

## **THE IMPACT OF ECONOMIC INTEGRATION ON SMALL AND MEDIUM ENTERPRISES COMPETITIVENESS IN ETHIOPIA, TIGRAY**

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Received: November 26, 2021; accepted May 27, 2022; published online June 24, 2022

### **ABSTRACT**

Ethiopia adopted substantial structural transformation policies and strategies and international goals and recorded a high share of value-added, GDP growth, and employment. This paper assesses the impact of economic integration on small and medium enterprises' competitiveness in Ethiopia, Tigray. Focusing on strategies, enabling environment, competitiveness, and challenges of the economic integration of small and medium enterprises. The study employed a cross-sectional mixed approach method. The data were collected from a sample of 148 SMEs selected based on proportional stratified sampling after a pilot test was conducted. Interviews with 15 leaders and 8 focus group discussions with the SMEs council were conducted. The result shows, the lack of access to finance, work promise, market linkage, quality and quantity input, dependency mentality, and rent-seeking behavior of SME operators are challenges for SMEs' productivity, and competitiveness. In addition, the commitment, and capacity of the leaders to support SMEs integration into the global market is weak. Thus, policies and strategies should review and adjust considering the current capacity of actors and agency leaders are very critical. Finally, establishing special financial institutions and market-supporting units might help SMEs' competitiveness. Work premises for production and market as well as infrastructure should be ready before the SMEs are established.

**Keywords:** Integration, competitiveness, small and medium enterprises, strategy

**Jel classification:** B4,C3,C4,O2, O12

## **INTRODUCTION**

The Government of Ethiopia has set several national and international development goals to be achieved by 2025. This includes, among others, attaining lower-middle-income status; diversifying and doubling the country's export capacity; lifting the contribution of the manufacturing sector from its current level of 5% to 17%; turning Ethiopia into a leading manufacturing hub in Africa and creating decent jobs and dynamic private sector that contribute to the growth and structural transformation (Tsegay,2018). The industrial sector in general, and the manufacturing sector are one of the economic strategic areas in attaining these goals and paving the way toward successful economic transformation. In a developing country like Ethiopia where capital and foreign exchange are scarce, and labor is relatively abundant, the most realistic and viable approach to kick-start industrialization and structural transformation is to initiate investment in small and medium enterprises (SMEs), especially those that rely on labor-intensive production technology. Thus, the development of MSEs in the manufacturing sector has been a big agenda for the Ethiopian Government to generate employment and reduce poverty through integrated competitive light manufacturing industries.

Considering this, the Government established the Small Enterprises Development Agency, a strategy formulated in 2004 to address the problem of MSEs (FDRE, 2012) at the Federal level in 2005/6 Proclamation 33/98) and Regional States level in 2001 2008 to coordinate the sector at the federal (Belay 2000: CSA 2003; Mulatu 2005; Adil 2007; Mesfin,2015) However, the strategies do not mention the medium level enterprises which are a very important factor for the promotion of the enterprises since Small and medium Enterprises are as an engine of economic growth (Charles,2008;Tsegay,20 15; Amentie et al.,2016), contribute for jobs creation and poverty alleviation (World Bank, 2007; MoUDH, 2012; Cibela, 2016; Dawit 2017; Yared, 2018), seed and backbone of the private sector (Biru, Vugar et al., 2017), and lay a fundamental foundation for the industrialized economy (MoUDH, 2012; Yared, 2018). Vakharia &Yenipazarli (2009) suggested that the process of economic integration has opened opportunities and increased pressure for SMEs to expand their value chain and to form a strategic alliance with local or foreign firms to facilitate production and distribute their products in the global market. Eshetu and Mammo (2009) argue that "Ethiopia has failed to benefit from the phenomenal growth in the SMEs sector". This emerges from the fact that the sector lacks appropriate policy, to integrate into microfinance institutions, Agriculture, and infrastructure sectors which lag behind the growth of SMEs (report, 2015).

