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The Informal Features of Micro and Small Enterprises and its Incompatibility with the Partnership Law in Ethiopia

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Abstract

This paper aims to analyze unfitness of micro and small enterprises with the existing trade law particularly partnership rules in Ethiopia. Qualitative research methodology is utilized in order to capture and analyze accurate and in-depth insight of the fact that micro and small enterprises in Ethiopia are not compatible with the existing partnership law though partnership form of firms are suitable for small business. The available literatures related to the issue were professionally scrutinized and analyzed for the purpose of the research.

The results of this research shows that micro and small enterprises in Ethiopia are formed as simply business organization which does not specify the kind of firm structure. Formation, management, liability and dissolution of micro and small enterprises deviate from the partnership requirements stipulated under the Ethiopian commercial code. Furthermore, micro and small enterprises are operating as informal sector business though the sectors' development strategy clearly states that they should be organized under trade law. Therefore, micro and small enterprises system should be reformed in order to make them to be compatible with the existing commercial law.

Key words: Micro and Small Enterprises, Business Organizations, Incompatibility, Informality, Partnership Law

1. Introduction

Before starting any business persons first plan to decide about the legal structure of their firm. Therefore, in a common trade practice, Entrepreneurs usually make decisions about the legal structure of their business firms before they engage into different commercial activities (Goldberg, 2007). Some of the commonly practiced forms of business firms are sole trader, partnerships, corporations or companies and some other mixed forms. When deciding whether the new venture should be formed as one of the above mentioned legal forms of firms, the founders consider the advantages and disadvantages of each. The choice of the kind of firm by the founders affects the profitability of the business and the resource of the partners.

In Ethiopia, for persons who want to operate business in cooperation with others, the Ethiopian commercial code provides different legal forms of firms. Partnership form of firm or business organization is one of the legal forms of a firm structure provided in the Ethiopian commercial code (The Ethiopian Commercial Code of 1960, art 212). There are four forms of partnership firms clearly recognized in the Ethiopian commercial code. All of the partnership forms of firms or business organization can be formed by partnership agreement concluded between partners.

As per article 211 of the commercial code, partnership agreement is defined as an agreement in which two or more persons join to cooperate by contributing in cash or in kind for the purpose of carrying out profit making activities. The commercial code also provides the regulation framework related to naming, personality, management, liability and dissolution of all kinds of partnerships.

Because of the ease of formation and operation, partnership forms of firms are more suitable for micro and small enterprises which operate business by small capitals. The idea of micro and small enterprises was introduced to the Ethiopian economy around 1990s through privatization drive and the Civil and Public Service reform policy (BerihuAssefa, AbebawZerfu and BrukeTekle, 2014).

Starting from that time this sector has been given due emphasis to bring positive change on the overall economic activities in the country. For this purpose, many of the economic policies of the state contain certain considerations for the success of micro and small enterprises in different

sectors of the economy. Most especially, the urban development and trade and industrial policy takes micro and small enterprises as a base for the renaissance of industrialization (Government of Federal Democratic Republic of Ethiopia, 2012).

The government has been providing many supports for the sector so as to improve the sectors' performance, because micro and small enterprises engage in different sectors of economy from local business up to modern trade so that they employ many people (MSEs Development Strategy, 2011).

Therefore, the government has developed strategies and laid down institutional framework to look after the implementation of this policy frame work in different administrative levels. Micro and Small enterprises (MSE) in general and the manner of their organization or structure in particular is governed by the 2011 micro and small enterprises development strategy and council of ministers regulation no 201/2012 which established the federal micro and small enterprises development agency.

According to this development strategy, Micro and small enterprises development agency is empowered to register enterprises under trade law or cooperatives proclamation (MSEs Development Strategy, 2011). From the kinds of firms under the Ethiopian commercial code partnerships are the most suitable for the small and micro enterprises. However, some of the features of micro and small enterprises make it incompatible with the existing rules governing partnerships under the commercial code. Therefore, this paper focuses on those informal features of MSEs and the incompatibility of features of enterprises to the partnership form of business organizations in Ethiopia.

2. Materials and Methods

This paper utilized qualitative research methodology in order to capture and analyze accurate and in-depth insight comparison between features of micro and small enterprises with the requirements for partnership form of firms under the Ethiopian commercial code. It is principally critical reading and analysis of literature and reviewed them during a desktop study; and exploration of relevant parts of the Ethiopian commercial code to the issue to write down ideas.

