part acquired from local producers. Fabricated-boards (laminated or normal MDF, HDF) and ply wood sheets are for the most part imported from abroad, particularly from countries like China. High quality timbers and sawn woods are also imported from countries like Austria (and such raw materials are commonly known in the local markets simply as “Australia”). Machines and tools, except those modified and produced locally, are mainly imported. Chemical and other inputs are acquired from both local manufacturers and import markets. These days it is common to see in the markets relatively low-priced material inputs (like MDF, plywood and décor boards, machines and tools) imported mainly from China. However, operators and final users, in particular, are often heard complaining on the quality, strength and durability of those materials imported from China.

Many of the micro and small enterprises in the wood furniture sector use somewhat small number of input suppliers. In this regard, most of the enterprises (48 percent) have reported to use only one to three input suppliers. The other 34.5 percent use four to six suppliers; and only 17.5 percent use more than six suppliers. Frequent purchase from few suppliers is likely to result in permanent interaction and helps to build trust between buyers and sellers. Consequently, operators would be confined to a limited number of suppliers from whom they can acquire inputs regularly even at times on credit basis. Nevertheless, purchase on cash basis is the most important mode of transaction, as most of the MSEs (close to 72 percent) acquire inputs in cash. Of course, some 24.5 percent of the

MSEs have reported that they often acquire inputs both in cash and credits. Acquiring inputs on credit basis naturally demands a higher level of reputation and rapport. On top of this, the transaction perhaps demands repeated purchase of raw materials in bulk than smaller quantity. The proportion of markups in prices could also be relatively higher when transactions are on credit basis.

Table 21: Input Acquisition

| Sources of primary inputs (raw-materials) are: | No of MSE (Percent) | Mode of acquisition: | No of MSE (Percent) |
|--|---------------------|--------------------------------------|----------------------------------|
| Local (domestic) | 51 (25.5) | On cash basis | 143 (71.5) |
| Imported | 0 | On credit basis | 8 (4) |
| Both | 149(74.5) | Both | 49 (24.5) |
| Total | 200 | Total | 200 |
| Possible number of input suppliers to a given MSE: | | Major problems of input acquisition: | Frequency of responses (Percent) |
| 1 – 3 | 96 (48) | High prices | 180 (48.39) |
| 4 – 6 | 69 (34.5) | Low quality | 92 (24.73) |
| More than 6 | 35 (17.5) | Low supply | 64 (17.2) |
| Total | 200 | Delays in delivery | 36 (9.68) |
| | | Total | 372 ⁶³ |

Source: field data

Various problems can affect the system of input acquisition. Prices, quality, supply (availability) and delivery are among the critical problem areas. In our case, “higher prices” (48.39 percent) is indicated by most of the enterprises (180 out of 200, i.e., 90 percent) as the major problem of input acquisition. This could be true given the recent trend and current situation of escalating prices in nearly

⁶³ The total exceeds the sample size (200) because of multiple responses

all types of commodities in this country. Input quality (24.73 percent) is the other major problem which is reported by about 92 (i.e., 46 percent) of the enterprises. In addition to these, low supply (17.2 percent) and delays in delivery (9.68 percent) are consecutively indicated as the major problems. Perhaps one way of coping up with escalating prices could be joint purchase of input supplies. Enterprises accustomed to joint purchases can benefit from economies of scale as large quantity entails reductions in unit prices of supplies, reduced transport and labor costs, efficient delivery, access to valuable information, etc. Nevertheless, only about 16.7 percent of the enterprises practice joint purchase of inputs and hence enjoy the benefits accruing out of this exercise.

Input suppliers (wholesalers and retailers) can be evaluated on the basis of some criteria, including quality, reliability, price, and customer service (see Figure 08). As can be seen from the chart, none of the MSEs evaluate their suppliers as very poor in all criteria of evaluation (i.e., quality, reliability and customer service) except in “price”. Some enterprises rated their suppliers to be very poor in terms of price; and the figures rapidly fall as we move from “Poor” to “V Good”. The small arrow in the chart indicates that slightly more than half (104, 52 %) of the MSEs evaluate suppliers as “poor” in terms of price.

Figure 08: Supplier Evaluation



Source: field data

Price criteria can be quite sensitive and even misleading as costs of materials could be beyond the suppliers' control, in the case of which they may not be in a position to offer fairly acceptable prices to the buyers (the evaluators in our case). Earlier, it has also been seen that "higher prices" was identified as the major problem of input acquisition by 180 (90 percent) of the MSEs (see Table 21). Suppliers are evaluated as "moderate" in terms of material quality (45 percent), reliability (57 percent), and customer service (50 percent). In the aggregate, 45 percent of the MSE operators evaluated their suppliers as having moderate status.

6.6. Summary

Two main categories of products, namely house-hold and office furniture, are identified in the MSEs sector. MSEs are more comfortable, due mainly to capacity reasons, with the production and distribution of the former than the latter. Product designs are carried out by the operators based on customer specifications or catalogues. Few cases of freelance designers and no cases of professional designers are encountered in product designs. The entire process of product design heavily relies on traditional methods. The production process is the key component (segment) of the wood-furniture MSE domestic value chain in the sense that it serves as a linking point for upstream and downstream activities of the entire chain. Enterprises in this sector are characterized by producing and selling finished goods. No enterprise is found to produce and sale component parts in the real sense. Beyond this, all of the MSEs are normally engaged in the design, production and sales of furniture products right from the beginning to the end product. The system of production seems relatively vertically integrated. Inputs (raw materials and subsidiary inputs, local as well as imported) flow into the system, manufacturing then takes place in the workshop, ultimately furniture products of different kinds flow out to the market. Workshop machines and tools are either imported or locally modified.

Various problems challenge the existence and operation of micro and small enterprises. The problems could either be internal or external to the firm. The three most serious problems in the order of their significance are: lack of working premise, lack of capital (initial as well as working), and lack of machinery. When asked to indicate key problems irrespective of the items “prescribed” by the researcher, operators mention “soaring costs of inputs” as the third serious problem, next to “working premises” and “capital”.

Micro and small enterprises acquire the required inputs from wholesalers, retailers or directly from own shops. Most of the MSEs acquire timbers from retailers, however. Some of the MSEs acquire the same from wholesalers. Own shops are relatively insignificant as a source of input. Retailers are important sources not only for timbers and other related raw materials but for the other inputs too. Input sources could be either local or import markets, or both. In the wood-work MSE sector, most (more than 74 percent) of the enterprises acquire or use inputs from both sources. Various problems can affect the system of input acquisition. Prices, quality, supply (availability) and delivery are among the problems. However, “high prices” and “input quality” are the critical problems of input acquisition.

Chapter Seven

7. Marketing Products

7.1. Introduction

The nature of the market and issues related to marketing the products are raised in this chapter. With regards to the market, questions to be raised may include: who frequently buy the products, namely, wholesalers, retailers, or direct consumers? Are the products (for the most part) for the markets in the locality or outside the locality? What are the major requirements in the domestic market? ... material quality? ... price? ... design? ... or delivery? Points related to sales outlets, the modes of sales, sales promotion, and the basis for pricing will also be raised and discussed in this chapter. Moreover, the perceptions operators have about sales trends in the past few years and their intentions (if any) for exports are very important and will be discussed in some details.

Subject matters like market and marketing are close to the issues of competition. Latter on, the chapter provides some points related to competition and competitiveness. The major points of discussion include looking into competitive position of individual enterprises relative to other MSEs in the sector, competition between domestic and imported products, and the measures (techniques) used by MSEs in order to stay competitive in the sector.

7.2. The Market

Wood-work MSEs produce furniture for household consumption and office purposes. As we have seen in chapter six, micro and smaller scale enterprises are engaged in the production of furniture mainly for household than office purposes; consequently any single order is quite small in scale. To the contrary, those enterprises that may receive orders for office purposes could be required to produce relatively in bulk. The MSE furniture production is generally accustomed to a market context whereby direct consumers are by far important than both retailers and wholesalers. This is just unlike the reality in the foot-wear MSE

sector in Ethiopia where, according to Tegegne (2009b), “wholesales and retailers are the main clients in the domestic market” and none of the MSEs sell directly to the consumers. In the wood-furniture sector, the physical nature of the products is not like that of the foot-wear products hence unsuitable to pass through the middlemen in the distribution channel. On the other side, however, there are also enterprises engaged in wholesaling and retailing furniture commodities that are imported mainly from the Asian countries.

In the domestic wood-furniture sector, most of the MSEs (192. i.e., 96 percent of the MSEs) receive orders from (hence sell their products to) direct consumers (85.7 percent). (See Table 22). Some of them get orders from retailers (only 14.3 percent) and none of them from wholesales. Even those that involve some retailers mainly deal with direct consumers and hence the role of the retailers is still insignificant in the market chain. As a result, the distribution channel for the most part is the shortest as it has only the producer at the one end and the direct consumer at the other end, without involving the middlemen. In this context of marketing, enterprises would directly reap the profits generated from retailing the products (Gereffi, in Tegegne 2009b: 170). This could be, among others, the main advantage of a short distribution channels.

Within the domestic market sphere, furniture products could be for the markets in the locality or outside the locality or both. Products and services for markets outside the locality serve as the export base for the locality concerned (Helmsing 2005b:302). In the LED context, furniture products “sold outside the local jurisdiction” (Bartik 2003:5) are said to be exports to the locality concerned hence money flows inwards. In our case, about 83.5 percent of the furniture products are for markets in the locality. Only 16.5 percents are for export outside the locality. This situation might be interpreted as a drawback if it were the case of other (poor) localities. But the locality in our case is the capital which has relatively strong, broad and rich market base than any other locality in the country. On the other side, one can argue that the proliferation of MSEs in other localities, too, may

have retained buyers locally as long as local MSEs are in a position to produce and offer products with the required level of quantity, material quality and price. Besides, government-supported, encouraged and organized micro and small enterprises are proliferating throughout the country and these enterprises could also hold some of the buyers in their respective localities. Such types of MSEs are encouraged and supported primarily in terms of getting working premises, micro credits, market access to construction projects, etc. Government-promoted micro and small enterprises are supposed to aim at creating employment opportunities, reducing poverty and ensuring economic growth. Moreover, MSEs are intended to be seedbed for industrial growth and expansion, which might graduate into medium and large scale establishments.

Table 22: The Market and Market Requirements

| Who frequently buy the products? | Frequency of responses (Percent) | Most of the products are for: | No of MSE (Percent) |
|----------------------------------|----------------------------------|-------------------------------|---------------------|
| Wholesalers | 0 | Markets in the locality | 167 (83.5) |
| Retailers | 32 (14.3) | Markets outside the locality | 33 (16.5) |
| Direct consumers | 192 (85.7) | Total | 200 |
| Total ⁶⁴ | 224 | | |

Market Requirements

| | V High | High | Moderate | Low | V Low | Total |
|---------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------|
| Market Requirements | No of cases (%) | No of cases (%) | No of cases (%) | No of cases (%) | No of cases (%) | |
| Material Quality | 14 (7) | 100 (50) | 84 (42) | 2 (1) | 0 | 200 |
| Lower Price | 62 (31) | 110 (55) | 26 (13) | 0 | 2 (1) | 200 |
| Superior Design | 7 (3.5) | 53 (26.5) | 85 (43) | 39 (19.5) | 16 (8) | 200 |
| Delivery Time | 5 (2.5) | 35 (17.7) | 62 (31) | 65 (32.8) | 31(16) | 198 |

Source: field data

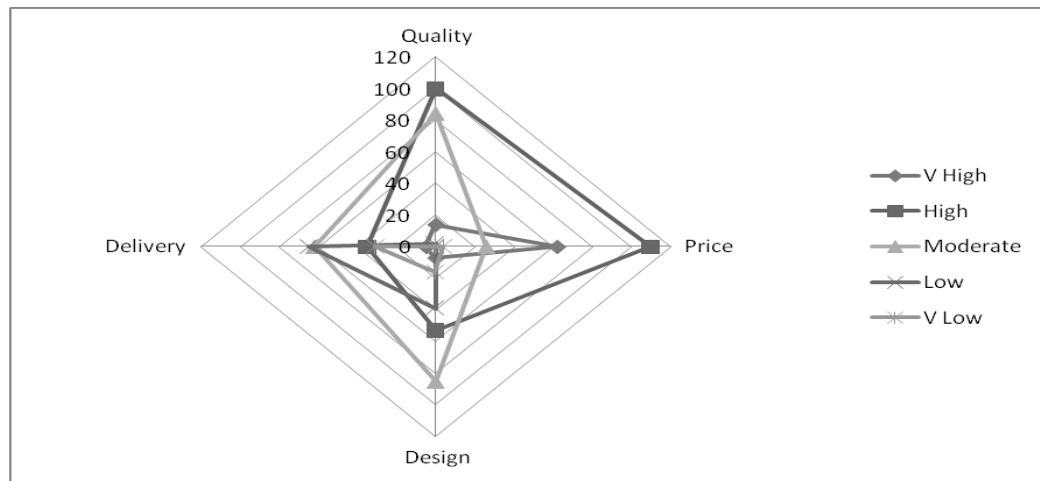
Market Requirements

Buyers in different market segments often focus on certain (sometimes peculiar) requirements. Superior design or quality can be the most important requirement in certain markets whereas affordable price is the critical requirement in the others. Superior design/quality, for instance, can be the prime requirement for specially ordered high class bridal commodities than mass-produced clothes and foot-wear, in which case price becomes the prime concern. Within the wood-work sector itself, the requirements of export markets can be quite opposite to that of domestic

⁶⁴ The total count is greater than 200 because of multiple responses

markets. Still within the domestic market, requirements can vary depending on the nature of the particular market segment to be served. Generally, in markets where superior quality/design is the prime requirement, price factors become less significant. Thus, those seeking superior quality/design need to forgo price advantages.

Figure 09: Market Requirements



Source: Table 22

Operators in the wood-work MSE sector perceive that “lower price” generally ranks first as a requirement in the domestic market, followed by “material quality”. The price factor is rated as “high” and “very high” requirement in the market. In comparison to price and material quality, “superior design” and “delivery” are less as a requirement for the market (see Figure 09). Rising cost of living (which is ever escalating in this country) and at the same time diminishing purchasing capacity of most of the buyers might have forced them to focus on factors like “prices” and “material qualities”, perhaps at the expense of factors like “superior design”, for which they might be required to spend additional and still more money. Buyers may focus on material quality primarily as a way of seeking an extended durability and service of the materials over many years. Table 23 summarizes the data assembled on market requirements.

7.3. Sales and Sales Promotion

As we have seen it, the distribution channel is the shortest type as it involves only the producer and the direct user. Most of the enterprises (89 percent) have only one sales outlet (shop) that is situated at the production site (see table 23). Only few (7.5 percent) have one more additional shop, which also serves as a display to attract more customers. None of the MSEs have more than two shops. Sales are primarily on cash basis (86 percent) and the rest 14 percent on both cash and credit basis. This mode of transaction is dominant perhaps due to: (1) sales is for house-hold users and (2) the size of the order is small (say, one, two, or three pieces at a time).

Prices in such types of markets are usually determined through negotiations, which of course do not ignore costs and markups in particular and market prices in general. Establishing and maintaining specific market prices for products that are not mass-produced is quite difficult and often not practical. Producers thus focus on negotiations in excess of the normal markups. Negotiations are thus done to maximize own gains. Display shops than production sites usually offer fixed prices at times tagged to the products. Negotiations are often the practice when buyers come to production sites to order certain types of furniture products on their own specifications.

Promotion is an important element among the four building blocks (the 4 P's) of the marketing mix (Kotler and Armstrong 1992). Marketers inform buyers of their products through promotion. One can easily understand that promotion is important particularly when a product is new, upgraded, altered or modified in some way or introduced to a new market. Different marketers use different media and methods of promotion, including advertising, personal selling, sales promotion, and public relations (ibid).

Table 23: Sales and Sales Promotion

| Sales outlets constitute: | No of MSE (Percent) | Sales are on: | No of MSE (Percent) | Prices are based on: | Frequency of responses (Percent) |
|---------------------------------|---------------------|-----------------------|---------------------|----------------------|----------------------------------|
| Only one shop (production site) | 178 (89) | Cash basis only | 172 (86) | Market prices | 65 (28) |
| One more additional shop | 15 (7.5) | Cash and Credit basis | 28 (14) | Cost + Markup | 80 (34) |
| More than two shops | 0 | Total | 200 | Negotiations | 89 (38) |
| No response | 7 (3.5) | | | Total ⁶⁵ | 234 |
| Total | 200 | | | | |

Sales Promotion

| | MSEs have (use) brokers? | MSEs use promotional media? | MSEs use which promotional media? | No of MSE (%) |
|-------------|--------------------------|-----------------------------|-----------------------------------|---------------|
| | | | Trade fair | 12 (6) |
| Yes | 8 (4) | 36 (18) | Printed materials | 35 (17.5) |
| No | 191 (9.5) | 156 (78) | Radio/TV | 0 |
| No response | 1 (.5) | 8 (4) | No response | 153 (76.5) |
| Total | 200 | 200 | Total | 200 |

Source: field data

In the wood-furniture MSE sector, most of the firms (78 percent), except some 18 percent, do not use well established promotional media. Some enterprises use printed media (17.5 percent) and trade fair (6 percent) to initially advertise and further promote their products. We should note that the proportion of “no

⁶⁵ The total count exceeds 200 because of multiple responses

response” is very high (76.5 percent) profoundly because MSEs do not use promotions as a business strategy. These days we sporadically see trade fairs supported by concerned local government bureaus to promote products of the micro and small enterprises that were initially encouraged and established with government support. In this sense, some private MSE express grievance for not enjoying benefits extended to the sponsored and highly “favored” micro and small enterprises.

The role of brokers is insignificant as about 95 percent of the enterprises do not have or use their own (client) brokers to sell their products. The role of brokers becomes apparent and very important only at the time of input (particularly raw materials) acquisition.

In relation to sales trends, it has been reported that over the last 4-5 years sales has been favorable and increasing for most of the enterprises (43.5 percent). This trend can be judged to be in tone with the reported rising demand (42.5 percent) for the wood-furniture products (see Table 24). On the other angle, business has been somewhat unfavorable and sales shows decreasing trends for the 26 percent of the micro and small enterprises. About 10 of the MSEs express that business has been as usual, as it is relatively constant.

Table 24: Perceptions about Demands and Sales Trends

| Description | The demand (market) for the product (s): | Sales over the last 4-5 years: | Enterprises have intentions for export? | |
|-------------|--|--------------------------------|---|---------------------|
| | No of MSE (Percent) | No of MSE (Percent) | | No of MSE (Percent) |
| Decreasing | 59 (29.5) | 52 (26) | Yes | 15 (7.5) |
| As usual | 55 (27.5) | 20 (10) | No | 183 (91.5) |
| Increasing | 85 (42.5) | 87 (43.5) | No response | 2 (1) |
| Fluctuating | | 37 (18.5) | Total | 200 |
| No response | 1 (.5) | 4 (2) | | |
| Total | 200 | 200 | | |

Source: field data

The wood furniture sector at any scale is not yet part of the global commodity chain. We are only in a position to talk about intentions, if at all. Even in this sense, only 15 operators (about 7.5 percent) have expressed their intentions to export products to markets in the neighboring countries if conditions permit. Those with intentions for export (though few) could possibly be those with bigger capital sizes (say more than 5 million Birr), better technology, machines, tools, and reliance on imported inputs, better organizational structure and management, better level of operators' education, reliable labor strength (say more than 15) and better pay scheme, better market share and remarkable sales, very good profit standing, long years of experience in the field, and those on the way to graduate to medium and large enterprise scales, etc.,. For most of the MSE it seems very remote to become exporter and get incorporated into the international market system. If, however, enterprise operators have intentions for export there are certain countries to which they intend to export. Mentioned countries include, neighboring African countries: the Sudan, Djibouti, the recently librated (seceded) state of Southern Sudan, Kenya, and other east African countries.

If the great majority of MSE owners (more than 90 percent) do not have intentions for export, what are the key reasons? The most important reason frequently mentioned is “capacity limitation”, which can be expressed as a sum total of limitations of capital, finance (including lack of collateral), working premise, machinery, expertise and experience, product quality, information, etc. Besides, some enterprise owners have interests and intentions to import and sell than to export domestic products. These are also the MSEs with relatively strong financial standing.

7.4. Competition

Competition is natural for firms marketing similar or substitute products. Competition under different circumstances might be expressed as fair, strong or severe depending on a number of factors. Products of enterprises face major competitions either from domestic or imported commodities or both. In many cases, enterprises devise certain measures to stay in the market or win business rivals in some ways. The actions taken or strategies devised to win rivals can be considered as measures of competitiveness.

When enterprises face competitive pressure, they are compelled to engender commensurate response. The “most viable response”, according to Humphrey and Schmitz (2000:3) “is to upgrade”. In other words, competitive environment often forces firms to innovate and upgrade. This subject will be seen in detail in the next chapter. In so doing enterprises can benefit from improved market returns and also pave the way to participate in the global commodity chain if the competition is mainly in view of international production standards, qualities, and other important market and marketing requirements. Individual enterprises thus should first be able to stay competitive within the local industry and then should be in a position to compete with imported commodities.

The current state of competition has been viewed by most of the respondents (74.5 percent) as strong, though not severe (see Table 25). On the other hand,

about 21 percent of the enterprises describe competition as fair. Competition is strong partly because an increasing number of entrepreneurs are joining the sector and imported commodities are flooding the country. Competition is not described as severe as such perhaps because (as seen in the previous chapter) the demand for wood-furniture products is promising thus enterprises are operating under relatively safe marketing context. The feature of competition was particularly described as severe only by 4.5 percent of the respondents, a proportion which was not that significant. However, assessments like fair, strong and severe could be quite subjective and sometimes elusive as may not be founded on objective realities. The root causes could also change frequently and their assessments as well. We may thus need to make eventual judgment with prudence.

Competitions whether fair or strong could come from local products or imported goods⁶⁶. In the Wood-work MSE sector, the majority of enterprise operators (about 88.5 percent) perceive that competitions significantly come from similar local enterprises. Only 9.5 percent of the enterprises perceive that competitions significantly come from imported goods. The threats of imported goods in the wood-furniture MSE sector is not taken that seriously perhaps because the two sets of commodities (local and imported) substantially are meant for different market segments, which may stipulate dissimilar market requirements and have potential buyers of distinct purchasing powers. Even within the domestic industry context, MSEs do not face significant competition from larger national enterprises (about 2 percent). However, we can not permanently expect the same scenario in the future. Things are likely to change and take up different shape both locally and globally. The impact of imported commodities, in particular, could be very much and felt substantially. Consumer wants and demands are changing. Retailers

⁶⁶ The domain of competition extends beyond the normally assumed local and imported goods proper. Recently, retail shops that sell “used furniture” are proliferating throughout the city. Such used furniture of course include those items previously produced locally or imported from abroad.

hitherto supposed to be main customers of local producers are now importers (to meet changing wants and demands) hence increasingly becoming competitors.

Enterprises can wield different techniques in order to be competitive in the industry. The techniques can be directly or indirectly relevant to any aspect of the marketing mix, namely, the product, the price, distribution channel or promotion. Capable enterprises can in some way touch all aspects of the mix while others could be highly selective depending on their capacities and interests. External requirements can also dictate individual enterprises to consider particular types of measures. In any case all are demanding and require operators to be more innovative. Some enterprises strive to minimize costs of operation so that they can offer lower prices. Some of them try to raise product quality to attract customers that can afford higher prices. Still others strive to hire skilled workers, use diverse promotional media or do something to improve the distribution channel.

In our case “offering quality products” (58 percent) has been preferred and exercised by most of the enterprises (152, about 76 percent) in order to be competitive within the industry. Offering quality product requires firms to do a lot of things ranging from input sourcing, acquisition of machinery and tools, proper designing facility to improve the entire or some aspects of the production process. More resources (or improvising on existing resources) and innovating capacities are needed to realize the objective of offering quality products. Those which are not effective in this might resort to lowering prices (23 percent) and some strive to minimize costs (19 percent). As can be seen the MSEs do not resort to promotional media as a way to enhancing competitive positions. Promotion itself is costly and particularly those firms that need to cut costs are not interested in it.

