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GEMINI Action
Research Program I:
Final Report

The Dynamic
Role of Micro
and Small
Enterprises
in the
Development
Process

GEMINI

GROWTH and EQUITY through MICROENTERPRISE INVESTMENTS and INSTITUTIONS
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GEMINI Action Research Program I: Final Report

The Dynamic Role of Micro and Small Enterprises in the Development Process

by

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EXECUTIVE SUMMARY

This paper examines the dynamic role played by micro and small enterprises (MSEs) in the development process. Based on surveys and studies in a number of countries of Africa and Latin America, it presents new findings on MSE growth patterns. Many of these findings have important implications for the design and implementation of programs to support the development of such enterprises. Central points highlighted in the paper include the following.

First, there is much turbulence among MSEs: many new enterprises are started each year, while many others cease operating. The rate at which new MSEs are being created typically exceeds 20% per year, a rate much higher than previously thought. The annual closure rate is also high, with most closures occurring within the first three years after start-up. Not all closures, however, are a result of business failures.

Second, among those MSEs that do survive, most do not grow. Only about a quarter of all new MSEs increase their work force, and most of these add only a few workers. Yet adding even a few workers can contribute in important ways to employment, to increases in economic efficiency and to income. Growing MSEs tend to be younger, to start smaller and to operate in dynamic sectors located in urban commercial areas.

Third, it is important to distinguish between those jobs arising from new starts and those that result from an expansion of existing enterprises. The former frequently reflect survival efforts by individuals with few options. Over the long term, about three quarters of MSE jobs come into existence through such new starts. Expansion jobs more frequently arise when entrepreneurs have identified profitable business opportunities; the resulting jobs are more likely to endure, to yield greater economic efficiency and higher returns.

Fourth, patterns of MSE growth are strongly influenced by the state of the macro economy. When the economy is expanding, relatively more MSE jobs are created through expansion, while the pressures to open more marginal, survival-type new enterprises slackens. When the economy is contracting, by contrast, the opposite forces are at work: relatively more survival-type new businesses appear, and fewer enterprises of any size are expanding. This means that broad-based macro policy reform aimed at creating a more dynamic economy can be an effective vehicle for fostering more durable employment and higher incomes among MSEs. Conversely, the absence of a dynamic overall economy constrains the kinds of programs that can be effective in promoting MSEs.

Fifth, MSEs headed by females have different dynamic characteristics compared to those operated by males. Female-headed enterprises are relatively more volatile. Not only are their new start and closure rates higher, but enterprises operated by women are more sensitive to both short and long run changes in the macro economy. However, they are less like than their male-headed counterparts to expand. These characteristics must be taken into account to ensure that female entrepreneurs are able to participate fully in the more dynamic aspects of MSE development.

Sixth, there is substantial diversity within the MSE universe. Four categories of MSEs seem to capture these differences: 1) new starts, where the entrepreneur is learning a range of new skills and where the initial objective is often primarily one of survival; 2) non-growing MSEs, which have overcome the

perils of start-up but have not expanded; 3) small growers, which have persisted and even grown in small amounts; and 4) graduates, MSEs that started very small and have made a transition to at least the middle ranges of the small enterprise spectrum. These distinct categories of MSEs have different contributions to make to the dual objectives of poverty alleviation and growth. Differences by category in needs and in constraints faced have important implications with regard to the types of assistance programs that are most appropriate for each.

Several key assistance implications follow from this analysis. For new starts, given the already high rate of new entrants and the corresponding high early failure rates, it may be prudent not to focus on assisting such enterprises, concentrating instead primarily on those that have managed to overcome the perils of the early start-up phase. For non-growing MSEs, intervention strategies for many survival activities might focus on either raising incomes without changing their employment size, or increasing the numbers of such MSEs that succeed in expanding. Micro credit programs can be quite effective in assisting such enterprises, particularly where the goal is to raise incomes. For small growers, for whom access to markets and to inputs are central problems, the simple provision of small amounts of credit will generally not suffice. For this group as well as for graduates, assistance needs are increasingly diverse. Cost-effective assistance programs that respond to this complexity will have to focus increasingly on enabling these enterprises to participate more fully in growing markets, encouraging them to specialize and strengthening their links to dynamic segments of the market.

CHAPTER I

INTRODUCTION

Micro and small enterprises (MSEs) are a 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. They have been given prominence in many development plans as well as in the strategies of many donors.

In most developing countries, the contribution of micro and small enterprises to employment and income appears to have been increasing over time. To some observers, this is an encouraging sign: markets are working, people are finding opportunities to participate in ways that empower and nourish many people, particularly including those that are otherwise most disadvantaged. To others observers, however, this increase in the numbers of people engaged in micro and small enterprises is a sign of failure of the economy to provide productive jobs; people are forced to take refuge in activities that provide only minimal, subsistence support.

Sorting out these differences is of great importance to those who wish to address the problem of poverty in the developing world. It is important to understand the characteristics and patterns of changes that are taking place in the domain of micro and small enterprises, combining this with a vision of how things might develop better in the future in order to specify things that might be done to help bring about that preferred outcome.

An important part of this sorting out involves a better understanding of the growth process among micro and small enterprises. Most past research in this area has been static in its orientation, providing a picture of how things look "today" (i.e. as of the time of the study). A comparison of such snap-shots for countries at different levels of development and with different policy settings, combined with historical data in a few countries (usually, today's industrialized countries), has led to some important generalizations concerning patterns of growth among micro and small enterprises.

There is a major limitation, however, on these cross-sectional and historical time series studies: their orientation has been, of necessity, almost entirely macroeconomic, focusing on the changing share in total output, income and employment of enterprises of different types and sizes. While these studies have enabled us to understand some important aspects of the evolving role of micro and small enterprises in the macro economy, they have been able to shed much less light on the microeconomics of change: patterns by which individual enterprises are started, evolve, and perhaps eventually go out of business.

In the past five years, a number of new studies have been undertaken that have helped to change that situation. These studies have used new survey techniques that make it possible to be more precise about patterns of enterprise births, survival, growth and closure. Among the data collection innovations have been the introduction of "closed" MSE surveys, continuous panel surveys, "tracer" studies of MSEs that had existed in the past, and modified baseline surveys that generated information concerning growth of the enterprise since its start-up.

These new surveys, which were undertaken as part of the GEMINI project supported by U.S. Agency for International Development and were under the overall supervision of staff from Michigan State University, have now been conducted in twelve countries. Comprehensive MSE growth data were generated from six core countries: Botswana, Kenya, Malawi, Swaziland, Zimbabwe, and the Dominican Republic. In these countries, not only was a modified baseline survey administered nationwide, but at least one other dynamic survey was also administered. Less comprehensive information was generated in six other countries, mostly funded by USAID through the GEMINI project: Jamaica, Lesotho, Niger, Nigeria, South Africa and Guinea. More details of the countries and surveys, which were administered to over 65,000 MSEs, can be found in the Appendix.

These surveys provide rich new insights into patterns of enterprise dynamics at the level of the individual producing or trading unit. This study summarizes what has been learned from these studies.

The universe of enterprises covered in these surveys includes all enterprises engaged in non-primary activities (i.e. excluding agriculture, forestry, hunting and fishing, mining and quarrying, but including the transformation, transport and marketing of primary products), where at least 50% of the output is sold (i.e. excluding products made primarily for home consumption), and engaging up to 50 workers (including unpaid family members, working proprietors, apprentices and part-time workers). This means that our definition of micro and small enterprises encompasses establishments consisting of one person weaving baskets for sale in the market; it also includes factories with forty or fifty workers, using complex machinery. We refer to this total as Micro and Small Enterprises (MSEs). For some purposes, we focus on the smaller end of this range - those with ten or fewer workers - referred to as microenterprises.

Anyone working in the area of micro and small enterprises is conscious of the great heterogeneity of the universe of small producers and traders. A central theme of this study is the search for meaningful patterns of growth for different components of this universe. One of the great and as yet unresolved challenges facing those seeking to understand this field is to find the most meaningful way of classifying these enterprises. Different analysts have focused on a variety of different defining characteristics: differences by size of the enterprise, by location, by gender of the entrepreneur, by sector, or by the degree to which the enterprise obeys the laws and regulations of the country.

Our principal efforts at categorization are presented in Chapter VI. In that Chapter, we suggest an approach based on the past history of the enterprise: its age and past growth experience. In particular, we propose a four-way separation that includes new start-ups; enterprises that have been in existence for some time but have not grown in terms of employment since they were established; enterprises that have grown since birth, but only in small amounts; and enterprises that have managed to graduate to the upper end of the small enterprise range.¹ These different categories of micro and small enterprises have different contributions to make to such goals as economic growth and poverty alleviation. Beyond this, our research

¹ As indicated in the discussion of Chapter VI, for some purposes we find it helpful to group together the second and third of these categories ("no-growth" and "small growth" enterprises). With that modification, our categorization is quite similar to that of the U. S. Agency for International Development, in their new formulation of strategies for sustainable development. In relation to microenterprise and small business development, they state that their programs will "address three elements that are critical to broad-based economic growth and participation: removing obstacles that impede the creation of new businesses that provide incomes; helping existing enterprises to expand; and supporting the transition of small businesses and microenterprises to the formal sector" (USAID, 1994). Our formulation in Chapter VI is quite similar to this three-part focus.

strongly suggests that different categories of enterprises face different problems and constraints, and can best be helped by different types of interventions.

A deeper understanding of patterns of growth among different categories of micro and small enterprises, the contributions that each can make to developmental objectives and the problems and constraints faced by each, can enable decision-makers to reach more informed decisions as to appropriate groups on which to concentrate, as well as the kinds of assistance likely to be the most helpful to that particular client group. It is our hope that the analysis presented here will contribute to that understanding.

The presentation is organized as follows. Chapter II paints a brief static picture of MSEs, setting the stage for the dynamic analysis that follows. A dynamic overview of MSEs is provided in Chapter III, highlighting the turbulent process of MSE creation and closure as well as MSE expansion and contraction. Chapter IV examines gender issues in more detail, followed by an exploration of the interrelationships between MSEs and the macroeconomy. Chapter VI explores the characteristics and assistance needs of different categories of MSEs. The concluding chapter provides a summary of findings and implications.

CHAPTER II

THE STATIC WORLD OF MSEs

This chapter presents a first look at the universe of micro and small enterprises (MSEs). The approach is static. It looks at questions of overall magnitude and enterprise size, of location and sector, of labor force and ownership. It also presents some information on the economic efficiency of enterprises of different sizes.

The review makes clear that this is a sector made up of a very large number of very small enterprises. Most operate in rural areas. While in most countries the majority are engaged in trading, there are also significant numbers in manufacturing activities. In most countries, the majority of owners and workers are women, with many participating as unpaid family members. Summary data for six core countries - Botswana, Kenya, Malawi, Swaziland, Zimbabwe, and the Dominican Republic - along with Lesotho are presented in Table 2.1. The discussion here highlights some of the key findings.

The micro and small enterprise (MSE) sector is far larger than reported in most official statistics.

Careful, house-to-house surveys of micro and small enterprises have found far more enterprises involving many more people than previous estimates based on official statistics, which often cover only registered firms. In nation-wide surveys, the share of households reporting that some member of the household operated a micro or small enterprise ranged from about 20% in Botswana to over 40% in Malawi and Kenya. Employment densities - the number of people engaged in MSE activities per 1,000 persons in the population - ranged from 70-90 in Botswana, Kenya, Lesotho and Malawi to 110 or more in Zimbabwe, Swaziland and the Dominican Republic. In six countries of Eastern and Southern Africa, estimated employment in micro and small enterprises is nearly twice the level of total employment in registered, large-scale enterprises and the public sector (Liedholm and Mead, 1994). Clearly, micro and small enterprises are a major source of livelihood for a significant proportion of the population in many developing countries.

Most activities categorized as micro and small enterprises are very small.

In most countries, the majority of MSEs consist of one person working alone. If one defines the MSE universe as those firms with 1-50 workers, the upper end of the tail - those with 10-50 workers - constitute less than 2% of the businesses in virtually all the African countries. Only in the Dominican Republic were there significantly larger numbers of enterprises at the upper end of the small enterprise range.

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TABLE 2.1

CHARACTERISTICS OF MICROENTERPRISES

	Bots wana	Keny a	Leso tho	Malawi	Swazi land	Zimbab we	Dominica n Republic
MSE employment/population age 15-64	17%	18%	17%	23%	26%	27%	19%
MSE employment per 1,000 persons in the population	71	83	84	92	118	127	109
Share of all MSEs that are one- person enterprises (%)	65	47	79	61	69	69	22
Share of all MSEs with 10-50 workers (%)	3	2	1	1	2	2	18
Share of hired workers in MSE labor force (%)	39	24	10	18	15	16	36
Locational breakdown of MSE employment (%)							
Urban areas	24	15	18	12	25	30	46
Rural towns	28	7	10	4	10	6	18
Other rural areas	48	78	72	84	65	64	36
Sectoral breakdown of enterprises: Urban areas only (%)							
Manufacturing	15	18	35	29	33	64	21
Commerce	71	74	41	62	56	30	63
Sectoral breakdown of enterprises: Rural areas only (%)							
Manufacturing	34	27	62	36	70	75	15
Commerce	64	66	27	60	24	16	75
Share of enterprises owned by females (%)	75	46	73	46	84	66	46
Share of all workers that are females (%)	67	40	76	40	78	57	38

Source: Survey data (see Appendix Table 1) except for the population data in the first line, which are taken from United Nations and World Bank statistics.

Most of the labor force in MSEs is made up of working proprietors and unpaid family members.