Therefore, the available literatures related to the issue were professionally scrutinized and analyzed for the purpose of the research.

The qualitative methodology is selected for this research because it is legal research and it mostly focused on the analysis of legal documents. Another major reason for the selection of qualitative research methodology for this research is the fact that the joint use of direct observations, document analysis and deep interviews are major data collection methods in the qualitative approach and that made it suitable for this research.

Therefore, qualitative approach is utilized because the focus of this paper, as mentioned above, is analysis of authoritative scholarly sources together with the data collected from purposive interviews and direct observations in order to show the incompatibility of the practices of micro and small enterprises with the partnership rules under the commercial code of the country.

3. Results and Discussion

3.1. Features of Small Enterprises in Ethiopia: Informality

When compared to the medium and large enterprises, micro and small enterprises have distinct characteristics particularly in terms of the way they engage in business and sector they engage in. In some countries they are called informal sector business (World Bank, 2009). The concept of the informal sector business was introduced into international usage in 1972 (Bangasser, 2000). In different literatures Informality of business is understood in different ways. The most common understanding is that informality refers to a way of doing business characterized by ease of entry to business and reliance on indigenous resources (Kenyon, 2007).

The first condition under the above definition shows the fact that Micro and small enterprises engage in economic activities without being registered (Kenyon, 2007 see above). Furthermore, most of them do not hold license for the business activity they engaged in. Of course, this is because micro and small enterprises in most of the developing countries have no legal personality.

As evinced by the report of World Bank on developing countries, more than half of the enterprises in south Asian and African countries are MSEs and from this around 40% are not

formally registered and established (Judith, 2002). The second condition that makes MSEs informal is their engagement in economic activities which are left unexploited by large business organizations and peculiar to a given community or sometimes called local business (Kenyon, 2007 see above). For instance, activities which are commonly named as hand crafts that, in most cases, do not require machineries are called informal sector.

This is mainly because Micro and Small Enterprises are operated by unpaid family members and occasionally paid employees or apprentices (Tenev, 2003). Most of Micro and Small Enterprises are minor business operations with having employees from family members who do not get any remuneration for their role (Tenev, 2003). In most of the developing countries their management is also not formal because of the loosely internal structure of the entity or the enterprise (Alhaji, 2019).

In Ethiopia, Micro and Small Enterprises development Agencies are established in all regions and districts to organize and support the enterprise owners operating in informal sector. These institutions are mandated with plenty of powers, like initiating youth and organizing them under the scheme of micro and small enterprises, assisting enterprises by organizing them in different economic sectors and creating domestic and international market linkages. The major challenge when organizing micro and small enterprises is selecting a kind of firm structure or business organization which fits with their informal features and purposes.

3.2 Commercial Exceptions and Informal Sector Business in the Ethiopian commercial law

The Commercial Code of Ethiopia states informal sector businesses as commercial exceptions or activities that should be excluded from the scope of application of the Commercial Code. Hence, likes of those activities provided under Articles 6-9, which include small scale farming, fishing and artisans are excluded from the scope of the application of the Code. Particularly, when we see article 5 of the commercial code, in its sub articles 5(5), 5(7), 5(9) and 5(11), it excluded handcrafts activities from the list of commercial activities.

Handcrafts men or artisans under this articles were defined as “persons who carry on an independent activity who live mainly on their manual work, who may carry on their activity with

assistance of members of their family and not more than three employees or apprentice and who buy such materials only when it is necessary for their activity, without setting up stocks”. Accordingly anyone who carries on the commercial activities but in the status of handcrafts man is excluded from being subject to the commercial code.

The rationale behind these exclusions is to encourage and protect small scale trading activities. Therefore, by being excluded from formal trade activities, small scale trades are not required to obey some of the duties of traders and business organization like keeping books and accounts (Commercial Code, art 64). Furthermore, they shall not be obliged to pay business tax under schedule “C” according to article 17 of income tax proclamation no. 286/2002

Currently, there are arguments that claim that the Commercial Registration and the Business Licensing Proclamation no. 686/2010 and other subsequent legislations have repealed the provisions dealing with handicraftsmen under the commercial code. But neither of these laws specifically excludes handcrafts from being commercial exception. These subsequent laws do not expressly or implied lyrepeal the parts of commercial code that deals with commercial exceptions.⁹ Instead of repealing those articles of the commercial code dealing with small enterprises, the subsequent legislations simply further provided additional activities subject to commercial code in addition to what is listed under article 5 of the code.

