



The Role of Microfinance on the Performance of Small and Medium Enterprises: A Case of Hossana Town

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Abstract

This study investigates the role of microfinance institutions (MFIs) on the performance of Small and Medium Enterprises (SMEs) in Hossana Town, Central Ethiopia. A primary data-driven quantitative research approach was adopted, utilizing an explanatory research design. Data were collected via self-administered questionnaires from a stratified random sample of 292 manufacturing, service, and urban agricultural SMEs. Reliability tests using Cronbach's alpha confirmed the internal consistency of the survey instruments, with all values exceeding acceptable thresholds ($\alpha > 0.70$). Multiple linear regression analysis was executed using SPSS Version 25 to evaluate the collective and individual capacities of key microfinance indicators loan amount, loan repayment period, training services, loan accessibility, frequency of loan disbursement, and collateral requirements to explain variations in SME performance. The regression model demonstrated robust explanatory power, with an adjusted R^2 value of 0.756, indicating that 75.6% of the variance in SME performance is accounted for by the microfinance variables. The ANOVA framework validated the overall significance of the model ($F = 151.328$, $p < 0.001$). Individually, training services ($\beta = 0.494$, $p < 0.001$), frequency of loan disbursement ($\beta = 0.367$, $p < 0.001$), collateral requirements ($\beta = 0.144$, $p < 0.001$), loan accessibility ($\beta = 0.117$, $p < 0.001$), and loan amount ($\beta = 0.097$, $p < 0.001$) exhibited statistically significant positive impacts on performance. Conversely, the loan repayment period exerted a significant negative effect ($\beta = -0.181$, $p < 0.001$). The study recommends that MFIs tailor loan amounts to specific enterprise needs, simplify application workflows, establish predictable disbursement cycles, and incorporate continuous capacity-building programs.

Keywords: Microfinance; Small and Medium Enterprises; Financial Accessibility; Training Services; Regression Analysis

1. Introduction

Access to institutional financial services remains a vital driver of private sector development, yet approximately 90% of populations in developing nations lack access to formal banking systems. This exclusion pushes vulnerable and rural communities toward informal financial mechanisms, perpetuating income inequality and hindering macro-level socio-economic progress. Microfinance institutions (MFIs) serve as crucial intermediaries designed to bridge this gap by offering customized financial products, including microloans, micro-savings, and structural training programs.

In Ethiopia, Small and Medium Enterprises (SMEs) face persistent systemic bottlenecks. While empirical literature underscores the positive correlation between entrepreneurial activities and economic development, substantial hurdles such as rigid collateral mechanisms, inadequate financial skills, high



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interest rates, and structural capital deficits limit the expansion of these enterprises. The primary objective of this study is to investigate the structural impact of microfinance provisions specifically assessing loan volume, repayment periods, ease of access, frequency of disbursement, collateral conditionality, and targeted operational training on the overall performance metrics of SMEs operating within Hossana Town, Central Ethiopia.

2. Literature Review

2.1.1. Theoretical Framework

This study is anchored on five prominent economic and organizational theories:

- **Institutional Theory:** Stresses the value of institutional quality, public support models, and formal regulatory frameworks in driving financial integration and fostering cross-firm networks.
- **Joint Liability Theory:** Analyzes how group-lending frameworks minimize asymmetric information risks and enforcement costs, facilitating safe credit delivery to resource-constrained micro-entrepreneurs.
- **Economic Theory:** Identifies capital availability as a fundamental prerequisite for corporate scaling, demonstrating how macro-level financial environments shape firm behavior.
- **Agency Theory:** Explores potential conflicts of interest and information asymmetries between the lender (principal) and the borrower (agent), highlighting parameters that impact credit sustainability.
- **Stockholder Theory:** Evaluates standard strategies centered on wealth maximization, balance patterns, and long-term organizational value for active stakeholders.

2.1.2. Empirical Review

Prior global and regional empirical studies demonstrate that credit volumes and structural loan components heavily influence firm growth indicators like sales and asset buildup. Ethiopian research reinforces that structural aspects like timing, flexibility, and operational education directly govern borrower repayment efficiency. However, strict institutional collateral frameworks often form supply-side barriers that limit formal credit delivery.

3. Methodology

3.1.1. Research Design and Sample Structure

An explanatory research design relying on quantitative analytical methods was implemented. The target population comprised 1,084 active manufacturing, service, and urban agricultural SMEs in Hossana Town, which engage a collective workforce of 5,877 managers and employees. Applying Yamane's sample size formula with a 95% confidence level and an error margin of $e = 0.05$, the target sample was determined as follows:

$$n = \frac{N}{1 + N(e)^2} = \frac{1084}{1 + 1084(0.05)^2} \approx 292$$

A stratified random sampling strategy was applied across the sectors, followed by systematic selection techniques inside each stratum to identify individual business units.