Ethiopia is exporting more as primary products than value-added products which in turn affect employment opportunity, better price, and long-term competency. The growth performance of the manufacturing industry which is the key indicator of the degree of structural transformation in the economy was lower than the target for the plan period. The poor growth performance of the light manufacturing industries and the delay in the implementation of large manufacturing projects were the major contributors to the slow growth in the overall manufacturing sector (Yodit,2015) Therefore, proper implementation and integration of light manufacturing industry developments call for urgent and systematic research on economic integration SMEs' policies and strategies. This paper focused on the economic integration of SMEs engaged in Wood and Metal, Textile and Garment, Leather and Leather Product Agro-processing, and Construction Input in manufacturing sub-sectors.

### **1.2 Problem Statement**

Ethiopia is characterized as an undeveloped country, chronic poverty, with a high population second to Africa, a lack of investment capital, and infant entrepreneurship are all persistent problems of the country (Elias,2015). Given this situation, one cannot expect the economic integration of SMEs and entrepreneurship to create a competitive situation as required and derived by SME members and actors at large. World Bank Group 2015 identified that the microfinance institution in Ethiopia does not accommodate small and medium enterprise needs. Without adequate support from financial institutions, SMEs could not run their business efficiently and effectively to enhance productivity and realize their competitiveness. As World Bank's Investment Climate also mentioned that SMEs as a fundamental foundation and seed for manufacturing industries. However, the quality and coverage of infrastructure is low, the inadequacy stems largely from resource and capacity constraints leading most SMEs to low productivity, and inefficient allocation of resources that hinder SME competitiveness (CBC,2013). The vision of Tigray is to create a society where extreme poverty becomes history and every citizen has access to a job. But underdeveloped nature of productive capacity and unemployment is a challenge of the region (GSTS,2019). This makes it difficult to strengthen the economic integration of SMEs in the manufacturing sector which calls for systematic research in this area. Research has been done in the area of small enterprises. However, as per the knowledge of the researcher, studies in the field of the economic integration of SMEs in the Region have not been done before. Therefore, the general objective of this study is to examine the economic integration of small and medium enterprises in Ethiopia regarding the critical analysis of the manufacturing sector in the Tigray Regional State

## **2. REVIEW OF RELATED LITERATURE**

### **2.1 Concept of Economic integration and competitiveness**

The newly designed Ethiopia Development Strategy published in 2011, defined SMEs based on capital and Labor. Small enterprises are those with 6-30 workers and total capital, not exceeding 1.5 million Birr for manufacturing enterprises, while medium enterprises have 31-100 workers with a total capital of less than 20 million Birr.

### **2.2 Economic and integration theories**

Integration is the process of bringing different economies together to remove their barriers and utilization all potential opportunities to bring sustainable growth to the country (Machlup et al,1977) cited by Amr Sadek et al, 2013, increase investment, sustainable demand, utilization of resources, and production efficiency (Marinov,1999; OECD,2018). Efficient allocation of resources brought about both efficient utilization of these resources and plays a significant role in the production of competitive products. Whereas improper strategic planning and not readiness for restructuring brought about a decrease in production. Application of a passive strategy instead of an active one, which is the slow resolution of new problems decreased the competitiveness of the products. The renovation and technical restoration based on the industry are implemented as part of investment programs. In this case, the production became more effective, and a technical base of product development is created. Thus, the government should realize the encouragement of internal demand, encouragement, and regulation of export, encouragement of technological development, and application of optimal government partnership in strategic sectors (Gulbaniz,2012).

Balassa (1995) also mentioned economic integration increased economic growth, improve access to advanced technology, way of communication, market structure, increased competition, and uncertainty intended to lead to lower prices for distributors and consumers. Additionally, it facilitates access to a larger consumer base and a greater share of qualified workers (Hosny,2013). But increased exposure to competition, political risk, and limiting rules and regulations. According to Margaret Lee,2014 economic integration creates a common market and removes any trade barrier to have regional cooperation and collaboration to free movement of production factors working on equitable distribution of costs and benefits among countries (Lee 2003) cited by Dawit, 2017. However, economic integration and its benefits are not fully applicable to integration because of the challenge of competition, market access and free trade, and Human resources capability (Meier, 1990; OECD,2004).