The ongoing draft commercial code also unequivocally excluded small trading and handcrafts from the list of commercial activities (Draft Commercial Code, article 5 sub articles (5) (7) (8) and (11). It also retained those exceptions under article 6 and 7 of the commercial code with minor amendments.

A close examination of micro and small enterprises shows that they are carrying on activities which are very wide in scope including commercial activities subject to commercial law and those exceptions especially in handcrafts men status which are out of scope of the commercial law. If we see the definition of micro enterprises, it is defined in terms of number of employees and the capital or asset that the enterprise owns.

⁹See Article 2 of the investment proclamation no. 769/2012, article 2 of trade practice and consumer protection proclamation 685/2010, article 2 of commercial registration and business licensing proclamation 686/2010

Accordingly, “micro enterprise is enterprise having a total capital, excluding building, not exceeding birr 50, 000 in the case of service sector or not exceeding birr 100,000 in the case of industrial sector and engages up to 5 workers including the owner, his/her family members and other employees” (Government of Federal Democratic Republic of Ethiopia MSE s Development Strategy, 2011). “Small enterprise is also defined as one having total capital, excluding building, from birr 50, 001 to birr 500, 000 in the case of service sector or birr 100,001 to birr 1, 500,000 in the case of industrial sector and engages from 6 to 30 workers including the owner, his/her family members and other employees” (MSEs Development strategy, 2011 see above).

From the definitions, we can understand that micro and small enterprises are almost similar with the meaning given for handcrafts men under the commercial code because they can carry out any activity and they can employ any number of employees provided it is below five and carry out business manually or mechanically provided that their capital complies with what is provided in the regulation or in the sectors development strategy.

However as mentioned above, micro and small enterprises in general and the manner of their organization or structure in particular is governed by the 2011 micro and small enterprises development strategy and council of ministers regulation no 201/2012 which established the federal micro and small enterprises development agency. According to the development strategy, Micro and small enterprises development agency is empowered to register enterprises under trade law (MSEs Development Strategy, 2011 see above). Being organized under trade law means to have features of one of the seven persons (sole trader, four forms of partnerships and two forms of companies) as envisaged under the commercial code.

Therefore, micro and small enterprises engage in both commercial or trading activities and the exceptions to commercial activities under the commercial code. When they carry out the commercial activities, they must comply with the rules governing firms under the commercial code concerning formation, management, liability, dissolution and etc. But the close examination of the practices of micro and small enterprises shows that they are not compatible with what is stated under commercial code. For external observer they may look like partnership kind of firms but actually they do not fit with the partnerships rules under the commercial code. Therefore, the

next part of this paper compares rules of partnerships under Ethiopian commercial code with the currently emerging micro and small enterprises.

3.3 Rules Governing Partnership forms of Business Organization in the Ethiopian Commercial code vis-à-vis Features of Micro and Small Enterprises in Ethiopia

Partnerships are commonly defined as “a voluntary contract between two or more competent persons to place their money, labor and skill or some or all of them, in lawful commerce or business, with the understanding that there shall be a proportional sharing of the profits and losses between them” (Black, 1991).

Therefore, Partnership is a kind of firm that small business persons create to operate business in collaboration with others. The intimate relation between persons has paramount importance to sustain partnership form of firms (Barnes, Terry and Richards, 2000). Consequently, when people want to form business firm or organization in which they want operate together in mutual trust and confidence they always form partnerships form of legal business structure.

The Ethiopian commercial code recognizes four forms of partnerships; these are ordinary partnership, general partnership, limited partnership and joint venture (Commercial Code, art 212).

Partnership forms of business organizations have their common characteristics and there are general principles to be applicable over all kinds’ partnership forms. From formation to dissolution partnership forms of business organization pass through similar procedures except for some differences peculiar to each. Thus, the next sub-sections compare rules governing partnership forms of business organizations from formation to dissolution under Ethiopian commercial code with the currently emerging micro and small enterprise in the country.