With most enterprises operating as one-person undertakings, it is not surprising that the largest employment category is working proprietors, a group that comprises more than half the MSE work force in most countries. When unpaid family members are added, the numbers reach three fourths of the workers in most places. Only in a few countries do hired workers comprise as much as 20% of the MSE labor force. Trainees and apprentices add a significant share of workers in some locations, particularly in West Africa; in Eastern and Southern Africa, as in other parts of the third world, apprentices constitute well under 10% of the MSE labor force.

Most MSEs operate in rural areas.

The share of all enterprises in urban locations - cities and towns with at least 20,000 inhabitants - reaches as high as 46% in the Dominican Republic and 30% in Zimbabwe, but was 25% or less in most other countries. Even adding enterprises in rural towns - generally, concentrations with 2,000-20,000 persons - still generally leaves well over half the enterprises in strictly rural areas of most countries. It is important to keep these facts in mind since many programs focus on enterprises in urban areas, where they are often more obvious and easier to reach.

While many MSEs are engaged in trading, a significant number are involved in manufacturing activities.

It is a common perception that micro and small enterprises are overwhelmingly made up of vendors and other small traders. There is some truth to this perception, since in many countries the majority of enterprises are engaged in commerce. It is important to recognize, however, that in all countries, small manufacturing activities are also an important component of the MSE sector. These manufacturing activities are particularly significant in rural areas, where they constitute a higher share of enterprises than in urban areas in each of the African countries with relevant data. Only in the Dominican Republic was the share of enterprises in manufacturing higher in urban areas than in rural locations.

Looking only at manufacturing activities, three activities have consistently been identified as the most important MSE categories: textiles and wearing apparel, food and beverages, and wood and forest products. Survey results indicate that these three groups comprise about 75% of manufacturing enterprises in urban areas of many developing countries, and nearly 90% of the rural enterprises. Yet these apparent regularities hide wide variations from country to country and between urban and rural areas as to which activity is most important, as well as the nature of the most prevalent activities within each of these broadly-defined sectoral groupings.

The majority of micro and small enterprises are owned and operated by women.

It is a striking fact that, in many countries, women outnumber men as owners and operators of micro and small enterprises. Furthermore, since working proprietors are the single largest category of the labor force, the great majority of workers in MSEs are also women. One of the recurring themes of this study concerns differences in enterprise characteristics according to the gender of the proprietor. Gender issues are examined in greater detail in Chapter IV.

Economic efficiency appears to increase with size among very small enterprises.

Earlier studies based on detailed analysis of data concerning sales and production costs in four developing countries suggest substantial differences in economic efficiency by enterprise size (Liedholm and Mead, 1987). In particular, the data indicate that returns per hour of family labor are significantly higher for enterprises with 2-5 workers, compared to enterprises with only one person working alone. This increase in economic returns continues for the next higher size group, those with 6-9 workers; thereafter, the number of observations is small and the results more ambiguous. Similar results were found in a recent survey of MSEs in Kenya (Daniels *et al.*, 1995). In all of these studies, the data suggest that one-person enterprises generate the lowest returns to the enterprise; even a small increase in size is associated with substantial increases in economic efficiency, which for these very small enterprises is closely associated with the level of income for those who work in the enterprise.

Implications

These characteristics comprise both the opportunities and the challenges for those working with micro and small enterprises. The opportunities arise since MSEs constitute a possible vehicle for addressing some of the major imbalances in many developing countries: the urban bias frequently found in assistance programs, and the limited participation of women in many of the benefits of development. The challenge comes from the fact that taking advantage of these opportunities generally requires a conscious effort to reach out to categories of MSEs that are less obvious and more difficult to reach. We discuss these aspects in more detail in subsequent chapters of this study.

CHAPTER III

THE DYNAMICS OF MSEs: CHURNING AND GROWTH

OVERVIEW

Micro and small enterprises are in a constant state of flux. Most of these changes are missed, however, if one focuses only on the aggregate changes over time in the level of MSE activity. It is only when the individual components of these changes are scrutinized that the magnitude of this churning becomes apparent. Not only are new firms being created (new starts, or births) while others are closing, but existing (surviving) firms are expanding and contracting. These components of change are sometimes summarized in two concepts: net firm creation, which is new starts minus closures; and net firm expansion, which is firm expansion less firm contraction. Since the individual components move in opposite directions, however, these net measures of change mask the magnitude of the churning that is taking place among MSEs.

In this chapter, the key survey findings on the individual components of these changes are examined. Specifically, the empirical evidence on new starts, closures, and existing firm growth (net firm expansion) will be scrutinized. Such an individual focus is important because each of these is subject to different forces, with different possible intervention implications.

NEW MSE STARTS

The rate of new MSE starts is extremely high.

Empirical evidence on new business starts (firm creation) in developing countries has been virtually nonexistent until recently. New findings from surveys in the six core countries, summarized in Table 3.1, reveal that the rate of new MSE starts is substantial. The annual rate of MSE new starts in these countries averages over 20 percent, ranging in a narrow band from 19.3 percent in Zimbabwe to 25.2 percent in Botswana. Although the figures are still somewhat crude in most cases, they are broadly indicative and, given the techniques used, provide lower-bound estimates of the orders of magnitude involved.¹

¹ New start (birth) rates are typically calculated by dividing all new firms appearing in a given time period (usually one year) by the number of firms in existence at the beginning of the year. Except for the Dominican Republic, the number of firms at the end of the year served as the base; given the net increase in the number of firms, this creates one source of downward bias. A second source of downward bias, present in all countries, is the omission of the short-lived firms that appear and the disappear within the year. A study of short-lived firms in the Dominican Republic indicates that if these are included in the analysis, the birth rate in the Dominican Republic would have increased by 6.5 percentage points. For more details of these methodological issues, see Liedholm and Mead (1994).

TABLE 3.1
ANNUAL MSE NEW STARTS RATE - BY INITIAL SIZE
AFRICA AND LATIN AMERICA

Country	Year	Enterprise Size (number of workers)			Overall average
		1	2 - 9	10 +	
Botswana	91	32.9%	11.5%	4.2%	25.2%
Kenya	92	33.7%	10.3%	1.6%	21.2%
Malawi	91	26.9%	14.1%	13.1%	21.7%
Swaziland	90	26.3%	10.8%	2.4%	21.7%
Zimbabwe	90	22.8%	10.6%	18.7%	19.3%
Dominican Republic	93	na	na	na	20.6%
Average		28.5%	11.5%	8.0%	21.6%

Source: computed from individual country survey data. Averages are unweighted across the six countries.

These surprising high figures are substantially above the 10 percent rate typically reported for small enterprises in industrialized countries.

Most new starts are one-person firms.

The vast majority of the new firms being created are one-person establishments. In the six core survey countries, in fact, these self-employed firms comprise almost 80 percent of the new starts (see Appendix, Table 2).

Relatively little is known about the central forces driving the MSE new start rates. A recent study by Daniels (1995) for MSEs in Zimbabwe indicates that the determinants of new starts differ between high and low profit activities. For high return activities, initial capital requirements, experience of the entrepreneur, and level of regulation are all inversely related to the new start rate. For low return activities, the rate of new starts is related (inversely) only to the aggregate level of economic activity; for these firms, the lower the level of aggregate economic activity, the higher the rate of new starts, reflecting the importance of the push-factor in firm creation.

Implications

A key implication of these findings is that there is no overall scarcity of entrepreneurs in the sense of individuals willing to incur the risk of establishing a new venture. Most of these new starts are one person firms, which are typically the least efficient and remunerative of the MSEs; they tend to enter in greater numbers when the overall economy is languishing. Given these findings, direct programmatic support of new starts should be undertaken only after careful consideration of other available options.

MSE CLOSURES

Closure rates are also high.

Survey results indicate that MSE closure rates are also quite high. The annual rate of closures of MSEs in the Dominican Republic, the only country for which accurate annual figures exist, exceeded 20 percent in the early 1990s.² The Dominican Republic findings, which are probably not atypical, highlight the extreme volatility of MSE activity, where simultaneously one large segment is starting just as another large segment of MSEs is closing.

MSE closures are not just due to business failures.

Why do MSEs close? The survey results make clear that only a portion, frequently a minority, of the closures can be attributed to the traditional "business failure," where the firm is not financially or economically viable. Somewhat less than one-half of the MSE closures in the six core countries were due to "bad business conditions" (see Appendix, Table 3); lack of demand and shortage of working capital were the two most frequently mentioned underlying external causes of these failures.³ For the others, approximately one-quarter of the MSEs closed for personal reasons, such as illness or retirement, while the remainder closed because they found better options or because the government forced them to close.

² Specifically, on the basis of area-based panel surveys, the annual closure rate was 29 percent in 1992 and 22 percent in 1993 (Cabal, 1995). In Zimbabwe, a closure rate of 11.5 percent per year (from 1991-1993) was reported from a similar area-based panel survey of MSEs (Daniels, 1995). 42 percent of the firms, however, could not be located in the resurvey, so this closure rate must be considered a lower-bound estimate. Area-based panel surveys, where all enterprises in the same areas are surveyed over time, generate much more accurate closure rates than those generated from either tracer or closed enterprise surveys, both of which are subject to severe selectivity biases that understate the closure rates. Annual closure rates derived from tracer surveys range from 1.3 in Nigeria (Kilby, 1994) to 4.1 percent in Jamaica (Fisseha, 1994), while those from closed enterprise surveys hover around 6 percent per year.

³ In Kenya (Parker, 1994), those who closed for demand reasons were much more likely to start a new enterprise than those who closed because of a lack of working capital. Indeed, overall, of those who closed, 60 percent subsequently opened new business, 15 percent worked in agriculture, 8 percent accepted paid employment, and 17 were no longer economically active.

Most MSE closures occur within three years of start-up.

When are MSEs most likely to close? Most closures occur in the early years of a firm's existence. In Botswana, Kenya, Swaziland, and Zimbabwe, over fifty percent of the MSE closures had occurred within three years of start-up (see Appendix, Table 4).⁴ MSE closures peaked before the end of the first year in Botswana and Swaziland, and between years one and two in Kenya and Zimbabwe. Clearly, MSEs are particularly vulnerable during the fragile initial years, when they are just learning how to operate the business.

Given the high MSE closure rates, particularly in the crucial initial years, it is helpful to know the characteristics of the MSEs that close and how, if at all, these differ from the characteristics of the survivors. The results of systematic analyses of closure patterns of MSEs in Swaziland, Zimbabwe, and the Dominican Republic have made it possible to paint an initial portrait of the type of enterprise that is most likely to survive.⁵ The findings of these studies are summarized in the following table.

TABLE 3.2
KEY DETERMINANTS OF MSE
SURVIVAL AND GROWTH

	Survival Likelihood (Higher if MSE)	Growth Likelihood (Higher if MSE)
Age	Older	Younger
Past Growth	Grown in Past	-
Initial Size	Smaller *	Smaller *
Sector	Not in Trading	In Particular Sectors that Vary by Country
Location	Urban, Not in Home	Urban, Not in Home
Gender	Male - Owned	Male - Owned

Sources: Derived from findings of McPherson (1992), for Swaziland and Zimbabwe, and Cabal (1995) for the Dominican Republic.

Note: * Not significant in the Dominican Republic.

⁴ More incomplete data from Malawi indicate that approximately one-third of the MSEs had closed three years after start-up.

⁵ For Zimbabwe and Swaziland, see McPherson (1992); for the Dominican Republic, see Cabal (1995). These studies make use of recent developments in "hazard analysis" to provide an explanation of enterprise closure and survival. The dependent variable in the analysis is the enterprise "hazard rate," which is the probability that a firm will close during the year. The independent variables used to explain the hazard rate are such items as the age, sector, and location of the enterprise. Econometric techniques are used to estimate the relationships (see Liedholm and Mead, 1993, or Allison, 1984, for details).

What are the salient characteristics of MSEs that are most likely to survive? In addition to age, the past growth, initial size, sector, location, and owner-gender might be expected to play a role. These points are discussed in turn below.

Growing MSEs are more likely to survive.

An important finding is the recognition that MSEs adding workers were more likely to survive than those that remained the same size. More specifically, the results from Zimbabwe and Swaziland indicate that for every one percent increase in employment, the MSE reduced its likelihood of closing during the year by approximately 5 percent (McPherson, 1992). Such findings are consistent with the notion that expanding MSEs have become more efficient and are thus more able to survive.

MSEs that are smaller at start-up are more likely to survive.

A direct relationship was found between the MSE's initial size and its survival chances. Firms that started the smallest, other factors being held constant, were more likely to survive than their counterparts that started larger.⁶ This finding is directly opposite to what one might have expected and indicates that smallness, by itself, is no impediment to survival.

MSEs are more likely to survive in sectors other than retail trading.

MSE survival rates varied significantly by sector. Retail trading MSEs in all three countries faced the highest closure risks; such firms were almost 30 percent more likely to close during the year, for example, than their counterparts in woodworking. Real estate, wood processing, wholesale traders, and non-metallic metal enterprises were the least likely to close, while trading, transport, and chemical MSEs were the most likely to do so in the two African countries.⁷

MSEs operating in urban commercial districts outside the home are more likely to survive.

Location appears to play a central role in determining MSE survival. Urban MSEs in the two African countries, for example, had an almost 25 percent greater chance of surviving the year, holding all other factors constant, compared to their counterparts in rural areas.⁸ Moreover, MSEs located in commercial districts were more likely to survive than those operated out of the home. Proximity to growing markets would thus seem to be an important factor in enterprise survival.

⁶ In the Dominican Republic, however, this relationship was not significant (Cabal, 1995).

⁷ The complete sector ranking of MSEs by survival probabilities from highest to lowest in Swaziland and Zimbabwe combined was as follows: real estate, wood processing, wholesale trade, non-metallic minerals, textiles, other services, food and beverage processing, construction, miscellaneous manufacturing, metal fabrication, hotels and restaurants, chemicals, retail trade, and transport. The rank differences, however, were not always statistically significant (McPherson, 1992).