Table 25: Competition

| Competition for the market is: | No of MSE (Percent) | Competitions significantly come from: | No of MSE (Percent) | Techniques used to be competitive | Frequency of responses (Percent) |
|--------------------------------|---------------------|---------------------------------------|---------------------|-----------------------------------|----------------------------------|
| Fair | 42 (21) | Similar local enterprises | 177 (88.5) | Offering lower prices | 59 (23) |
| Strong | 149 (74.5) | Larger national enterprises | 4 (2) | Offering quality products | 152 (58) |
| Severe | 9 (4.5) | Imported goods | 19 (9.5) | Minimizing costs | 49 (19) |
| Total | 200 | Total | 200 | Using promotions | 0 |
| | | | | Hiring skilled workers | 0 |
| | | | | Using no techniques | 0 |
| | | | | Total | 260 ⁶⁷ |

Perception of Competitive Position (relative to other enterprises) in the Sector

| | Highly Competitive | Average | Less Competitive | Sum |
|--------------------------------|--------------------|---------------|------------------|-----|
| Factors of Comparison: | No of MSE (%) | No of MSE (%) | No of MSE (%) | |
| Material quality | 96 (48) | 92 (46) | 12 (6) | 200 |
| Design/Model | 54 (27) | 140 (70) | 6 (3) | 200 |
| Price ⁶⁸ | 140 (70) | 57 (29) | 3 (1.5) | 200 |
| Punctual delivery | 58 (29) | 140 (70) | 2 (1) | 200 |
| Ability to handle large orders | 19 (9.5) | 55 (28) | 126 (63) | 200 |

Source: field data

⁶⁷ Total figure exceeds 200 because of multiple responses

⁶⁸ Everything being constant, offering lower price means offering competitive price

Enterprises can have own perception of their competitiveness, i.e., the way they position themselves among enterprises within the industry. Most of the enterprises (126 enterprises, i.e., 63 percent) perceive that they are less competitive in terms of ability to handle large orders. Only few MSEs (about 9.5 percent) are confident to be competitive in handling large orders. This perception is based on objective reality that enterprises are micro and small with highly limited capacity to receive and deal with large orders. The effect is apparent. Those MSEs capable of handling large orders are those normally able to grow and prosper faster than the others. They can increase financial returns, labor strength, market share, physical expansion (in terms of space of operation, machinery, tools, etc.). They will also enjoy favorable conditions to innovate and upgrade, which in turn would pervade in every aspect of the business system.

On the other hand, about 70 percent of the MSEs perceive that they are highly competent in offering lower prices; and about 29 percent have modest status in offering affordable prices. Only very few of them (less than 2 percent) are less competitive in terms of prices. Generally speaking, MSE operators perceive that their competitiveness ranges between price (in which case they are competitive) and handling large orders (in which case they are less competitive). In terms of the other factors, namely, material quality, design and delivery, most of the MSEs perceive that they have average status in the sector, and the situation can be simply portrayed on a continuum as follows:

| Competitive | | Average/Ordinary | | Less Competitive |
|-------------|------------------|---------------------|--------|-----------------------|
| 70% | 48% --- 46% | 70% | 70% | 63% |
| Price | Material Quality | Delivery/Efficiency | Design | Handling Large Orders |

70 percent of the MSEs perceive that they have competitive position in the sector since they offer lower prices. On the other extreme, 63 percent of the MSEs perceive that they are less competitive since they can not handle large orders.

Between these two extremes come the other factors of comparison (quality, delivery, and design). From these three factors, material quality, falls somewhere between “competitive” and “average” positions.

Domestic Products Vs Imported Goods

Competition can no more be described as a domestic issue as the flow of imported goods is increasing from time to time. Competition for markets among domestic firms has already been felt and described as strong. This being the situation, imported goods are introducing and posing more competitive challenges on domestic products. This is a reality since there are several “price” as well as “non-price” (Humphrey and Schmitz 2000:15) factors of differences between domestic products and imported goods. Attempts were made to identify four major factors of differences, namely, quality, design, price and delivery. Enterprise operators were asked to rate domestic and imported products against the four factors along an ordinal scale running from exceptionally competitive (1) to least competitive (5). (See Table 26).

Domestic products are rated by 97 (close to 50 percent) of the respondents as exceptionally competitive and by 63 (32 percent) of the respondents as competitive in terms of quality, i.e., in terms of material strength and durability. Imported products, on the other hand, are rated as exceptionally competitive in terms of design. The design factor is particularly important as it gives leverage to imported goods to be highly competitive in the market. The majority of MSE operators (135, i.e., 73 percent) rate designs of imported goods as exceptionally competitive. And the rest of the operators (50, i.e., about 27 percent) rate the same as competitive. This means that none of the respondents rate “design” of imported commodities below “competitive” on the scale. Table 26 and Figure 09 present the comparisons made between domestic products (DP) and imported goods (IG) on the basis of assessments of operators.

Table 26: Domestic products Vs Imported goods

| Domestic Products (DP) | | | | | | |
|---|----------|-----------|-----------|-----------|---------|-------|
| Exceptionally Competitive (1) – Least Competitive (5) | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | Total |
| Factors | DP (%) | DP (%) | DP (%) | DP (%) | DP (%) | DP |
| Quality ⁶⁹ | 97 (50) | 63 (32) | 34 (17) | 0 (0) | 2 (1) | 196 |
| Design | 5 (2.7) | 46 (24.6) | 80 (42.8) | 37 (19.8) | 19 (10) | 187 |
| Price ⁷⁰ | 74 (38) | 47 (23.9) | 57 (28.9) | 15 (7.6) | 4 (2) | 197 |
| Delivery | 42 (23) | 45 (24) | 62 (33) | 28 (15) | 9 (5) | 188 |
| Imported Goods (IG) | | | | | | |
| Exceptionally Competitive (1) – Least Competitive (5) | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | Total |
| Factors | IG (%) | IG (%) | IG (%) | IG (%) | IG (%) | IG |
| Quality | 77 (40) | 37 (19) | 43 (23) | 19 (10) | 15 (8) | 191 |
| Design | 135 (73) | 50 (27) | 0 (0) | 0 (0) | 0 (0) | 185 |
| Price | 45 (23) | 32 (16) | 35 (18) | 53 (27) | 31 (16) | 196 |
| Delivery | 45 (23) | 68 (35) | 57 (29) | 17 (9) | 7 (3.6) | 194 |

Source: field data

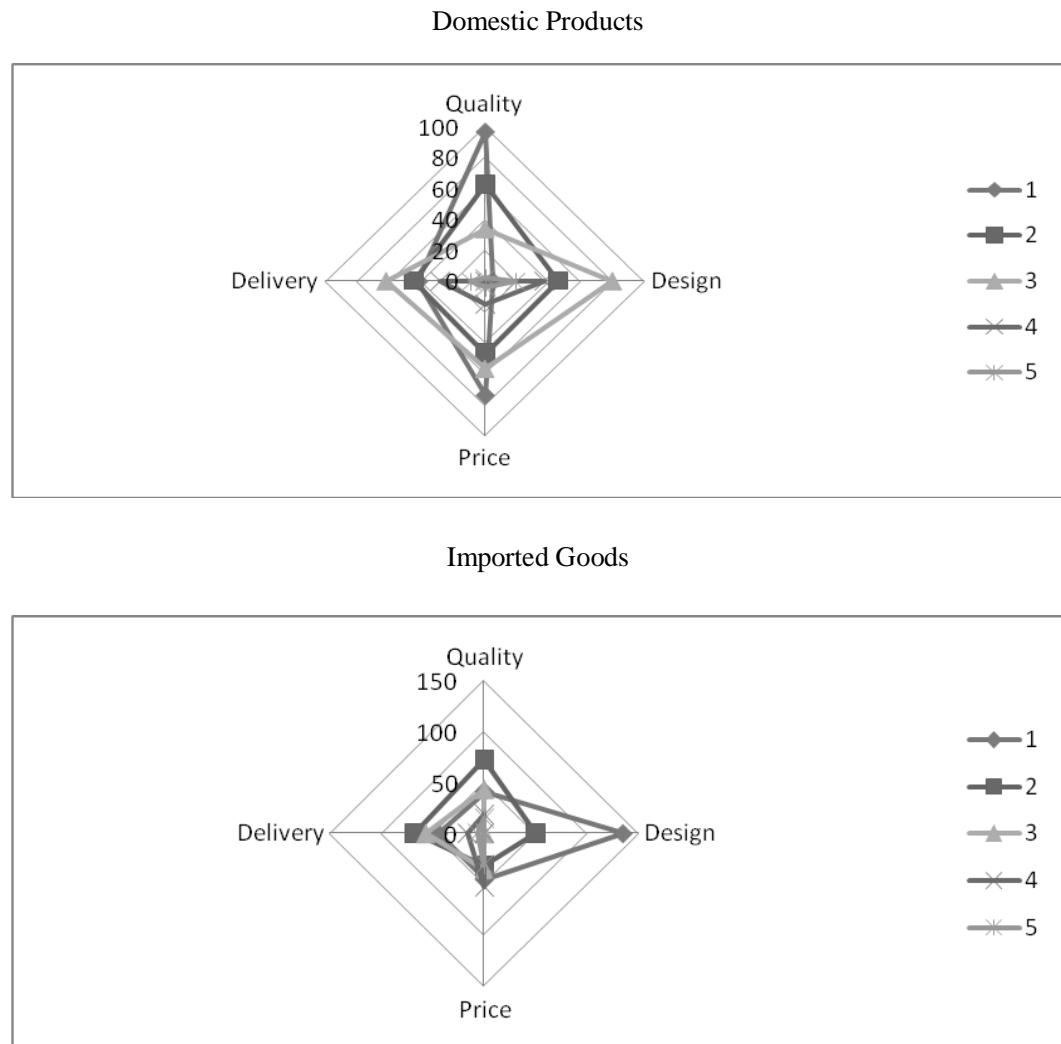
Material quality (strength) and Design can be taken as the critical factors that give market leverages to domestic and imported products, respectively. Imported goods are more competitive than domestic products in design and finishing. At the same time imported goods become less competitive than domestic products in terms of material strength and durability. Domestic products also appear as relatively competitive in terms of price. But the case of price should be taken with caution. We shouldn't say that local products are cheaper than their imported

⁶⁹ Described in the questionnaire as “material strength and durability”

⁷⁰ Everything being constant, offering lower price means offering competitive price

counterparts. This is against the reality observed on the ground. One operator said, “I can’t afford to offer prices cheaper or even at a par for a TV Stand similar to the one imported from China”. Products coming from China could be relatively cheaper than local products at least for two reasons: (1) economy of scale and (2) inferior material quality.

Figure 10: Domestic Vs Imported Products (*in chart*)



1 = Exceptionally Competitive; 2 = Competitive; 3 = Average/Ordinary; 4 = Less Competitive; 5 = Least Competitive (*Source: Table 26*)

7.5. Summary

In the domestic wood-furniture market, most of the MSEs receive orders from and sell their products to direct consumers. Few retailers but no wholesalers are involved in the distribution of products. The distribution channel is therefore the shortest, involving mainly the producers and the consumers. MSEs in this distribution channel have the opportunity to reap the profits resulting from retailing the products. Most of the MSEs have only single outlet situated at the production site. Some have more than one sales outlet that also serves as a display point for the products. Sales are primarily on cash basis (86 percent) and the rest 14 percent on both cash and credit basis.

Most of the MSEs do not use well established promotional media. Some MSEs use printed media and trade fair to initially advertise and further promote their products. The role of brokers is insignificant as about 95 percent of the enterprises do not have or use their own (client) brokers to sell their products. The role of brokers becomes apparent and very important only at the time of input (particularly raw materials) acquisition.

Lower prices and material quality (in terms of strength and durability) are the prime requirements in the domestic market. The wood-furniture sector is not yet part of the GCC. Export intentions seem to be very remote due mainly to capacity limitations. Competition for local markets is strong since an increasing number of entrepreneurs are joining the sector. The flow of imported goods is also increasing from time to time. Domestic products are relatively competitive in terms of offering products of better material quality (strength and durability). Imported goods, on the other hand, are competitive in terms of superior designs. MSEs may use different techniques to stay competitive in the sector. The techniques in many cases range from reducing costs of production to improving (upgrading) the quality of products.

Chapter Eight

8. Upgrading

8.1. Introduction

This chapter deals with upgrading. Upgrading can be described as a practice that has to do with the processes of innovating and thus “making better products more efficiently and moving into more skilled activities along the value chain” (Fuerst 2010:90). Competitive pressures force enterprises to innovate and upgrade (Humphrey and Schmitz 2000:1-3). The existence and operation of “lead firms” in quasi-hierarchical chains increases competitive pressures and at the same time helps local producers to upgrade (ibid). In this model of relationship, the lead firms (the buyers) would transmit knowledge to the producers/suppliers. Nevertheless, this mechanism of quasi-hierarchical relation doesn’t exist in the context of the wood-work MSE sector. Even in the absence of this, MSE are still in a position to exercise a sort of “incremental upgrading”, in through “learning by doing” (ibid).

Given the current business environment where competition for market is so sharp as a result of lots of access to products from proliferating MSEs and flooding imported commodities, upgrading or innovating in any way would become imperative not only to win but also to stay in the market at ease. MSEs can undertake upgrading in terms of product, transformation (production) process, or function (efforts made by the operators to moving into other (but related) business activities (Humphrey and Schmitz, in Fluery and Fluery 2001:118) or a combination of some or all of these domains of upgrading.

8.2. Upgrading Products and the Production Process

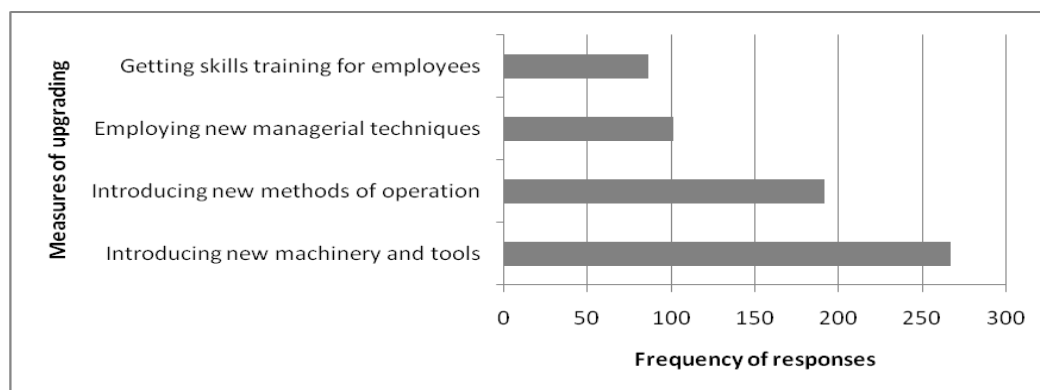
Most of the MSE operators (about 71 percent) think that they have tried to upgrade the quality of their products, mainly through acquisition of quality raw materials, complementary inputs, and better product design and product quality

control. However, some 29 percent of the operators admit that they have made little or no effort to upgrade their product quality. These are among the ones that usually fail to afford prices of quality raw materials and accompanying inputs. Consequently, they often have a tendency to acquire cheaper inputs that eventually reflect on product qualities.

Besides, product diversification is an option at the disposal of those operators who want to diversify and benefit from niche markets. Diversification can also be taken as a strategy to reduce business risks. Diversification in our case is delimited to and means increasing product assortments within the furniture product lines. Once operators started to produce some sorts of furniture and thereby able to attract customers and collect a good return, they are likely to multiply product assortments. More than 89 percent of the respondents reported that they have diversified, or at least tried to diversify, their products. More than 58 percent of the operators still intend to diversify their products in the future.

Enterprises can have diverse options of upgrading and transforming the production process. An enterprise can use a single or a combination of upgrading measures. The measures can obviously be expensive and strongly depend on the financial capacity of the firm under question. Some are able to introduce new machines and tools. Some have only to improvise out of what they really have or resort to other less expensive alternatives to upgrade the production process, like introducing new methods of operation, employing new managerial techniques or getting skills training for employees. For instance, on-the-job skills training can be provided by the owner or experienced operators in the firm. Some of the measures (like purchasing new machines) are quite expensive and hence far reaching particularly for those micro enterprises that are heavily constrained by financial shortages. This would impair their potential and could impede them from graduating to a higher echelon in the hierarchy of enterprises. It also heavily deters their dynamism in the changing business and economic environment.

Figure 11: Measures taken to upgrade the production process⁷¹



Source: field data

The measures taken by MSEs in order to upgrade the production process are more inclined to the physical (hardware) aspects of the firm, like introducing new machines and tools. The measure of introducing new machines includes the acquisition and use of locally modified machines (*modifics*) as well. The measures taken by MSEs to upgrade through improved managerial techniques and provision of skills training (for the workers) are not as important as the measures taken to improve the hardware aspects of the firm. On the part of the owners this could be justified on some grounds: (i) there is no “spare” money which could be invested on things like training and development, (ii) investing on hardware means acquiring and owning tangible assets and making more income in the short run. In view of this, measures to provide training may not add up to the physical asset of the owner and may not bring about financial returns in the short run.

8.3. Moving into Non-Production Activities

Micro and small enterprises can also move into other (non-production) functions on top of their production activities. In this case, MSEs are said to exercise functional upgrading. However, moving into this domain of upgrading is not that

⁷¹ The total count of frequency of responses is greater than the sample size (200) because of the possibility of multiple responses.

simple for the MSEs engaged in furniture production. Functional upgrading may mainly be exercised in the areas of design and promotion (see Table 27). Most of the MSE operators (68 percent) claim that they are involved in product design activities. Nevertheless, such involvements are not for commercial (external) transactions but for own uses in the workshop. As has been seen earlier, designs are often carried out by the owners/operators for the most part manually and still operate in an underdeveloped state.

Significant cases of MSEs (82 percent) have never tried to move into promotional activities. Those 16.5 percent claiming to have entered into promotional activities merely intended to state that they have made some efforts to promote their own products through internal or external channels. Beyond that, however, we can not find wood-work MSEs involved in promotional activities as an independent business function side by side with the production and sales of furniture.

Table 27: Moving into Non-Production Functions

| Response | MSEs ever tried to move into product design activities? | MSEs ever tried to move into promotional activities? | MSEs intent (plan) for the future: | |
|-------------|---|--|---|---------------------|
| | No of MSE (Percent) | No of MSE (Percent) | Intent (plan) of operators: | No of MSE (Percent) |
| Yes | 136 (68) | 33 (16.5) | To expand the business | 159 (79.5) |
| No | 47 (23.5) | 164 (82) | To continue with the current business at the same scale | 24 (12) |
| No response | 17 (8.5) | 3 (1.5) | To change the business | 12 (6) |
| Total | 200 | 200 | No response | 5 (2.5) |
| | | | Total | 200 |

Source: field data

We can not see commercial involvement of operators in both design and promotion activities. Partially, this could be explained by “the limited vision” of the owners/operators, “which is mostly governed by their knowledge and experience” (Yu, in Tegegne 2009b:176). Commercial involvement of MSEs in diverse business activities beyond the traditional function of production is encouraged in order to relax the heavy concentration of competition in this particular segment of the value chain. Apart from this relaxing effect, MSE involvement in diverse but related business activities paves the way for intra-sector division of labor and specialization. It may also speed up the graduation of MSE into medium and large enterprise scales and expand employment opportunities and income base for the locality. The effect can generally be felt in the backward as well as foreword linkages of the chain. Ultimately, the whole process might yield in greater synergy and brings about a highly competitive wood-furniture sector in the locality that would have the potential to enter the wider export market.

Table 28: Upgrading Efforts: *précis*

| Type of Upgrading | Means of Upgrading | Additional efforts | Main purpose |
|------------------------------------|---|---|--|
| Product Upgrading | Acquisition of quality raw materials | Diversification (increasing product assortments) | Commercial |
| | Acquisition of quality complementary inputs | | |
| | Better product design | | |
| Transformation Process | Introducing new machines and tools | Employing new managerial techniques | Improving the production process |
| | Introducing new methods of operation | Getting skills training for employees | |
| | | Resorting to other less expensive methods of improving the production process | |
| Functional Upgrading ⁷² | Design | Promotion | Non-commercial (for own use in the workshop); thus may not be taken as functional upgrading proper |

Source: own construct (on the basis of field survey)

As a final remark, it has to be observed that “Firms in developing countries, as firms everywhere, are under pressure to improve their performance and increase

⁷² Functional upgrading can be exercised in the (non-production) functional areas of design and promotion. We can not see commercial involvement of MSE operators in both activities. Micro and small enterprises use internal and some external means (like personal selling and trade-fairs, respectively) to promote their products.

their competitiveness” (Humphrey and Schmitz 2000:3). This will be achieved through upgrading, which is deemed the “most viable response” to competitive pressures (ibid). According to Gereffi and Kaplinsky (2001:5), “firm upgrading involves insertion into local and global value chains in such a way as to maximize value creation and learning”. All trajectories of upgrading can be real if there is investment by the local producers and there is effective support from the local institutions (op cit) in creating conducive business environment and extending the necessary support in terms of technical support, information, training, etc. This is the essence of LED in which firms and local institutions (particularly government institutions) collaborate to raise the performance of enterprises with an aim of increasing their role in local development.

8.4. Summary

MSEs are engaged in the production and sales of furniture products. Upgrading is imperative to become and sustainably stay competitive in the sector. It can be exercised in the form of product upgrading, transformation process or undertaken as any other form of non-production function.

Most of the MSE operators think that they have tried to upgrade the quality of their *products*, mainly through acquisition of quality raw materials, complementary inputs, and better product design and product quality control. However, some of the operators admit that they have made little or no effort to upgrade their product quality.

The measures taken by MSEs to upgrade the *production process* are more inclined to the physical (hardware) aspects of the firm, like introducing new machines and tools. The measures taken by MSEs to upgrade through improved managerial techniques and provision of skills training (for the workers) are not as important as the measures taken to improve the physical aspects of the firm.

Moving into the domain of *functional upgrading* is not that simple for the MSEs engaged in furniture production. Functional upgrading may mainly be exercised in the areas of design and promotion. Most of the MSE operators claim that they are involved in product design activities. Nevertheless, such involvements are not for commercial (external) transactions but for own uses in the workshop.

Most of the MSEs have never tried to move into promotional activities. Those few MSEs claiming to have entered into promotional activities merely intended to state that they have made some efforts to promote their own products through internal or external channels. We can not find MSEs involved in promotional activities as an independent business function.

Quasi-hierarchical types of relations are not common in the wood-work MSE sector. Even in the absence of this, MSE are still in a position to exercise “incremental upgrading”, in other words, “learning by doing”. However, the extent of upgrading and innovation observed in the MSE sector is not that satisfactory and confined to products and limited areas of the production process.

Chapter Nine

9. Relationships

9.1. Introduction

We can identify three major categories of stakeholders, namely, the wood-furniture MSEs, the suppliers and buyers, and government institutions. The web of relations that takes place between and among MSEs is conventionally termed as inter-firm relations, which can be expressed in two major ways. First, in terms of the enterprises with and among which the relationships exist, and second, in terms of the types (areas) of relationships. In the first case, firms can have relations among themselves (inter-firm relations), with suppliers (wholesalers and retailers) and buyers (industrial buyers and direct consumers). Industrial buyers are wholesaling or retailing firms that buy for resale; whereas direct consumers are the final users that buy for household or office purposes. In the second case, relationships can take place and expressed in a number of ways, to mention some: market relations (transactions), information exchange, design exchange, borrowing (finance as well as material inputs), sharing machinery, etc. Issues related to chain governance will follow the discussions on the web of relations in the value chain.

Beyond the realm of inter-firm relationship, MSEs also have relations with government institutions and agencies. When enterprises operate formally, their relations with government institutions become apparent. Therefore, all the three areas of relationships, i.e., inter-firm relations, relations with suppliers and buyers, and relations with government institutions are generally the subject matters going to be discussed under this chapter.