3.3.1 Formation and Legal Personality

Except joint venture partnerships, all business organizations in Ethiopia can be formed by written agreement called a partnership agreement (Commercial Code, art 210). This agreement is required to be documented as memorandum of association. The agreement must contain all rights and duties of parties including the name, address and nationality of each partner; and the

business purpose, address and name of the firm (Commercial registration and licensing proclamation, art 11).

Thus, partnerships acquire legal personality and considered as duly formed under the commercial code when the copies of memorandum of association containing the above listed and other complementary documents enter into commercial registry (Commercial registration and licensing proclamation, art 11). Except joint ventures, the commercial code confers all partnership forms of business organization with legal personality, when they are duly formed (Ethiopian Commercial code, art 210). Legal personality is considered to be conferred only when the firm has its separate name and separate actual existence from the partners.

One of the benefits of acquiring legal personality is that it makes partners to not be personally liable for the debts of the firm (Ethiopian Commercial code, art 294). And also it protects properties of the entity or the firm from personal creditors of the partners. Thus, the creditors of the given partnership cannot first resort to the personal properties of partners before resorting to the partnership itself and the personal creditors of the entity or partnership cannot also be considered as creditors of the firm (Ethiopian Commercial code, art 294).

In opposite to the above discussion concerning formation and legal personality of partnerships, neither properties of micro and small enterprise nor the personal properties of owners of these enterprises enjoy such kind of legal protection because, micro and small enterprises have no separate existence or legal personality and they do not enter to commercial registry unlike those business organizations organized under the commercial code.

The micro and small enterprises development agency takes the responsibility of registering these enterprises in Ethiopia (Government of Federal Democratic Republic of Ethiopia, 2011). This means the way micro and small enterprises agency registers enterprises is different from that of commercial registrar.

Furthermore, according to the observations of this researcher in some selected towns like Hawassa, Arbaminch and Jinka, almost all enterprises registered by government agencies do not specify the firm names which show kind of firm in their memorandum of associations. Therefore, despite micro and small enterprises are formed by an agreement which seems like

partnership agreement under the commercial code, most of their agreements do not specify the kind of firm but they are simply named as organizations.

Specifying the kind of a firm in the firm name of the organization is a duty of founders of partnerships in Ethiopian commercial code (Government of Federal Democratic Republic of Ethiopia, 2011). Micro and small enterprises are owned by friends or sometimes by families and operate businesses under observatory of the government agencies without specifying the kind of firms.

A firm name has a significant value, if you ever want to franchise or sell your business. In addition to economic benefits, firm names have also legal importance because they help third parties to identify the kind of a firm. Identifying the kind of a firm helps to know the liability of owners of the firm. Furthermore, firm names help to identify involvement owners the management and properties owned by firms. Therefore, firm names are another manifestation of separate existence of firms from their owners. Non-specification of kinds and names of firms in case of micro and small enterprises in Ethiopia makes them incompatible with the requirements in the existing partnership laws. The internal structures and management of micro and small enterprises areal so different from partnerships registered by the trade registrar that fact will be discussed in detail in the following sub-sections.

3.3.2 Management

Partnership form of firms are managed by partners themselves or persons appointed by partners (Barnes, Terry and Richards, 2000). Most of the time, it is the partnership agreement which determines the management of partnership firms(Ethiopian Commercial code, article 236).Partners may agree in advance as to how to administer the partnership business. Thus, the way and process of management of the firm may be as agreed upon under memorandum of association and articles of association of the entity.

Similarly, under the Ethiopian commercial code, partners of partnerships are not under obligation to follow any trend or any law in appointing managers but rather they can choice any one as manager from members or outside the members of partnership (Ethiopian Commercial code, article 236). If the partnership agreement does not specify the manager/s of partnership, the law

presumes that all partners as managers of partnership except the limited partners of limited partnership. In case of limited partnership manager/s may be the general partner/s of the partnership or any other outsider (Ethiopian Commercial code, article 300). Limited partners of limited partnership cannot manage the partnership. If they engage in management they cannot enjoy their limited liability privilege (Ethiopian Commercial code, article 300).