⁸ The rural - urban distinction, however, was not statistically significant in the Dominican Republic (Cabal, 1995).

MSEs headed by males are more likely to survive, but only when all types of closings are considered.

The gender of the entrepreneur also is a significant determinant of MSE survival. More specifically, female - headed MSEs were less likely to survive the year than their male - headed counterparts, all other factors constant. These analyses examined the survival and closing of MSE due to all factors. Relatively high percentages of the closings of female-headed MSEs in these countries, however, were due to personal and other non-business reasons. When only closings due to pure business failures were analyzed separately, the gender of the entrepreneur was no longer a significant determinant. Thus, **in terms of closings due to business failures only, female-headed and male headed MSEs were equally likely to survive.**

Macroeconomic conditions also affect closure rates.

Finally, at a more macro level, there is evidence from Zimbabwe and the Dominican Republic of an inverse relationship between the overall level of economic activity and the closure rate, particularly in low-return activities.⁹ Thus, as the overall level of activity increases, the likelihood that MSEs would survive the year increases as well.

Implications

These closure findings provide important insights into the potential riskiness of various client groups that appear in the portfolio of many existing or potential MSE projects and programs. Those MSE projects or programs that wish to minimize the riskiness of their client portfolios might want to focus their attention on MSEs that have grown, that have existed longer than three years or that operate in commercial districts in urban areas in sectors other than trading. Alternatively, for programs focusing on the more risky MSEs, the findings provide a basis for incorporating these risk factors into their performance evaluations.

NET MSE EXPANSION

To this rapid churning resulting from the entry of new firms and the closure of others must be added the growth from the net expansion of existing enterprises over time. The net expansion depicts the expansion less the contraction of those MSEs that survive; it summarizes two opposing dynamic forces at work.

The indicator typically used to measure the magnitude of the net expansion of MSEs and the one used in the surveys reported in this study is the change in the number of workers since start-up. This

⁹ Using regression analysis, Daniels (1995) found an inverse relationship between the GDP growth rate over the 1988-1993 period and the annual closure rate in Zimbabwe. Similar findings have been reported for the Dominican Republic (Cabal, 1995).

measure tends to be favored because it is most easily and accurately remembered by the entrepreneur and does not need to be deflated.

Employment change provides a lower-bound estimate of net firm expansion.

What biases might arise from the use of employment as a measure of expansion rather than alternative indicators such as changes in sales, output, or assets? Although data on these other indicators are sparse, some recent surveys have begun to shed light on this issue. Parker's (1995) analysis of the growth in Kenyan MSEs, for example, found that net increases in real sales were almost double the growth in employment. A similar pattern was revealed in the Jamaican Quarterly Panel Survey of MSEs (Gustafson and Liedholm, 1995), where the change in real sales was twice the change in employment. Such findings highlight the lumpy nature of employment, which appears to increase with a lag after a sizeable growth in real sales, and indicate that the employment growth measures provide a lower-bound, more conservative estimate of net firm expansion.

Growth rates of existing MSEs are substantial.

One of the most striking findings to emerge from the various surveys is the high overall growth rates exhibited by existing (surviving) MSEs. Table 3.3 reveals that the average compound employment growth rate since start-up was 8.7 percent per year in the eight countries with relevant data.¹⁰ The country variation around this average is large, however, ranging from 2.4 percent in Lesotho to 24.0 percent in Kenya. These high growth rates are all the more impressive when it is recognized that, except for Botswana and Lesotho, they are at least double the overall growth in GDP in these countries during the 1980s. Moreover, in absolute terms, the annual number of new jobs created per enterprise is impressive (see Table 3.3, column 3).

When MSE employment growth of existing firms is examined year to year rather than from start-up, there is also evidence of net MSE contraction during certain periods. In Jamaica, for example, employment in existing MSEs declined almost 10 percent from 1993 to 1994 (Gustafson and Liedholm, 1995), while in the Dominican Republic over the same period the decline was 3.2 percent (Cabal, 1995). The role of the overall economy in explaining these short-run variations will be examined in Chapter V below.

The majority of MSEs did not grow.

Despite these generally rapid average growth rates, the majority of MSEs in survey countries did not grow at all since start-up. Survey results indicate that less than one-quarter of the MSEs had added any

¹⁰ The compound growth measure provides a lower-bound estimate of the growth rate compared with the average growth rate measure, which uses initial employment as the base. An absolute measure, the annual change in jobs per firm, is also presented in Table 3.2; it can be particularly useful in assessing the overall contribution of the smallest firms to job creation. The data for all the growth measures were generated by asking entrepreneurs retrospective information (event histories) about their firms.

workers at all since their start, while over three-quarters remained the same size.¹¹ MSE employment expansion was the exception rather than the rule, and the overall net expansion was thus being propelled by a minority of the enterprises.

TABLE 3.3
ANNUAL EMPLOYMENT GROWTH OF EXISTING SMALL ENTERPRISES
ALTERNATIVE MEASURES
Annual Change Since Start-up

Country	Annual Growth Rate - Average Growth Measure ^a (Percent)	Annual Growth Rate-Compound Growth Measure (Percent) ^b	Annual Change in Number of Jobs Per Firm (Number) ^c
BOTSWANA	8.4%	6.3%	0.119
KENYA	29.0%	24.0%	0.297
LESOTHO	5.9%	2.4%	0.094
MALAWI	10.5%	9.0%	0.112
SWAZILAND	6.6%	4.1%	0.061
ZIMBABWE	7.4%	5.6%	0.084
SOUTHERN/EASTERN AFRICA -AVERAGE	11.3%	8.6%	0.128
NIGER	8.5%	5.7%	0.101
DOMINICAN REPUBLIC	15.1%	12.6%	0.157
WORLD- AVERAGE	11.4%	8.7%	0.128

Sources:

Swaziland - Fisseha and McPherson, 1991
 Lesotho - Fisseha, 1991
 Zimbabwe - McPherson, 1991
 Kenya - Parker and Torres, 1994
 Dominican Republic - Cabal, 1992
 Botswana - calculated from data generated by Daniels and Fisseha - 1992
 Niger - calculated from data generated by Jourard, Liedholm, and Mead - 1992
 Malawi - calculated from data generated by Daniels and Ngwira, 1992

Notes: ^aAverage annual growth rate in terms of employment and is calculated as: $(\text{Current Employment} - \text{Initial Employment}) / \text{Initial Employment} / \text{Firm Age}$.

^b Annual compound growth in employment is calculated as: $\{(\text{Current Employment} / \text{Initial Employment})^{(1/\text{Firm Age})} - 1$.

^c Average annual growth in jobs since start up is calculated as: $(\text{Current Employment} - \text{Initial Employment}) / \text{Firm Age}$.

¹¹ About 5 percent of the enterprises had declined in size since start-up (See Liedholm and Mead, 1994).

Most of the growing MSEs added just a few workers.

Of those MSEs that grew, over ninety percent added less than four workers. About five percent of the expanding MSEs "graduated" from the microenterprise seedbed and ended up with more than 10 workers. Thus, the largest share of the employment expansion was due to most of the growing MSEs expanding just a little.

Adding even a few workers can increase the economic efficiency of MSEs.

When an existing MSE expands by adding even one or two workers, it is quite likely that this will be associated with a significant increases in its economic efficiency as well as in its net income. Most new MSE start-ups are one-person enterprises, which is also the least efficient size category (see discussion in chapter 2 above). If some of these MSEs subsequently expand, adding even one more worker, they will be moving into a size category where their economic efficiency as well as their net income are likely to be significantly higher.¹² Moreover, the jobs created should be more enduring and should generate higher returns.

What are the characteristics of expanding MSEs?

Given the economic significance of MSE expansion, it is important to know the characteristics of those enterprises that expand and how, if at all, they differ from those that do not grow. The results of a systematic analysis of the determinants of growth in the six core countries along with Lesotho make it possible to provide a profile of the type of MSE most likely to expand.¹³ The overall findings, which are summarized in Table 3.2 above, on the role of age, initial size, sector, location country, gender of entrepreneur, as well as human capital will now be examined.

Younger MSEs are most likely to grow.

The analysis suggests an inverse relationship between the age of the MSE and expansion. Thus, it was the younger MSEs that were most likely to generate more expansion jobs. Similar results were reported in the Dominican Republic (Cabal, 1995) and Kenya (Parker, 1995). Examining the growth and age performance of individual MSEs over time, however, Parker (1995) found that the inverse age and growth relationship held only for MSEs that started with one worker or with more educated entrepreneurs. Much of the expansion occurred in the first two years in the life of the enterprise. After the eighth year, a common pattern of downsizing took place, however, among MSEs of all types and sizes.

¹² See Chapter 1 above as well as Liedholm and Mead, 1987, for cross section evidence. See Parker, 1995, and Parker, Riopelle and Steel, 1995, for time series evidence.

¹³ Following McPherson (1995), statistical techniques (linear ordinary least squares regression equations) were used to test whether or not the various independent variables, such as age and initial size, were significantly related to the dependent variable, which was enterprise growth since start-up measured in absolute terms. See Liedholm and Mead (1994) for details.

Smaller MSEs are most likely to grow.

An inverse relationship was also found between initial size and growth of the MSE. The smaller MSEs at start-up thus added more expansion jobs per firm than did their larger scale counterparts, a powerful finding for those concerned with employment creation. Parallel findings have been reported elsewhere in Africa (Parker, 1995; McPherson, 1995), although a direct relationship between initial size and growth was found in the Dominican Republic (Cabal, 1995).¹⁴

MSEs in particular sectors are more likely to expand; but these sectors vary from country to country.

The sector in which an MSE operates also appears to be an important determinant of growth. At the most aggregate sectoral level, MSEs in manufacturing and services were more likely to expand than those in trading. At a more disaggregated level, however, the specific sectors that were likely to generate more MSE expansion varied from country to country. In Swaziland, for example, MSEs in non-metallic minerals expanded substantially less than retail trading, while in Kenya all sectors, including non-metallic minerals, expanded more rapidly than retail trading. What these findings suggest is that sectoral differences are significant at the country level in explaining MSE expansion, reflecting perhaps each country's comparative advantage - its unique fingerprint. At the same time, no universal sectoral growth patterns emerged.

MSEs operating in urban, commercial areas outside the home are more likely to expand.

Another important set of factors identified by the analysis as a determinant of MSE expansion was location. MSEs located in rural towns and villages, for example, were less likely to grow than their urban-based counterparts. Moreover, MSEs operating in commercial districts or even alongside the road showed a markedly stronger tendency to expand than did those operating from the home. Other studies have yielded generally the same results, but with a few exceptions. McPherson (1995), for example, found that in Southern Africa MSEs operating in even traditional markets were more likely to expand than home-based firms, while Cabal (1995) found that size of locality had no effect on the likelihood of expansion in the Dominican Republic.

MSEs headed by males are more likely to expand than those headed by females.

The analysis indicated that male-headed MSEs were more likely to expand than female-headed ones, even when controlling for such variables as sector and location. Although similar results have been reported by McPherson (1995) and Parker (1995), it is noteworthy that ownership-gender proved not to be statistically significant in the Dominican Republic (Cabal, 1995). These findings will be explored in greater depth in the following chapter.

¹⁴ As Parker (1995) has shown, this finding needs to be qualified with the recognition that enterprises that start with one person cannot contract and still remain as an on-going enterprise. For larger enterprises, the fact that growth in some was offset by contraction in others is a partial explanation for the lower average growth rate for enterprises starting at a larger size.

Entrepreneurs with experience, vocational training, or secondary education are more likely to expand.

Although data limitations precluded the inclusion of the "human capital" in the formal statistical analysis, related studies provide evidence that it does significantly affect MSE expansion. McPherson (1992) found that entrepreneurs in Southern Africa with vocational training expanded their MSEs nine percent faster than those without such training. For Kenya, Parker (1995) reported that entrepreneurs who had at least seven years experience were likely to expand their business more rapidly than those without such experience. Entrepreneurs who had completed secondary school were also found to be more likely to expand in Kenya (Parker, 1995), Zimbabwe (McPherson, 1992), and the Dominican Republic (Cabal, 1995).¹⁵ Completion of primary school by the entrepreneur, however, was found to have no significant effect on MSE expansion in any of these countries.

The state of the macroeconomy also influences expansion patterns.

Finally, at the more macro level, there is evidence of a direct relationship between the level of economic activity and MSE expansion. The higher the level of overall economic activity, the greater the amount of MSE expansion. This relationship will be examined in more detail in Chapter V.

Implications

Facilitating the expansion of existing MSEs can contribute to increased economic efficiency and higher returns to the enterprise along with more permanent type jobs. The analysis yields important clues as to the forces leading to enterprise expansion. Assistance programs need to work with these forces, taking advantage of them wherever possible. This might mean reinforcing and strengthening the positive attributes of any particular client group. It might mean linking rural firms with more dynamic urban markets, or seeking to expand access to more effective educational programs. Carefully crafted programs designed to facilitate a switch to expanding product lines might contribute in important ways to this process. The implications of these findings for programs and projects are explored in more detail in Chapter VI.

¹⁵ No significant relationship between secondary school education and MSE expansion, however, could be found in Botswana or Swaziland (McPherson, 1995).

CHAPTER IV

GENDER ISSUES

Significant gender differences in the patterns of MSE growth have been identified at several points in the preceding discussion. In this chapter, these gender effects and the issues they raise will be examined in greater detail. After a review of the static gender profile, the gender evidence on new starts and closures along with that on net expansion will be synthesized. Evidence on the relationship between the macroeconomy and gender-differentiated growth patterns follows, along with a discussion of the implications of these findings for programs and policies.

STATIC PROFILE

Female-headed MSEs are numerous, often in the majority, but tend to be concentrated in a few low return, home-based activities.