9.2. Inter-Firm Relations

Inter-firm (horizontal) relations are very important for enterprises operating in any sector. Micro and small enterprises, in particular, require developing cooperative relationships among themselves. Most of the MSEs are constrained by lack of

resources to acquire everything they require individually. Through cooperation they can benefit from what others can have in the sector. MSEs would also develop synergy and may be able to compete with medium and larger enterprises and imported commodities. Cooperative inter-firm relationships render individual firms less susceptible to risks, foster mutual exchange of information and know-how between firms and create a rich pool of collective knowledge (UN 2001:2). Moreover, cooperative inter-firm relationship can serve as a potential/precondition for firms spatially concentrating to form business clusters.

Enterprise operators have been asked to tell whether they have cooperative relationships among themselves. About 41 percent have indicated that they exercise cooperative inter-firm relations. However, most of them (53 percent) insist that they do not enjoy cooperative inter-firm relations at all except doing everything individually (at firm level). (See Table 29). This seems a bit exaggerated, however. We normally expect positive and cooperative relationships between and among firms in the sector, though there could be strong competition for the purse of the buyer at the same time. In any case, this situation signals that operators could not develop optimistic view about the business environment in terms of inter-firm relations.

Table 29: Cooperative Relations with Similar Firms (inter-firm relations)

| MSEs experience cooperative inter-firm relations? | No of MSE (Percent) | MSEs ever entered into a sub-contract agreement with others? | No of MSE (Percent) | If MSEs do not enjoy inter-firm relations, possible reasons could be: | No of MSE (Percent) |
|---|---------------------|--|---------------------|---|---------------------|
| Yes | 81 (40.5) | Yes | 16 (8) | No need for inter-firm relations | 55 (27.5) |
| No | 106 (53) | No | 162 (81) | No opportunity for inter-firm relations | 46 (23) |
| No response | 13 (6.5) | No response | 22(11) | No trust | 45 (22.5) |
| Total | 200 | Total | 200 | No response | 54 (27) |
| | | | | Total | 200 |

Source: field data

Several reasons could exist for not enjoying cooperative relationships. About 27.5 percent of the respondents generally see no sufficient reason (need) for inter-firm relations. In this response, we can read elements of negative attitude towards inter-firm relations as operators could not apparently see the advantages and therefore have the inclination to stay away from it. On the other hand, some 23 percent could “not find the opportunity” for inter-firm relations. These are relatively the ones with positive attitude hence try to take advantage of it when conditions permit. In the extreme case, about 22.5 percent of the operators believe and tell that there is “no trust” among MSEs. This is a serious challenge to the culture of business cooperation. On top of this, the rate of “no response” is relatively high (27 percent), perhaps implying the low level of perception about the benefits of or the negative attitude towards inter-firm relations in the sector.

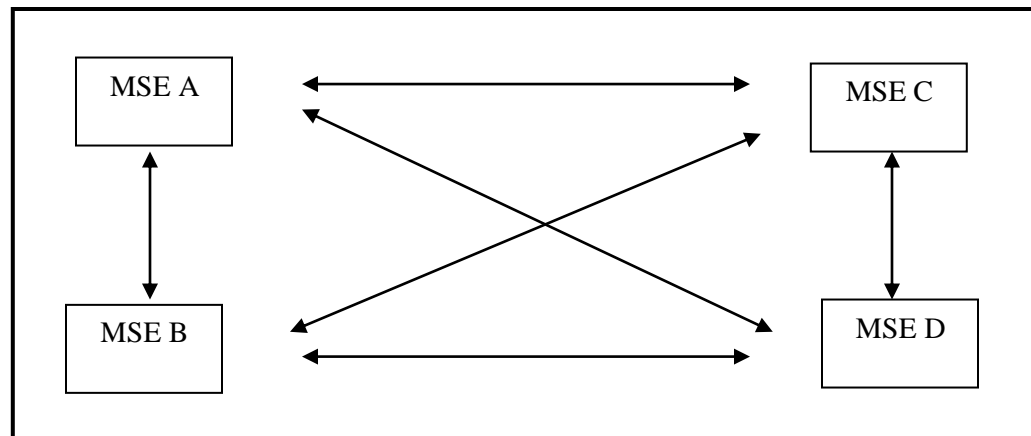
Subcontracting is one way of advancing strong inter-firm relations in any sector, though the process is likely to generate a kind of quasi-hierarchical (instead of horizontal) relations between firms. The culture of subcontracting in the wood-

work MSE sub-sector appears to be not that important. Only 8 percent of the MSEs claim to have ever entered into subcontracting. Two main reasons can be behind this. First, the enterprises operate at a very small scale; do not get large orders hence there is no need for subcontracting (forward linkages). If there are cases of subcontracting, such would rather come from medium and larger enterprises (cases of backward linkages). Second, MSEs may not be willing to transfer or share business opportunities among themselves.

Areas of Inter-Firm Relations

Micro and small enterprises can have inter-firm relations or cooperation in a number of ways. Figure 12 illustrates the web of inter-firm relationship, which defines the possible horizontal relations that prevail among and between MSEs. Normally, non-market relationships dominate inter-firm relations. The non-market relations are usually expressed in the form of exchange of information, labor and design, borrowing and sharing of resources, joint purchase of inputs, and joint use of transport facilities.

Figure 12: Horizontal (Inter-Firm Relationship)

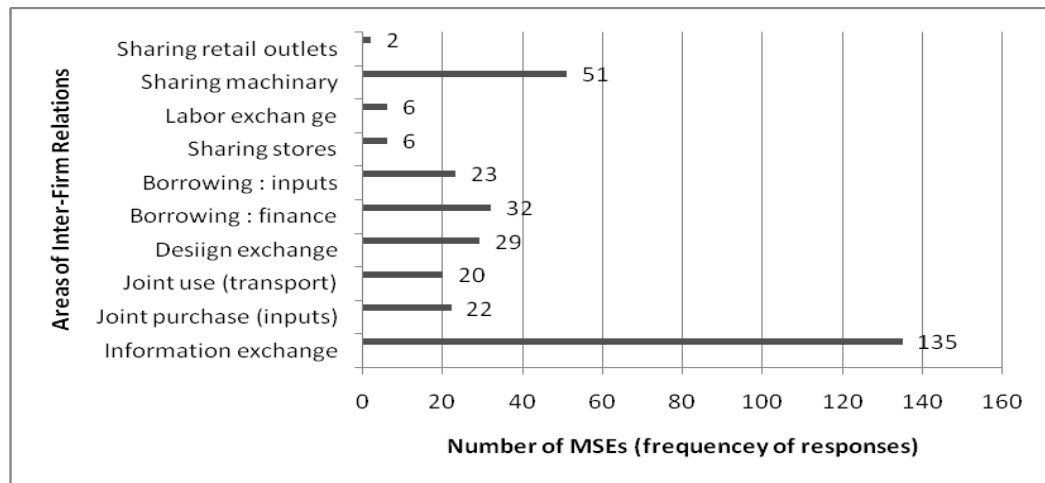


Source: own construct (2012)

The most common non-market relationship is “information exchange” (see the figure below). MSEs may routinely exchange among themselves different sorts of

information pertaining to the business. The communication network conveys information ranging from daily rumors to facts, which could be taken as useful depending on the perception of the recipient as well as credibility of the source. Information related to availability and costs of both imported and local raw materials, machinery, rents, transport, labor and other subsidiary inputs including designs are all vital to the operators. Information related to current sales (market) prices is also helpful. Moreover, information related to such government actions as registration and licensing, tax assessment and taxation are very important to the operators. Nevertheless, searching for, screening and judiciously using information for business purposes depend on the capacity and disposition of individual operators.

Figure 13: Areas of Inter-Firm Relations



Source: field data⁷³

Inter-firm relations are exercised in other areas too. Though information exchange (41.4) is the most important (dominant) form of relationship, MSEs also have

⁷³ The total frequency of responses is 326, which is greater than the sample size (200). This is due to the possibility of multiple responses provided by MSE operators. Therefore, “information exchange” (41.4 percent), “share of machinery” (16 percent) and “borrowing money” (9.8 percent) means there are 135, 51 and 32 frequencies of responses for each, respectively, out of the total frequency of 326.

cooperative relations in terms of sharing machinery (about 16 percent) and borrowing money (about 9.8 percent). MSEs also exchange designs and borrow inputs from each other. Sharing machinery is mainly done through rents, whereby the owners generate additional income out of the deal. Design exchange is often done between MSE operators that have intimacy and trust among themselves. Otherwise, it could be kept secret as it is one means of excelling competitors, at least in the very short run! Competitors can easily acquire or imitate designs once products are on market.

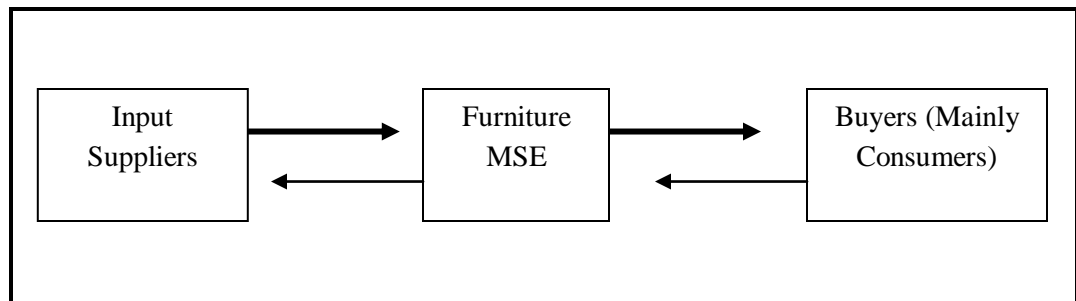
Micro and small enterprises might need to have business associations (BA), like the ones described by Bert Helmsing (2005b). MSEs could collectively resolve several business-related issues and promote certain interests through such associations. However, MSEs engaged in the production and sales of furniture do not have business association (BA). Some of them in fact reported to have “mini” financial associations locally known as *equb*, perhaps peculiar to the Ethiopian business culture. *Equb* is somewhat informal and exclusively economic in nature and is often established to meet financial needs of its members. Fixed amount of contribution (stake) is collected from members usually every Sunday and the collected amount will be given to one/two of the members. The process goes on like that until all members get their turn⁷⁴. Individuals may also be entitled for half of the contribution and join the *equb*. *Equb* can have different life span (short, long or relatively permanent) depending on the financial strength, size and interest of the members. Normally, individuals use the money obtained through *equb* for business (and investment) purposes, for instance, to acquire some fixed asset (like working premise, machinery, vehicles, tools), raw materials, and other inputs in bulk. Generally, *equb* enables people and creates better opportunity for business expansion.

⁷⁴ Some writers (for instance, Gebrehiot and Wolday 2006) describe *iqub* as “rotating saving and credit association”

9.3. Relations with Input Suppliers and Buyers

Beyond inter-firm relations between and among the MSEs, there are also relationships between MSEs and input suppliers on one hand and MSEs and buyers of the products on the other. Both market (arm's length relations) and non-market relations prevail in this case of the relationship. Transaction (Selling/Buying) is the key form of market relationship.

Figure 14: Market Relationship: *transaction*



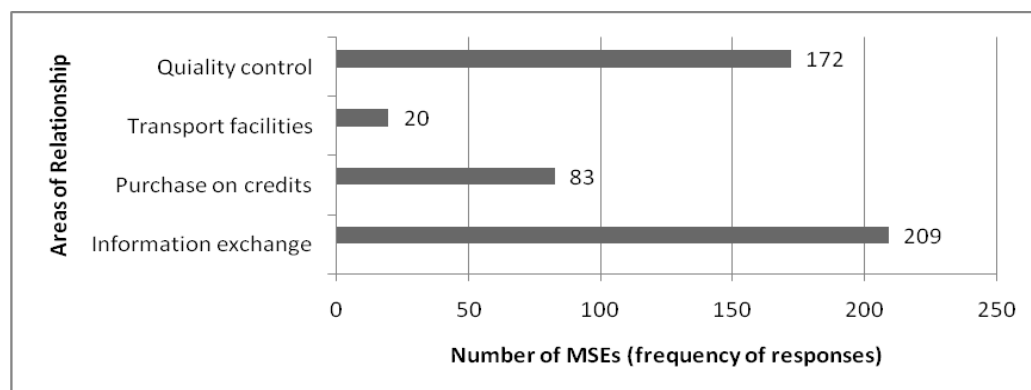
Upstream relations (*Domain of inter-firm relations*) *Downstream relations*

Source: own construct (2012)

In Figure 14, the forward (thicker) and backward (thinner) arrows indicate primarily the flow of materials (inputs and final products) and money, respectively. Both arrows also indicate the flow of information in different directions. Vertically, we have both upstream (between MSEs and input suppliers) and downstream (between MSEs and buyers) relations. The idea of “vertical” doesn’t however imply hierarchical relationships whereby some firms are superior and others are subordinate. Here, it is used to describe the upstream and downstream linkages in the value chain. Hierarchical relationship and coordination could be evident only in enterprises that have vertically integrated businesses of input supply (sawmills and timber supply shops), furniture-MSEs and sales outlets. Horizontally, we have the domain of inter-firm relations between and among the furniture MSEs. This is a network of relationship “between firms of more or less equal power” (Humphrey and Schmitz 2000:4).

Beyond market transactions, there can also be a number of ways of relationships between MSEs and input suppliers, for instance. Only some major areas are mentioned here. Like in the case of inter-firm relations, “information exchange” is the most important area of relationship. MSEs normally need input-related information from the suppliers. And the suppliers may need information related to market conditions in general and demands for inputs in particular. They at times adjust the amount of supply, quality and prices of inputs based on such information.

Figure 15: Areas of Relationship with Suppliers



Source: field data

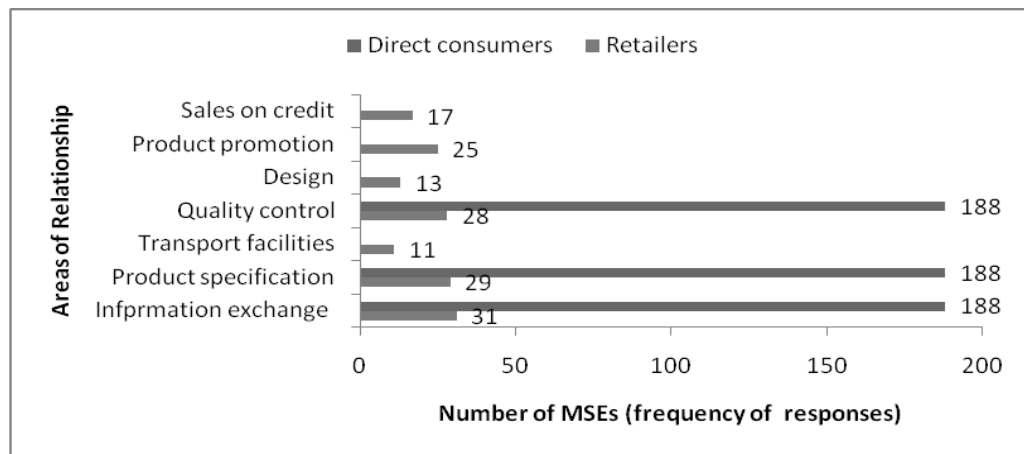
Following information exchange (43.18 percent⁷⁵), quality control (35.54 percent) becomes the other most important area of relationship and cooperation between MSEs and suppliers. If we take the logic that input quality determines product quality, the control for product quality should start from the inputs. Suppliers play pivotal role in this regard. At the initial stage, the burden of controlling quality is shared between the suppliers and the producers. At the latter stage, of course,

⁷⁵ The total frequency of responses is 484, which is greater than the sample size (200). This is due to the possibility of multiple responses provided by MSE operators. Therefore, “information exchange” (43.18 percent) ,“quality control” (35.54 percent) and “purchase on credit” (17.15 percent) means there are 209, 172 and 83 frequencies of responses for each, respectively, out of the total frequency of 484.

other stakeholders (like the buyers) will also be involved. The third important form of relationship is expressed in terms of purchase on credits (17.15 percent). Purchase on credit expedites transactions and greatly helps both parties. It is often done between those parties that have developed better rapport and trust.

Enterprises also have relations of different types and magnitude with buyers of final products. The buyers can be categorized in to two groups, based on the purpose of the purchase. The first group (retailers and wholesalers) are industrial buyers since they buy products in order to resale. These are the buyers who enter the channel as middlemen between the producers and other buyers. The second group constitutes direct buyers who buy products as final consumers. This group of buyers purchases products directly from the producers without involvement of the middlemen. Hence, the distribution channel becomes the shortest when compared to channels involving middlemen.

Figure 16: Areas of Relationship with Buyers



Source: field data

As it was seen earlier, the most important business partners of MSEs are the direct consumers. Retailers are not that important and wholesalers do not totally enter into the buyers' channel. Because of this the sum of frequencies for retailers (which is 154) is quite limited and below the actual sample size (200). Information exchange (20 percent) is an important area of relationship between MSEs and the retailers. It is followed by product specification and quality control. When we say relations with buyers we actually mean to say relations with direct consumers, who predominate in the transaction. Information exchange, product specification and quality control (33.3 percent each) are all important terms of relations between the MSEs and the direct consumers⁷⁶. Product specification and quality control are important areas of relationship. At the time of order, buyers often inform producers regarding what should be produced, in what material, size and quantity. All these could serve as a means of pre-control. After products are

⁷⁶ The total frequency of responses in relation to "direct consumers" is 564, which is greater than the sample size (200). This is due to the possibility of multiple responses provided by MSE operators. Therefore, information exchange, product specification and quality control are all equally important (33 percent each), which means there are 188 frequency of responses for each out of the total frequency of 564.

produced, the buyers will closely comment on products and demand corrections if deviations occur. This would serve as a means of post-control. In both cases producers would have advantages and obligations of maintaining product quality.

Relations among and between the stakeholders could generally be considered as diverse and intricate. Nevertheless, the major areas of relations can be summarized as follows:

Table 30: Areas of Relationships: *précis*

| Modes of relations | Major areas (types) of relationship | Remark |
|--|--------------------------------------|--|
| Inter-firm relations | Information exchange | Listed in the order of their importance |
| | Sharing machinery | |
| | Borrowing money | |
| Relations with input suppliers | Market (Transaction) | The key relationship |
| | Information exchange | Listed in the order of their importance |
| | Quality control | |
| | Purchase (inputs) on credit | |
| Relations with buyers (retailers ⁷⁷) | Market (Transaction) | The key relationship |
| | Information exchange | Listed in the order of their importance |
| | Product specification | |
| | Quality control | |
| | Product promotion | |
| Relations with buyers (direct consumers) | Market (Transaction) | The key relationship |
| | Information exchange | Listed irrespective of order of importance |
| | Product specification | |
| | Quality control | |
| Relations with government institutions ⁷⁸ | Registration and licensing | Listed irrespective of order of importance |
| | Enforcement of rules and regulations | |
| | Tax assessment and collection | |

Source: field data

⁷⁷ We hardly find wholesalers as buyers of products; even retailers are insignificant in that line of transaction.

⁷⁸ See “relations with government institutions” on pp 188-193

9.4. Chain Governance

The notion of governance is conceived to be central to the analysis of value chains (Gereffi *et al* 2001: 4). According to Humphrey and Schmitz (2001:21), “a chain without governance would just be a string of market relations”. Governance⁷⁹ is required to make important decisions in the value chain. In this context, three basic forms of governance are identified. These are: inter-firm networks, quasi-hierarchy, and hierarchy (Gereffi and Kaplinsky 2001: 4; Humphrey and Schmitz (2000:16; 2001:1); Gereffi *et al* 2005:83).

Quasi-hierarchy and hierarchy are not that common in the wood-work MSE sector. Quasi-hierarchy describes the “relationship between firms in which one is clearly subordinated to the other” (Humphrey and Schmitz 2000: 4). Quasi-hierarchy is less likely to prevail in the wood-work MSE value chain. This could be linked to or possibly emanate from: (1) absence of “lead firms” or “industrial buyers” that buy products, thereby exercise control over the producers, and (2) lack of “subcontracting” practices in the wood-work MSE sector.

If the wood-work MSE value chain had wholesalers and retailers as major buyers, these “industrial buyers” would specify for the producers such parameters as “what should be produced”, “the quantity”, “the quality”, and “when to produce”, etc. Eventually, the producers (the MSEs) would be under pressure to exercise some sort of upgrading, which is obviously “buyer-driven”. The downstream end of the value chain is critically dominated by direct consumers who, of course, would exercise some control over the quality and price of the products they buy. Their influence (control) on the producers diminishes when the consumers instantly purchase ready-made furniture. Their influence becomes strong when

⁷⁹ According to Gereffi *et al* (in Bain 2010), “governance” is described as “...the power and authority to determine how resources are distributed throughout the value chain”. The governance structure, pattern and practices generate “division of labor” within the chain hence significantly influence the allocation of resources and redistribution of benefits (Ponte and Gobbon, in Bain 2010:4)

they order and want to stipulate specifications. The other point is “subcontracting”, which is not a common practice in the MSE sector. Only 8 percent of the MSEs claim to have ever entered into a subcontract agreement with others. Subcontracting brings the partners into quasi-hierarchical relations in which the contractor becomes subordinate (Humphrey and Schmitz 2000:4).

Hierarchy, which implies “vertical integration within enterprises” (ibid) is also less evident. However, some degree of vertical integration (hierarchy) could be observed in the public enterprises and some of the furniture MSEs. Public enterprises own sawmills and distribution centers that could be hierarchically organized within the public enterprise structure. A sort of hierarchical relationship can also be observed in some of the furniture MSEs that run the activities of wood-sawing, timber-supply, furniture-production and sales under one (integrated) enterprise. Such MSEs have own sawmills, timber retail shops, production workshops and display and sales outlets. Still others have a combination of some of these activities integrated under single enterprise.

In addition to the modes of quasi-hierarchy and hierarchy, enterprises can exercise private governance through local business associations (BA) (Helmsing 2005b; Humphrey and Schmitz 2000:5). Business associations can safeguard and promote common interests and in some way regulate operations of the members. The opportunity of enjoying private governance through BA is missing since MSEs do not have it.

Beyond internal agents, agents external to the value chain could also exercise some degree of governance. The most important in this case is public governance through government agencies (Gereffi et al 2001:4; Humphrey and Schmitz 2001:11). Government agencies set “product and process parameters” (ibid). However, this is a loose experience as government institutions are mainly: (1) concerned with regulating production standards of selected (conceivably sensitive) sectors, like pharmaceutical and food processing, and (2) engaged (are quite busy)

in the enforcement of revenue-related requirements like licensing and tax collection.

In the wood-work MSE sector, enterprises acquire key resources from domestic sources and their products are destined to domestic markets. Consequently, the allocation of key resources and the distribution and redistribution of benefits in the value chain are governed by local (domestic) actors. Financial resources come from domestic sources (such as personal savings, family transfers, and micro-credits). Machines (except the modified ones, which the operators call them *modific*) and tools, chemicals and other components are imported from abroad and MSEs get them through local retailers. Power in the value chain seems to concentrate in the hands of public enterprises which control and regulate the plantation of pine forests and the distribution of key inputs (pine cut-logs and timbers). Once entered the distribution channel, the key inputs are controlled by domestic wholesalers, retailers and associated brokers. Production decisions and product designs are made by MSE owners/operators. Designs are meant only for internal consumption at the firm level. Eventually, furniture products will be handed over to direct consumers without much involvement of middlemen.

Finally, on the basis of the observations made so far, it is possible to generalize that arm's length market relations (transactions) and inter-firm networks (horizontal linkages) characterize the relationship that prevails in the wood-work MSE sector.

9.5. Relations with Government Institutions

Local economic development initiative creates partnerships among various development actors. The partnership between the private sector and the local government is the most important concern here. In other words, this section is concerned with looking into the relations of MSEs with government institutions. Sustainability of economic growth and development could be assured, among other measures, through “greater participation of the private sector” (MoFED

2010:8) since it is the real player in the economic domain of the country. In order to realize sustainably of development the private sector has to be genuinely supported by the government sector. In spite of the “potential contribution” of MSEs to employment creation, poverty alleviation and development, the role of the government in extending support to the sector’s overall development was quite insignificant (UNICTAD 2005, cited in Tegegne and Mehret 2010; Eshetu and Zeleke 2008).