### **2.2,1 Competitiveness**

The competitive manufacturing industry can be defined as it is the ability to create, innovate, produce quality products, and optimal sales of goods and services at reasonable prices on national and foreign markets (Drwillo,2002) and the firm's capability to survive in the competition against its competitors. To enhance competitiveness and export capacity in the light manufacturing sector in developing countries like Ethiopia faces critical barriers in penetrating export markets, including the inability to meet international standards (in terms of price, quality, delivery, health, labor, and environment), lack of marketing capacity and knowledge, and insufficient understanding of international networks, and weak managerial skills and entrepreneurial spirit and capacities both in theory and practice, and a motivational system like tax and subsidies. Thus, SMEs can be capable to produce high-quality products, and innovation to meet market demands. They could design a strategy to participate in a competitive market, enhance their production capacity, and then increase the quality of their products demanding the international market. Thus, the economic integration of SMEs is achieved with medium- and long-term objectives (Marinov,1999) but, Helleiner, 1999 argues that small and medium enterprises are lacking to compete in the larger market due to skill and knowledge constraints. In some countries, government procurement practices are a form of state aid, with the state purchasing goods and services from favored enterprises at higher than market prices. The competition office can urge that government procurement be conducted in a transparent and competitive fashion that gives all qualified sellers an equal opportunity to compete. The agency can help to develop procurement procedures that ensure competitive outcomes. It can also assist the government in adopting measures that help to prevent bid rigging and price-fixing on government contracts. In virtually all countries, cartel conduct in government procurement is a serious problem (Hans et.al, 2012).

### **2.2.2 Enabling Business Environment**

Donor Committee for Enterprise Development (DCED) describes the business environment as the complex interplay of policies, laws, and regulations that affect business development in each place (ADB (2014). One of the roles of strategy implementers is to make the working area free play for the operators. A conducive environment helps business operators' easy entry and out of the business. The existence of a strong supportive government institution helps to search the new market, demand forecasting, and market information (Berhun et al., 2014; A weak enabling business environment is the key constraint on the development of the SME sector.

### **3. METHODOLOGY**

The study adopted a case study research design which is a cross-sectional mixed approach method to supplement data obtained in one approach with that of another and to provide a full picture of the issue under consideration. To attain the aim of the study, qualitative and quantitative data were used. The study population included 1448 operators of small and medium enterprises from purposively selected 5 sub-sectors of the manufacturing sector. To carry out this study, 123 operators were selected through a stratified sampling method after the pilot test was managed to determine the appropriateness and relevance of the questions in the instrument. For interview purposes, 15 small and medium enterprise development agency leaders and experts and stakeholders, and 8 groups of SME council members were selected purposively for focus group discussions. The data collected from primary sources and non-participatory observations were recorded, edited, organized, analyzed, interpreted, and presented with research questions. The quantitative data were analyzed using descriptive statistics SPSS version 25 and were presented by tables,

### **FINDING AND DISCUSSIONS**

#### **1. Policies and Strategies of SMEs**

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Are the policies and strategies applicable to SMEs	96	1	5	3.53	1.239	1.536
Are the policies and strategies flexible and ready to amend	96	1	5	3.23	1.244	1.547
The policies and strategies were designed based on the regional context	95	1	5	3.13	1.142	1.303
The policy contributes to the living hood improvement of SMEs	94	1	5	3.21	1.086	1.180
The financial policy of the country affects the operating activities of SMEs	94	1	5	3.09	1.142	1.305
Strategies were favored for large-scale enterprises than SMEs	95	1	5	2.99	1.096	1.202
Strategies promote the productivity of SMEs	96	1	5	2.93	1.207	1.458
Strategies promote entrepreneur and human capital	95	1	5	2.92	1.217	1.482
the policies offer the utmost attention to SME	96	1	5	2.90	1.138	1.294
Valid N (listwise)	89					

There is a slight significant statistical difference among mean score indicators of related Policies and Strategies Implementation. From the statistical description, Strategies promote entrepreneur and human capital, as well as productivity of SMEs and the policies are offered utmost attention to SMEs depict that the mean and standard deviation of (M = 2.92, S.D = 1.217), (M = 2.93, S. D = 1.207),(M= 2.90, S.D =1.14), Strategies were favored for large-scale enterprises than SMEs (M= 2.99, S.D =1.096, and The financial policy of the country affects the operating activities of SME (M= 309, S.D =1.142) respectively which are felt below average 3.10. But the respondents are undecided on the issues of the flexibility of policies and strategies, regionally contextual, its contribution to livelihood, the effect of fiscal policy on operating activities of SMEs, strategies favoring large enterprises over SMEs, strategies promoting productivity of SMEs and entrepreneur and human capital and policies offering utmost attention to SMEs.