3.2. Data Collection and Measurement Model

Primary data were gathered via self-administered, structured questionnaires rated on a 5-point Likert scale, ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). Instrument reliability was validated using Cronbach's alpha (α). The diagnostic checks confirmed high internal consistency across all target dimensions:

Dimension Evaluated	Number of Items	Cronbach's Alpha (α)
Loan Amount	5	0.786
Loan Repayment Period	5	0.802
Training Services	5	0.843
Loan Accessibility	5	0.850
Frequency of Loan Disbursement	5	0.860
Collateral Requirements	5	0.797
Performance of SMEs	5	0.832
Total Instrument Scale	35	—

3.3. Statistical Analytical Framework

Data processing was carried out via SPSS Version 25, integrating descriptive measures with multi-variable linear regression modeling. The empirical relationship is framed through the following linear equation:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \varepsilon$$

Where:

- Y: Performance of SMEs (Dependent Variable)
- X_1 : Loan Amount
- X_2 : Loan Repayment Period
- X_3 : Training Services
- X_4 : Loan Accessibility
- X_5 : Frequency of Loan Disbursement
- X_6 : Collateral Requirements
- β_0 : Intercept term; β_1 to β_6 : Unstandardized coefficients; ε : Stochastic error component

4. Results

4.1.1. Descriptive Profile and Diagnostic Tests

The survey achieved a 100% active response rate ($N = 292$). The gender breakdown indicated 65.4% male and 34.6% female participants. In terms of academic distribution, technical and vocational graduates comprised the largest group at 38.0%, followed by degree holders at 25.7%. Sector-wise, 43.8% of the firms operated in the manufacturing industry, 37.4% in the service sector, and 18.8% in urban agriculture.

Diagnostic checks for regression assumptions confirmed acceptable normality, with skewness values staying within the standard $[-1, +1]$ range and kurtosis within $[-2, +2]$. Multi-collinearity tests showed high tolerance values (> 0.10) and low Variance Inflation Factors (VIF), well below the conventional threshold of 5:

Explanatory Predictors	Tolerance Value	Variance Inflation Factor (VIF)
Loan Amount (X_1)	0.418	2.393
Loan Repayment Period (X_2)	0.483	2.070
Training Services (X_3)	0.578	1.730
Loan Accessibility (X_4)	0.783	1.276
Frequency of Loan Disbursements (X_5)	0.400	2.497
Collateral Requirements (X_6)	0.430	2.323

4.2. Regression Output and Hypothesis Decisions

The comprehensive model summary yielded an R coefficient of 0.872, an R^2 of 0.761, and an Adjusted R^2 of 0.756. This demonstrates that 75.6% of the variance in SME performance is driven by the six selected microfinance predictors. The ANOVA test confirmed strong statistical significance for the overall linear combination ($F\{6, 285\} = 151.328, p < 0.001$).

The individual parameter test statistics are presented below:

Model Predictor Components	Unstandardized B	Standard Error	Standardized β	p-value	Empirical Decision
(Constant)	-0.261	0.363	—	0.474	—
Loan Amount	0.078	0.036	0.097	0.031	Accept

Model Predictor Components	Unstandardized B	Standard Error	Standardized β	p-value	Empirical Decision
(X ₁)					H ₁ (Positive)
Loan Repayment Period (X ₂)	-0.194	0.044	-0.181	0.000	Accept H ₂ (Negative)
Training Services (X ₃)	0.503	0.039	0.494	0.000	Accept H ₃ (Positive)
Loan Accessibility (X ₄)	0.112	0.031	0.117	0.000	Accept H ₄ (Positive)
Disbursement Frequency (X ₅)	0.501	0.062	0.367	0.000	Accept H ₅ (Positive)
Collateral Requirements (X ₆)	0.126	0.039	0.144	0.001	Accept H ₆ (Positive)

$$Y = 0.078X_1 - 0.194X_2 + 0.503X_3 + 0.112X_4 + 0.501X_5 + 0.126X_6 - 0.261$$

The empirical findings confirm that capital size additions ($B = 0.078$, $p < 0.05$) help small firms tackle operational hurdles and fund expansion. However, extended repayment terms show a significant negative effect ($B = -0.194$, $p < 0.05$). This indicates that overly prolonged schedules may place heavy long-term interest burdens on small firms, tying up cash flow and weakening operational efficiency.

Conversely, MFI training programs show the strongest positive impact ($B = 0.503$, $p < 0.05$), highlighting how essential business skills enhance structural efficiency and strategy. Regular disbursement cycles ($B = 0.501$, $p < 0.05$) help firms balance their cash inflows and outflows, which mitigates liquidity risks and ensures steady operations. Finally, simple access criteria ($B = 0.112$) and manageable collateral frameworks ($B = 0.126$) significantly lower entry barriers, enabling target SMEs to secure vital funds for stability and growth.

5. Conclusion

This study demonstrates that microfinance provisions significantly influence the performance dynamics of manufacturing, service, and urban agricultural SMEs in Hossana Town. Training initiatives, predictable disbursement frequencies, transparent loan accessibility, and adequate capital sizing serve as vital drivers of enterprise growth. Conversely, prolonged loan repayment matrices present clear disadvantages by introducing long-term financial strain.

Future research should focus on tracking long-term capital allocation strategies across distinct industry sectors and evaluating how digital financial technologies can help lower traditional collateral barriers.

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Conflict of Interest

The authors declare no competing financial or non-financial interests regarding the completion and publication of this research article.

Data Availability Statement

The primary datasets generated, processed, and analyzed during this study are preserved within institutional repositories and can be obtained from the corresponding author upon reasonable request.

AI Usage Disclosure

No generative artificial intelligence tools or automated language models were deployed during data processing, statistical regression analysis, or drafting stages of this manuscript.

Author Contributions

- **Dagnachew Tamene Ano:** Conceptualization, Methodology, Formal Analysis, Writing – Original Draft.
- **Kibamo Kiranso Tefeso:** Project Administration, Software Diagnostics, Validation, Writing Review & Editing, Investigation, Primary Data Collection, Resource Management, Final Validation.

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