Large numbers of MSEs are owned and operated by women. At least 45 percent of MSEs in each of our survey countries were female-headed, and in four of the seven the majority was owned by females (see Table 2.1). Women, however, accounted for a somewhat smaller share of total MSE employment. This was due not only to the smaller average size of female-headed MSEs, but also to the small percentage of females that were employed in male-headed firms.¹ The importance of women-owned MSEs as generators of women's employment is reflected in these findings. MSEs headed by women also tend to be concentrated in a relatively narrow band of sectors or activities. Downing and Daniels (1992) have noted that women-owned enterprises are concentrated and dominant in a number of more traditional manufacturing activities such as beer brewing, knitting, dressmaking, crocheting, and grass and cane work, as well as in retail trading. Although data are scarce, there was some evidence to support the contention that profits generated by these types of activities were quite low. In Zimbabwe (Daniels, 1994), for example, the five sectors in which over two-thirds of the female enterprises operate were among the least profitable enterprise sectors in the country.² Finally, MSEs headed by women were more likely than their male counterparts to operate from the home; in the survey countries, for example, 45 percent of the female-headed MSEs were home-based, while only 19 percent of those with male owners operated out of the home. Since it is the home-based MSEs that tend to be hidden and overlooked, women owners of MSEs are more likely to be "invisible entrepreneurs" (Weidemann, 1992).

¹ In the Dominican Republic, for example, only 15 % of the employees of male-owned MSEs are women (Cely, 1993).

² Similar findings were earlier reported for MSEs in Egypt (Davies, Mead, and Seale, 1992).

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NEW STARTS AND CLOSURES - GENDER-DISAGGREGATED

New start rates are higher for female than for male-headed MSEs.

New start rates for female-headed MSEs are substantially higher than those of male-headed firms. In the six core countries, the female rate was over five percentage points higher than the male rate, a pattern that held in each country as well (see Table 4.1). These findings suggest that the surprisingly high overall enterprise birth rates (20 percent or more) reported in Chapter III are being driven to a considerable extent by new businesses being started by female entrepreneurs.

TABLE 4.1
ANNUAL MSE NEW STARTS RATE - BY GENDER OF ENTREPRENEUR

Country	Gender of Proprietor			
	Female	Male	Joint	Overall
Botswana	26.7%	22.3%	17.6%	25.2%
Kenya	24.3%	18.8%	17.8%	21.2%
Malawi	24.9%	18.6%	25.3%	21.7%
Swaziland	21.7%	22.9%	10.9%	21.7%
Zimbabwe	22.1%	12.9%	8.1%	19.3%
Dominican Republic	24.1%	19.2%	N.A.	20.6%
Overall Average	24.1%	19.1%	15.9%	21.6%

Source: computed from individual country data. In each case, these figures are calculated using figures on enterprise births during the last full year preceding the survey. Averages are unweighted across the five countries.

What factors might explain these gender-differentiated enterprise birth rates? One possible explanation centers on the sectoral concentration of female-headed enterprises. In Zimbabwe, for example, Daniels (1995) noted that the five sectors with the highest percentage of women entrepreneurs had the lowest capital and skill entry barriers, which allowed easy entry and may have contributed to high new entry rates, with a clear potential for overcrowding.

Closure rates are also higher for female than for male-headed MSEs, but only when all reasons for closure are considered.

Annual enterprise closure rates disaggregated by gender are scarce. In the Dominican Republic, the only country with the requisite information (Cabal, 1995), annual closure rates for enterprises run by

females (43.2%) were over three times those for male-headed MSEs (13.2%). Thus, both MSE closure and new start-up rates were higher for firms headed by females.

What reasons might have accounted for the higher closure rates of the enterprises operated by females? Was it because they were concentrated in sectors with high closure rates, such as trading, or was it due to gender itself? The previously described analysis of closure patterns of MSEs in Swaziland, Zimbabwe, and the Dominican Republic (see pages 12-16 above) revealed that the probability of female-run enterprises closing during the following year, holding other effects constant, was approximately 50 percent higher than for those for enterprises run by males. Thus, gender itself would seem to be a significant factor in determining enterprise closings. A large share of the closings of female-headed MSEs, however, was for personal rather than for business reasons. Indeed, when only the closings due to "business failure" were examined, the gender variable no longer proved to be significant. Thus, female proprietors were no more likely to close due to business failures than were their male counterparts, once the effects of all other variables were taken into account.

NET EXPANSION - GENDER-DISAGGREGATED

Female-headed MSEs generally grow less rapidly than those headed by males.

The annual average growth rates of MSEs headed by females were substantially lower than those of their male-headed counterparts in all the survey countries (see Appendix, Table 5). Excluding Kenya, an outlier with extremely high growth rates for both female and male enterprises, female-headed enterprises grew in a narrow band around 7 percent, while those with male owners grew in a similarly narrow band around 11 percent per year.

Female-headed MSEs are frequently concentrated in slowly growing sectors.

What factors might account for these dramatic and statistically different growth rates by gender? Sector is often considered to play an important role in explaining these differences. Downing and Daniels (1992), among others, have marshalled evidence to show that female-headed enterprises tend to be concentrated in sectors where the smallest amount of enterprise growth is occurring. Indeed, the individual country surveys reveal that in many of the sectors where the highest growth rates are found, such as construction, transport, and personal services, female ownership is minimal.

Yet even for firms within the same sector, there is evidence that female-headed enterprises typically grow less rapidly than their male counterparts. Appendix Table 5 reveals that, with two exceptions, enterprises owned by males grow more rapidly (or at the same rate) than those owned by females in the manufacturing (ISIC 3), trade (ISIC 6) and service (ISIC 9) sectors of the African countries surveyed.³

³ Such gender differences also continue to occur at even more disaggregated levels. In their analysis of forest-based enterprises in the Southern/Eastern Africa, for example, Arnold *et al.* (1994) report that, within the ISIC 33 category, grass, cane, and bamboo enterprises (the majority of which were female-owned) grew at an annual rate of 4 percent, while the woodworking enterprises (where virtually all the entrepreneurs were male) grew at an annual rate of 31 percent. Downing and Daniels (1992) also found that the slower growth rate for female owned firms typically also held at the more disaggregated level within sectors.

But there are important exceptions.

The slower growth of enterprises owned by women was not always the case. Trading in Malawi and services in Swaziland provide counter examples, reminding us that MSEs owned by women do not always grow less rapidly than their male counterparts. Moreover, in several countries, females were dominant in sectors that experienced among the highest growth rates. For example, textile manufacturing and textile trading in Zimbabwe and textile manufacturing in Botswana, which were all predominantly female, exhibited the highest employment growth rates.⁴ These findings provide an important reminder that not all female MSEs are mired in low growth sectors.

Sector alone cannot account for the gender growth rate differentials. Indeed, the previously described statistical analysis of the determinants of existing enterprise growth in Africa (Chapter 3) revealed that existing male-run enterprises grew more rapidly than those run by their female counterparts, even after controlling for the effects of sector and other important growth determinants.⁵

Fewer Female-owned MSEs expand.

One of the reasons for the relatively slower average growth rate of existing female-headed firms was that fewer of them were growing. As indicated in Table 6.2, only 15 percent of the female-headed enterprises expanded in the surveyed countries, while about 25 percent of the male-headed firms grew. A similar pattern was found in each country individually.

Fewer female-owned MSEs "graduate".

Among the female-headed enterprises that did expand, relatively few succeeded in "graduating" to the size category of firms with ten or more workers. Although we shall see in chapter six that the "graduation" rate of microenterprises in general was low (1.1 %), the comparable rate for enterprises owned by females is even more minuscule. As indicated in Table 6.2 below, the "graduation rate" of male-headed MSEs was eight times that of their female-headed counterparts.

What are the possible explanations for these gender effects on growth? Mentioned in the literature are such factors as the dual domestic and productive responsibilities of women, or possible differences in the business objectives of females and males. Females may also be more risk-averse than their male counterparts and thus may be more likely to use any available funds for diversification into new activities rather than for an expansion of existing ones (Downing and Daniels, 1992). Females may also be under more pressure to use business funds to meet household needs (Berger, 1989).

⁴ Daniels (1995) also found that female-owned MSEs in Zimbabwe were more likely to expand their paid employment than were their male owned counterparts. In addition, there is some evidence from Jamaica that by using employment rather than real sales measures of growth, one may be relatively understating the performance of female-owned MSEs (Gustafson and Liedholm, 1995).

⁵ It should be noted, however, that a similar analysis undertaken with data from the Dominican Republic found no statistical significance between gender of ownership and growth (Cabai, 1995).

THE MACRO ECONOMY AND MSEs - GENDER-DISAGGREGATED

Female-headed MSEs exhibit much short-run volatility.

Recent survey findings indicate that female-headed MSEs are more strongly affected by changes in the overall level of economic activity, both in the short and longer run, than their male counterparts. In the short run, women-owned MSEs have exhibited much more quarter-to-quarter volatility than those owned by males. The 1993-94 Jamaica Quarterly Panel (Gustafson and Liedholm, 1995) showed, for example, that employment in female-owned MSEs typically fluctuated by 10 percent every quarter, while employment in male-owned firms rarely changed by more than 5 percent.

New starts and closure rates of female-headed MSEs are particularly sensitive to changes in the overall economy.

In longer run, there is preliminary evidence of a gender-differentiated response of entry and closure rates to changes in the overall level of economic activity. The evidence of an inverse relationship between the new entry rate in low return activities and the overall level of the economy was noted in Chapter 3. Since female-headed enterprises tend to be concentrated in such activities, one would expect the new entry rates of female-headed MSEs to decrease as the economy expands. Correspondingly, one might expect the closure rates for such low return, female-dominated activities to be directly related to the level of activity. As overall economic conditions improve, such low return, survival type activities become less crucial. Recent evidence from the Dominican Republic provides support for the latter contention. For 1992-93, a good year, the annual closure rate of female-headed MSEs was 42.3%, but only 13.2% for the male counterparts; for 1993-94, a bad year, the female closure rate plummeted to 29.7%, while the male rate remained virtually unchanged at 13.4% (Cabal, 1995).

PROBLEMS - GENDER-DISAGGREGATED

Perceived problems are quite similar by gender.

One of the striking findings of the MSE surveys was the general similarity in types of perceived main problems reported by male-owned and female-owned businesses (see Appendix Table 6). One often hears about the special problems faced by women entrepreneurs in small enterprises in the third world, and no doubt there are many such special problems; yet it may be worth recognizing that, in broad outlines, the principal problems they face appear to be similar to those encountered by their male counterparts. Many of the major challenges facing those who start and run a small business are common to entrepreneurs of both genders.

Inadequate market demand is the most often cited problem of female entrepreneurs.

The primary problem cited by female entrepreneurs was not a lack of capital but an inadequate market demand, closely followed lack of access to raw materials and intermediate inputs. Men, by

contrast, complained somewhat more about their access to fixed and working capital, their access to tools and equipment, and constraints arising from government regulations. It is possible that these gender differences primarily reflected the particular activities in which female and male entrepreneurs are engaged.

Does this mean that credit is not also a need for women entrepreneurs? As discussed by Downing and Daniels (1992), "although women may cite insufficient working capital less often than men, this does not mean they have more access to working capital. It may indicate that women's market problems are more paramount. Without a market, they may have little viable use for financing."

Implications

One of the important implications of the gender findings is that there are large numbers of potential female clients of MSE programs, but many have been overlooked because they are typically "invisible entrepreneurs." MSE programs must be aggressive in identifying and approaching female clients by actively seeking them out and penetrating the household, where the vast majority of such MSEs operate.

It is also important that the dynamic characteristics of female-headed MSEs be incorporated into the design and implementation of policy and projects. Large numbers of women-owned MSEs are concentrated in highly volatile, household-based, low return activities where growth prospects are bleak. For many of these MSEs, careful consideration should be given to the types of financial and non-financial interventions particularly appropriate for the non-growing enterprises, a topic examined in more detail in Chapter VI. For those female entrepreneurs that desire to expand, attention must be focused on the multiple requirements of shifting into more lucrative product lines. The simple provision of working capital alone will generally prove to be insufficient unless the corresponding product markets, inputs, technology and skill are also in place or made available.

CHAPTER V

MSEs AND THE MACROECONOMY

Micro and small enterprises make a major contribution to the total economy in the nations in which they operate. Conversely, the state of the overall economy has a significant impact on patterns of growth of MSEs. In this chapter, we set out the major dimensions of these interrelationships.

MSEs are a major source of new jobs.

Survey data suggest that, during the 1980s, the expansion in employment in micro and small enterprises absorbed close to 30% of the increase in population of working age.¹ Since not everyone of working age is working or even seeking work, the contribution of MSEs to the absorption of new workers joining the labor force is substantially higher than this.² In terms of secular patterns of growth in developing countries, then, MSEs appear to be the single most frequently chosen path for people seeking to find a way of earning a living as they enter the labor force.

New MSE jobs come into being in two ways: through new business creation, and through the expansion of existing enterprises.

The distinction between jobs coming from new business starts and those arising from an expansion of existing businesses is important since in many cases the forces leading to the growth of employment are different. It is often also true that the quality of the jobs arising from these two sources is different.

A higher percentage of the new jobs arising from new start-ups reflects survival efforts by people with few options.

While not always true, a significant proportion of new enterprise starts are driven by a necessity of finding any source of income, even those providing only minimal returns, in situations where few alternatives are available. As indicated in chapters III and IV above, a substantial share of MSE new starts are one-person enterprises concentrated in activities that are the easiest to get started, i.e. those with the lowest barriers to entry, with a consequent danger of overcrowding and resulting low returns.

¹ Based on data from the six core countries: Botswana, Kenya, Malawi, Swaziland, Zimbabwe and the Dominican Republic. For details, see Mead, 1994a. The aggregate estimate for these six countries was 28.7%. In these data, working age is considered as 15-64.