### Competitiveness

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Available skilled manpower	94	1	5	3.24	.980	.961
Available of infrastructure	95	1	5	2.72	1.059	1.120
Available cheap manpower	95	1	5	3.33	1.005	1.009
SMEs have produced domestic demand for products	95	1	5	2.74	1.023	1.047
SMEs have produced external demand for the product	95	1	5	2.49	.944	.891
SMEs have the capability to produce high-quality product	95	1	5	2.48	1.009	1.018
SMEs have a competitive strategy to compete in the market	95	1	5	2.66	1.027	1.056
Government incentives (tax redaction subsidy and training)	94	1	5	2.79	1.163	1.352
Availability of quantity and quality of raw material/input	95	1	5	2.74	1.240	1.536
Valid N (listwise)	93					

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These questions were also supplemented by key informants and discussants that the policies and strategies are important to get out of poverty if it implements properly. But it lacks proper implementation because of lacking scientific knowledge and skills, a lack of understanding of the federal SME's strategies, and the commitment of the leaders, especially in the low-level position. The linkage of SMEs Strategy with other sectors is very poor even though the interest of the government is very high.

There is a significant statistical difference among the mean score of Competitiveness factors. The respondents are indifferent between disagreeing and undecided on the rest of the indicators explained in the above table. The respondents disagreed on SMEs have produced external demand for products (M =2.49, S. D=0.944 that SMEs have the capability to produce high-quality products (M =2.48, S. D=1.009). Available of infrastructure (M=2.72, S. D=1.059), SMEs have produced domestic demand for products M =2.74, S. D=1.023), SMEs have a competitive strategy to compete in the market (M =2.66, S. D=1.027,.) and Availability of quantity and quality of raw material/input (M =2.4, S. D=1.240) are felt below average 2.79.

**Enabling environment**

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Have adequate knowledge of SME strategy to support SMEs	96	1	5	2.61	1.127	1.271
Working environment conducive	96	1	5	2.63	1.008	1.016
Provision of facilitating SMEs to get finance	95	1	5	2.44	.986	.973
Provision of supporting SMEs to get business development skills	96	1	5	2.68	1.061	1.126
Provision of helping SMEs to get working promise/place	96	1	5	2.45	.983	.966
Provision of facilitation to create market linkage for SME	96	1	5	2.47	.973	.946
Valid N (listwise)	95					

There is no significant statistical difference among the mean score of Practice of Economic Integration among SMEs in the MS indicators. The whole indicators or their mean depicts that the respondents are indifferent between disagreeing and undecided on those issues listed as an indicator.

Though the government design strategy to support small and medium enterprises, the above result shows that the mean value creating a conducive working environment regarding facilitation to get finance (M =2.44, S. D=0.986, working premises =2.45, S. D=0.983 and market linkage with others M=2.47 and S. D=0.973 are felt below average 2.55. And most of the respondents agreed that no conducive environment was available for the economic integration of SMEs created by the regional governments even though initiation is there. This implies that the city lacks commitment and serious attention in providing the service compatible to run a business applying the best experience taken from other successful countries using the existing resources. The interview results also supported the above idea SMEs are working in the difficulty of failure in creating an enabling business environment. No proper study was conducted before the SMEs are established such as the criteria, who supports them? does the supporting unit have the capacity in knowledge, skill, and administrative system better than the SMEs? Does SMEs willing to work as a team or independently? Additionally, all the discussants identified that the role of leaders is limited with poor coordination of responsible sectors, improper functioning of the council, and a great lack of contribution in establishing a suitable environment for the SMEs in accessing current information, providing a favorable working place and attractive market opportunity. This problem might emanate from a lack of shared vision toward the role of SMEs in employment creation, economic growth, poverty alleviation, and economic integration.