The actual relationship between the two entities (i.e., local government and the private sector) appears to be very weak. The broadly conceived partnerships shrink into routine administrative relationships with an aim on the government side of simply enforcing legal requirements. The main reason for this state of ordinary relationship could be the absence of well integrated LED initiatives/programs that would bring MSEs onboard to contribute to local economic development.

Micro and small enterprises maintain relations with government institutions as long as they operate formally. In more specific words, government agencies require MSEs to register, get license, operate within the legal framework and pay taxes, and renew licenses on scheduled timetable. Recently, the government has been too busy to bring MSEs into the legal framework; hence the relations in this regard are getting momentum than ever before. Beyond this, however, the support extended by the government to the private MSE sub-sector is not that apparent.

MSE operators have own perceptions of the relations with government institutions. Most of the operators (more than 72 percent) perceive that the tax assessment practice, in particular, is unfair. It is not only unfair but also unbearable for many of them. Recently, some micro enterprise operators are heard desperately saying: “let them [the government] takeover the entire firm than asking for such amount of tax”. This means that the tax is more than the entire capital of the firm. If this is the case then the problem is attributed to the current tax assessment practice.

Beyond this, more than half of the operators (close to 57 percent) witness that they often encounter administrative difficulties during the seasons of tax payment and license renewal. Many of them (64 percent) also reveal that they sometimes encounter mistreatments in their dealings with government agencies and officials (see Table 31).

The recent decentralization process has given the *woredas* (the lowest administrative tiers) responsibilities perhaps beyond their capacity to discharge efficiently. The process naturally requires and mandates such government tiers to take on political, economic and social responsibilities. Hence, local government tiers are forced to shoulder such responsibilities, given what Gumareas (1998:24) has stated as “meager resources and herculean tasks” to describe the assignment of substantial duties amid heavily constrained resources.

Particularly during the tax payment seasons, the tax payers are likely to encounter difficulties. What they actually observe on the ground has influenced their evaluation of the administrative capacity and efficiency of local governments. Partly due to this, most of the operators (the tax payers) are not comfortable with the business environment and thus inclined to underestimate the efforts of government agencies towards creating an enabling environment for the business. The tax payers, too, are not immune from the blame, however. The Inland Revenue officials, on top of admitting internal weaknesses, blame the tax payers for not coming and settling everything on time. According to them, most of the tax payers become active only at the end of the scheduled period, resulting in unmanageable crowds on the agencies. When assessed as a whole, the tax system of the country is relatively backward, not yet well reformed and problems still persist on both sides, i.e., the tax payers as well as the tax assessors and collectors.

Table 31: Perceptions about Government Institutions and the Business Environment

| Description | Perception, No of MSE ⁸⁰ (Percent) | |
|---|---|--------------------------------------|
| During license renewal and tax payment seasons, administrative practices are: | Smooth, 84 (43) | Difficult, 113 (56.5) |
| The tax assessment practice are: | Fair, 55 (27.5) | Unfair, 145 (72.5) |
| MSEs encounter any mistreatment in their dealings with government agencies: | Yes ⁸¹ , 158 (79) | No, 42 (21) |
| Business rules and regulations are: | Favorable, 78 (39) | Unfavorable, 118 (59) |
| Business rules and regulations are: | Predictable, 61 (31) | Unpredictable, 132 (66) |
| Over the last 4-5 years, the business environment has: | Improved, 76 (38) | Deteriorated ⁸² , 64 (30) |
| Government agencies strive to create an enabling business environment? | Yes, 51 (25.5) | No, 130 (9) |
| Problems associated with: | | |
| Bureaucracy (administrative inefficiency) | Minor, 6 (3) | Serious ⁸³ , 128 (68) |
| Inability (weakness) to provide essential services | Minor, 42 (21) | Serious ⁸⁴ , 110 (56) |
| Corrupt practices | Minor, 24 (12) | Serious ⁸⁵ , 70 (35) |

Source: field data

⁸⁰ A sum total short of 200 (the sample size) is attributed to “No response”

⁸¹ Yes, sometimes = 128 (64); Yes, always = 30 (15)

⁸² The rest 60 (30) perceive that the business environment is “unchanged”

⁸³ The rest 54 (28.7) perceive that bureaucratic problems are neither minor nor serious, but moderate

⁸⁴ The rest 44 (22.5) perceive that inability to provide services is neither minor nor serious, but moderate

⁸⁵ The rest 102 (52) perceive that corruption is neither minor nor serious, but moderate

Business rules and regulations may be understood as frameworks mainly pertinent to issues like registration, initial capital requirements, professional certification, facility requirements, business ethics and product standards, licensing, license renewal, tax assessment procedures, accounts keeping, tax payments, compliant procedures and practices, etc. In this sense, most of the MSE operators (59 percent) perceive that business rules and regulations in general are not favorable for them. Only 39 percent of the operators perceive the business rules and regulations as favorable. Operators also have doubts regarding predictability of business rules and regulations as most of them (66 percent) are of the opinion that such rules and regulations are unpredictable.

Not only rules and regulations, frequent changes/reshuffling of officials, too, highly contribute to the unpredictability of administrative practices. Operators have strong feeling that rules and regulations are subject to frequent changes, consequently posing problems on the entire MSE business. Even though things are changing fast, it is only 38 percent of the operators who are of the opinion that the business environment has improved over the last 4-5 years. About 32 percent of the operators hold totally pessimistic view towards the business environment. The rest 30 percent feel the status quo, as the environment is unchanging meaningfully over the last 4-5 years. Changes are there, of course; but the changes might have brought slight impact (positive) on the MSE.

In relation to government institutions, bureaucratic red-tape has been perceived by 68 percent of MSE operators as relatively serious problem, followed by inability (weakness) of the institutions to provide essential services (like electric power supply, waste disposal, sewerage systems, telephone lines, roads, security, etc). MSE operators did not only identify and rate the major problems related to government institutions. They also suggest certain policy measures that the government should undertake. In this regard, MSE operators vary from those who are not totally interested to those who are willing to suggest. The first ones are pessimistic and not interested to provide any suggestion. Such operators say: “I

will not give any suggestion since no change will take place!!” On the other hand, those who are willing to suggest, forward the following points that they think will help improving and changing the business milieu:

The government should stabilize input (both raw material and subsidiary input) prices; The government should exercise some sort of control over input wholesalers (as wholesalers are supposed to manipulate prices of certain inputs and often cause the same to soar up);

The government should introduce certain protectionist as well as support measures aimed at favoring domestic MSEs;

The government should exert efforts to improve (reform) the bureaucracy; should upgrade the skill and capacity of civil servants in the bureaucracy; should also create skills training opportunities for the MSE operators;

Concerned government agencies should provide opportunities of skills training for the MSE operators;

The government has to participate MSE operators while formulating laws, regulations and strategies affecting the survival and operation of MSEs;

Tax rates should be compatible (fair) with the capacity and overall situation of the majority of the MSEs;

The government has to create conducive business environment for fair competition; there should be separation between business and politics; the credit system should be impartial and accessible to all.

9.6. Summary

We can identify three major categories of stakeholders, namely, the wood-furniture MSEs, the suppliers and buyers, and government institutions. Correspondingly, three major types of relationships are identified: inter-firm relations, supplier-MSE and MSE-buyer relations, and relations with government institutions.

The first one is between and among the wood-furniture MSEs (horizontal relations). Non-market relations, mainly expressed in the form of information exchange dominate the inter-firm relationships. Though information exchange is

the most important (dominant) form of relationship, MSEs also have cooperative relations in terms of sharing machinery and borrowing money. MSEs also exchange designs and borrow inputs from each other.

The second type of relationship is between MSEs and suppliers on one hand and MSEs and buyers on the other hand (“vertical” - upstream and downstream - relations). Both market (arm’s length relations) and non-market relations prevail in this case of the relationship. Transaction (Selling/Buying) is the key form of market relationship. “Information exchange” is the most important area of non-market relationship. Quality control and purchase on credits become the next important areas of relationship and cooperation between MSEs and suppliers. The most important buyers of MSEs are the direct consumers. Retailers are not that important and wholesalers do not totally enter into the buyers’ channel. Information exchange, product specification and quality control are all important terms of relations between the MSEs and the direct consumers.

On the basis of the observations made so far, it is possible to generalize that arm’s length market relations (transactions) and inter-firm networks (horizontal linkages) characterize the relationship that prevails in the wood-work MSE sector. In the wood-work MSE sector, enterprises acquire key resources from domestic sources and their products are destined to domestic markets. Consequently, the allocation of key resources and the distribution and redistribution of benefits in the value chain are governed by local (domestic) actors.

The third type of relationship is with government institutions. The actual relationship between local government and the private sector appears to be very weak. The broadly conceived partnerships shrink into routine administrative relationships with an aim on the government side of simply enforcing legal requirements. The relations are thus confined only to registration, licensing, license renewal and tax collection. MSEs are said to operate formally as the government has recently taken extensive measures to bring MSEs into the legal

framework. However, bureaucratic procedures and administrative inefficiency, followed by inability to provide essential services, are identified as the major problems on the part of the government. MSEs are also affected by other problems emanating from the policy, institutional and business environment at large.

Chapter Ten

10. The Role of MSE Value Chains in LED

10.1. Introduction

The role of MSEs in LED is remarkably observed when MSEs are studied through the analysis of value chains. The wood-work MSE sector has been selected for this purpose. This sub-sector was identified by the government as one of the key areas in the manufacturing sector together with leather and footwear, textile, food processing, metal-works, and agro-processing. Moreover, globally, the furniture sub-sector is recognized for its large-scale and expanding business with its fastest trade than any of the others, including textile and footwear (UNIDO 2003:1; Abonyi 2006:2). This is an excellent opportunity ahead for the wood-furniture MSEs having the potential and intent to enter the global commodity chains.

At this current stage, however, we have an exposure confined only to the wood-furniture MSE domestic value chain since final products are meant only to the local (domestic) markets. In this chapter, the structure of the value chain is presented with the support of “mapping”, i.e., graphic presentation of the wood-work value chain. A brief description is provided to illustrate the flow of resources and value adding activities across the chain.

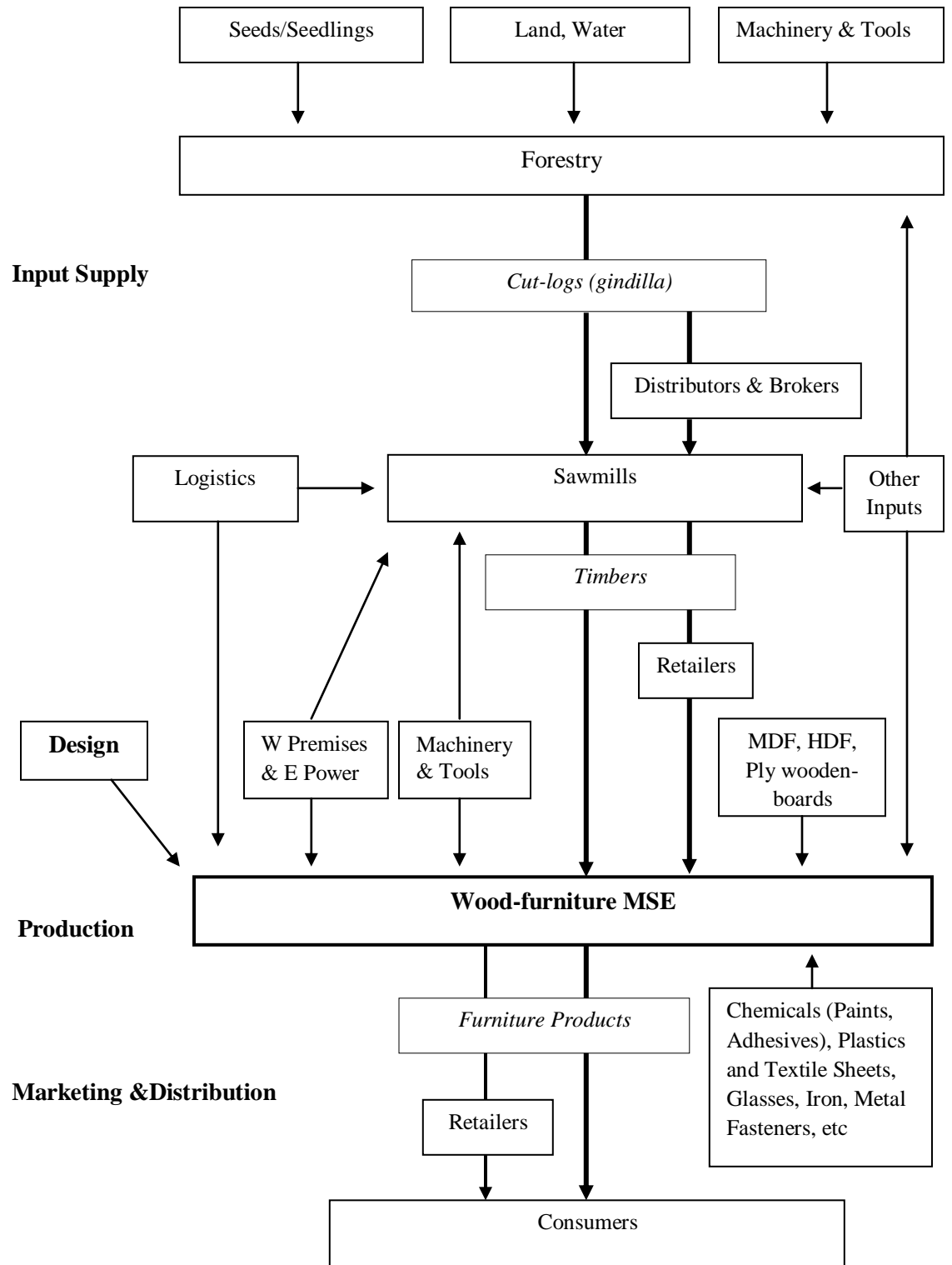
The chapter also discusses the major problems (weaknesses) of the value chain. The problems can be discerned as internal or external. The former is internal since it is specific to any particular firm. The second one is external since it emanates from the value chain and the general environment at large. The chapter finally presents the role of micro and small enterprises (MSE) and their value chains in local economic development (LED).

10.2. Mapping the Wood-Work Value Chain

Value chain mapping involves a systematic illustration of the chain's overall configuration. The process helps to portray the actors participating, the value adding activities undertaken and support services provided to realize input-sourcing and processing, production/manufacturing, marketing and distribution and final consumption. The domestic wood-work value chain is illustrated here (see Figure 17) on the basis of the observations made so far. Mapping the wood-work value chain may provide several advantages. Mapping the value chain would particularly serve as an important instrument:

- to graphically (and easily) demonstrate the structure of the MSE domestic value chain and thereby impart the general pattern of relationships in the chain;
- to identify the critical upstream and downstream agents (stakeholders) involved at every segment of the value chain;
- to illustrate the flow of resources and value adding activities (both primary and secondary activities) in the chain;
- to track backward and forward linkages in the value chain: trace input sourcing and spot possible destinations of products through tracking the distribution channel; and
- to trace and spot the possible sources and points of drawbacks in the value chain.

Figure 17: Mapping the Wood-Furniture MSE Domestic Value Chain



The ticker lines in the map (Figure 17) indicate the major routes or streams: from the primary input sources (pine plantations⁸⁶) through sawmills to the furniture MSEs⁸⁷ until final products reach the ultimate destination (the consumers). Cut logs from cultivated pine trees serve as the principal source of primary inputs for the furniture MSEs. Cut-logs, timbers, sawn woods and boards flow through the ticker line. Timbers and different forms of solid-woods flowing out from the sawmills (both public and private sawmills) would go to the distributors (both wholesalers and retailers) and ultimately enter the furniture MSEs. Imported fabricated-boards, like medium density fabricated-boards (MDF) and high density fabricated-boards (HDF), semisolid items, plywood and décor boards will also enter the value chain and augment the system of input sourcing. Various inputs and value adding activities enter at different stages and segments of the value chain. Many of the boxes contain different inputs that would flow through the value chain. The thinner lines (arrows) indicate the flow of such inputs and value adding activities into the system. The flow of resources and value adding activities through both the ticker and thinner lines portrays the entire configuration of the predominantly domestic wood work value chain.

Distributors (both wholesalers and retailers) of cut-logs (locally termed as *gindilla*) and brokers are important middlemen to transfer the logs to the privately owned sawmills. However, retailers rather than wholesalers are very important agents of input-sourcing for MSEs, a fact sufficient to demonstrate the scale of operation in the furniture MSE sector. “Design” is not only an input as such but also an

⁸⁶ Pine plantations (trees) are taken here as the primary (forest) input sources. Raw logs are harvested from cultivated pine trees and distributed to different sawmills. Pine tree areas (for instance, the Sole-Jigessa pine forests and enterprises in Shashemene) have own workshops and sawmills to cut trees and prepare logs (*gindillas*) and sawn-woods (timbers). In the case of some remote areas (for instance, Illubabor), capable enterprises can have an option of using mobile sawmills.

⁸⁷ It should also be noted that some furniture MSEs in the study area (Addis Ababa) have own sawmills, which would in many cases serve both internal (for the firm’s input supply) and external (commercial) purposes.

important value adding segment in the chain together with input sourcing, production and distribution. “Machinery and Tools”, besides the main workshop apparatus, include all forms of accessories and spare parts. Logistics represents essential supports, including transport, warehousing and relevant services, which would facilitate and expedite the move of resources and activities in the value chain. Essential inputs like finance and labor may pervade across the entire chain. Labor includes all categories: skilled, semi-skilled, and unskilled labor. Unspecified inputs (for instance, telephone, stationary, fuel, lubricants, fertilizers, etc.) would come under “Other Inputs”. Intangible inputs, notably information and resultant decisions, will accompany the flow of inputs and activities throughout the value chain.

MSEs produce furniture on the basis of either order specifications or operators’ designs. Furniture products are meant entirely for domestic markets, where “lower prices” and “material quality” (in terms of strength and durability) are the major requirements. The role of middlemen (wholesalers and retailers) in this part of the distribution channel is quite insignificant since the biggest proportion of the products enters directly into the consumers’ box. Only small percentage (14 percent) of the products passes through the retailers. Because of this (as can be seen on lower end of Figure 17), the line that passes through the “Retailers” is not as thicker as the one that enters directly into the “Consumers” box.

Value chains are products of the value-adding performance of different actors (participants) across the chain. The map (Figure 17) shows that there are six key actors on the main route of the value chain. These are: (1) public enterprises, (2) distributors and brokers, (3) sawmill enterprises⁸⁸, (4) timber traders, (5) furniture MSEs, and (6) buyers (both final users and retailers). The chain of relationship between these actors can be conceived as being organized at three basic levels:

⁸⁸ Sawmills can belong to public enterprises, furniture MSEs or can be independent businesses in their own right, as sawmill enterprises

The first level is at the chain's most upstream zone and dominated by 'public enterprises' as major source of input. At this first level, public enterprises have linkages with: (i) distributors and brokers; (ii) sawmill enterprises, and (iii) wood-furniture MSEs. Public enterprises have vertically integrated organizational structure that includes sawmills and distribution centers, among others. The relation within this managerial structure is basically hierarchical. Beyond this, however, market linkages characterize the relationship between public enterprises and all other buyers, including distributors, sawmill enterprises, and wood-work MSEs. Provided that there is shortage of raw-materials supply and there is a setting in which public enterprises dominate upstream linkages, the value chain at this level is mainly supply-driven.

The second level is relatively complex and involves three major actors: (i) distributors and brokers, (ii) sawmill enterprises, and (iii) timber traders. All these three actors serve as suppliers of inputs to the users⁸⁹. However, distributors (and brokers) appear to dominate in the distribution of inputs, i.e., cut-logs, semi-processed lumbers and timbers to the users. Purely arm's length market linkages characterize the relations between the intermediate suppliers of inputs (namely, the distributors, sawmill enterprises, and timber traders) and the users (industrial buyers).

The third level is at the chain's most downstream zone and dominated by the operation of wood-furniture MSEs, which acquire inputs, manufacture house hold and office furniture and sale the same to the buyers (both retailers and final consumers). The role of retailers is insignificant since most of the products directly reach final consumers. In the absence or insignificant presence of middlemen (wholesalers and retailers, respectively), the chain is normally formed by a short distribution channel, connecting the producers and the consumers.

⁸⁹ Users are 'industrial buyers' that purchase major inputs to reprocess (cut-logs) or resale (timbers) to other users (sawmills, timber traders, furniture manufacturers)

Market linkages characterize the relations in the downstream value chain. If retailers were very important in the distribution channel, they could have the possibility of entering into quasi-hierarchical relations with furniture producers. This would happen if the retailers: (i) provide product specification and design; (ii) dominate in marketing and related activities; and (iii) play meaningful role as middlemen at the lower end of the distribution channel.

The relationship chain starts from public enterprises and flows down through different segments until end products reach the final users. All are domestic actors and the chain is essentially governed by such domestic actors. However, public enterprises dominate chain governance at the upstream activities of input sourcing. Major distributors buy logs and timbers from public enterprises and distribute the same to the sawmills and timber traders through the help of brokers. At this point of the chain, distributors and brokers play pivotal role in governing and dictating the input market. Once the inputs reach the sawmills and timber traders, the transaction would become easier and smooth. At this stage, furniture MSEs may have different alternatives to acquire inputs. Finally, furniture products reach buyers (both retailers and final users), where the role of retailers is not that important as most of the orders come directly from and go directly to the final users.

The map (Figure 17) and its plain descriptions should not, however, conceal the reality and simply illustrate the smooth flow of resources and activities in the value chain from the source to the destination. Micro and small enterprises involved in the value chain are confronted with complex problems and drawbacks arising internally from within the firm or/and externally from the sector (its value chain) and the general environment. This will be discussed under “weaknesses of the value chain”, below.

10.3. Weaknesses of the Value Chain

Problems of diverse magnitude challenge the existence and operation of micro and small enterprises. The problems could be either internal or external to a particular firm. Internal problems are closely associated with weaknesses (or limitations) of the firm whereas external problems are embedded in the general business environment hence pose threats from outside, affecting all MSEs as a sector. Enterprises are able, under normal circumstances, to manage and fairly control internal problems. However, it is beyond the scope and capacity of individual MSE to manipulate external problems. The logic implied by the broader framework of LED (Figure 01) can be raised at this juncture since major (strong) and relatively minor (weak) influences are denoted by thicker and thinner lines, respectively. External influences are strong and beyond the firm's direct control whereas influences coming from a single firm are relatively minor to the external environment.

The Ethiopian wood-furniture MSE sector value chain is restrained by quite a lot of problems. As has been seen, most of the MSEs are challenged by lack of capital, working premises and machinery. Shortages of raw materials supply, problems in input quality, and soaring costs of virtually all sorts of inputs are the critical problems in input sourcing. Moreover, backward linkages are disturbed due to shady role of brokers⁹⁰ which complicate the process of input transfer (supply) and acquisition. Artificial price increases, unfair distribution of supply guided by the brokers' will, and unhealthy relations in the value chain are all evident as a result.

Private sawmill operators complain about and mention a number of problems, including supply shortage and declining (inferior) quality of cut-logs, tight

⁹⁰ The brokers are not licensed hence "invisible" – operate informally. They do not have fixed venue or offices; as a result, can not be traced to assume official responsibilities. However, such brokers are readily close to intervene in the business deals between sellers and buyers.

competition brought about by other buyers (furniture-MSEs), problems created by the brokers and soaring costs of logs and other inputs. As a result of these and other internal problems, production (output) scale is quite small; hence sales are mostly for those highly survivalist or micro level furniture producers. Financially as well as operationally strong MSEs would thus have their own sawmills or resort to other sources, including government-owned sawmills, industry villages (collection of government-supported MSEs) and private timber suppliers. Bypassing local sawmills and resorting to other sources could to some extent: (i) have a deterring impact on the normally expected productive market linkages between local sawmills and furniture MSEs; and (ii) restrain the growth of the local sawmills sub-sector.