² Labor force estimates are notoriously unreliable. For five countries in Africa covered by our surveys, the UNDP has estimated the growth of the labor force at 72% of the growth in population of working age (see Mead, 1994a, for details). If that relationship also holds in the Dominican Republic, it implies that the growth of employment in MSEs absorbed about 40% of the growth in the labor force in these six countries.

New MSE jobs arising from an expansion of an existing enterprise, by contrast, are more likely to reflect a response to an identified business opportunity.

Entrepreneurs take on additional workers primarily because they have tried a particular pattern of doing business, have found a market and seek to expand their participation in that market. Such a pattern of employment expansion in response to identified opportunities is particularly likely to hold in cases where the added worker is a paid worker: the entrepreneur would only take on an additional worker if there is a reasonable prospect of covering the added costs from additional sales revenues. This reasoning is less clear if the added worker is an unpaid family member or a trainee.

Returns to labor in jobs resulting from an expansion of existing enterprises appear to be substantially higher than those arising from new business start-ups.

A recently completed survey in Kenya provides estimates of net returns to labor in various types of micro and small enterprises. Looking at new jobs that came into being during the 18 months previous to the survey, returns to labor in enterprises that had expanded their labor force during that period were more than twice the levels for enterprises established during those eighteen months (Daniels, Mead and Musinga, 1995). This is consistent with our expectation that expansion jobs are not only more likely to endure but also likely to provide higher incomes than those that result from new business starts. It is also consistent with the earlier mentioned findings of the higher efficiency of MSEs with more than one worker.

Most MSE jobs come into being through people starting new businesses.

Of the 4.8 million people working in MSEs in the six core survey countries at the time of the recent surveys, about 3.7 million of those positions - just over 75% of the total - came into being when the enterprise itself was started. The remaining quarter were taken on as a result of an expansion of existing micro and small business, subsequent to their start-up.

Over shorter periods of time, these patterns can differ substantially, depending primarily on the state of the economy.

While the figures in the previous paragraph reflect long-term patterns of job-creation, the patterns can be quite different over shorter periods of time. In particular, there is evidence that, when the overall economy is growing well, many micro and small enterprises are also thriving and expanding by adding to their work force. Under such circumstances, the majority of new jobs in MSEs result from an expansion of existing enterprises. In times of macroeconomic stagnation, by contrast, all enterprises - large as well as small - are under pressure to cut back on their levels of employment. But people must still eat. To sustain themselves, then, many people are pressed to start new enterprises, since there are few alternatives available to them. In such times, then, the majority of new jobs in MSEs come from new business starts.

Detailed data from the Dominican Republic support this description. In that country, Miguel Cabal (1995) followed patterns of change in microenterprises in several locations over two years. The first year was a period of dynamic growth in the economy; the second year was one of stagnation. The resulting pattern of employment growth among MSEs is shown in table 5.1 below.

The impact of the macroeconomic conditions on patterns of employment growth is obvious. During good times, expanding employment in existing micro and small enterprises made a major contribution to employment growth, while more jobs were lost from firm closings than from new enterprises being started. The following year, when the economy was stagnant, existing enterprises were reducing their employment levels; employment growth from net new starts, by contrast, switched from negative to positive.

It is interesting to note that the main difference between these two years in terms of net new start-ups comes not primarily from variations in birth rates but rather from closure rates, which were much higher in good times than in the bad year.

TABLE 5.1
PATTERNS OF EMPLOYMENT GROWTH:
DOMINICAN REPUBLIC
(percentages)

	Growth rate in GDP/cap (% per year)	Percent change per annum in employment in MSEs:		
		from net new start-ups	from expansion of existing enterprises	Total: net overall change in MSE employment
Period of rapid economic growth				
March 1992 - March 1993	5.5%	-1.7%	+12.4%	+10.8%
Period of slow economic growth				
March 1993 - March 1994	0.5%	+1.7%	-3.2%	-1.5%

Source: Cabal, 1995.

Furthermore, as indicated in Chapter IV, the biggest variations in closures are in those enterprises owned by women. One possible explanation is that many of the enterprises run by women are activities yielding only low returns, that the entrepreneur is glad to be able to close when circumstances in the family improve.

A recent study of patterns of change in employment and sales in Jamaica also throws further light on this pattern (Gustafson and Liedholm, 1995). The period covered by this study - from mid-1993 through the end of 1994 - was one of macroeconomic stagnation. It appears that real GDP per capita was constant or even declining during this period. The survey results, looking at a panel of existing enterprises to examine their change over time, found an average decline in employment of nearly 20%, while average real sales per month dropped in these enterprises by an average of 35%. Microenterprise promotion programs found themselves operating in particularly hostile circumstances; the unfavorable macro environment resulted in substantial contraction in both employment and sales for the average enterprise.

Implications.

A person running a program with the principal objective of helping existing enterprises to expand must be aware that, in good times, the economic environment is supporting her efforts. When the economy itself is stagnant, by contrast, it will be much more difficult for micro and small enterprises to grow, even with the best types of support.

Patterns of MSE growth are also strongly influenced by other aspects of macroeconomic policy.

The discussion of the previous point focused primarily on rates of growth of real GDP, and how variations in aggregate growth rates can influence patterns of MSE growth. But there are other aspects of macroeconomic policy that also impinge on the growth prospects for MSEs. One key issue has to do with **price stability**. In countries where monetary and fiscal policies are not under control so prices are increasing rapidly, it is extremely difficult for small enterprises to plan for orderly real growth. High nominal interest rates - even if reasonable in real terms - introduce a major additional dimension of risk, which can be particularly daunting for nascent entrepreneurs.

A second important policy variable concerns the **stability of the policy environment**. Long-term growth requires an ability to plan for the future. If policy established today is likely to be countermanded by new directives or new interpretations tomorrow, it is difficult to adopt a long-term time horizon. Such planning is also made more difficult where fraud leads to additional uncertainty as to the interpretation of the law.

A third important dimension of policy concerns the issue of **access**: to imports and foreign exchange, to credit, to domestically produced intermediate inputs, to markets. Governments set the rules in each of these markets. They can establish them in such a way as to facilitate access on the part of micro and small entrepreneurs; or they can tilt the balance in favor of larger enterprises or the public sector.

A recent survey in Zimbabwe throws light on some aspects of this changing policy environment (Daniels, 1994). Microenterprise surveys were done twice in that country: once in 1991, and again in 1993. The 1991 survey came at the conclusion of a two-year period when real GDP/capita was approximately stable. During the two years from 1991 to 1993, by contrast, the economy was facing the worst drought in a century; real GDP/capita declined by about 3% per year. During the latter period, furthermore, there was extensive liberalization of the economy; the inflation rate increased sharply, and nominal interest rates were increased to keep pace with inflation. As Table 5.2 shows, the problems faced by small businesses were quite different in these two time periods.

TABLE 5.2
 PRINCIPAL PROBLEM REPORTED
 AT THE TIME OF THE SURVEY:
 ZIMBABWE

(percent of respondents listing this as most serious problem)

	1991 survey	1993 survey
Marketing	17.8%	27.5%
Finance	12.6%	22.7%
Inputs	17.7%	22.6%
Tools/Machinery	9.4%	3.6%
Transport	16.0%	3.1%
Government regulations	0.4%	2.3%
All others	10.1%	6.5%
Subtotal: percent reporting problems	84.0%	88.3%
No problems reported	16.0%	11.7%

Source: Daniels, 1994, p. 50.

The nature of the problems faced clearly changed sharply over this two-year period. As a result of a liberalization of imports and the removal of domestic restrictions, transport problems were significantly alleviated, as were problems of access to tools, machinery and equipment (many of which are imported). With the stresses of a drought-induced stagnant national economy, however, domestic markets were contracting. High inflation rates pushed up nominal interest rates, while access to raw materials and other inputs continued to be a serious problem for many. Again, these figures serve to remind us that the kinds of problems and constraints that small enterprises face can vary substantially as a result of both changes in macroeconomic circumstances (here influenced strongly by the weather) and an evolving policy environment. An assistance organization offering one kind of help (e.g. management training, or short-term micro credit) might precisely fill the needs of the clients under one set of circumstances, but be totally inadequate to their needs at a different point in the evolution of the economy.

Other evidence of the importance of particular government policies on microenterprise growth comes from cross-country comparisons. Producers in Malawi and in Zimbabwe were seriously constrained by problems in obtaining raw materials: leather for small shoemakers, cloth for tailors, metals for small machine shops. In large part, these problems arose from the government's regulatory policies, that gave priority to the needs of large businesses (see Mead and Kunjoku, 1993). In Kenya, a significant number of enterprises faced problems of harassment by the government, sometimes in the form of bulldozing of their work place (see Parker with Torres, 1994). Clearly, such policies and regulations have had a major deleterious effect on the growth of microenterprises in particular countries.

Rural MSEs are particularly affected by the state of the rural economy.

Rural producers are often particularly isolated, and thereby closely linked to developments in their own locality. The degree to which this constrains the growth of rural MSEs depends primarily on three things³ :

- the rates and patterns of growth of agriculture, which is normally the main source of income in rural areas;
- the nature of the labor market, which can generate additional income from wage employment, perhaps in secondary towns, thereby creating additional demand for non-farm goods in services in rural areas as well as reducing the pressures on people to engage in low-productivity producing and trading activities; and
- the degree to which the rural economy is integrated with the rest of the country. This is strongly influenced by the effectiveness of the transport and trading system that links rural small producers with the outside world.

In those economies, particularly in Africa, where agriculture forms a large percentage of GDP, the pattern of rural MSE development closely mirrors the performance of agriculture. Given the desultory overall performance of the agriculture sector in many countries of Africa, it is not surprising that the majority of new MSE jobs in rural areas came from new starts rather than from demand-pull expansion. Conversely, the percentage of new jobs from new starts or that resulted in "graduation" tended to be higher in those countries where agriculture did relatively well (Liedholm, McPherson, and Chuta, 1994).

Implications

These considerations assume particular significance since the discussion of chapter 2 makes clear that the majority of MSEs are in rural areas. Two principal implications follow.

There are important things that can be done to stimulate the growth of rural non-agricultural MSEs that focus on either more dynamic agricultural growth or improved linkages between rural producers and developments in nearby towns and cities.

Higher incomes in rural areas, whether from a dynamic agricultural sector or from wage employment, can create rural markets for the products and services supplied by MSEs; alternatively, improved transport and marketing systems can provide outlets for rural producers by linking them to more distant and more dynamic market centers.

In the absence of either expanding rural incomes or effective links with the outside, rural non-farm enterprises will find it extremely difficult to expand their output, since they will be attempting to sell in isolated and slowly-growing markets.

³ See Haggblade and Liedholm (1991) for a more detailed formulation of these arguments.

In such circumstances, MSE credit programs or non-financial assistance may make possible some increases in enterprise income; but there are severe limits to how far such policies can go in raising either income or employment. Particularly in relatively isolated areas, rural MSEs cannot be the engine that pulls the rest of the rural economy forward; such a "bootstrap" approach to development ("lifting oneself by one's own bootstraps") is an approach that faces major limitations. In such situations, perhaps the most important thing one can do to encourage the growth of rural non-farm MSEs involves a concentration on a more dynamic agriculture and/or more effective distribution systems.

Non-farm activities can also have important feedback effects in stimulating agricultural growth.

There is evidence from West Africa and elsewhere that rural households use profits from non-agricultural activities to invest in agriculture, thereby raising the productivity of their farming activities (see Reardon, Crawford and Kelly, 1994; Liedholm and Kilby, 1989). Since as much as 80 percent of rural household cash revenue comes from non-farm sources, and given the paucity of financial institutions, this has been a key source of investment funds not only for MSEs but farming activities as well. A key implication of this finding is that the growth of non-farm activities can have important multiplier effects in stimulating the growth of agricultural output.

The direct effects of government licensing and regulatory policy appear to be limited, both in constraining new starts and in discouraging MSE growth. The indirect effects are more subtle and more pervasive.

Many MSEs get started and continue for some time to operate outside the law (see Jourard, Liedholm, 1992, and Mead, 1994). When such enterprises are asked about their principle problems, issues of government controls and regulations are rarely mentioned as issues of serious concern (see Table 6.2).

Many of the problems that entrepreneurs do identify, however, have their roots in the regulatory environment: access to inputs, whether domestic (influenced by marketing controls and policies towards local monopolies) or imports (affected by foreign exchange control systems); or access to capital (influenced by a host of regulations of the financial system). Such regulations are particularly significant in influencing the ability of micro enterprises to grow. Since enterprise expansion often involves more complex interactions with other commercial entities (traders, manufacturers, service agencies, the government), the development of smoothly-operating market systems can be an important determinant of enterprise growth. The government has a key role to play in establishing such market systems.

Implications

Two key implications arise from these considerations.

Regulatory issues are substantially more important for MSEs than is revealed simply by asking the entrepreneur what his principal problems are.

Many regulatory impacts operate in circuitous and indirect ways that only emerge based on more detailed analysis of patterns of production and trade.

Regulatory issues are substantially more important in their impact on the ability of enterprises to grow than in their effects on new enterprises seeking to get started or to survive.

This is particularly significant since we have argued that jobs arising from enterprise expansion are more likely to endure, more likely to reflect market-based opportunities, and more likely to generate higher incomes than those coming from new starts.

It is easy for those engaged in MSE programs to underestimate the significance of the macroeconomic context in which their clients operate. This can result in types of assistance being offered that are inappropriate to the needs of the clients; it can also lead to missed opportunities to deal in cost-effective ways with the most pressing constraints these enterprises face. Finally, it can lead to distorted evaluations of the effectiveness of different programs, either because the macro context was unusually unfavorable so even the best programs could not have succeeded, or because program evaluations are claiming credit for successful MSE growth when in fact the main explanation was overall growth that was carrying MSEs forward.