When we see the practice of micro and small enterprises in Ethiopia by taking the management affairs as special point of discussion, they are always formed by appointing one manager, one chairman and one cashier from the owners of enterprise, if the enterprise has more than two members (Interview with Aster Seifu, 2016). Other owners of enterprise, if any, are considered as employees but they actually carry out management activities equally with the manager, chairman and cashier. *The* manager, chairman and cashier of MSEs are always required to be one of the owners of enterprise. This shows that though it resembles the appointment of manager by agreement between parties or by memorandum of association in case of partnerships, it is different in that there is an implied obligation of following the trend that each and every enterprise formed and registered by micro and small enterprises agency must have one manager, cashier and chairman.

It is an obligation over enterprise operators that these influential persons must be one of the owners i.e. they cannot be outsiders. Therefore, unlike partnerships under the Ethiopian commercial code, micro and small enterprises cannot appoint outsider manager. This restriction affects persons who want to operate business at micro and small enterprise level. Some concerned organs justify this restriction as way of controlling and determining responsibility among the owners of enterprises. As a result, one can conclude that micro and small enterprises sector is creating its own system which is slightly different from what is provided for partnership form of business organizations under the commercial code.

Liability of members of partnership forms of business is unlimited unlike shareholders in case of companies (Barnes, Terry and Richards, 2000). But under Ethiopian commercial code all of the partnerships have legal personality. Thus, because of the legal personality conferred, creditors of partnerships have one duty that is before they attach the property of partners or before they go to claim performance of the entity's obligation from the members, creditors must first claim it from

the entity or from the partnership then they can resort to the property of partners (Ethiopia commercial code, article 294).

Even though the liability of owners of Micro and Small Enterprises is unlimited as like partnership forms of business organizations, unlike partnerships micro and small enterprises are not enjoying separate existence from the owners of the enterprise. Therefore, sometimes the owners of micro and small enterprises are treated as joint and several debtors especially for their debts from micro financial institutions are concerned (Omo Micro Finance Institute, 2011).

This is when Micro and Small Enterprises operators or owners have no collaterals and if that fact is approved by micro and small enterprises agency, the enterprises owners can acquire loan from micro finance by entering a group guarantee promising to pay it back personally (Omo micro finance institute, 2011). In that case the owners of micro and small enterprises are personally liable for the debts of their enterprise. Therefore, micro financial institutions are treating the owners of micro and small enterprises as joint and several debtors so that they claim the discharge of duties from the latter not from the enterprise as an entity.

This shows micro and small enterprises legal personality is weaker than personality of partnerships under the Ethiopian commercial code. Therefore, particularly when discharging of debts that they owe from micro financial institutions is concerned, the liability of the owners of micro and small enterprises seems personal to the members rather not considered as debt of the enterprise as a legal entity. This is another discouraging factor affecting persons owning micro and small enterprises.

Though the concept of dissolution is not clearly defined anywhere under the Ethiopian commercial code, we can find grounds of dissolution under articles of the commercial code. There are three main grounds of dissolution for partnerships; these are dissolution by the operation of law, dissolution by agreement, and dissolution by court order.

The Ethiopian partnership law provides conditions for dissolution of partnership by operation of law. One of these conditions is when it achieves the purpose for which it is established or if it is impossible to achieve (Ethiopian Commercial code, art 217). Similarly, when the definite period

of time determined during its formation expires, the partnership will also dissolve by law (Ethiopian Commercial code, art 217).

The other reasons for the dissolution of partnerships by the operation of law are death, incapacity or bankruptcy of a partner (Ethiopian Commercial code, art 260). This means if one of the partners of any of partnership dies or not capable to continue in partnership the law states that the partnership will no longer exist among other partners. The only exception for this is, if there is an agreement to continue the partnership between the remaining partners as per Article 260(3) of the commercial Code.

Sometimes partnerships dissolve by court order. According to article 218 of the commercial code court can order dissolution of a partnership for good cause when a partner or a creditor makes an application for that purpose. Accordingly the existence of good cause under the above mentioned provision is the important factor to be examined by court before deciding on the dissolution of the partnership.

Partners may also end their partnership relationship by agreement. This is because from the very beginning, it comes to existence by agreement between partners; it can thus be ended up on their agreement (Commercial Code, art 217). Therefore, In this sense, if partners agreed unanimously; nothing can stop them to terminate the business engagement even before the lapse of the agreed time (Commercial Code, art 217).