### Networking with SMEs

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic
Have good relationships among SMEs	95	1	5	2.54	1.040	1.081
Experience sharing among SMEs	95	1	5	2.69	1.063	1.129
Transfer of knowledge human power and capital among SMEs	96	1	5	2.48	.995	.989
Valid N (listwise)	94					

There is almost no significant statistical difference among the mean score of networks among actors. The statistical description of having good relationships among SMEs, experience sharing among SMEs, and transfer of knowledge human power and capital among SMEs depict that the mean and standard deviation of (M = 2.54, S.D = 1.04), and (M = 2.48 S. D .995) respectively which is felt below the average of 2.57. Based on the result they are not agreeing on the human power and capital among SMEs, and they are indifferent between disagreeing and undecided on having a good relationship among SMEs and experience sharing among SMEs.

**Challenges faced by SMEs**

	N	Minimum	Maximum	Mean	Std.	Variance
	Statistic	Statistic	Statistic	Statistic	Deviation Statistic	Statistic
There is adequate support services for the training provision	95	1	5	2.94	1.270	1.613
There are adequate support services for workplace provision	94	1	5	2.61	1.128	1.274
There are adequate support services in credit /finance provision	94	1	5	2.45	1.094	1.196
There are adequate support services for creating market linkage	95	1	5	2.49	1.193	1.423
SMEs have got all services at the one-stop service center	95	1	5	2.59	1.125	1.266
There are adequate support services in the technology provision	94	1	5	2.47	1.034	1.069
Committed of support SMEs	95	1	5	2.54	1.090	1.187
Procurement of capital goods is easy	95	1	5	2.59	1.162	1.351
Easily to access information about market	95	1	5	2.49	1.157	1.338
Easily equation rent/land	92	1	5	2.39	1.109	1.230
Valid N (listwise)	89					

There is no significant statistical difference among the mean score of the indicators listed types of Challenges Faced by SMEs indicators. The whole indicators or their mean depicts that the respondents are indifferent between disagreeing and undecided on those issues listed as an indicator. Respondents agreed that except adequate support services for the training provision(M=2.94, S.D=1.270), all(adequate support service, access to facilitate credit /finance, established one-stop service center, technology transfer, the commitment of leaders, procurement of capital goods, easy access to information about the market, and acquisition of land /rent are felt below the mean average of 2,85.that is the main challenge of economic integration for all SMEs in manufacturing subsector. The key informants also agreed the above-stated problems have been influencing the daily operation of SME activity. To that extent, the training given to SME operators was not demand-based and adequate to fill their gap. The provision of land is problematic, the lease price of the land increases from 0.7 to 300-birr k/meters which is not affordable by SMEs.

Moreover, delays in the process and rent-seeking behavior due to a lack of coordination and collaboration between SMEDA and the Mekelle Municipality office. Further, lack of responsible and accountable officials in the public service. The other critical challenge for SMEs is the financial regulation of the country which is not accessible to SMEs.

## 5. CONCLUSION

Enterprises Majority 46.7% of the respondents agreed that the strategies do not promote the entrepreneur and human capital, and productivity of SMEs and offer utmost attention to SMEs rather priority is given to micro, large enterprises, and foreign direct investment. Though policies and strategies are important to get out of poverty, it was not implemented properly due to a lack of scientific knowledge and skills to understand the federal strategies and commitment of the leaders, especially at the low-level position and experts to support and coordinate SMEs activities. Additionally, the linkage of SMEs Strategy with other sectors is very poor even though the interest of the government is very high due to the lack of action of government officials and less effort by SMEs. The government cannot create enabling environment to understand the federal strategy to support implementors in the provision of access to finance, working place, and market for SME operators. This can lead to low productivity and lack of completion in the market due to quality input and insufficient finance.