Micro and small enterprises suffer not only from financial and material shortages but also from non-financial and non-material constraints like lack of skilled labor, weaknesses in business management, including poor marketing skills and inadequate knowledge of production techniques. The other very important constraint is lack of capacity to acquire and process and effectively use market-related information. MSEs and the value chain in which such MSEs operate also suffer from problems related to the institutional and policy environment, which could mainly be expressed as lack of effective and more or less sustainable government support.

The status of “design” greatly affects the competitive position of MSE in any sector. Capacity to design appears very important in the wood-furniture sector as well since similar commodities are flooding from abroad, particularly, the far-east exporters. In the wood-furniture MSE sector, designs are mainly made by the owners/operators themselves based to some extent on customer specifications. The practice of using freelance designers is at a very infant stage. Moreover, it is unlikely to find MSEs making use of hired (professional) designers. The current state of design in the sector marks a weak link in the value chain. It delays the possibility of entry into more competitive markets.

Upgrading is one of the most important considerations in the discourse of value chains (See for instance, Humphrey and Schmitz 2000; Fuerst 2010; Morris 2001; Dolan and Tewari 2001; Gereffi 2001; Fleury and Fleury 2001). It involves innovation and improvements in product design, quality, production processes and functions in the value chain. Upgrading is a means at the disposal of enterprises: (i) to stay competitive in the domestic market and (ii) eventually find entry points into the foreign trade. In the wood-work MSE sector, upgrading efforts are inadequate and limited only to certain aspects of products and production processes. Upgrading efforts are not “buyer-driven” as such. The value chain’s downstream is quite short since there are no wholesalers and sufficient number of retailers that serve as middlemen (industrial buyers) who could set parameters for the producers⁹¹. Only few retailers are involved in the distribution channel. The furniture products are thus destined to the final consumers. Buyer-driven upgrading efforts emerge on the part of the producers (the suppliers) when “lead-firms” play the key role in the “quasi-hierarchical” chains. Such lead-firms would exert strong pressure, demanding the producers to innovate and upgrade. More important, lead-firms of the quasi-hierarchical chain may also extend support (information and technical) to the producers. This is a scenario missing in the wood-work MSE sector, however. As a result MSEs are left on their own to find ways of exercising upgrading only to a limited extent, which, as Humphrey and Schmitz (2000) stated, could be “learning-by-doing”.

Inter-firm relations, i.e., relations between MSEs, are generally unsatisfactory. And the prevailing relations are mainly confined to information exchange. Moreover, the culture of sub-contracting that creates a form of quasi-hierarchical relationship between enterprises is not that important. Two main reasons could be

⁹¹ In a typical buyer-driven value chain, industrial buyers (“lead-firms”) set parameters regarding what, how, when and how much should be produced. The lead-firms communicate the parameters, enforce compliance, monitor the performance of producers (suppliers) and exercise control, hence govern the chain (see for instance, Humphrey and Schmitz 2001: 21-22; Gereffi *et al* 2001:4)

behind this. First, the enterprises operate at a very small scale; do not get large orders hence there is no need for subcontracting (forward linkage). If there are some cases of subcontracting such would rather come from medium and larger enterprises (backward linkage). Second, MSEs may not be willing to transfer or share business opportunities among themselves.

Chain governance in the wood-work MSE value chain is exercised by domestic/local agents since most of the inputs are from local sources and end products are destined to domestic markets. According to Helmsing (2005b) and Humphrey and Schmitz (2000:5), in addition to quasi-hierarchical relations, enterprises can exercise chain governance through local business associations (BA). However, local business associations are missing in the wood-work MSE sector. Consequently, (i) the MSEs could not safeguard and promote common interests, and (ii) their value chain could not enjoy “private governance” possibilities generated through such BAs.

The problems – internal or external, financial or non-financial, material or non-material, specific to MSEs or related to the value chain at large – have eventually resulted in the poor performance of the entire chain. Poor performance of the value chain in turn impedes or at least delays the possibilities of upgrading and ultimate entry of MSEs into the international furniture markets.

10.4. The Role of MSE Value Chains in LED

Three categories of LED initiatives, namely, community based economic development, business (enterprise) development, and locality development are identified (Helmsing 2001). This research has been concerned with the second category (enterprise development) and has an objective of exploring the role of MSEs in LED through modest analysis of the wood-work MSE value chain. Different literatures on micro and small enterprises indicate that MSEs contribute for a sizeable proportion of the urban economy (see for instance, Loop 2000; Tegegn and Mulat 2005; Tegegn and Mehret 2010; FDRE 2011; Liedholm and

Mead 1999; Dijk 2000; Todaro 1997; Harper 1989; Hyman 1989). Insignificant presence of large scale (capital-intensive) industries, the size of capital requirement (hence relative ease of entry), and availability of abundant even surplus labor make MSEs important players in the urban economy of less developed countries, including Ethiopia.

The role of micro and small enterprises (MSEs) in local economic development (LED) is considerable⁹². It is possible to observe that MSEs and the value chains in which such MSEs are embedded may contribute to local economic development in different ways. The contributions of wood work MSE value chains to LED may be captured under three different but interrelated themes: (1) the wood-work MSE value chain, (2) local resources mobilization and employment creation, and (3) inter-firm relations and upgrading.

The Wood-Work MSE Value Chain

The wood work MSE value chain will be discussed through providing summarized account of input-sourcing, production (including product design), marketing and distribution, and the state of competition in the sector.

The wood-work value chains start out from the very upstream activities of *input-sourcing*. Wood-work MSEs use both primary and auxiliary inputs. Timbers serve as the major input (raw material) for the furniture industry. Besides, fabricated boards, ply-wood sheets and chip-wood boards are used along with the major inputs. The major inputs (timbers) are for the most part acquired locally and to some extent imported from abroad. Fabricated-boards and ply woods are imported. Currently, pine trees (mainly, *cupressus lustanica* and to some extent *pinus patula* species) serve as the major source of raw-logs and timber supply for the furniture industry. Since it is increasingly becoming very difficult to get pine trees from

⁹² See, for instance, Dijk 2000; Helmsing 2005b; Loop 2000; Tegegne and Mulat 2005; Elias 2005; and also Liedholm and Mead 1999; Tsegureda 2002)

nearby localities, some enterprises are using “mobile saw-mills” to acquire and process logs into timbers from the very area where such trees are cultivated and cut logs are supplied.

Merchants also distribute logs to the sawmill enterprises (there are about 45 registered saw mills in the city). Besides, some of the furniture MSEs have their own machines and hence regularly purchase and process the logs for own consumption (input supply) and sales. The process of input supply/acquisition is not that simple and linear, it is rather intricate as there are brokers in between who can either facilitate or complicate the process. The saw mills then process and distribute sawn-woods (timbers) to the wholesalers, retailers and users. Most of the MSEs acquire timbers from retailers. Retailers are important sources not only for timbers but for the other inputs too.

Extensive and progressive operations of MSEs stimulate input suppliers of different localities. The backward linkages these MSEs enter into stimulates local markets and economies. First, public enterprises in different regions may be attracted to develop vast areas of plantations (pine tree and other plantations) and different scales of sawmill operations. At the same time, the practice of forest development would help redress problems of forest degradation, depletion and ensuing environmental hazards. Second, the markets for auxiliary inputs suppliers (both wholesalers and retailers) would certainly flourish. Both processes of primary and auxiliary input sourcing would involve the broadening of employment opportunities and expansion of wholesaling, retailing, brokerage, logistics and transport and extra business functions. As a whole, MSE value chains encourage diversification as different types of activities are linked to the value chain.

Production is the core of the MSE proper. It is also the key component (segment) of the wood-furniture MSE domestic value chain since it is positioned at a linking point for upstream and downstream activities of the entire chain. We have two

major categories of furniture products: (1) House-hold furniture, and (2) Office furniture. Engagement in the production of office furniture requires more capital and large labor size as the orders are usually in bulk. Therefore, relatively, small rather than micro enterprises seem to be fit for the production of office furniture. Micro enterprises are more comfortable with the production of house-hold than office furniture. Nearly all of the producers (in both micro and small enterprises) are engaged in the production of multiple types of products. For the MSEs it is not feasible to produce and sale single products, for which they may not find sufficient market.

Along with the production process, *Design* is an important component of a value chain. Capacity to design appears very important in the wood-furniture sector since similar commodities are flooding from abroad, particularly, the far-east exporters. In the wood-furniture MSE sector, designs are mainly carried out by the owners/operators themselves based to some extent on customer specifications. At present, the design function is at an underdeveloped stage. In the future, however, with the growth and expansion of the sector, complemented with effective practices of innovation and upgrading, the design function itself is likely to become more professional and specialized field that attracts more freelance as well as professional designers and associated workers, as a result broadening the scope of employment opportunities. This kind of progress entails the use of computer-aided design and such other advanced technologies in the field.

MSEs provide final products to different *market segments*. Likewise, wood-work MSEs supply furniture products to the domestic market. Wood-work MSEs play a role in supplying diversified house-hold and office furniture to local markets that constitute house-hold consumers, local institutions (government as well as non-government, including private institutions) and resellers. In this process, MSEs satisfy the needs of local customers for furniture goods and mobilize financial resources in the transaction. More and more efforts in product diversification increase product assortments that would enable local operators benefit from niche

markets. Through better and upgraded performance, MSEs can increase the sales outlets and generally scale up the scope of local markets.

Beyond the scope of local markets, micro and small enterprises also export products to other localities, hence bring revenue home. This is in tune with what Helmesing (2005b) describes the situation as the “export base” of the locality. And this is among the most important concerns in LED.

The wood furniture sector at any scale of operation is not yet part of the global commodity chain. We are only in a position to talk about intentions, if at all. Even in this sense, only about 7.5 percent of the operators have expressed their intentions to export products to markets in the neighboring countries if conditions permit. Well-performing and successful MSEs that have sound capital base, better knowledge of production techniques, marketing skills, and access to latest technology and global business information are likely to find export entry, initially at the neighboring African countries (for instance, South Sudan, Djibouti and Somalia) provided that such MSEs can offer quality and competitive products. Besides, some enterprise owners have interests and intentions to import and sell than to export domestic products. These are the MSEs with relatively strong financial standing and capability to link with industries and marketers abroad, import commodities and reliably supply domestic markets.

In the wood-furniture sector, most of the MSEs receive orders from (hence sell their products to) direct consumers. Some of them get orders from retailers and none of them from wholesales. Even the role of the retailers is insignificant in the products market chain. As a result, the distribution channel for the most part is the shortest as it involves only the two major actors, namely, the producer and the direct consumer, as the end-product supplier and buyer, respectively. More than 80 percent of the furniture products are for markets in the locality. Only 16.5 percents are for export (within domestic markets) outside the locality. “Lower price”, as per the perception of the operators, ranks first as a requirement in the

domestic market, followed by “material quality” – a factor that implies product strength and durability.

Most of the enterprises have only one sales outlet (shop) that is situated at the production site. Only few have one more additional shop, which also serve as a display to attract more customers and orders. Sales are primarily on cash basis. Prices are usually determined through negotiations, which of course do not ignore costs and markups in particular and market prices in general. In the wood-furniture MSE sector, most of the firms, except some 18 percent, do not use well established promotional media. Some enterprises use printed media and trade fair in order to advertise and further promote their products. The role of brokers is insignificant since about 95 percent of the enterprises do not have or use their own (client) brokers. The role of brokers becomes apparent and very important only at the time of raw-materials (cut-logs and timbers) acquisition that takes place in the upstream zone of the wood-work value chain.

The current state of *competition* in the wood-work MSE sector has been viewed by most of the operators (74.5 percent) as strong, though the demand for wood-furniture products is promising. Competition is strong partly because an increasing number of entrepreneurs are joining the sector and imported commodities are flooding the country. Competitions whether fair or strong could come from local products or imported goods. In the wood-work MSE sector, the majority of enterprise operators perceive that competitions significantly come from similar local enterprises. The threat coming from imported goods is relatively tolerable, at least for the time being, since the two sets of commodities (local and imported) are meant for different market segments, which are likely to stipulate different market requirements and have potential buyers of distinct purchasing powers.

Marketing and distribution can be considered as blood-vessel of the entire value chain. Upstream, the system helps to procure the necessary inputs from the

suppliers; downstream, it helps to deliver final products to the buyers. In both cases, the system helps to transmit information pertinent to the life and dynamism of the value chain. Marketing and distribution is a mechanism to feed, support, rejuvenate and develop the value chain. It keeps the chain as cohesive as possible. In doing so, marketing and distribution enhances the contribution of the chain towards local economic development.

Mobilizing Local Resources and Creating Employment

MSEs are best means of *mobilizing local resources* including local material resources, knowledge, dispersed finance and labor. MSEs are particularly effective in mobilizing and using the fragmented (small-scale) financial as well as material wealth of individuals in the locality. Individual entrepreneurs can mobilize personal resources, create and run sole-proprietorships (about 90 percent of the MSE are sole-proprietorships). It has been seen that “own savings” (46.8 percent), followed by “family transfers” (40 percent) were the most important sources of initial capital. MSE operators initiate and start business by mobilizing capital as low as below 5000 to more than half a million Birr. More than half (52 percent) of the MSE operators have initially invested between 5000 and 50000 Birr to start the business. Currently, about 48 percent of the MSE operators reported to mobilize capital assets ranging between 20000 and 500000 Birr. About 33 percent of the MSEs in this category have capital of more than 50000 Birr. At still higher levels, about 10 percent of the MSEs have capital of more than 500000 Birr; and about 6.5 percent of the MSEs in this category have capital assets estimated at more than a million Birr. Beyond sole-proprietorships, individuals could join hands, marshal diversified (not only finance) and fragmented resources to create and run partnerships. Mobilization of resources is evident throughout the value chain, right from the upstream to the downstream value adding activities till products reach their ultimate users. Forestry, distribution and logistics, sawmills, retailing, production and marketing are all vital venues for mobilization of resources, particularly local resources.

MSEs *create employment opportunities* in two interrelated ways: in terms of self-employment and creation of employment opportunities for others. In the first place, MSEs engage (self-employ) as many small-scale entrepreneurs as possible (as entry barriers are relatively low). It has been seen that there are at least 360 operators (owners) in the wood-furniture MSE sub-sector alone, 108 timber traders and at least 45 sawmill operators (owners), without including those who own sawmills together with furniture MSEs, in the locality. In all cases, MSEs enable operators to generate income. Such incomes would serve as means of livelihood then, and more importantly, as means of growth, business expansion and investment. Secondly, MSEs serve as a means of employment creation for those who are unskilled, semi-skilled and skilled job seekers. As per the 2011 MSE development strategy, MSEs can generate employment for 1-30 workers per firm. The current labor strength of wood-furniture MSEs in the locality ranges between 2 and 25. The average is about 7.4, which is as twice as the average labor size (3.6) observed at the initial stage.

MSEs enhance the income of operators (and families) and employees (and families) thereby raise their purchasing power in the local markets. About 59 percent of the workers earn income within 500-1000 Birr, and 83 percent of the workers earn income of 500-2000 Birr per month. Through self-employment and creation of job opportunities for others, MSEs greatly contribute to subsistence (short-run) and poverty alleviation (long-run). Employment creation is not confined to one point (the production segment) as such. The possibility of employment creation extends throughout the value chain right from input sourcing to production and design, and marketing and distribution. In between there are several points of intervening activities that create employment opportunities, including warehousing, logistics and transport, services and other related and support businesses.

Beyond employment creation, MSEs may serve as seedbeds for *entrepreneurship*, ground for business development and leadership, and avenue for medium and

large enterprises (MLE). About 46 percent of the owners have multiple responsibilities, hence exposures to diverse challenges. They play a role as owner, operator and manager of the firm at the same time. Employees of MSEs, in addition to their specific duties, will also learn other technical and business functions that would help them in their future careers.

In addition to resource mobilization and employment creation, MSEs may stimulate the local economy primarily through revenue generation. MSEs generate revenues to the locality through attraction of income from other localities and through payment of taxes to the local government. MSEs expand the local tax base as more and more of them are being brought to the formal registration and licensing. Recently, the government has been too busy throughout the country to bring MSEs into the legal framework; hence the relations are getting momentum than ever before. More and more MSEs to the formal sector means more and more revenue to the government. Furthermore, about 78 percent of the MSE acquire working premises through rent. This implies that MSEs stimulate the local economy since they pay rents to the owners and the owners, in turn, pay rental taxes to the government.

MSEs can also spur the local economy through spillover effects onto other sectors. MSEs can influence other sectors through backward linkages while sourcing diverse inputs from local suppliers and markets. MSEs can also stimulate the local economy through forward linkages while selling products to the locality as well as outside the locality (furniture export to other localities). MSEs derive benefits from and spillover their effects onto other localities (and sectors) through the catchment areas and points of the value chain.

Inter-Firm Relations and Upgrading

We can identify two principal types of relationships in the sector: (1) Relations between and among the MSEs, which is simply expressed as inter-firm relations; and (2) Relations between MSEs and suppliers and buyers.

Non-market relations dominate *inter-firm relations*. The most widely exercised type of relationship takes place in terms of “information exchange”. Though information exchange is the dominant form of relationship, MSEs also have some cooperative relations in terms of sharing machinery and borrowing money. MSEs also exchange designs and borrow inputs from each other. Sharing machinery is mainly done through rents, whereby the owners generate additional income out of the deal.

Beyond inter-firm relationships we also find relations between MSEs and input suppliers on one hand and MSEs and buyers of the products on the other. Market (arms-length) relationships that can be expressed in the form of simple and direct transaction dominate the relations of MSEs in both directions, i.e., with suppliers and buyers. Following market transactions, information exchange is the most important area of relationship. Quality control and purchase-on-credits become the other relatively important areas of relationship and cooperation between MSEs and suppliers. On the other side, product specification, quality control and product promotion are all important terms of relations between the MSEs and the buyers.

The network of relationships so created horizontally among the MSEs and somehow vertically between suppliers and the MSEs and then between the MSEs and the buyers would all contribute in different ways to the value chain. Strong relations, in particular, would facilitate transactions, including purchases on-credit, enable the exchange of important business-related information, facilitate the technical and design exchange, make possible the transfer of materials and ultimately stimulate upgrading efforts in the value chain.

In addition to the above types of relations, we can also identify relations between MSEs and government institutions. Micro and small enterprises have relations with government institutions as long as they operate formally. Local governments require MSEs to register, get license, operate within the legal framework and pay taxes, and renew licenses within specified period of time. It is however felt that

the relations should not be confined to the routine administrative duties and fulfillment of legal requirements. LED essentially is a strategically planned process (Gumaraes 1998). The government sector and the private sector (including the MSE sub-sector) are expected to converge to partnership in realizing the objectives of LED (see, for instance, the works of Helmsing 2001, 2005a; 2005b; Blakely 1994; Swinburn and Yatta 2006; Rodriguez-Pose and Tijmstra 2009; Gumaraes 1997, 1998; Bartik 2003; Rogerson 2002). Taken in a nutshell, the aim of the partnership is to co-manage existing resources, create jobs and stimulate the local economy.

The wood-furniture MSEs acquire key resources from domestic sources and their products are destined to domestic markets. Consequently, the allocation of key resources and the distribution and redistribution of benefits in the value chain are governed by local (domestic) actors. Financial resources come from domestic sources (such as personal savings, family transfers, and micro-credits). MSEs get most of the imported machines and tools, the necessary chemical materials and other components through local retailers. Power in the value chain seems to concentrate in the hands of public enterprises that control and regulate pine forests. Public enterprises control the supply of key inputs (mainly, cut-logs and to some extent, timbers). Once entered the distribution channel, the key inputs are controlled by domestic wholesalers, retailers and associated brokers. Production decisions and product designs are made by MSE owners/operators. Designs are meant only for internal consumption at the firm level. Eventually, furniture products will be handed over to direct consumers without much involvement of middlemen.

Competition forces MSEs to innovate and upgrade products and operations. MSEs, as Porter (1990) pointed out, become more competitive due to “pressure and challenges” that would primarily come from similar local enterprises and imported goods. MSEs derive advantages from “strong domestic rivals, aggressive home-based suppliers, and demanding local customers”.

Competitiveness of both the MSEs and the locality in which they operate increases and “sustained through a highly localized process” (ibid), which is realized through better performance of the entire value chain. When value chains perform better, local sectors become highly competitive and local value chain actors derive maximum benefits from the process.

MSEs are forced to upgrade in order to stay competitive in the market. *Upgrading* involves “making better products more efficiently and moving into more skilled activities along the value chain” (Fuerst 2010:90). Upgrading is an exercise of “innovating” to enhance the value added along the chain (ibid). This exercise will greatly help create strong and more competitive industrial sector. This will in turn motivate local input suppliers to make available quality inputs in abundant supply. On the other side, effective competition benefits local consumers whose choices will be satisfied with diverse and quality products offered at reasonable prices.

In the absence of “lead-firms” and “enterprise clusters”, better performing MSEs can still exercise “incremental” (“learning-by-doing”) upgrading (Humphrey and Schmitz 200). This would increase the competitiveness of local enterprises in the face of imported commodities, in particular. Operators in the wood-work MSE sector try to upgrade the quality of products, mainly through acquisition of quality raw materials, complementary inputs and better product design. Besides, product diversification is an option for those operators who want to diversify and benefit from niche markets. Operators can have diverse options of upgrading and transforming the production process. Some of them introduce new machines and tools. Some of them improvise out of what they have at hand or resort to other less expensive alternatives, like introducing new methods of operation, employing new managerial techniques or getting skills training for employees.

When MSEs grow, upgrade and graduate to MLEs, the process in some measure increases the prospect of entering into the global commodity chains (GCC)⁹³. At this latter stage, enterprises will acquire and accumulate international standards of production, learn and coin strategies for global competition and play their part in attracting foreign exchange through effective forward linkages. At this stage, MSEs would enable the national economy to attract foreign exchange and redress deficits in the balance of payments (BOP). At some point in the future local firms may link up with global lead firms in the industry. This would effectively realize their integration into the global value chains (GVC). The key premise of the GVC approach, as per the words of Gereffi (1999), is that national (as well as local) economic development calls for the need to link up with the most prominent and influential “lead firms”⁹⁴ in the furniture industry.

10.5. Summary

This chapter unfolds that the domestic wood-furniture value chain extends from the point of primary input sources, i.e., forestry, where pine trees are harvested to the point of consumption of final products. In between, many value adding resources and activities enter the value chain. Cut-logs flow into the sawmills and in turn timbers and other inputs enter the furniture MSEs. Distributors get involved at different points of the distribution channel. Ultimately final products (both house-hold and office furniture) will flow mainly directly to the consumers. Nevertheless, the entire operation is not that much smooth as the value chain is

⁹³ Currently, however, most of the MSEs do not have intentions for “export” (abroad) mainly on grounds of capacity limitations.

⁹⁴ “What distinguishes lead firms from their followers or subordinates is that they control access to major resources (such as product design, new technologies, brand names, or consumer demand) that generates the most profitable return in the industry”. Lead firms shouldn’t necessarily be the manufacturers that are involved in the production of finished goods. Lead firms can be located “upstream or downstream” from the point of manufacturing in the value chain. Therefore, they can be designers, major distributors (retailers), critical suppliers, or manufacturers. (Gereffi 1999:3)

constrained by a range of problems emanating internally from within each firm and externally from the environment at large.

The MSE value chain is restrained by quite a lot of problems. Most of the MSEs are challenged by lack of capital, working premises and machinery. Shortages of raw materials, problems in input quality, and soaring costs of inputs are the critical problems in input-sourcing. The sawmill enterprises are not well positioned as suppliers of timbers in the value chain. MSEs also suffer from non-financial and non-material constraints. The state of design marks a weak link in the value chain. It delays the possibility of entry into more competitive markets. Upgrading efforts are inadequate and limited only to certain aspects of products and production processes. MSEs are left on their own to exercise upgrading only to a limited extent. Inter-firm relations are unsatisfactory, and confined mainly to information exchange. Sub-contracting, which normally creates quasi-hierarchical relationship, is not an important duty in the sector. Business associations (BA) are missing in the sector; hence MSEs could not enjoy “private governance” through such BAs. The problems indicated so far may result in poor performance of the entire value chain, which in turn impedes upgrading efforts and ultimate entry of MSEs into the international furniture markets.