When see the purpose of the formation of Micro and small enterprises, it is not only to satisfy the profit making or economic interests of owners but also to achieve political and macroeconomic interest of the government (Government of Federal Democratic Republic of Ethiopia, 2011). This can be understood from the government program that Micro and small enterprises are formed with purpose of enhancing macro-economic development (Government of Federal Democratic Republic of Ethiopia, 2011). Micro and small enterprises shall not dissolve by any cause rather they upgrade to medium enterprise level then to large enterprise through graduation process when their capital increases (Government of Federal Democratic Republic of Ethiopia, 2011). That is because, it is also the policy direction of the state to create permanent job opportunities and reduce poverty and joblessness by creating different job opportunities by increasing capacity

of enterprises potential of hiring employees (Government of Federal Democratic Republic of Ethiopia, 2011).

For this end micro and small enterprises are not required to be dissolved for whatever reason. Thus, as to the observations and interviews of this researcher, when one member or some of the members of micro and small enterprises went out from the organization for whatever reason the enterprise will continue being jointly held by the remaining members (Interview with Mustefa, 2019). They perpetuate like company form of business organization. Therefore, practically dissolution grounds for micro and small enterprises are not similar with that of partnerships formed under the Ethiopian commercial code.

4. Conclusion and recommendations

In Ethiopia, present day witnessed unprecedented increase in numbers of micro and small enterprises over all corner of the country. These micro and small enterprises are required to be governed under trade law according to the sector's development strategy. The commercial code of Ethiopia is the main trade law which provides acceptable firm structures and rules that govern each kind of firms. From the existing kinds of firms, partnership firms are the most suitable legal structure for the small businesses which operate commercial activities with a small capital and lesser number of employees. The commercial code also lists the sample of activities that are considered as trading activities which are subject to commercial law and also it lists out non-commercial informal activities which cannot be subjected to commercial law. Micro and small enterprises are carrying out both commercial and non-commercial or informal trading activities.

These informalities of micro and small enterprises made them incompatible with the rules and regulations governing partnership laws in the country. Micro and small enterprises registered as business organization do not specify under their memorandum of associations whether which form of business organization they follow from what is provided under the commercial code. In Ethiopian commercial code, we have four forms of partnerships and all except joint venture have legal personality.

Because of these legal personality, the liabilities of partnership firms cannot be directly considered as the liability of the members and the vice versa is also true. Therefore, because of legal personality conferred to them the creditors of partnerships cannot claim payment or discharge of duties directly from the partners before seeking it from the partnership. Debtor of any partnership must claim discharge of any duty from the entity before resorting to its members.

Whereas when we see the practice regarding micro and small enterprises, sometimes the owners are being considered as personally liable for the debts of their enterprises specially when they enter into group guarantee as several and joint debtors. From this one lawyer can understand that the liability of the owners of micro and small enterprises is neither unlimited liability like partnerships nor limited liability like companies.

This shows micro and small enterprises organized as business organization in Ethiopia are not practically enjoying legal personality as provided in the commercial code. With regard to management, though micro and small enterprises are managed by their owners as like partnerships, the trend that each micro and small enterprise must have one manager, one chairman, one cashier, who must be from its members or owners, shows that it adopted its own way of business management jurisprudence which is not provided in the commercial code. But when we see the life of enterprises micro and small enterprises are intended to live long like a company.

That is because they are organized to create permanent jobs for youth and if one of the members unable to continue for whatever reason the enterprise stay alive being held by the remaining members. This makes them completely different from partnerships under the commercial code whose life is dependent up on the life and willingness of partners. Therefore, micro and small enterprises have features incompatible with existing law partnerships in Ethiopia.

Practically, Micro and Small Enterprises are not duly formed and structured under trade law, when they were conducting trading by being registered by micro and small enterprises agency. Thus, there is no uniformity in the forms of business organizations and the ways of registration by trade registrar and Micro and Small Enterprises Development Agencies. Therefore, to rectify all defects and lack of uniformities on the formation, management, liability up to dissolution of

enterprises and to avoid such duality MSEDAs should not register enterprises because it is the power of trade registrar from its very nature. As like other similar organs in other countries from where Ethiopia has taken experiences, this researcher recommends MSEDAs in Ethiopia should provide other services through its one center service program but should not register enterprises because it is the function of commercial registrar.

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