CHAPTER VI

THE DIVERSE NEEDS OF ENTERPRISES: LESSONS FOR DONORS AND IMPLEMENTING AGENCIES

A review of the characteristics of micro and small enterprises confirms what all those working in the field know: this is an extremely diverse set of enterprises. Two points, central to this heterogeneity, have important implications for those responsible for designing and implementing MSE assistance programs:

Different types of MSEs have different contributions to make to the process of development.

Some types of microenterprises are particularly effective in combating poverty, while others can make a major contribution in terms of economic growth.

Different categories of MSEs face different problems, and therefore can best be supported by different types of assistance.

An understanding of these differences makes it possible to focus on appropriate categories of enterprises in offering assistance, and to offer support based on the needs of the particular types of clients selected for encouragement.

Building on the dynamic information presented in previous chapters, we have found it useful to examine Micro and Small Enterprises (MSEs) in four major categories:

- i) **New starts:** enterprises just getting under way. The needs of this group for support are significantly different from those of enterprises that have been in existence for some time, that have managed to overcome many of their start-up problems.
- ii) **Non-growing enterprises:** these are enterprises that have survived the perils of start-up but have not added to their employment since they were first established.
- iii) **Small growers:** enterprises that have been in existence for some time and have added to their work force since starting, but have grown only in small amounts.
- iv) **Graduates:** enterprises that started from a very small base and have made a transition to reach at least the middle ranges of the small enterprise spectrum.

The principal characteristics and problems of MSEs in these different categories are summarized in Tables 6.1 - 6.3 below. Additional information is provided in Tables 6 - 9 in the appendix. Our discussion examines these enterprise categories one by one, suggesting the characteristics of MSEs in each group, the goals and objectives that might be appropriate for the encouragement of each, and the project and policy implications.

NEW STARTS

A number of microenterprise assistance programs are targeted at MSEs just getting started.

Many programs working with newly-established enterprises focus on particular client groups: those that are specially vulnerable (low-income women, people in poor regions, etc.), or groups for whom the government feels a particular responsibility (retrenched civil servants, demobilized soldiers, etc.).

Two objectives are generally advanced for programs designed to provide assistance to these newly-established enterprises:

- **increase the rate of new start-ups**, eliminating barriers that hinder people from starting out in business; and
- **help newly-established enterprises to survive**, reducing the high attrition rate among those just getting under way.

In considering these programs and their objectives, we start from several facts concerning this target group.

- a) **Micro enterprise new start rates are already high.** Many people are already exercising an option of opening a new business. As we have seen in chapter III, net start rates of 20% or more per year are the norm in most of the countries with relevant data.
- b) For those that do get established, **it does not appear that the legal and regulatory framework has been a serious hindrance** to the establishment of most enterprises. In most countries, a substantial percentage start with little or no legal recognition; as indicated in Table 6.3, governmental restrictions are rarely mentioned among the most serious problems facing newly-established enterprises. In most countries, it is unrealistic to think that the easing of registration requirements or the removal of other similar legal obstacles will result in a major increase in the number of new small enterprises getting established.

TABLE 6.1
CHARACTERISTICS OF MICROENTERPRISES:
CONTRIBUTION TO INCOME AND WELFARE

	New starts	Non-growing enterprises	Enterprises experiencing small growth	Enterprises that had graduated	Total, all enterprises
i. Contribution to employment					
Share of all existing enterprises	28.1%	42.8%	12.0%	0.6%	100%
Share of employment among existing enterprises	26.0%	27.7%	18.4%	5.1%	100%
Source of new employment over the long haul	80%	0%	10%	5%	100%
Av. no. of workers per enterprise	1.8	1.2	2.9	16.3	1.9
ii. Part time or full time activities?					
Av. no. of months worked per year	10.6	10.9	11.2	10.7	10.9
Av. no. of days worked per month	23.3	24.2	25.4	24.8	24.3
iii. Contribution of MSE to household income (% of all respondents in category)					
100% of hh income	30.7	35.6	34.0	21.7	33.7
50-99% of hh income	33.3	35.5	41.9	59.5	35.3
Less than 50% of hh income	36.0	28.9	24.2	18.7	31.0
iv. Contribution to distributional objectives					
Percentage of female owners	56.9	60.4	38.5	8.4	54.2
Percentage of female workers	47.0	55.1	35.9	8.9	42.2
Percent of employment in rural areas	71.6	74.1	70.4	79.5	72.7

Notes: all data are from the six core countries (Botswana, Kenya, Malawi, Swaziland, Zimbabwe and the Dominican Republic). Source: Survey data.

TABLE 6.2
GROWTH CHARACTERISTICS OF MICROENTERPRISES
(percent distribution of all enterprises more than 1 year old that started with 1-4 workers)

	No-growth	Small growth	Graduates	Total
All micro enterprises	77.2%	21.7%	1.1%	100.0%
Female-owned enterprises	84.7%	15.2%	0.2%	100.0%
Male-owned enterprises	75.1%	23.3%	1.6%	100.0%
Manufacturing enterprises	88.5%	10.7%	0.8%	100.0%
Trade and commerce enterprises	76.2%	23.5%	0.4%	100.0%
Enterprises in urban areas	77.3%	21.8%	0.8%	100.0%
Enterprises in secondary towns	73.3%	26.2%	0.5%	100.0%
Enterprises in rural areas	77.5%	21.3%	1.2%	100.0%

Note: This table refers to all enterprises that had been in existence for more than a year and that started with less than five workers. Those with missing data, those whose employment declined or grew by intermediate amounts are excluded from these statistics. These exclusions account for less than 5% of those covered by the surveys that started with less than five workers.

TABLE 6.3
PRINCIPAL PROBLEM
AT THE TIME OF THE SURVEY

	New starts	Non-growing enterprises	Enterprises experiencing small growth	Enterprises that had graduated	Total, all enterprises
Percent with no problems	11.2%	8.7%	5.5%	2.3%	9.2%
What was the most important problem? (percent of those reporting problems)					
Working capital	13.2%	14.6%	12.3%	12.4%	13.8%
Fixed capital	2.6%	5.7%	6.5%	0.1%	4.8%
Other capital	11.8%	8.5%	6.2%	2.9%	9.1%
Capital, total	27.7%	28.9%	25.0%	15.3%	27.7%
Markets	29.1%	27.1%	26.4%	7.4%	27.3%
Inputs	26.6%	25.1%	21.6%	42.4%	25.5%
Govt. reg.	3.7%	3.3%	3.8%	4.3%	3.8%
Other problems	12.0%	15.7%	23.2%	30.7%	15.8%

Source: survey data from Kenya, Malawi and Zimbabwe.

- c) On the other hand, a **significant share of all newly-established enterprises do not survive for long**. As noted in Chapter III, attrition rates are highest in the first few years. Efforts aimed at a reduction in these high failure rates among new start-ups might be more appropriate than a concentration on increasing the rate of new entrants to the world of microenterprises.

Programs designed to help people get started and to help more new businesses survive the early teething years face a number of particularly daunting challenges. These emergent business people must master a host of new skills; their needs can be diverse and complex, which can substantially raise the cost of assisting them. High attrition rates reduce the returns derived from these efforts, since many of those that are helped will not survive for long in business.

Chances of success can be substantially increased if the assistance is channeled primarily to entrepreneurs who have had experience in that particular activity, perhaps having worked for someone else before starting a new business, to enable them to master at least some aspects of the business. Building on previous experience in this way can raise the cost-effectiveness of assistance programs, since it decreases the range of new skills that the entrepreneur must master.

Efforts to strengthen the skill base for nascent entrepreneurs while building on existing skills has another important potential contribution: it can increase the share of new starts that are in activities yielding higher returns rather than simply flooding into product lines with the lowest barriers to entry, activities that may already have large numbers of participants selling in saturated markets.

For newly established enterprises, as for several other categories, the most serious problem reported by the entrepreneur was one of finding markets (see Table 6.3). Another frequently reported problem, particularly for newly established enterprises, came from the fact that customers placed orders but then did not pick them up or pay for them. Categorized here under the heading of "other capital," this might be expressed as a problem of **too much credit given**, rather than **too little credit received**. Problems relating to access to raw materials and other intermediate inputs are also a frequent source of complaint.

With this diversity of reported problems, it may be unrealistic to think that raising the supply of any single missing ingredient will substantially raise the flow of new entrants to the microenterprise universe. While over 10% of them report that they face no problems, the high attrition rate among new start-ups means that this figure might best be interpreted as stating that they do not yet know what their most serious problems will be.

Implications

This reasoning suggests two approaches for projects aimed at newly-established enterprises:

- **Provide on-the-job training for potential new entrepreneurs**, before they start a new business. One useful approach would involve programs aimed at enabling nascent entrepreneurs to work for others for a period of time before starting out on their own. Apprenticeship or on-the-job training can be invaluable in increasing the likelihood of success for new entrepreneurs.

- **Build on existing skills**, whether derived from such training or based on the entrepreneurs' existing knowledge. Demobilized soldiers may have already learned about machinery repair, or may know how to drive; retrenched civil servants may have the skills required to learn to operate computers or to organize and manage private schools. It is important to identify and build on such existing skills, in preparing people for the challenging task of running their own small business.

Even with these efforts, the task of providing assistance to newly establishing businesses is not an easy one. This leads to another possible implication that many project planners have adopted:

- **Restrict assistance to entrepreneurs that have proven themselves by running a business for at least a year**, getting through their early teething problems on their own.

Alternatively, some have chosen a different option:

- **Limit assistance for newcomers to people who have had relevant experience before starting out on their own**, perhaps having worked for others in the same product line. The need to direct scarce resources to places where they can be used most productively would argue for such a restriction.

NON-GROWING MSEs

Most existing MSEs have not grown since start-up.

We have seen in our discussion of Chapter 3 that, of those enterprises that do manage to survive the difficult start-up years, most do not grow. Among the universe of existing enterprises, then, the largest category is made up of non-growing enterprises. In a number of countries with recent small enterprise surveys, three quarters of all enterprises that started with less than 5 workers had not added even one worker to their labor force between the time of start-up and the date of the survey (see table 6.2). When measured in terms of employment, growth is the exception rather than the rule for micro and small enterprises.

As shown in table 6.1, sixty percent of the proprietors and over half the workers in non-growing enterprises are women. Most of these businesses are full-time activities in the sense that they operate every day, all year around.

The great majority of these non-growing MSEs can be thought of as survival activities.

Among the most important characteristics of such survival enterprises are the following:

- their very small size, averaging only about 1.2 workers per enterprise, with most consisting of only one person working alone;¹
- their operation in ways that often mingle resources used in the enterprise with other activities of the household;
- their almost exclusive reliance on family labor: nearly 95% of the non-growing enterprises rely exclusively on working proprietors and unpaid family members, making no use at all of paid employees;
- their simple management techniques; and
- the fact that many people participate in these activities, in spite of the fact that the incomes they generate are low and declining over time, because they have no better alternatives available to them. Close to 30% are strictly supplementary activities, providing less than half the household's income (see table 6.1).

Implications

Intervention strategies for survival activities might concentrate on one or both of two objectives:

Focus on raising income rather than employment generation.

There are a number of different programs that can contribute in important ways to this objective of raising income, even without necessarily changing the essential characteristics of these enterprises as very small, family-based activities. This goal can be pursued through efforts to reduce costs, by increasing the volume of sales, or by switching to product lines that yield higher returns. Both financial and non-financial assistance can contribute to each of these objectives. The following table gives examples of each type of intervention.

¹ The figures in this paragraph are derived from survey data in the six core countries: Botswana, Kenya, Malawi, Swaziland and Zimbabwe and the Dominican Republic.

TABLE 6.4
ASSISTANCE OPTIONS AND OBJECTIVES
TO RAISE ENTERPRISE INCOME

Objective:	Financial assistance	Non-financial assistance
Reduce costs	Lower interest rates on borrowed funds. More access to credit makes it possible to buy inputs in bulk, therefore at lower price	Better management or different production technology mean lower costs per unit
Raise volume of sales	More access to credit makes it possible to purchase more inputs and thereby increase sales	Better marketing systems can open up access to larger markets
Switch to more productive product lines	New products may require more fixed or working capital	Product adaptation can help to serve a more profitable market

Each of these different types of intervention has the potential of raising incomes for those engaged in the enterprise. Because these interventions seek to reach the large numbers of microenterprises that are family-based and that currently often provide only low levels of income, these are important and useful things that correspond well with a focus on poverty alleviation, a focus of USAID as well as of many other donors and non-governmental organizations active in this area.

On the other hand, there are clear limits to the kinds of gains that one can hope to achieve from these changes, so long as the enterprise continues to operate on a household basis, with simple management skills and marketing patterns. An appropriate second goal for non-growing enterprises, then, might be:

Increase the numbers of such enterprises that succeed in growing.

As indicated above, only about a quarter of the enterprises that start out very small currently manage to increase their levels of employment. While not relevant or appropriate for all non-growing micro enterprises, a goal of helping a larger number move into the growth category is a worthwhile component of any MSE support program. This would involve helping them make a transition to more sophisticated management and more complex involvement in the market. Such an expansion - particularly if it is associated with the use of hired labor - is a reflection of the fact that the enterprise is moving to the next higher plateau, where the opportunities for increases in income and welfare are substantially higher. The types of interventions that might contribute to this goal are discussed in the following section.

SMALL GROWTH

The category of small growth is made up of enterprises that start out very small and grow in small amounts. For our empirical analysis, we have delineated the category as made of enterprises that started out with 1-4 workers and that have added 1-4 additional workers to their labor force since start-up. As indicated above, about a quarter of those that started out in this very small size range have managed to make this transition. While over 60% of these small-growth enterprises continued to rely exclusively on

family members and other unpaid workers, the remaining enterprises - nearly 40% of the small growers - had at least one paid employee. On average, these small-growth enterprises were more than twice the size of the non-growers, with an average of 2.9 workers per enterprise (compared to 1.2 for the non-growers).