Though the government designed a strategy to support small and medium enterprises, most of the respondents agreed that no suitable work area gave room for the economic integration of SMEs created by the regional governments even though initiation is there. lacks commitment and serious attention to creating a conducive working environment and applying the best experience taken from other successful countries using the existing resources is low. Problems were starting with the establishment of SMEs since no proper study was conducted before the SMEs are established. What are the criteria to establish; who support them? does the supporting unit have the capacity in knowledge, skill, and administrative system better than the SMEs? and does SMEs willing to work as a team or independently? The expert's knowledge and skills are not better than /below/ the SME operators. This situation makes the working environment discouraging and implementers cannot strive with full potential in promoting SMEs. Additionally, the role of leaders is limited with poor coordination of responsible sectors, improper functioning of the council, and lack of shared vision towards the role of SMEs providing a favorable working place and attractive market opportunity in creating the working area compatible for business is weak.

Leadership needed to fill the gaps in coordinating the stakeholder's involvement in this issue. In countries like Ethiopia, available cheap and skilled labor for SMEs is obvious. SMEs cannot absorb the available workforces in the sector and pay less cost for human labor, in turn, increasing productivity. On the other hand, SMEs were not produced quality materials to compete in the international market due to a lack of competitive strategies, quality and quantity inputs and government motivation at large. SMEs were always dependent on the government to arrange markets and promote their product and prepare business cards and promote themselves and create a link with local and international markets. They are limited in the local market due to a lack of market assessment based on studies knowing demanded products by the local and international markets. Moreover, the gap in technology transfer, capital, market linkage exposure to foreign markets, and management system since they used family employees. Further, unwillingness to take risk of producing quality products and fear of increasing cost of production, and lack of internationalization outlook.

Respondents agreed that adequate support service to provide a workplace, access to facilitate credit /finance, established one-stop service center, technology transfer, the commitment of leaders to support SMEs, procurement of capital goods, easy access to information about market and acquisition of land /rent are the main challenge of economic integration for all SMEs. To that extent, the training given to SME operators was not demand-based and adequate to fill their gap. Thus, SMEs are working in difficult situations due to a lack of commitment and weak support of the leaders and experts to mobilize and coordinate different stakeholders to engage directly or indirectly in SMEs activities. The provision of land is problematic, the lease price of the land increases from 0.7 to 300-birr k/meters which is not affordable by SMEs and not considered the situation of the enterprises. Moreover, delays in the process and rent-seeking behavior due to a lack of coordination and collaboration between SMEDA and the Mekelle Municipality office. Further, lack of responsible and accountable officials in the public service. The other critical challenge for SMEs is the financial regulation of the country which is not accessible to SMEs. SMEs are missed in the strategies. Regarding market linkage, SMEs were, limited in the local market due to a lack of quality and quantity input in the market that emanates from poor linkage with suppliers and a lack of foreign currency for buying quality input products to compete in the market. As a result, the product they are producing lacks demand in the international market. Only 43(5041,700) birrs by small and 18(438067,313 birrs) export in 2018/19.

## **6. RECOMMENDATIONS**

The result of findings and knowledge acquired from the literature, recommendations are proposed to be carried out to resolve the challenges which are identified.

Re-orient and adjust the small and medium enterprise strategies and provide a compatible work area for SME operators. Small and Medium Enterprise Development Agency leaders at different levels should be committed and persistent in implementing and coordinating different activities related to economic integration among SMEs in the manufacturing sector. SME council stakeholders and private sectors should be involved actively in proper coordination and capacity building for SMEs support providers (SMEs experts) and SMEs and close support, follow-up, and evaluation towards improving the SMEs in the manufacturing sector. Small and medium enterprise development agencies should give awareness creation to SMEs that the benefit of integrating each other and organizing in a developmental circle and working together building team spirit to integrate complementary assets and investments to promote jointly with common resources. The government should prepare the land and feasibility study on work premises, access to finance, and infrastructure before establishing operators, and the lease price of land should consider SME operators' financial capacity. The Regional government should establish a separate financial institution to facilitate SMEs' productivity and increase their competitiveness. SMEs should create a strong relationship and network with the region's large-scale enterprises and inputs suppliers through forwarding and backward linkage (subcontracting and outsourcing). The training program should aim to enable potential SMEs, particularly youth and women to develop a sustainable business ideas and SMEs startup. The business operators should be ready for change and accept new technologies. The operators should create an ability of independence rather than waiting for another to offer them (be visionary, hard work, and persistent). The government of the country should insert maximum effort to create a strong integration within the neighboring countries to get access to free trade and market to enhance SME's competitiveness.

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