The role of micro and small enterprises in local economic development is considerable. It has been possible to observe that micro and small enterprises (MSE) and the value chains in which such MSEs embedded may contribute to local economic development (LED) in different ways. The contributions have been captured under three main themes:

- (i) The segments of the value chain,
- (ii) Local resources mobilization and employment creation, and
- (iii) Inter-firm relations and upgrading.

MSEs contribute to local economic development (LED) through all segments of the value chain right from input sourcing to marketing and distribution. The inter-firm relations and upgrading efforts that would come within the value chain will also enhance the contributions of MSEs to LED. MSEs are effective in mobilizing local resources (fragmented financial and material resources of individuals) and creating employment opportunities (both for the owners and employees) across the segments of the value chain.

Chapter Eleven

11. Concluding Remarks

11.1. Introduction

This chapter, the final chapter, presents concluding remarks drawn on the basis of the findings and discussions made in the previous chapters. The chapter starts with imparting some theoretical insights pertinent to the operation of value chains in the wood-work MSE sector and the role and policy relevance of micro and small enterprises in local economic development. The chapter finally presents conclusions and recommendations drawn on the basis of the findings and observations made in the course of this research.

11.2. Theoretical Reflections

Theoretical reflections are constructed on the basis of the literature and empirical observations made so far and provided here as insights into: (i) the MSE value chains and (ii) the role and policy relevance of MSEs. The first one is concerned with important issues pertinent to the MSE value chain, whereas the second one is concerned with providing brief explanation of the policy relevance and role of micro and small enterprises in local economic development.

Insights into the MSE value chains

The value chain approach to local economic development examines enterprises in a chain that runs from “input-suppliers to final buyers” and also the “relationships among them” (ACDIVOCA 2010). The most important point is that value is added at each segment along the chain until the product reaches the final user. Any case of “weak link” in the chain would jeopardize the competitiveness of the entire value chain. Effects of inefficiency in production and marketing are not confined to particular segments of the value chain, but also pervade into other components of the chain and ultimately lead to economic deterioration and poverty (ibid; ILO 2007:6).

Well-functioning value chain effectively links and integrates the segments of economic activities across different sectors. The linkage takes place:

- (i) across primary, secondary, and tertiary sectors. The three sectors involve primary input sourcing, manufacturing, and distribution and marketing, respectively; and
- (ii) across the seemingly isolated formal and informal economic activities. Though economic activities are not tightly separated/isolated, as Kaplinsky and Morris (2000) argued, value chain narrows whatever gap exists between the two sectors.

In both cases, value chains assume the fundamental structure that embraces input-sourcing (timbers and other subsidiary inputs), design, production (manufacturing and assembling furniture) and marketing (communicating, selling and delivering furniture products). In the first case, value chains are instrumental in integrating economic activities, as Kuzilwa and Ngowi (2009:189) have argued, across primary, secondary and tertiary sectors. In the second case, value chains create linkages between informal and formal sectors (economic activities). At this juncture, it can be argued that micro and small enterprises (MSEs) are much closer to “informality” than medium and large enterprises (MLEs). (See the hierarchy of enterprises, Annex 7). This could mean that the linkages so created are likely to be quite strong in the working environment of MSEs than MLEs or any higher tier of business enterprise.

The domestic value chain (DVC) perspective, in stead of the global value chain (GVC) setting, has been more pertinent to the discourse in this study. However, the notion of domestic value chain (DVC) should be taken with due care as it focuses and, for that matter, is based on the most downstream functions (forward linkages) of the chain. End products are entirely meant for local (domestic) markets, which means, none of the products enter export (global) markets. If the focus were to include backward linkages, MSEs use inputs not only from

domestic sources but also those imported from abroad, though most of the inputs are still from domestic sources. And this is likely to distort our conception of the DVC. What makes the value chain “domestic” in our case is the extent to which the chain is embedded in the domestic scene. Inputs are mainly acquired from domestic sources, designs and production decisions are made by the local producers, and end products are entirely for domestic markets.

The DVC, like the GVC, is made up of the four key components of a value chain. In the wood-work MSE sector, however, one basic component of the chain, i.e., design, is not independently treated but captured under the production process. This has happened because of the status of “design” as a component in the domestic value chain. Design is mainly the duty of the operators and its overall status is traditional and relatively backward. This would greatly affect the competitive position of MSE products, particularly when compared to imported goods. The status of design as a segment of a value chain is remarkable when observed in the operation of global markets where “lead firms” have the upper hand in product specification and design.

Governance is required to coordinate activities throughout the value chain. Nevertheless, the relevance of chain governance is more apparent and rigorous in the presence of, principally, “buyer-driven” models and their key actors, known as “lead firms”. The Gereffi’s concept of “buyer-driven” value chain is confined to the context of GCC⁹⁵. At the global scale, labor-intensive commodities like apparel, footwear and furniture products come under the buyer-driven model. These products are buyer-driven because major decisions related to design, branding and marketing are made by large-scale retailers. In this “trade-led” business system, global retailers make imperative decisions for manufacturers

⁹⁵ The term GVC is preferred to the term GCC since the former presupposes (or is concerned with) “who adds value where along the value chain” (Humphrey and Schmitz 2000:10). The latter, on the other hand, focuses on the “end products”. Value chain is the “most inclusive of the full range of possible chain activities and end products (Gereffi and Kaplinsky 2001 :3)

located in the third world (Gereffi and Memedovic, UNIDO 2003b:5). On the other hand, furniture products of MSEs in Ethiopia are entirely meant for domestic markets and virtually all decisions related to design, input-sourcing, production and marketing are made by the local actors. Specific decisions related to product types and quantities are significantly made by the very producers and the local buyers (ultimate consumers). In view of this, furniture products of the domestic value chain (DVC) apparently fail to qualify for the Gereffi's mainstream buyer-driven model.

Lead-firms are the key actors in the buyer-driven model. Such firms exercise control over suppliers through quasi-hierarchical relations. They decide on what is to be produced and at least specify or utmost provide product "design". Most of such firms are located in the high-income countries, whereas their counterparts (the suppliers) are dispersed in less developed countries. This is the mode of relationship in the context of global value chains (GVC). According to Humphrey and Schmitz (2000), the existence and operation of lead-firms in the chain can help local producers to upgrade (i) *products* and (ii) *production* (the transformation process). The lead-firms would not, however, leave important aspects of *functional upgrading* (design and marketing) to the local producers. This is irrelevant to the DVC, however. In the wood-work MSE value chain, most of the inputs come from local sources and, most importantly, end products are meant for domestic markets. MSEs supply their products to the domestic buyers, mostly to the direct consumers and, to some extent, to the retailers. In this frame of relationship, there is no room for the local producers to be controlled by the buyers. And there is no substantial opportunity to benefit from the buyers in their efforts to learn, innovate and upgrade. Hence, MSEs are left mainly on their

own to exercise “incremental upgrading” (or “learning-by-doing”)⁹⁶ (ibid), instead of enjoying buyer-driven upgrading.

Through inter-firm relations (horizontal relations) MSEs develop synergy and may be able to become competitive with the products of large enterprises and imported commodities. Inter-firm relations render individual firms less vulnerable to risks, enable mobilization of fragmented resources, foster exchange of information and know-how between MSEs and create a large pool of “collective knowledge” (UN 2001:2). Beyond this, better performing value chains complemented with cooperative inter-firm relations can serve as a pre-condition for firms spatially concentrating to form business *clusters*, which, in turn, would effectively contribute to LED. The cluster setting enables MSEs to compete with larger enterprises, both in the local and global markets. However, the situation in this regard is currently unsatisfactory since wood-work MSEs exhibit weak inter-firm relations and they do not have spatial concentration of functions and firms to form strong clusters in the sector.

Finally, it is necessary to note that domestic value chains operate “in the same way as global chains” Kuzilwa and Ngowi (2009:189). Both models involve design, input-supply, production and marketing. Global value chains interface with local value chains. This would lead to a conclusion that successful performance of enterprises in the local chain determines their entry into the global value chain (ibid).

Insights into the role and policy relevance of MSEs

Studying MSEs through value chains, instead of limiting analysis to the production segment, appears to be a convincing way of understanding the role of MSEs in development (LED). The success, even failure, the competitiveness and

⁹⁶ The idea of “incremental upgrading” has been proposed for those enterprises operating in clusters. Such enterprises, even if in the absence of foreign “lead-firms”, can upgrade through “learning-by-doing” (Humphrey and Schmitz (2000)

role of MSEs in resource mobilization, creation of employment opportunities, poverty alleviation and contribution of the sector to economic growth heavily relies on the performance and effective integration of all segments operating along the value chain. The strengths or weaknesses of MSE performance start right from the very upstream activity of input-sourcing through the production system to the most downstream activities of delivering the MSE products to the final users, including support services in the distribution channel. Competitiveness of the MSE value chain has impact on competitiveness of the locality and the entire economy (Porter 1985; 1990). Hence intervention policies and strategies aimed at MSE development need to touch (deal with and support) at least the key segments of the value chain.

Deeply embedded in their value chains, micro and small enterprises enable at least two very important things to happen: mobilization of local resources (that could otherwise remain untapped) and creation of employment opportunities at different levels (segments) of the domestic value chain. This has been discussed in some detail in chapter 10.

MSEs provide the ground for mobilization of dispersed resources (particularly small-scale financial resources) of individuals who intend to enter into or run and expand existing small-scale businesses. MSE operators have been starting wood-work businesses by raising financial capital as low as below 5000 Birr (though this is totally meaningless these days) to more than half a million and even a million in some cases. Initial finance comes largely from own savings and family transfers. The impression of “low entry barrier” is becoming relevant only for micro enterprises that require small amount of money, simple machines, tools, very small working space and few workers. Given the current costs of business and escalating inflation, it is becoming critically demanding to enter into wood-work MSEs, particularly small-scale enterprises. The revised (2011) MSE development strategy must have taken this reality while formulating new definitions to the sector.

On the other side, social factors (like ethnicity, religion, and informal relations) that are believed to set entry barriers in certain sectors (see, for instance, Macharia 1997; Tegegne 2009b; Tebarke 2011) are more or less irrelevant to the wood-work MSE sector in Ethiopia. The key requirements to start business in this sector and its entire value chain are substantially related to the availability of adequate finance, material resources, skills (particularly, for furniture design and production) and suitable working premises. Thus the reality on the ground may call for the availability of diversified sources of capital including microfinance (for start up capital) and bank loans (for business expansion, in particular).

Moreover, MSEs make possible the use of appropriate and simple (mainly, labor-intensive) technologies, including the use of locally made and modified tools and machines. Beyond local resources, MSEs can also attract financial and material resources and technical expertise from outside (i.e., from other localities, regions, and the national level). MSEs serve as a means to stimulate and promote local development through mobilization and attraction of resources and use of various kinds of labor-intensive technologies.

MSEs create employment opportunities through business creation (new) and expansion (of existing enterprises). On average wood-work MSEs provide employment for about seven persons, i.e., as twice as the average workforce at the initial (startup) stage. The contribution of MSEs to the creation of jobs and poverty alleviation has been recognized by many governments of the Third World, including Ethiopia (for instance, through the GTP (2010), the FDRE (1997) and the new FDRE (2011) MSE development strategies). The labor absorption capacity of the MSE sector (including those in the informal sector of the economy) is high. Through employment creation, MSEs contribute to poverty reduction. Poor people often find work in MSEs, hence the development of these enterprises helps the poor to benefit from equitable income distribution and enjoy welfare. MSEs thus contribute to confidence and empowerment of individuals. Moreover, MSEs serve as a training ground for entrepreneurship, encourage effective use of

the skill and talent of people without demanding higher level training and education.

On top of their pivotal role in mobilizing local resources and creating employment opportunities, MSEs also lay the foundation for industrial development. This one is strongly advocated by the GTP (2010). The new MSE development strategy of Ethiopia (2011) also underscores that the MSE sector provides the basis for the country's industrial development (UNDP 2011:42). "Growth-oriented" MSEs, in particular, are engaged in economic activities whereby surpluses are reinvested for business expansion and development. The growth-oriented MSEs mobilize local resources, permit greater investment, activate competition, raise productivity, exploit niche markets, increase the overall demand hence spur the local economy, and consequently have considerable contribution to LED (Tegegne and Mulat 2005:61; FDRE 1997: 4-5). However, there is a point of concern at this particular juncture. Only the "growth-oriented" MSEs are likely to lay the foundation for industrial development. This would happen if MSEs are performing very well on sustainable basis, inflation is contained and MSEs are able to generate surplus, and the entire business environment is enabling. Otherwise, most of the MSEs, particularly micro enterprises, remain "survivalist" hence their graduation to the higher tiers would be at stake. Consequently, the idea that "MSEs lay the foundation for industrial growth" gradually becomes feeble.

Finally, it is important to remark that MSEs, by being particularly suitable to areas where it does not pay for medium and large enterprises (MLEs), contribute to decentralized development through local resource mobilization, capital accumulation and balanced distribution of income and, as Tegegne and Mehret (2010:14) have stated, MSEs provide lower level (affordable) goods and services for the common people, hence generally redress regional economic disparities. By providing opportunities for those in remote and isolated (marginalized) locations, MSEs help reduce rural-urban migration and associated problems. MSEs generally contribute to social change and political stability. The trends in

decentralization strategies progressively justify the proliferation and importance of small enterprises. Furthermore, MSEs are given important place in the “development plans of donors” (Liedholm and Mead 1999:1).

11.3. Summary and Concluding Remarks

Micro and small enterprises (MSE) contribute to local economic development (LED) all the way through their value chains, right from input sourcing, production to marketing and distribution. In virtually all segments of the value chain, MSEs do play important role and enable localities to mobilize resources, create employment and stimulate the local economy. Therefore, this research focuses primarily on value chains rather than the production aspect *per se* in an effort to appreciate the role of MSEs in LED. Studying value chains means grasping issues in the entire system as production is just a component in the broader value chain.

Value chains can be global or domestic. At present, however, we are confined to and speak of domestic value chains. The wood-work MSE sector has a domestic value chain mainly because its major inputs are from domestic sources, designs are carried out by the local producers, and, more important, forward linkages (via finished goods) are entirely confined to domestic markets. In this country, the furniture industry at any scale has not yet entered into the global system of commodity chains.

The basic components and modes of operations of both, global and domestic, value chains are fairly the same as they involve the requisite functions of input sourcing, design, production, and distribution and marketing. The difference is one of a scope. If the necessary conditions (both internal and external) are duly in place and effectively functional, domestic value chains can mature and be integrated into the global value chains.

The furniture domestic value chain is also made up of the major value chain segments indicated above. Considering its overall status in the domestic value chain as compared to the status of design activities in the buyer-driven value chains (of the GCC), product design is conveniently itemized under the production process:

- *Input-sourcing* starts from the very upstream activity of forestry to the supply of timbers to the MSE. Cut-logs from the plantations enter into public or private sawmills. Timbers leave sawmills and enter into the MSEs that manufacture furniture products. The role of distributors (wholesalers and retailers) and brokers is very important in the distribution of cut-logs to sawmills and, latter on, timbers to the MSEs.

Micro and small enterprises acquire the required inputs from wholesalers and retailers. Most of the MSEs acquire timbers from retailers, however. Some of the MSEs acquire the same from wholesalers. Retailers are important sources not only for timbers but for the other inputs, too. The process of acquisition of cut-logs is not that simple and linear, it is rather intricate. There are a number of middlemen (brokers) in between, for instance. Though the role of brokers is significant in several ways, they can also complicate the input acquisition process. Various problems can affect the system of input acquisition. Prices, quality, supply (availability) and delivery are among the problems. However, “high prices” and “input quality” are the critical problems that challenge input acquisition.

- The *production process* is the key component (segment) of the wood-furniture MSE domestic value chain in the sense that it serves as a linking point for upstream and downstream activities of the entire chain. Enterprises in this sector are characterized by producing and selling finished goods. No enterprise is found to produce and sale component parts in the real sense. Beyond this, all of the MSEs are normally engaged

in the design, production and sales of furniture products right from the beginning to the end product. The system of production seems relatively vertically integrated.

Two major groups of products are identified: house-hold furniture and office furniture. MSEs are more comfortable, due mainly to capacity reasons, with the production and distribution of house-hold furniture. Product *designs* are carried out by the operators based on customer specifications or catalogues. Few cases of freelance designers and no cases of professional designers are encountered in product design activities. Designs are for internal consumption; not for external (transaction) purposes. The process of product design heavily relies on traditional methods. This would have serious implication to the competitiveness of MSEs with imported goods.

- *Marketing and Distribution* involves the marketing, sales and delivery of furniture products to the users. The role of middlemen (wholesalers and retailers) is insignificant in the distribution of final products. Few retailers but no wholesalers are involved in the distribution of products. Most of the MSEs receive orders from and sell their products to the consumers directly. The value chain's downstream is thus formed by a short distribution channel that involves only the producer and the final user. In this mode of distribution channel, MSEs have the opportunity to reap the profits resulting from retailing the products.

At the time of transaction, lower prices and material quality (in terms of strength and durability) are the prime requirements of the domestic market. The wood-furniture sector is not yet part of the GCC. Export intentions seem to be very remote due mainly to capacity limitations. Competition for local markets is strong since an increasing number of entrepreneurs are joining the sector. The flow of imported goods is also increasing from

time to time. Domestic products are relatively competitive in terms of offering products of better material quality (strength and durability). Imported goods, on the other hand, are competitive in terms of superior designs. MSEs may use different techniques to stay competitive in the sector. The techniques in many cases range from reducing costs of production to improving (upgrading) the quality of products.

Most of the MSEs are relatively young, indicating their recent entry into and limited experience with the business. Though the MSEs are registered, licensed and pay taxes, still there are many elements of informality in their operations. Most of the MSEs are managed by the owners themselves. The role of the owner in the business could be limited, moderate or all-inclusive depending mainly on the size of the enterprise. The role is likely to be all-inclusive if the enterprise is very small. The role generally becomes modest and quite limited as we move up in the hierarchy of enterprises. In the wood-furniture MSE sector, the business is just sole occupation for most of the owners, and only few of them have the business as additional occupation.

Social variables (such as ethnicity, religion, and informal relations) are seen in some studies as important factors that influence entry into the business circle. This is, however, more likely as we move down the hierarchy of enterprises and is more important in some types of businesses. Ethnic origin, for instance, does not appear as an important entry factor in the wood-furniture MSE sector. This is against the reality in many other cases where people from the *Gurage* minority dominate MSE businesses.

Wood-work MSEs in Ethiopia operate under conditions of severe financial and non-financial constraints. Shortage of capital, lack of working premises and machinery, shortage of raw materials and power supply, rising costs of inputs are among the problems challenging the proper functioning of the MSEs. Though not explicitly indicated by the operators as such or may be considered as less relevant,

apart from financial and material constraints, micro and small enterprises also suffer from other problems of non-financial and non-material origin. In this regard, MSEs are substantially constrained by lack of skilled labor, poor business management and marketing skills, inadequate knowledge of production techniques, and poor access to marketing-related information, hence poor knowledge of market opportunities. Such non-financial drawbacks add to the other problems and seriously affect the operation and success of MSEs. On top of this, the bureaucracy, inefficiency of public officials and inability of the public sector to provide essential services are all sources of problems to the MSE sector.

The key internal and external problems persistently impose negative impacts on the functioning of the value chain. The problems hinder MSEs from growth, graduation to SME and then to large enterprise scale. The problems prohibit the integration of MSEs into the global commodity chain in which such enterprises would play meaningful role in the local as well as national economic growth and overall development.

Enterprises in the wood-furniture sector need to initiate and recurrently exercise upgrading. The process involves “making better products more efficiently and moving into more skilled activities along the value chain” (Fuerst 2010). Upgrading can be undertaken in terms of and through three trajectories: product upgrading, process upgrading, and functional upgrading (Humphrey and Schmitz, in Fleury and Fleury 2001). This exercise would help MSEs remit some of the current problems. More importantly, upgrading is the way to grow, expand (locally), contribute to the overall improvement of the value chain. It is an effective way to advance further and get integrated into the global commodity chains. The practice enhances the competitive position of individual enterprises in an industry. As Porter (1990) has emphasized it, upgrading, as an act of innovation, is the way not only to achieve but also to sustain competitive advantages. Though there are certain efforts, this is a practice not yet well undertaken in the MSE sub-sector, however.

MSEs are engaged in the production and sales of furniture products. Upgrading is imperative to become and sustainably stay competitive in the sector. MSE operators try to upgrade the quality of *products*, mainly through acquisition of quality raw materials, complementary inputs, and better product design and product quality control. The measures taken by MSEs to upgrade the *production process* are more inclined to the physical (hardware) aspects of the firm, like introducing new machines and tools. The measures taken by MSEs to upgrade through improved managerial techniques and provision of skills training (for the workers) are not as important as the measures taken to improve the physical aspects of the firm. Moving into the domain of *functional upgrading* is not that simple for the MSEs engaged in furniture production. Functional upgrading may mainly be exercised in the areas of design and promotion. If there are engagements in the product design activities, such are not for commercial (external) transactions but for own use in the workshop.

Quasi-hierarchical types of relations are not common in the wood-work MSE sector. Even in the absence of this, MSE are still in a position to exercise “incremental upgrading”, in other words, “learning by doing”. However, the extent of upgrading and innovation observed in the MSE sector is not that satisfactory and confined to products and limited areas of the production process.

Two major types of relationships are identified in the wood-work MSE value chain: (i) inter-firm relations, and (ii) supplier-MSE and MSE-buyer relations.

Inter-firm relationship is between the wood-furniture MSEs (horizontal relations). Non-market relations, mainly expressed in the form of information exchange dominate the inter-firm relationships. Relationship is also evident between MSEs and suppliers on one hand and MSEs and buyers on the other hand (“vertical” - upstream and downstream - relations). Both market (arm’s length relations) and non-market relations prevail in this case of the relationship. Transaction (Selling/Buying) is the key form of market relationship. “Information exchange”

is the most important form of non-market relationship. Quality control and purchase on credits become the next important areas of relationship and cooperation between MSEs and suppliers. The most important buyers from the MSEs are the direct consumers. Retailers are not that important and wholesalers do not totally enter into the buyers' channel. Information exchange, product specification and quality control are all important terms of relations between the MSEs and the direct consumers. Micro and small enterprises are generally affected by lack of sound inter-firm relations, which could have provided an excellent opportunity to redress some of the major problems in the value chain and improve the current state of the sector.

Arm's length market relations (transactions) and inter-firm networks (horizontal linkages) characterize the relationship that prevails in the wood-work MSE sector. MSEs acquire key resources from domestic sources and their products are destined to domestic markets. Consequently, the allocation of key resources and the distribution and redistribution of benefits in the value chain are governed by local (domestic) actors. Power in the value chain concentrates in the hands of public enterprises which control and regulate plantations and the distribution of primary inputs. Once entered the distribution channel, the primary inputs are controlled by domestic wholesalers, retailers and associated brokers. Production decisions and product designs are all the responsibilities of the MSE operators.

Beyond the value chain, MSEs also have relationship with government institutions. The actual relationship between local government institutions and the private⁹⁷ MSE sector appears to be very weak. The broadly conceived partnerships often shrink into routine administrative relationships with an aim on the local government part of simply enforcing legal requirements. The relations

⁹⁷ The prefix "private" is used in order to distinguish between the privately owned MSEs studied in this paper and those micro and small enterprises created by organized groups (particularly the youth) and supported by the government

are thus confined only to business registration, licensing, license renewal, tax collection, and related affairs⁹⁸.

Micro and small enterprises can often face constraints emanating from weaknesses in the business and wider institutional environment. Furniture MSE owners have the feeling that the government is mainly in favor of micro and small enterprises created and supported through the existing MSE development strategy. Such MSEs are recognized to have access to working premises, credits, public markets, training, BDS, and information and advice. Moreover, bureaucratic red-tape (lack of administrative efficiency and effectiveness) has been perceived by most of the MSE operators as relatively serious problem, followed by inability (weakness) of the institutions to provide essential services.