Information generated from surveys in the six countries clarifies a number of characteristics of these slowly growing enterprises (see Table 6.1). Compared to the non-growers, there is a decline in the share of enterprises with women as entrepreneurs, from 60% to below 40%. There is also a similar decline in the share of the work force that are women. A larger percentage of these enterprises are of major importance to household welfare, with over 75% contributing at least half of the household income. Data from a supplementary questionnaire in Kenya suggest a substantially higher percentage of entrepreneurs that selected the activity because it was viewed as having good economic prospects, with a correspondingly smaller percentage choosing it simply because it matched the family's constrained options (see Appendix Table 7). Fewer of the entrepreneurs had previously been unemployed, while a larger percentage had either run another business or had been employed in another enterprise. A higher percentage had received training since start-up, and a higher percentage were seeking opportunities for further training (see Appendix Table 8). All of these indicators suggest a higher skill level as well as a more commercial orientation for the entrepreneurs in this group, compared to the non-growers.

Table 6.3 presents information on the nature of the problems faced by these and other types of enterprises. Several points stand out as one moves to the right across this table. An increasing share of enterprises were able to identify problem areas causing them difficulties. As entrepreneurs become more active, they also become increasingly aware of the factors that hold them back from growing more; conversely, those that have grown at all are more likely to be ambitious in seeking to expand more.

A second idea reflected in table 6.3 is that, as enterprises become more dynamic, more of their problems migrate to the "other" category. They find they must deal with problems of work space, of transport, of access to utilities (water, electricity, telephones) etc. What this suggests is a simple but important idea:

More dynamic MSEs have changing and more complex needs that often cannot be met by assistance programs offering only one type of intervention.

Most cost-effective programs specialize in particular types of assistance. However, many dynamic MSEs have multiple needs that must be solved simultaneously. The kinds of programs that might respond in a cost-effective way to this challenge are discussed in the concluding chapter of this study.

GRADUATES

While only about 1% of all MSEs starting very small succeed in "graduating," this is an important group since it provides substantial numbers of jobs, is a major source of today's intermediate enterprises, and is most closely attuned to market opportunities.

If enterprises that have grown in small amounts have a more commercial orientation than those that have not expanded their work force at all, those that have experienced significant growth are of particular interest. The movement from a very small starting size to an intermediate level is a challenging task. As we have indicated, the survey results suggest that only about one percent of all enterprises starting with 1-4 workers have succeeded in making a transition to employ at least 10 people. Yet since each such enterprise adds substantial numbers of workers to their labor force, this group accounts for about a quarter of all new jobs that are created as a result of the expansion of existing enterprises.

Approaching the question from the other end of the process, among those enterprises currently employing 10-50 workers, about half started with less than five workers and subsequently grew. This means that even though only a small percentage of the small starts have made this transition, the process is important in providing a "seed bed" feeding today's universe of medium-sized enterprises.

Based on the information from the six core countries, summarized in Tables 6.1 - 6.3 as well as in Appendix Tables

7 - 9, several characteristics of the graduates stand out. Like the other categories, these enterprises are likely to be full-time activities, operating approximately the same numbers of months per year and days per month as the other categories. But they are much less likely to be supplementary activities; over 80% of the graduating enterprises contributed at least half of the household's income. They are much more likely to have been started by someone who previously worked as a paid employee rather than someone who was previously unemployed. As an approach to a country's unemployment problem, the encouragement of graduating enterprises makes its contribution primarily through the creation of paid employment opportunities rather than through an increase in employment among entrepreneurs.

While small traders are more likely to grow somewhat, small manufacturers are more likely to grow in substantial amounts.

The sectoral breakdown of MSEs, presented in table 6.2, suggests that, while the likelihood of any growth at all is higher for traders than for manufacturing enterprises, the likelihood of graduation - small though it is for all microenterprises - is about twice as high for manufacturing enterprises, compared to traders.

Patterns of graduation are surprisingly similar across regions.

Perhaps the most surprising thing about the regional variations reported in Table 6.2 is how little they differ. Enterprises operating in dispersed rural areas have virtually the same growth patterns as those in the major cities. Those in secondary towns - locations with 2,000-20,000 inhabitants - are somewhat more likely to grow at all, although somewhat less likely to grow in large amounts. In general, though, these figures suggest similar overall patterns of growth in rural and urban areas. The fact that most

enterprises operate in rural areas (see chapter 2) reminds us of the importance of including the rural clients in the target group of assistance programs.

More dynamic MSEs are involved in more complex marketing patterns.

As one moves across these tables from non-growing enterprises to those growing in small amounts to those that graduate, one of the changes that takes place in the enterprise concerns more complex ways of interacting with the market. In part, this has to do with the sources of inputs: are they gathered or made directly by the household, or are they purchased on a commercial basis from others? It also has to do with patterns of selling of the output: selling directly to friends and neighbors who are final consumers, or selling to other businesses, either traders or manufacturers, who either use the product as an input to their activities or sell it themselves to other buyers.

A move towards more complex marketing patterns along either of these lines involves the mastery of a range of new skills. It often requires more sophisticated cash management; it also means being able to meet the requirements of more demanding and discriminating buyers, who are able to shop around among various alternative sources of supply. For enterprises that are able to master these requirements, however, the more complex patterns have two distinct advantages. They enable the enterprise to specialize, focusing only on those functions that it performs best, thereby contributing to increases in efficiency and income. Furthermore, these changes enable the business to move beyond relatively slowly-growing localized markets to larger and more dynamic markets for their products and services. For isolated rural producers, such links make it possible to tie into more dynamic and more distant markets. These same market linkages can also provide important information to producers as to which products are most in demand and how they must be made if they are to meet the customers' requirements.

Survey responses throw light on the significance of these changes in marketing patterns (see Appendix, Table 9). In terms of our growth categories, the table suggests that while no-growth and small-growth enterprises both sell overwhelmingly directly to individuals, a significant share of the graduates have moved to a primary reliance on traders for their markets, while a few were selling to other manufacturers. The table also makes clear that a movement beyond sales directly to individuals is associated with a higher share of the enterprises expanding their work force, as well as a higher average growth rate in employment. A much higher percentage of enterprises selling primarily to traders had grown; on average, they had grown quite rapidly. Of the smaller group selling primarily to other manufacturers, the percentage that had grown was not very different from those selling to individuals, but the average growth rate was more than twice as high. Clearly the movement to more complex marketing patterns - difficult as these changes can be for microenterprises to manage - has resulted in significantly higher performance in terms of employment growth.

Graduating MSEs appear to have mastered these more complex arrangements. As a result, they face fewer problems finding markets for their products.

Table 6.3 reflects the clear drop in the importance of markets as a principal constraint for the enterprises that have graduated.

Capital also appears to be a less widespread constraint for the more dynamic MSEs.

The number of enterprises listing credit as their principal problem is substantially smaller for those that have graduated, compared to those that have grown only little or not at all. Like the issue of markets, these entrepreneurs apparently have found ways of dealing with their credit needs, while other problems have come to the forefront: access to inputs, to utilities, to transport and to work space, with the latter categorized in Table 6.3 under the heading, "other problems."

Implications

The objectives for assistance programs as these relate to graduating enterprises can be expressed in broad terms that are similar to those for small growers:

- **increasing the pace of growth**, for those that are engaged in such growth; and
- **opening this avenue to increasing numbers of entrepreneurs**, particularly those currently participating only to a limited degree.

The range of skills that an entrepreneur requires to enable him or her to manage these changes is complex. Unlike the simplicity of micro credit programs, that can provide significant benefits by offering one thing to large numbers of low-income people, efforts to assist entrepreneurs seeking to grow more rapidly or to graduate must address a more complex set of needs. While the assistance needs become more diverse, the target group of potential clients becomes smaller, exacerbating the problem of cost-effectiveness for assistance programs designed with this client group in mind.

Table 6.3 indicates that working capital needs are a concern even for graduating enterprises; but these businesses generally require substantially more funds than are offered by micro credit schemes. That table as well as everything we know about these businesses and the challenges they face make clear that small amounts of credit alone will generally be quite inadequate to their needs.

One possible way of responding to the need on the part of more complex enterprises for more multi-faceted assistance is to **focus on particular subsectors**. Such a subsector specialization would enable assistance organizations to gain a deeper understanding of technological and management requirements as well as market structures and potential market niches that could be filled by growing enterprises.

Another strand of this search for cost-effectiveness in the encouragement of more complex growing enterprises involves **working with and reinforcing the operations of the market**. As enterprises grow in size and sophistication, an increasing share of their needs will be met on a commercial basis from other businesses specialized in accounting or bookkeeping, training or marketing. Through a process of "buyer-mentoring," enterprises placing orders can be expected to take some responsibility for helping suppliers

meet their requirements (see Grierson and Mead, 1995). Assistance programs must be designed to promote and encourage these market-based relationships. As in the case of subsidized credit, providing such assistance on a free or heavily subsidized basis can be a serious hindrance to such developments.²

A third aspect of cost-effective programs for more dynamic enterprises involves attention to the macroeconomy. For these enterprises seeking to grow more rapidly, **the policy environment becomes increasingly important**. The government has a key role in establishing and enforcing the rules of operation of the market: who can participate, where they can operate, who has access to foreign exchange or to credit, or what happens if an enterprise does not fulfill a contract. The overall stability of the macroeconomic environment, as influenced by monetary policy and the fiscal balance of the government, the honesty with which procedures are followed and rules enforced, are all of crucial importance in setting a context in which small enterprises can thrive and grow. Unpredictable and arbitrary administration of policy makes it extraordinarily difficult to run a growing business, as does a high rate of inflation. Assistance programs operating in such circumstances face unusually difficult challenges.

A fourth aspect of cost-effective interventions is the recognition of the importance of **human capital**. Many of the enterprises that succeed in growing in substantial amounts are run by entrepreneurs who have previously worked in that line of business for others, thereby mastering at least some aspects of the business. There appears to be an interaction between general education and business skills: those best able to derive benefits from their experience are those with some education. These facts are significant in indicating the importance of providing both an appropriate educational system and opportunities for on-the-job training; they can also help target assistance to those entrepreneurs most likely to be able to take advantage of it.

It is a major challenge to seek to provide such assistance in a cost-effective way. For a program to be cost-effective, it must first of all be effective: it must respond to the true needs of the enterprise, providing real benefits to those it seeks to help. Furthermore, it must provide that assistance in such a way that the benefits are commensurate with the costs of supplying them. Our discussion of approaches to the provision of such assistance is presented in the concluding chapter.

² Kilby's (1988) review of the Kenya Industrial Estates program provides the clearest statement of the dangers arising from a failure to heed this message. Kilby's analysis places the justification for such interventions in the context of a desire to "break the entrepreneurial bottleneck." He indicates that, in the face of limited numbers of enterprises in the 10-50 worker range and limited "graduation" into this category by smaller enterprises, major programs in several countries in Africa have attempted both to train potential entrepreneurs and to provide mechanisms whereby public sector institutions could supplement or even replace the limited capacities of private business people to undertake various entrepreneurial functions. His careful review of the Kenya effort, which leads him to judge it to be a failure for a long list of reasons, should be required reading for anyone considering the establishment of a program of this type.

CHAPTER VII

SUMMARY AND IMPLICATIONS

SUMMARY

This study has pointed out a number of characteristics of micro and small enterprises and their growth patterns that have strong implications for the design of programs to support the development of MSEs. The key points emerging from the preceding discussion include the following.

1. There is much churning in the universe of micro and small enterprises. Many new enterprises are started each year; but many others also cease operation. While new start rates vary by sector and location as well as over time, there is an underlying positive net stream of new businesses feeding the universe of MSEs. Not all closures should be considered as failures, since in some cases entrepreneurs close one business in order to move on to a preferable economic opportunity; but for many - particularly those that take place in the first few years of life of the enterprise (when closure rates are highest) - the closure does reflect the fact that the enterprise was losing money, so the entrepreneur had no alternative but to cease operating the business.
2. **Among those enterprises that survive, most do not grow in terms of employment.** Of all new enterprises starting out at the very small end of the size range, only about a quarter subsequently added to their work force. Of course many of the others may have gained in efficiency and taken other steps to increase the incomes of those they employ; but in terms of employment, an expansion in employment in the enterprise is the exception rather than the rule.

Beyond this, among the remaining quarter that do expand their work force after start-up, most grow only in small amounts, adding only a few additional workers. The process of graduation whereby enterprises start out very small and subsequently move into the upper end of the small enterprise range is a transition managed by only about one percent of those that start out very small.

3. **Employment opportunities in MSEs come into being in two different ways: as new businesses are started, and through the expansion of existing enterprises.** The distinction between these two is important since there is reason to believe that jobs arising from an expansion of existing enterprises are more likely to reflect an entrepreneur's response to a business opportunity: more workers are taken on only when a market opportunity has been identified, based at least in part on the experience of the enterprise. While some new start-ups are clearly similar in orientation, a larger percentage of the new starts reflect the push of people who must find any source of income to keep themselves alive, rather than the pull of identified and profitable business opportunities.

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Over the long haul, most MSE jobs come into existence through new starts; about three quarters of existing job openings in MSEs came into being in this way, with the remainder resulting from the expansion of existing enterprises. Over shorter periods, the balance between these two sources of MSE employment can vary substantially. One of the strongest influences appears to be the state of the macroeconomy: when the economy as a whole is growing well, many MSEs are adding to their work force, while the pressure to start new businesses slackens. When the economy itself is growing more slowly, the opposite forces are at work: many existing small enterprises are stable in size or perhaps even contracting; but a shortage of viable options increases the pressures on people to start new businesses, even if these generate only minimal returns.