Despite the problems, MSEs play considerable role in local economic development (LED)⁹⁹. In this research, the entire operation of MSEs has been studied through domestic value chain. The MSE value chain effectively links and integrates the segments of economic activities across primary, secondary, and tertiary sectors. The three sectors involve primary input sourcing, manufacturing, and distribution and marketing, respectively. Moreover, value chains pervade across formal and informal economic sectors, linking (and “integrating”) the seemingly separated formal and informal economic activities, thereby narrowing the gap existing between the two sectors.

⁹⁸ The government has recently taken extensive measures to bring MSEs into the legal framework, which forces them to register, get licensed and pay taxes.

⁹⁹ The role and contribution of MSEs in local economic development could be observed at two principal stages: first stage, in the domestic sphere (when MSEs have only domestic value chains and markets) as micro and small enterprises use domestic resource inputs from and export their products to other localities; and second stage, when MSEs grow, upgrade, graduate to medium and large scale enterprises (MLE) and ultimately enter into global commodity chains (GCC).

The multifaceted role of MSEs (and their value chains) in LED can be captured under three main themes: the segments of the value chain, local resources mobilization and employment creation, and inter-firm relations and upgrading. MSEs contribute to LED through all segments of the value chain right from input sourcing to marketing and distribution. The inter-firm relations and upgrading efforts that would come within the value chain will also enhance the contributions. MSEs are effective in mobilizing local resources (fragmented financial and material resources of individuals) and creating employment opportunities (both for the owners and employees) across the segments of the value chain. MSEs serve as a means to stimulate the local economy in all catchment areas and points of the value chain. More important, MSEs serve as seedbeds for entrepreneurship, ground for business development and leadership, and avenue for medium and large enterprises (MLE) that may strive to be integrated into the global commodity chain through export. At this latter stage, enterprises will acquire and accumulate international standards of production, learn and coin strategies for global competition and play their part in attracting foreign exchange through effective forward linkages.

11.4. Recommendations

Micro and small enterprises (MSEs) are heavily constrained by wide-ranging problems that possibly emanate internally from within the MSE (the individual firm itself), from the value chain in which such MSEs operate and externally from the general (broader) environment. Few recommendations are provided here to help MSE operators and other stakeholders in their efforts to resolve some of the problems in the sector.

Lack of capital is among the critical problems of MSE operators both at the initial and latter stages. MSEs require sufficient amount of money for running and expanding the business. The supply of sufficient micro finance is essential for the operation, growth and expansion of micro and small enterprises. But the

availability and supply of micro finance is heavily constrained due primarily to the capacities and policies of the micro-finance institutions (MFI) in the country. Most of the MFIs provide services of limited scope like savings and very small amount of credit (micro credit). They target the lowest section of the society since their major objective is aimed at poverty reduction (Haftu *et al*, in Tegegne and Meheret 2010: 72).

The objectives and services of MFI shouldn't be limited to or revolve around poverty reduction alone (Itana 2002:2). The financial services of MFIs should also be accessible to small entrepreneurs who seek to get sufficient amount of money for business growth and expansion (Ibid). In order to remit the problems of micro financing hence the shortage of financial resources, the government should exert extra efforts to encourage and effectively attract private MFIs to the market and offer sufficient micro finance for MSE entrepreneurs and operators. This practice, according to Tegegne and Meheret (2010), brings in dual advantages of "increasing choices to the beneficiaries and making more capital available to the MSEs".

Shortage of working premises has been identified as one of the key problems in the MSE sector. Available working premises in most cases are inconvenient to accommodate business tasks and related requirements. Though some are located in business areas, some are located within residential neighborhoods and premises. The rents are quite expensive, sometimes leading to bankruptcy and eventual closure. Relevant government agencies may need to design appropriate policy and regulatory framework to address such and related problems¹⁰⁰. This practice is common to those MSEs supported by the government. The policy framework needs to relax and embrace the concerns of those MSEs privately established, owned and operated. In this regard, local government organs can arrange for available working areas for those operators who are willing to move the business

¹⁰⁰ The measures can extend into stabilizing the escalating rents of working premises

to the new location. Moreover, MSE operators may need to establish business associations (BA) within the legal framework in order to negotiate and safeguard and effectively promote their interests around different issues.

Micro and small enterprises are increasingly suffering from shortages of primary input supplies (raw materials). Currently such raw materials come from pine trees that serve as the principal source of cut-logs and timbers. Forestry agencies and government (public) enterprises should work towards developing, expanding and improving the cultivation of pine trees in order to increase the supply and quality of raw materials. It is well known that the Ministry of Agriculture and concerned bodies are already in an ambitious reforestation programs. However, the reforestation programs should also focus on the cultivation of pine trees, particularly the *pinus patula* species that serve as input sources for the wood-work sector. In this venture, regions apparently develop unused lands, protect the environment, introduce machineries and new technologies, establish associated processing enterprises (mainly sawmills), create employment opportunities, and raise local as well as regional incomes. This practice augments the base/upstream of the value chain (i.e., input-sourcing) and consequently bears positive impacts on the other segments of the chain, including the final destination.

The duty, standard and norm of brokers (the agents in the distribution channel) should come into the right track. Efforts of the government to bring informal business activities into formal should also extend to the field of brokerage. Brokers have to work with license so that they would be held responsible for wrong and unethical practices. Their role should be one of facilitating market relations between buyers and sellers. Towards making brokerage very efficient and ethical, government or concerned organs may need to arrange training workshops on continuous basis for licensed dealers and brokers. The other strategy to fight the unethical practices and harmful effects of brokers is to boost the supply of raw materials through expansion and development of forestry and related facilities.

Electric power is one of the essential inputs in the production process. However, power shortages and interruptions often disturb and paralyze business activities in this country. Power shortages and interruptions apparently have cost implications. Many businesses are thus forced to use alternative sources, notably generators, to get electric power. This is, however, impractical in the wood-furniture MSE sector. It is quite expensive and not a feasible way to get the power required for operating machines and running the production process. Concerned government authorities, notably EEPCO, are therefore responsible for supplying the required and sufficient electric power to the industry and the business at large. As per the government's promise, the problems of power shortage and interruption could be resolved in the future through the construction and operation of more hydro-electric power dams in the country.

Once established, MSEs need to grow, prosper and contribute to the local (and national) economy in many ways. Apart from financial and material constraints, MSEs may also suffer from serious weaknesses in the management of business, poor marketing skills, inadequate knowledge of production techniques, and poor access to marketing-related information, etc. Such non-financial and non-material constraints impede the "growth and prosperity" of MSEs (Fitsum, 2002: 254). Relevant government agencies and MSE development programs need to make non-financial support¹⁰¹ opportunities available for the MSEs. The supports could be in a variety of ways including skills training (both technical and business), technical assistance, advice, and support in informing, identifying and developing markets.

Individual (internal) efforts at the firm level should be complemented with cooperative (external) inter-firm relations. Inter-firm relations in the wood-furniture MSE sector are confined by and large to "information exchange".

¹⁰¹ The non-financial and (for the most part) non-material services extended in order to enhance the position of MSEs can come under a collective term referred to as Business Development Services (BDS) (Fitsum 2002:255).

Alongside, relations should expand into the other areas of cooperation too. Inter-firm relations are generally weak, thus need to develop. Linkages (vertical and horizontal) and cooperation are settings conducive for upgrading. It has been a dismal trend that costs of inputs (hence prices of products) are uncharacteristically going up. Things are already becoming tough for most of the MSEs as costs of running the business are getting unaffordable. In this upsetting context, MSEs need to build up effective inter-firm relations in all possible areas. For instance, MSEs may need to exercise such practices as joint purchase of inputs and joint use of transport in order to cope up with the restraining impacts of costs. MSEs are small in size; consequently, they could not compete with large enterprises both locally and globally. MSEs can deal with this kind of problem through inter-firm relations and cooperation. Through sound inter-firm relations, MSEs can build collective efficiency that can help them become and stay competitive with larger enterprises and imported (similar as well as substitute) commodities.

The contributions of MSEs to LED become more effective and sustainable if all-rounded efforts are made at all levels of responsibility. Efforts should be made at firm (enterprise), local and national levels.

At the firm level, MSE operators need sufficient entrepreneurship mettle to manage the problems and live up to the demands of the business in the sector. The existence of such spirit may help operators to stay and succeed within trying as well as harsh circumstances. When such spirits are alive, entrepreneurs would be innovative to exploit every flash of opportunity to improvise, change and diversify business ideas and practices. Moreover, vibrant entrepreneurship culture is imperative for MSEs to graduate to the higher business tiers, more importantly to MLEs.

MSE operators need to track persistent problems and make the required adjustments to the business on continuous basis. They need to develop saving culture and reinvest and expand business. This would make them even resilient in

the face of expected/unexpected adversities like economic shock and other crisis. They also need to acquire technical trainings to update their skills and remain competitive in the environment.

The competitiveness of any locality, region or nation, as Porter (1990) suggests, “depends on the capacity of its industry to innovate and upgrade”. MSEs need to make more and persistent efforts in upgrading products, the production process and functions. As has already been suggested, MSEs need to develop the culture and practice of inter-firm relations and cooperation. Well developed inter-firm relations could serve as a mechanism to solve many of the problems and also serve as precursor for future business clusters, which in turn, “favors innovation and helps local firms to compete globally” (Humphrey and Schmitz 2000:3).

At the local and national level, responsible government organs and agencies need to create favorable business environment for smooth and effective functioning of micro and small enterprises. Government sector needs to provide the necessary public goods and business support services. The government should try to extend at least some of the supports¹⁰² that are intended or actually provided to the government-assisted MSEs. In addition to its helping effect, this measure could redress the feeling of private MSE operators that the government is biased towards government-assisted MSEs.

The government should continuously reform the bureaucracy in order to expedite the registration, licensing, tax assessment, taxation, and license renewal processes. Officers are said to lack in the necessary capacity, qualification and organizational commitment to discharge duties and live up to the expectations of the customers. Capacity building schemes and, whenever possible, improvements in the benefits packages need to be undertaken to upgrade the level and material satisfaction of officers of local government agencies. Alongside, proper accountability

¹⁰² For instance, training, BDS, information, access to markets, etc (MSE development strategy 2011)

mechanisms should be in place to control the performance and behavior of the officers (particularly their relations with the customers).

More important, the government sector should be in a position to provide favorable rules and regulations and be effective in enforcing the same. The government should also make relentless efforts to provide essential services and infrastructure. The prime role of the government and its agencies at all levels is to create favorable environment for the smooth and successful operation of business enterprises. It is at this juncture that both sectors (the private and the public) become effective partners and ultimately discharge their part towards local economic development.

Research Suggestions:

- (i) This research is confined to the wood-work MSE sector; hence similar researches should be carried out in other sectors, too, in order to provide deeper insights into the features and operations of domestic value chains. This research didn't employ complex quantitative methods of analysis in addressing the issues of MSE value chains and their overall role in LED. To fill that gap, more rigorous quantitative models may be used to better analyze and empirically test the functioning of domestic value chains (DVC) of MSEs;
- (ii) More research is required to see the ways and mechanisms through which MSEs might undertake upgrading, effectively exercise innovation, graduate into MLEs and ultimately get integrated into the global value chains (GVC);
- (iii) Policy research is required to look deeply into the legal framework and the broader policy environment that affects the survival and operation of industries; particularly that of micro and small enterprises (MSE). Favorable business environment is critical for MSE development. One of the requisites in this regard is the policy and institutional setting. Many

countries can have MSE policies and development strategies. One such policy framework and strategy is the new MSE development strategy (2011) of Ethiopia ¹⁰³. Though extensive issues are treated in this document, it is still helpful to undertake comparative analysis and study of policies/strategies of different countries that exhibit more or less similar socio-economic features.

- (iv) Further research should be rigorously undertaken to build broader insights into the role of micro and small scale enterprises (MSEs) and their value chains in local economic development (LED).

¹⁰³ The MSE development strategy focuses more on (or in other words, heavily biased to) government-supported micro and small enterprises.

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Annexes

Annex 1: Questionnaire

Dear respondent,

This questionnaire is designed to collect data for a research project titled “The Role of Micro and Small Enterprises (MSEs) in Local Economic Development (LED): With a Focus on Wood-Furniture Value Chains. The purpose of the project is to produce a dissertation leading to a PhD Degree at the University of South Africa (UNISA). The data is meant entirely for this purpose! Hence you are kindly requested to provide genuine information that is critical to the success of this project.

Thank you very much!

Elias Berhanu (Ph. D. candidate, UNISA)

Name of the Enterprise: _____

Kifle ketema (Sub-city): _____

Woreda/Kebele (local government unit): _____

Instruction:

- (i) Enter the number of your choice in the blank spaces; and
- (ii) Provide your own answer (opinion) when requested to do so.

1. Personal Data of Operators/Owners

- 1.1. The owner is: _____ 1) owner, operator and manager; 2) owner and manager; 3) owner and operator; 4) only owner (far from the actual operation of the business)
- 1.2. Owner’s sex: _____ 1) male; 2) female
- 1.3. Owner’s age: _____ 1) below 25; 2) 26 - 35; 3) 36 - 45; 4) above 45
- 1.4. Owner’s ethnic origin: _____
- 1.5. Owner’s literacy level: _____ 1) illiterate; 2) read & write only; 3) elementary/junior; 4) high school complete; 5) diploma; 6) degree; 7) other _____
- 1.6. Does the owner have any specialized training? _____

- 1) Yes, related to the current business
 - 2) Yes, but not related to the current business
 - 3) No specialized training at all
- 1.7. This business is owner's: _____ 1) sole occupation;
2) additional occupation

2. The Enterprise: Origin and Identity

- 2.1. Age (years) of the enterprise since establishment: _____
- 2.2. Legal status: _____ 1) licensed; 2) not licensed
- 2.3. Ownership form is: _____ 1) sole proprietorship; 2) partnership
- 2.4. Does the enterprise have formal (own) name? _____ 1) yes; 2) no
- 2.5. Who manages the business? _____ 1) the owner;
2) hired manager; 3) relative/friend
- 2.6. The enterprise is in: _____ 1) independent working premise;
2) within the home premise
- 2.7. The working premise was acquired: _____ 1) with rent;
2) without rent
- 2.8. Size of initial capital (in Birr): _____
- 2.9. Size of current capital (in Birr): _____
- 2.10. Source of initial capital: _____ 1) own savings;
2) family transfers; 3) credits from friends/relatives; 4) micro
credits; 5) other: _____
- 2.11. How do you meet your current financial needs for your
business? _____ 1) own savings; 2) borrowing from formal sources;
3) borrowing from informal sources; 4) supplier credits; 5) cash
advance from clients; 6) others: _____
(Can have multiple responses)
- 2.12. In case you have never taken loans from banks, the reason could be:
_____ 1) you don't need loan; 2) your firm is
informal; 3) lack of collateral; 4) fear of interest rates; 5) any other
reason: _____

3. The Product, Design and Production

- 3.1. Here, the enterprise is engaged in: _____ 1) production only;
2) production & sales
- 3.2. The enterprise produces: _____ 1) single type of product;
2) multiple types of products
- 3.3. The nature of your product: _____ 1) finished goods;
2) component parts; 3) both
- 3.4. Please provide the list of your products?

| 3.4.1. Finished Goods | | 3.4.2. Component Parts |
|-----------------------|--|------------------------|
| | | |
| | | |
| | | |
| | | |
| | | |

- 3.5. Who designs the product? _____ 1) Freelance designers; 2) Owners/Operators; 3) Hired designers; 4) Customer specification; 5) Copying designs (from books, bulletins, other firms, imported products). (*You can have multiple responses*).
- 3.6. How do you carryout designs? _____ 1) Manual methods;
2) Advanced design technology (machine); 3) Both
- 3.7. The production process is _____ 1) highly manual;
2) machine-intensive
- 3.8. Production machines are? _____ 1) locally modified (*modific*);
2) imported machineries; 3) both
- 3.9. Production machines are: _____ 1) own machines;
2) hired machines; 3) both

4. Input Supply

4.1. Who are your major suppliers of inputs? (Tick in the appropriate space)

| Inputs | Wholesalers | Retailers | Own firms (shops) |
|--|-------------|-----------|-------------------|
| 4.1.1. Sawn Timber (raw material) | | | |
| 4.1.2. Component parts (if any) | | | |
| 4.1.3. Equipment (machines and tools) | | | |
| 4.1.4. Chemicals (paints, adhesives, etc) | | | |
| 4.1.5. Other inputs (nails, plastics, etc) | | | |

(Can have multiple responses)

4.2. Where do suppliers (wholesalers and retailers) get those inputs from? _____ 1) local producers; 2) importers; 3) both

4.3. Your major suppliers are: _____ 1) local producers; 2) importers; 3) both

4.4. How many suppliers do you have? _____ 1) 1-3; 2) 4-6; 3) more than 6

4.5. How do you generally appraise your suppliers on the basis of the criteria given below? Your evaluation runs through a scale of: very poor; poor; moderate; good; and very good. (Tick under the appropriate column)

| Criteria | V. Poor | Poor | Moderate | Good | V. Good |
|------------------------------------|---------|------|----------|------|---------|
| 4.5.1. Quality | | | | | |
| 4.5.2. Reliability | | | | | |
| 4.5.3. Price* | | | | | |
| 4.5.4. Costumer service (handling) | | | | | |

**Unfairly higher prices by suppliers entail "poor" evaluation results*

- 4.6. Do you have (use) imported inputs? _____ 1) Yes; 2) No
- 4.7. How do you get inputs? _____ 1) on cash; 2) on credit; 3) both
- 4.8. Have you ever purchased inputs jointly with other firms?
_____ 1) yes; 2) no
- 4.9. What are the major problems of acquiring inputs?
_____ 1) high prices; 2) low quality; 3) low supply;
4) delays in delivery. (*Can have multiple responses*)

5. The Market, Marketing and Distribution

- 5.1. Who buy your products? _____ 1) wholesalers;
2) retailers; 3) direct consumers (*Can have multiple responses*)
- 5.2. Most of your products are: _____ 1) for markets in Addis;
2) for markets outside Addis
- 5.3. The demand (market) for your product(s): _____
1) declining; 2) as usual; 3) rising
- 5.4. Assess the degree to which the following factors are a requirement
in the domestic market on a scale of: very high; high; moderate;
low; and very low. (Tick under the appropriate column)

| Factors | V. High | High | Moderate | Low | V. Low |
|-----------------------------------|---------|------|----------|-----|--------|
| 5.4.1. Quality | | | | | |
| 5.4.2. Lower Price | | | | | |
| 5.4.3. Superior Design | | | | | |
| 5.4.4. Delivery and Delivery Time | | | | | |

- 5.5. Your sales outlet constitutes: _____ 1) only the current site;
2) one more additional shop; 3) more than 2 shops
- 5.6. Your sales are: _____ 1) on cash basis only;
2) on cash and credit basis
- 5.7. How do you fix prices? _____ 1) market prices;
2) cost + markup; 3) negotiations (*Can have multiple responses*)
- 5.8. Do you use brokers? _____ 1) yes; 2) no
- 5.9. Do you use promotional media? _____ 1) yes; 2) no
- 5.10. If you use promotional media, which one? _____ 1) trade fair;
2) printed materials; 3) radio/TV; 4) any other: _____
(*Can have multiple responses*)
- 5.11. Sales over the last 4-5 years: _____ 1) has increased;
2) remains constant; 3) has decreased; 4) fluctuated
- 5.12. Do you have intentions for export? _____ 1) yes; 2) no
- 5.13. If yes, where? _____
- 5.14. If no, why? _____

6. Competition and Competitiveness

- 6.1. Competition for the market is: _____ 1) fair; 2) strong; 3) severe
- 6.2. Competitions significantly come from: _____ 1) similar local enterprises; 2) larger national enterprises; 3) imported goods (from abroad)
- 6.3. Where do you approximately place/position your enterprise (*vis a vis* similar enterprises) in terms of degree of competitiveness

ranging from highly competitive to least competitive against the factors indicated below?

| Factors | Highly Competitive | Average / Ordinary | Least Competitive |
|--|---------------------------|---------------------------|--------------------------|
| 6.3.1. Quality (material quality) | | | |
| 6.3.2. Design/Model | | | |
| 6.3.3. Price* | | | |
| 6.3.4. Punctual delivery/efficiency | | | |
| 6.3.5. Ability to deal with large orders | | | |

**Everything being constant, offering lower price means offering competitive price*

6.4. How do you compare “your product” with “imported goods” on a scale of 1-5 against the factors specified below? (1= exceptionally competitive; 2) competitive; 3) average/ordinary; 4) less competitive; 5= least competitive). Mark *DP* for your (domestic) product and *IP* for imported products (goods), under the appropriate column. In case *DP* and *IP* are supposed to be equal on a given factor, write both (*DP, IP*) under the appropriate column.

| Factors | 1 | 2 | 3 | 4 | 5 |
|---|----------|----------|----------|----------|----------|
| 6.4.1. Quality (material strength & durability) | | | | | |
| 6.4.2. Design/Model | | | | | |
| 6.4.3. Price* | | | | | |
| 6.4.4. Punctual delivery | | | | | |

**Everything being constant, offering lower price means offering competitive price*

6.5. To be competitive, which techniques do you use? _____
1) offering lower prices; 2) offering quality products; 3) minimizing costs; 4) using promotions; 5) hiring skilled workers; 6) no technique. (*Can have multiple responses*)

7. Upgrading efforts

- 7.1. Have you ever made efforts to upgrade the quality of your products _____ 1) yes; 2) no
- 7.2. Have you ever diversified the types of your products? _____ 1) yes; 2) no
- 7.3. Do you have a plan to diversify your products in the future? _____ 1) yes; 2) no
- 7.4. Which of the following measures are taken in order to improve the production process of your firm? Tick where appropriate. (*Can have multiple responses*)
- 7.4.1. Introducing new machines and tools _____
- 7.4.2. Introducing new methods of operation _____
- 7.4.3. Employing new managerial techniques _____
- 7.4.4. Getting skills training for employees _____
- 7.5. With all these (the above) efforts, do you think your firm has improved its operations and product qualities? _____
1) yes; 2) no
- 7.6. Have you ever tried to move into product design activities? _____ 1) yes; 2) no
- 7.7. Have you ever moved into promotional activities (like sales promotion or advertising)? _____ 1) yes; 2) no
- 7.8. What is your plan for the future? _____
1) expand the business; 2) continue with the current business (at the same scale); 3) change the type of business
- 7.9. In case your plan is to “change the type of business” (to move into another line of business), what is the reason? _____

8. Labor

- 8.1. The number of workers, *initially* (when you start the business):

- 8.2. The number of workers, *currently* : _____:
(male _____ female _____)
- 8.3. Terms of employment (enter the number of workers)

| | | | |
|-------------------|-----------|----------|-----------|
| | Permanent | Contract | Temporary |
| Number of workers | | | |

8.4. Level of skill of employees (enter the number of workers)

| | | | |
|-------------------|---------|--------------|-----------|
| | Skilled | Semi-skilled | Unskilled |
| Number of workers | | | |

8.5. Wage of workers (in Birr): (enter the number of workers)

| | | | | | |
|-------------------|-----------|----------|-----------|-----------|------------|
| | Below 500 | 500-1000 | 1001-2000 | 2001-3000 | Above 3000 |
| Number of workers | | | | | |

8.6. The normal working hours per day: _____

8.7. Rank the following labor problems as per their level of significance (from 1 to 3; assign 1 to the most significant, 3 to the least significant)

| Labor problem | Level of significance (1 - 3) |
|--|-------------------------------|
| 8.7.1. Absentism | |
| 8.7.2. High labor turn-over | |
| 8.7.3. Misconduct: misuse of resources/dishonesty/theft, etc | |

8.8. Have you ever provided skills training opportunity for the workers?
_____ 1) yes; 2) no

8.9. If "yes", who trained your workers? _____

9. Inter-firm relations

9.1. Do you have cooperative relations with *other (similar) firms*?
_____ 1) yes; 2) no

9.2. If “no”, why? _____ 1) no need;
2) no opportunity to cooperate; 3) no trust; 4) other reason(s)

9.3. If “yes”, please indicate the areas of cooperation. Tick where appropriate.

(Can have multiple responses)

9.3.1. Information exchange _____

9.3.2. Joint purchase of inputs _____

9.3.3. Joint use of transport _____

9.3.4. Design exchange _____

9.3.5. Borrowing: finance _____

9.3.6. Borrowing: input-supply _____

9.3.7. Sharing stores _____

9.3.8. Labor exchange _____

9.3.9. Sharing machinery _____

9.3.10. Sharing retail outlets _____

9.3.11. If there are others, please indicate

9.4. Do you have a business association (BA)? _____ 1) yes;
2) no

9.5. If “yes”, what objectives do you achieve through it?

9.6. Have you ever entered into a subcontract agreement with others?
_____ 1) yes; 2) no

9.7. Please indicate the forms of relations with *suppliers of inputs*. Tick in the appropriate space. *(Can have multiple responses)*

9.7.1. Information exchange _____

9.7.2. Purchase (input) on credit _____

9.7.3. Transport facilities _____

9.7.4. Quality control _____

9.7.5. If there are other forms, please indicate

9.8. Please indicate the forms of relations with *buyers (retailers and wholesalers)*. Tick in the appropriate space. (*Can have multiple responses*)

9.8.1. Information exchange _____

9.8.2. Design _____

9.8.3. Product specification _____

9.8.4. Transport _____

9.8.5. Quality control _____

9.8.6. Product promotion (marketing) _____

9.8.7. Sales (product) on credit _____

9.8.8. If there are other forms, please indicate

9.9. Please indicate the forms of relations with *buyers (direct consumers)*. Tick in the appropriate space. (*Can have multiple responses*)

9.9.1. Information exchange _____

9.9.2. Product specification _____

9.9.3. Quality control _____

9.9.4. If there are other forms, please indicate

10. Perceptions about local government institutions

10.1. Are there local government agencies related to your business? _____ 1) yes; 2) no

10.2. If there are, who are they? _____

- 10.3. If you have relations, for what purposes? _____ 1) license; 2) tax;
3) other, specify _____
- 10.4. Have you ever encountered any mistreatment in your dealings with
government agencies? _____ 1) yes, sometimes;
2) yes, always; 3) not at all
- 10.5. How do you perceive the business rules and regulations in the
locality: _____ 1) favorable; 2) unfavorable
- 10.6. The business rules and regulations are: _____
1) predictable; 2) unpredictable
- 10.7. How do you judge the current tax assessment practice?
_____ 1) fair; 2) unfair
- 10.8. During tax payment seasons, you often encounter:
_____ 1) smooth administrative practices;
2) difficult administrative practices
- 10.9. Do government authorities provide support for your business?
_____ 1) yes; 2) no
- 10.10. If yes, how often? _____ 1) regularly; 2) sometimes
- 10.11. Do government authorities strive to create an enabling
business environment in the area? _____ 1) yes;
2) no
- 10.12. Over the last 4-5 years, the business environment in which
you operate has: _____ 1) improved;
2) deteriorated; 3) unchanged
- 10.13. Which of the following could be considered as serious
problems on the part of government institutions that are
related to your business? (The degree of severity ranges
from 1= serious to 3= less serious). Please tick where
appropriate.

| | 1 | 2 | 3 |
|--|----------|----------|----------|
| 10.13.1. Unfavorable rules and regulations | | | |
| 10.13.2. Bureaucratic red-taps (administrative inefficiency) | | | |
| 10.13.3. Inability to provide essential services (telephone lines, electric-power, roads, sewerages, etc) | | | |
| 10.13.4. Corruption | | | |

10.14. What policy measures should government authorities take in order to improve the current business environment? Suggest at least three basic measures:

10.14.1. _____

10.14.2. _____

10.14.3. _____

11. Possible problems in the business

11.1. Please indicate the extent to which the following factors affect your business (as serious problem; moderate problem; and minor problem). Tick under the appropriate column).

| Factor | Serious | Moderate | Minor |
|--|---------|----------|-------|
| 11.1.1. Lack of capital | | | |
| 11.1.2. Lack of credit facilities | | | |
| 11.1.3. Lack of demand (market) | | | |
| 11.1.4. Lack of working premise | | | |
| 11.1.5. Lack of raw materials | | | |
| 11.1.6. Lack of management skill | | | |
| 11.1.7. Lack of skilled workers | | | |
| 11.1.8. Lack of local government support | | | |
| 11.1.9. Lack of machinery | | | |
| 11.1.10. Lack of latest technology | | | |
| 11.1.11. Lack of electric power | | | |

11.2. Please state the three most significant problems to your business (in the order of their importance):

10.2.1. _____

10.2.2. _____

10.2.3. _____

Acknowledgement:

I would like to acknowledge kindly that some important points particularly for the items under number 10 and 11 of this questionnaire are taken from the World Bank's survey instrument titled: "Local Development Enabling Survey (March 22, 2004)". I would also like to acknowledge sincerely that important items in several parts of the material have been adapted from the doctoral work (on leather and leather products value chain) of Tebark Lika (PhD), Addis Ababa University.

Annex 2: Interview Checklist 01

Respondents: MSE Owners/Operators

1. Owner's/Operator's: gender (M _____ F _____);
Age _____ Years
2. Age of MSE since establishment: _____ Years; Why/how did you
start this business?

Do you have additional occupation?

3. Level of education: _____;
Special training: _____
4. Initial capital _____ Birr; Current capital _____ Birr
5. Source of initial capital _____
6. How did you acquire the working premise? _____
7. What are your products? _____
Who are your customers? _____
8. Number of workers: _____
9. What are your major inputs? _____
10. From where do you acquire inputs? _____
11. How do you carry out "designs"? _____
12. Do you have cooperative relations with other MSEs? _____
13. How do you see the business environment? _____

14. What are the major problems of your business?

15. Have you ever thought of quitting this business? _____; If so, why?

Annex 3: Interview Checklist 02

Respondents: Sawmill Operators

1. List your products?

2. List your major inputs?

3. Indicate the sources of major inputs?

4. Who are your customers (major buyers)?

5. How did you acquire the working premise? Rent ____ Owen premise ____

6. List (describe) the major problems related to your business:

Respondents: Timber Traders

1. List the items you sell:

2. You are engaged in: wholesaling _____ retailing _____ both _____

3. Do you sell imported items? Yes _____ No _____

4. Who are your customers (major buyers)?

5. List (describe) the major problems related to your business:

Annex 4: The LED Actors and Generations

Annex 4.1. The LED Actors

| Element | Public sector | Private sector | Community sector |
|------------------------|---------------------------------------|---|------------------------|
| Principal mechanism | Bureaucratic organization | Market processes | Voluntary associations |
| Decision maker | Administrators and experts | Individual producers, consumers, savers and investors | Leaders and members |
| Guides to behavior | Regulations | Price signals and quantity adjustments | Agreements |
| Criteria for decisions | Policy and best means to implement it | Efficiency, maximization of profit and/or utility | Interests of members |
| Sanctions | State authority backed by coercion | Financial loss | Social pressure |
| Mode of operation | Top-down | Individualistic | Bottom-up |

Source: Uphoff 1993, in Elias 2005 (Characteristics of 3 sectors involved in LED promotion)

Annex 4.2. LED Generations

Since the 1960s, LED has passed through three broad stages/”waves” of development. Today LED is in its “third wave”. Although LED has moved through each of these waves, elements of each wave are still practical today (World Bank 2009a). The table summarizes the three stages of LED.

4.2.1. Three Waves of LED

| Three waves of Local Economic Development | | |
|--|---|---|
| Wave | Focus | Tools |
| First: 1960s to early 1980s | <p>During the first wave the focus was on the attraction of:</p> <ul style="list-style-type: none"> • Mobile manufacturing investment, attracting outside investment, especially the attraction of foreign direct investment (FDI) • Hard infrastructure investments | <p>To achieve this, cities used:</p> <ul style="list-style-type: none"> • Massive grants • Subsidized loans usually aimed at inward investing manufacturers • Tax breaks • Subsidized hard infrastructure investment • Expensive “low road” industrial recruitment techniques |
| Second: 1980s to mid 1990s | <p>During the second wave the focus moved towards:</p> <ul style="list-style-type: none"> • The retention and growing of existing local businesses • Still with an emphasis on inward investment attraction, but usually this was becoming more targeted to specific sectors or from certain geographic areas | <p>To achieve this cities provided:</p> <ul style="list-style-type: none"> • Direct payments to individual businesses • Business incubators/workspace • Advice and training for small and medium sized firms • Technical support • Business start-up support • Some hard and soft infrastructure investment |

| | | |
|--|---|--|
| <p>Third: Late 1990s onwards</p> | <p>The focus shifted from individual direct firm financial transfers to making the entire business environment more conducive to business.</p> <p>During this third (and current) wave of LED, more focus is placed on:</p> <ul style="list-style-type: none"> • Soft infrastructure investments • Public/Private Partnerships • Networking and the leveraging of private sector investments for the public good • Highly targeted inward investment attraction to add to the competitive advantages of local areas | <p>To achieve this, cities are:</p> <ul style="list-style-type: none"> • Developing a holistic strategy aimed at growing local firms • Providing a competitive local investment climate • Supporting and encouraging networking and collaboration • Encouraging the development of business clusters • Closely targeting inward investment to support cluster growth • Supporting quality of life improvements |
|--|---|--|

Source: World Bank 2009a (a brief history of LED)

4.2.2. Traditional Vs Modern LED Practices

| Traditional Practices | Modern (3 rd Wave) LED Practices |
|--|---|
| FDI attraction, ignoring local businesses | Focus on the local business environment |
| No national or legal framework for LED | Increasing legislative frameworks for LED |
| Focus on manufacturing sector | Focus on agriculture, manufacturing, service... |
| Hard infrastructure investment | Focus on soft infrastructure |
| Action based on little local economy information | Evidence based strategic planning |
| Public sector only real player | Partnership: private, public, & community |
| Supply driven | Demand driven |
| Sectoral interventions | Territorial interventions |
| LED is undertaken within political boundaries | LED is undertaken within economic space with sometimes multiple jurisdictions |

Source: Swinburn and Yatta (2006:8): Traditional and modern LED practices

Annex 5: Characteristics of Micro and Small Enterprises

| | Micro enterprises | Small enterprises |
|-------------------|---|--|
| Number of workers | Roughly 10 or less full-time workers | Roughly 10 to 50 full-time workers |
| Work-force | The workforce is comprised primarily of family labor | Hired workers comprise a significant share of the total work-force |
| Source of finance | Rely almost entirely on each transactions, informal credit markets, and supplier credit. Start-up commonly funded by family savings | Limited access to formal financial markets; commonly rely on informal financial markets, supplier credit and reinvested earnings |
| Management | Little management specialization | Some specialization in management functions |
| Technology | Traditional: based on widely existing technical knowledge, existing labor skills and existing raw materials supplies | Less traditional: innovation required in some aspects of the transformation process |
| Products | Products and services are generally simple and unsophisticated; prices are low; cater to 'basic needs' of low-income consumers | Products and services range from simple to more complex; span a broader range of consumer types |
| Markets | Typically serve highly localized markets through simple marketing channels | Marketing patterns somewhat more complex reflecting innovation in raw material procurement or in output sales |
| Competition | Competition is intense as a result of ease of entry and localized market area | Competition less intense due to barriers to entry |
| Earnings | Returns to owners/entrepreneurs generally very low | Returns higher but subject to greater variation and risk |

Source: Boomgard 1989, in Hyman 1989(Distinguishing characteristics of micro and small enterprises)

Annex 6: MSE Classification/Definition (in “employment size”)

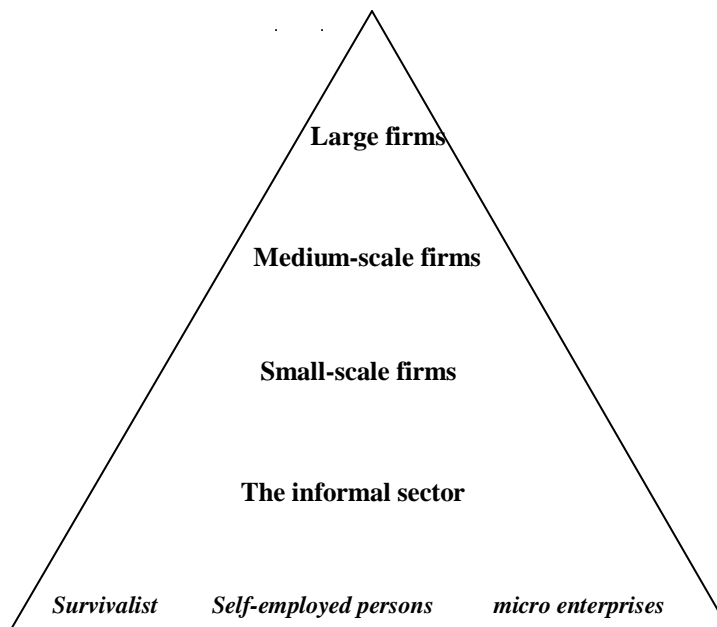
| Country/ Agency | Classification/Definition |
|--------------------|--|
| Botswana | Micro-enterprise: an enterprise with less than 6 workers (including the owner) Small enterprise: an enterprise with less than 25 paid employees Medium enterprise: an enterprise with less than 1000 employees |
| Burkina Faso | MSE : a private enterprise with a minimum of 3 salaried employees (where the manager is the owner or a partner) |
| Zambia | Micro-enterprise: an enterprise employing up to 10 persons Small-enterprise: an enterprise employing up to 30 people |
| EU | Micro-enterprise: an enterprise with less than 10 persons Small-enterprise: an enterprise with less than 50 persons Medium-enterprise: an enterprise with less than 250 people |
| World Bank | Micro-enterprise: an enterprise that employees between 1-10 people Small-enterprise: an enterprise that employees between 11-50 people Medium-enterprise: an enterprise that employees between 51-300 people |
| Ethiopia* | Small-scale enterprises, according to the Central Statistical Authority, are manufacturing enterprises with less than 10 persons. (Micro enterprises include informal sector activities). The Ministry of Trade and Industry classifies micro and small enterprises on the basis of “paid-up capital” |

Source: Tegegne and Meheret (2010:11-13)

*Note: Since March 2011 the revised MSE development strategy has provided new criteria to define micro and small enterprises in Ethiopia. As per the new strategy, micro enterprises are those enterprises that have 5 workers (including family labor) and total asset of not more than 100,000 Birr (for manufacturing enterprises). Small enterprises, on the other hand, are those enterprises that have 6-30 workers and asset of not more than 1.5 million Birr (for manufacturing enterprises) (FDRE 2011).

Annex 7: Hierarchy of Enterprises

We can resort to a pyramidal sketch to illustrate the position of MSEs in the hierarchy of enterprises.



Source: Fidler & Webster (1996), in Tseguereda (2002:18)

The diagram vividly imparts a couple of facts: i) the informal sector activities naturally occupy the lowest strata in the hierarchy of enterprises, and ii) the number of enterprises drastically increases as we descend along the hierarchy. At the bottom are informal micro enterprises, with their considerable range of activities that would provide scope for employment and self-employment.

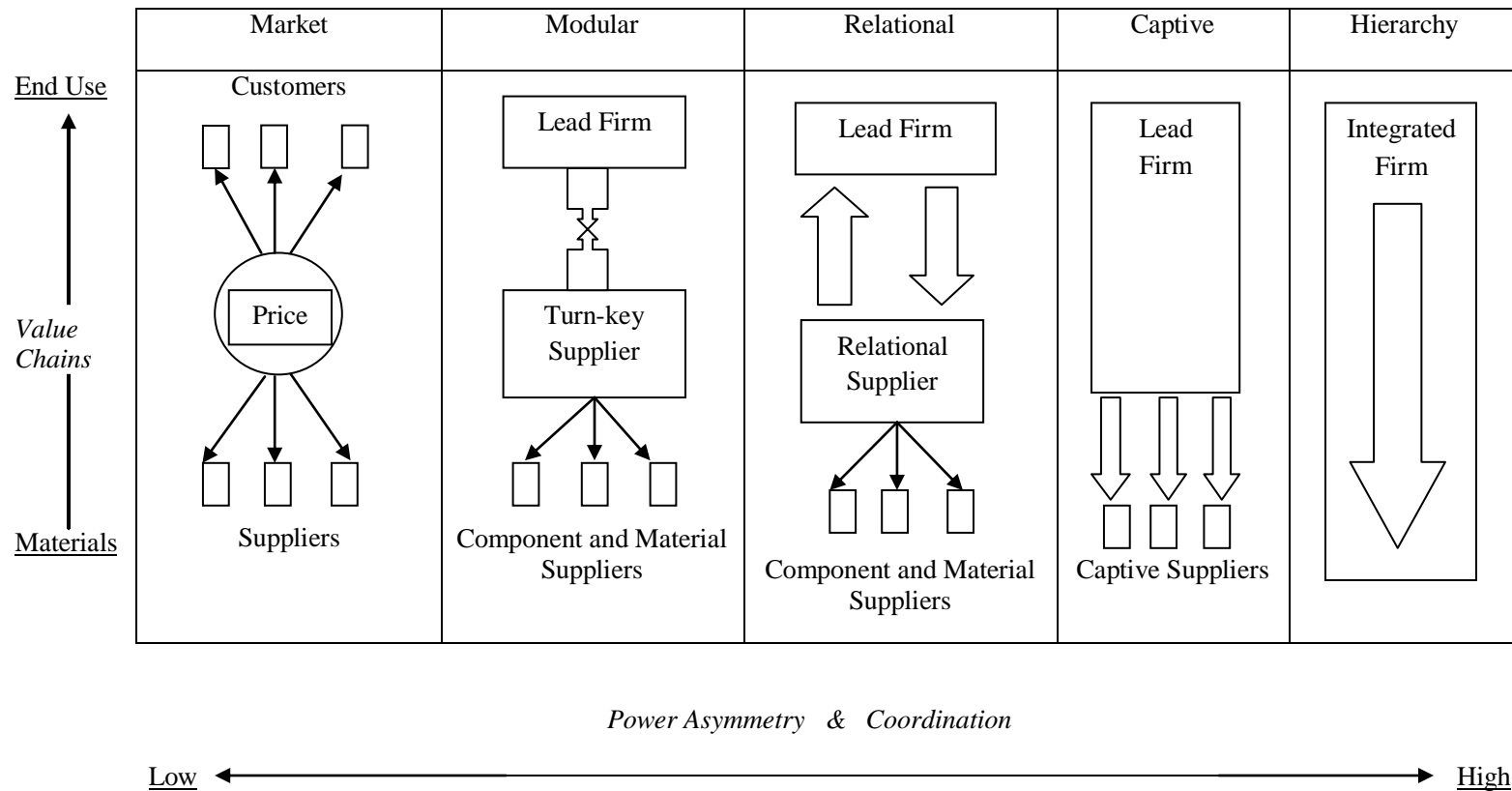
Annex 8: Global Value Chains

Annex 8.1: Producer-driven/Buyer-driven Value Chains

| Features | Producer-driven commodity chains | Buyer-driven commodity chains |
|---------------------------|--|---|
| Nature of Industry | Capital-intensive | Labor-intensive |
| Nature of Capital | Industrial capital | Commercial capital |
| Commodity type | Intermediate and Capital goods | Consumer goods |
| Core Competencies | Manufacturing; R&D | Design; marketing |
| Entry Barriers: Source | Economies of scale | Economies of scope |
| Entry Barriers: Level | High | Relatively low |
| Ownership of Mfg firms | Transnational firms | Local firms, located in the third world |
| Typical industries | Heavy machinery, aircrafts, automobiles, computers | Wood-furniture, apparel, footwear |
| Main network links | Investment-based | Trade-based |
| Network structure | Vertical | Horizontal |

Source: Gereffi (1992)

Annex 8.2.Types of global value chain governance



(Source: Gereffi et al 2005)

Annex 9: Labor size

| Labor Size | Initial | | Current | |
|-------------|----------------|-------|----------------|-------|
| | Number of MSEs | Total | Number of MSEs | Total |
| 2 | 89 | 178 | 18 | 36 |
| 3 | 29 | 87 | 17 | 51 |
| 4 | 21 | 84 | 26 | 104 |
| 5 | 3 | 15 | 25 | 125 |
| 6 | 4 | 24 | 21 | 126 |
| 7 | 5 | 35 | 13 | 91 |
| 8 | 1 | 8 | 17 | 136 |
| 9 | 1 | 9 | 15 | 135 |
| 10 | 3 | 30 | 14 | 140 |
| 11 | 2 | 22 | 7 | 77 |
| 12 | | 0 | 2 | 24 |
| 13 | 1 | 13 | 3 | 39 |
| 14 | 1 | 14 | 4 | 56 |
| 15 | 3 | 45 | 3 | 45 |
| 16 | | 0 | 3 | 48 |
| 17 | | 0 | 2 | 34 |
| 18 | 1 | 18 | 4 | 72 |
| 19 | 1 | 19 | | 0 |
| 20 | | 0 | 2 | 40 |
| 21 | | 0 | | 0 |
| 22 | | 0 | | 0 |
| 23 | | 0 | 2 | 46 |
| 24 | | 0 | | 0 |
| 25 | | 0 | 2 | 50 |
| Total | 165 | 601 | 200 | 1475 |
| No response | 35 | | 0 | |
| Average | 3.642 | | 7.375 | |
| Min | 2 | | 2 | |
| Max | 19 | | 25 | |

Source: field data

Annex 10: Identifying the three most important MSE problems

| Identified problems: | TF | F (1 st) w = 3 | F (w) | F (2 nd) w = 2 | F (w) | F (3 rd) w = 1 | F (w) | TF(w) | Rank |
|-----------------------------|-----|-------------------------------|-------|-------------------------------|-------|-------------------------------|-------|-------|------|
| Shortage of capital | 107 | 40 | 120 | 51 | 102 | 16 | 16 | 238 | 2 |
| Lack of working premise | 128 | 77 | 231 | 40 | 80 | 11 | 11 | 322 | 1 |
| Lack of machinery and tools | 59 | 29 | 87 | 16 | 32 | 13 | 13 | 132 | |
| Lack of skilled labor | 8 | 0 | 0 | 1 | 2 | 7 | 7 | 9 | |
| Lack of government support | 47 | 11 | 33 | 9 | 18 | 27 | 27 | 78 | |
| Shortage of power supply | 51 | 3 | 9 | 8 | 16 | 40 | 40 | 65 | |
| Lack of latest technology | 40 | 7 | 21 | 8 | 16 | 25 | 25 | 62 | |
| Shortage of raw-materials | 44 | 27 | 81 | 11 | 22 | 7 | 7 | 110 | |
| Lack of credit facilities | 16 | 3 | 9 | 5 | 10 | 8 | 8 | 27 | |
| Lack of demand | 31 | 23 | 69 | 8 | 16 | 0 | 0 | 85 | |
| Lack of management skill | 3 | 0 | 0 | 1 | 2 | 1 | 1 | 3 | |
| Taxation problems | 4 | 1 | 3 | 3 | 6 | 0 | 0 | 9 | |
| Soaring costs of inputs | 80 | 33 | 99 | 27 | 54 | 20 | 20 | 173 | 3 |

Source: field data

[TF = total frequency; F (1st) = frequency as the 1st most important problem; F (2nd) = frequency as 2nd; F (3rd) = frequency as 3rd; w = *weight* assigned to frequencies in each category; F(w) = frequency *weighted*; TF(w) = total frequency *weighted*]

Order of significance runs from 1 through 3; thus, if a given problem is mentioned (identified) by an operator as the 1st most important problem in his/her firm, it would have an inverse weight of 3 points; if it is mentioned as the 2nd most important problem, it would have a weight of 2; and if a problem is mentioned in the 3rd place, it would have an inverse weight of 1 point.