4. **Different types of micro and small enterprises face different kinds of constraints.** This is not a world where one type of assistance can effectively meet the needs of all different types of enterprises. Our discussion focused on four different categories:

- **newly-established enterprises**, where the entrepreneur needs to master a whole range of new skills and where a principal objective in the short run may be simply the survival of the business;
- **established enterprises that are not growing**, the majority of existing small businesses. A central goal here might be to make possible an increase in income for the entrepreneur and any associated workers.
- **established enterprises that are growing, but only slowly.** These enterprises are more commercial in their orientation than the non-growers; it may be more feasible to provide them with support that will enable them to grow more rapidly and/or to increase their efficiency.
- **established enterprises that have graduated to the upper end of the small enterprise scale.** These are the success stories of the MSE world. Support for them will require more sophisticated interventions tailored to their circumstances and needs.

5. **These different types of micro and small enterprises have very different contributions to make to the dual objectives of poverty alleviation and growth.** Non-growing enterprises are a vehicle through which large numbers of people seek to address problems of poverty. Programs aimed at this target group can increase the likelihood that such enterprises can survive; they can also help those so engaged to earn somewhat higher levels of income. Assistance focused on enterprises that have added to their labor force, by contrast, make their major contribution in the area of growth: not only increases in employment, but also in terms of more substantial increases in productivity and income. Both goals are justifiable and significant. Which of the two one chooses to emphasize has an important impact on the type of enterprise to which one should pay most attention. This in turn has important implications with regard to types of assistance programs that are most appropriate, since different categories of enterprises face different constraints and therefore have different needs.

6. **The majority of MSEs are owned and operated by women; but enterprises with women as owners are often quite different from those owned by men.** In general, enterprises owned by women are smaller; are more likely to be in trading rather than in manufacturing; and are less likely to grow than those with male owners. Special efforts will be needed if women-owned businesses are to participate fully in the more dynamic aspects of MSE development.

IMPLICATIONS

Different PVO and NGOs have different goals and objectives in their work with micro and small enterprises, as do different donors. These goals can differ substantially: in the degree to which they focus on poverty alleviation (as opposed to growth), the degree of targeting towards particular groups (e.g. women, the rural population, people in certain localities), or their faith in the reliability of market relationships or beliefs concerning the need to circumvent the limitations of the market.

The information presented in this paper helps clarify the characteristics of different types of microenterprises, to enable responsible officials to concentrate on types of enterprises that correspond most closely with their objectives.

Surviving enterprises that have not grown are an appropriate target group for PVOs or donors with a particular focus on poverty alleviation.

Enterprises that have expanded since start-up - and particularly those that have "graduated" - are more appropriate to those with a growth focus.

These are not hard-and-fast separations into water-tight compartments. Some enterprises have expanded in terms of income and investment, even though their employment has not grown; they clearly can contribute to a growth objective. Conversely, some enterprises have added only unpaid family members to their work force, and continue to make their principal contribution in the area of poverty alleviation. In broad outlines, however, this separation captures the principal contribution of each category of enterprise.

Individual PVO/NGOs also have particular approaches, including particular packages of assistance that they offer. Some provide credit, while others focus on technology, bookkeeping, marketing, or any of a range of other types of interventions. Some offer more than one of these types of assistance, while others specialize by doing only one.

A PVO that offers only credit would generally not be interested in a recommendation that it stop offering credit and switch to management training. A more relevant question for such an organization might be whether it should add an additional function, such as management training, to supplement a credit program ("they can't make use of our credit unless we also give them advice on how to use it"); or whether an institution offering multiple types of assistance should drop one or more of these, or should set up management procedures to keep each activity separate so they can be separately administered and costed. A related question might be: suppose one institution feels that its target group of MSE clients requires both credit and management training, while it offers only the latter; can the organization find a working

partnership with another institution that offers the credit, so their separate activities are coordinated and mutually reinforcing?

In a sense, these are administrative/structural, "second tier" questions that have to do with **delivery procedures for supplying assistance**. But there is a prior set of "first tier" questions: **what types of assistance do different groups of microenterprises need?** Is it "enough" to provide entrepreneurs with one type of assistance (e.g. micro credit), all by itself, or would providing two types of assistance in a coordinated way be more effective? The principal objective of this paper is to summarize what we currently know about this question. As suggested in the previous discussion, an important part of the response must be based on a disaggregation of the MSE universe.

NEW STARTS

The first category of MSEs identified in our earlier discussion was that of **new starts**. There are numerous programs all over the developing world that provide advice, training and small amounts of credit to very low-income people, to help them get started in business.

In view of the existing high enterprise birth rates, the high attrition rates in early years of an enterprise's life, and the multiple needs of these new businesses, we find this a particularly problematic group for assistance programs. For those who wish to offer support to clients in this category, our discussion suggested two approaches:

- I. **concentrate on providing experience for those considering setting up a new business**, before they start out on their own, by developing internships or on-the-job training programs; and
- ii. to the extent that one does seek to assist new start-ups, **build on existing experience**, both in terms of any training offered and in terms of the selection of particular enterprises to support.

The problematic nature of programs for the promotion of new businesses has meant that **many project administrators and funding agencies have decided to stay away from new starts**, concentrating only on enterprises that have managed to overcome their original teething problems by surviving in business for at least the first year that the business is in operation. In general, we find this approach to be justified.

NON-GROWING BUSINESSES

This is the largest group of micro and small enterprises. While some of these enterprises generate substantial returns, most are essentially survival activities. As such, they are a particularly appropriate target group for those donors and assistance organizations with a primary focus on poverty alleviation.

For non-growing enterprises, micro credit programs can provide important help, particularly in raising incomes by reducing costs.

There is an important category of MSEs that can be helped immensely if they can gain access to small amounts of credit, provided without any other complementary support, in ways that are easily accessible, on reasonable terms. This is the category of enterprise that has survived their early teething problems and whose main objective is not primarily to expand by hiring additional workers but to provide greater income for participating family members. Small amounts of credit can help this group in important ways, primarily by reducing their costs and by enabling them to purchase inputs in larger quantities. For this group of enterprises - and they constitute well over half of all existing MSEs - small amounts of credit can be of tremendous help, even without any other type of assistance.

While such micro credit programs are highly desirable, it is important to recognize their limitations. They do not respond to what many entrepreneurs describe as their most serious problem: expanding markets, and improved access to inputs.

Survey results in several countries strongly suggest that, even for this large category of MSEs (those that have been in existence for some time and that have not grown), micro credit programs do not respond to the most serious problems the entrepreneurs say they face. As reported in table 6.2, access to credit ranks third, behind problems of markets and availability of inputs as their most pressing problems. They report that their most serious problem is one of markets: if they produced more, they would have a hard time finding someone to buy it. Credit programs can help such people raise incomes, even if they are not able to increase their sales, and that can be very useful. But there are severe limitations to how far such programs can carry the enterprise, unless one can also help them address the other constraints, in terms of their ability to sell more, and to have better access to required inputs.

The central appeal of micro credit programs is not that they address the most serious problems of their clients; rather it is that they clearly do help, and that we know how to offer that type of assistance to large numbers of clients in cost-effective ways. A major challenge is to find cost-effective ways of addressing other, even more urgent problems facing that same group of enterprises, relating to markets and supplies of inputs.

The most effective programs for dealing with non-credit needs of non-growing enterprises may be indirect ones.

These entrepreneurs are frequently quite unsophisticated and widely dispersed. Training programs designed to upgrade their management skills have generally proven to provide only limited benefits while operating at high costs. Effective programs to address the non-credit needs of this group must operate primarily at a systems level: changing policies that affect large numbers of small producers, working indirectly through the supply of raw materials or other inputs, or establishing better marketing systems (perhaps through the activities of private traders), to enable dispersed small producers to link up with more dynamic segments of the market.

GROWING BUSINESSES

In order to grow in terms of employment, productivity and income, an enterprise must submit itself increasingly to the discipline of the market, in anticipation of the benefits that a closer alignment with the market can bring. This will necessitate a growing understanding of the market's requirements in terms of product types, quality, timeliness and price. It also requires expanding knowledge about and mastery of improved production technologies, and a variety of associated management skills. The corresponding benefits include an opportunity to specialize and to link the enterprise's fortunes with more rapidly growing segments of the market.

None of this is easy. Nor should a recognition of the complexity of the task facing aspiring entrepreneurs be taken as implying that assistance programs should attempt to provide training and assistance in all these areas, either to teach entrepreneurs to perform these functions or to perform them on their behalf. This older model of enterprise development has been tried in the past and found to be severely wanting (see Kilby, 1988).

Our analysis leads us to suggest a substantially less ambitious program that we think it has a better chance of providing cost-effective support for growing enterprises, whether these are seeking only to grow in small amounts or to graduate to substantially larger size. Our suggestions are at three levels:

- i) At an economy-wide level:

The macroeconomic context is particularly crucial to the expansion of productive microenterprises.

The most dynamic periods of enterprise expansion are those when prices are stable and when the overall economy is growing. Particularly for rural areas, a dynamic agriculture contributes in important ways to the expansion of productive employment among rural micro and small enterprises (which, in most countries, constitute the majority of MSEs). Conversely, when the overall economy is distorted, heavily regulated or stagnant, relatively little expansion takes place among MSEs.

National policies can contribute in important ways to human capital formation.

An effective public education system that incorporates a respect for entrepreneurship, along with a public recognition and validation of apprenticeship and on-the-job training programs, can have an important contribution to make to the supply of potential entrepreneurs.

The regulatory environment needs to avoid discriminating against MSEs in terms of access to imports as well as to domestic raw materials.

Growing enterprises must have equitable access to the inputs required for their production needs. Government regulations and marketing controls have frequently been used to channel available supplies to the public sector or to larger private firms, leaving MSEs severely disadvantaged.

ii) At a sectoral level:

Focusing assistance on particular subsectors can raise the effectiveness of support to growing enterprises.

Selecting particular subsectors for attention can enable those providing assistance to specialize, gaining familiarity with problems and opportunities. This can mean an identification of opportunities for product development based on a better understanding of market niches and market structures. It can also lead to more specialized knowledge about technological and management problems and their solutions.

Much of the effort in the promotion of growing enterprises should be aimed at developing commercial, market-based linkages between independent enterprises.

Many types of enterprise competence can be purchased in the market; this should be encouraged and facilitated, not stifled and under-cut through subsidized provision of the same services. In the same vein, vertical commercial linkages between independent enterprises can enable small enterprises to specialize in those functions that they do best. Effective assistance programs can contribute to the spread of such market-based linkages.

iii) At an individual enterprise level:

To the extent that assistance is provided directly to individual enterprises, this should be focused and short-term, of a problem-solving nature.

There is often a tendency to think in terms of long-term relationships providing training and advice over several months or even years. Such programs can be very expensive, and often produce only limited results, and frequently involve problems of long-term dependence on the assistance. Cost-effective programs are more likely to be built around providing specific answers to specific questions, with a short turn-around.

A major part of such assistance should involve referrals: to commercial agencies able to provide the assistance for a fee, or to existing institutes or organizations able to provide assistance.

Most countries already have an array of technology institutes, training programs, and commercial organizations, often operating well below capacity, that are willing and indeed eager to participate in a network seeking to respond to particular problems of growing businesses. Even if these have sometimes been less effective than one would hope, the best strategy is generally one of strengthening existing structures through informed referrals rather than rebuilding the whole through a new assistance program.

Some countries have sought to deal with this direct provision of advice and assistance to growing small businesses through non-commercial mentoring relationships between large and small businesses. While such arrangements clearly have a contribution to make, we

would place more emphasis on relationships that have a commercial basis, so the buyer has a direct interest in ensuring that the supplier performs as a reliable partner.

There is no one right way to do microenterprise development. There are lots of wrong ways: in providing assistance that does not really help, or in providing help that is useful but is very expensive, that therefore cannot be generalized and that get in the way of developments that would otherwise help more people. The main message of this paper may be a recognition of complexity and diversity. There are different types of enterprises that have different valid and important contributions to make to the development process, that face different needs and can be helped in different ways. The design of effective programs must be built on an understanding of that complexity. It is hoped that this paper can contribute to that understanding.

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APPENDIX

SUMMARY OF SURVEY TYPES AND COUNTRIES

Five principal types of surveys have been used to generate the dynamic information for our studies:

- i) Modified baseline surveys, covering large numbers of small enterprises and asking retrospective information about employment at the start-up as well as the date of establishment of the enterprise. When combined with information on levels of employment "today" (as of the date of the survey), these surveys make it possible to examine average rates of employment growth over the life of the individual enterprise.
- ii) Closed enterprise surveys, in which individuals in sample households are asked retrospective questions about whether they previously operated a small enterprise that has now ceased operating. If so, information is collected about start-up and closure sizes and dates, reasons for closure and what the person has done since.
- iii) Retrospective bore-hole surveys, where entrepreneurs are asked to "tell the story (or history) of their enterprise." Generally, these retrospective studies have focused on enterprises in particular subsectors.
- iv) Tracer studies, that start with a list of enterprises that had been identified at a certain point in the past to see what has happened to them (or to their owners) since they were first studied.
- v) Panel or prospective surveys, where individual MSEs or all MSE in particular locations are resurveyed after specified time intervals.

The surveys that have contributed to this new understanding are listed in table 1 below. All of these except the survey in Guinea were funded by USAID. Detailed sources are provided in the notes to the table.

As the table indicates, the baseline surveys have reached a large number of small enterprises in twelve countries. In the first six countries listed in table 1.1, the baseline questionnaire was administered to 28,000 respondents. Much of our subsequent analysis focuses on those six. We refer to them as core countries; they provide us with the richest body of data about small enterprise dynamics. Other countries on the supplementary list include three where the modified baseline survey was administered, but only in certain localities (Guinea, South Africa) or to a smaller sample of respondents nationwide (Lesotho); and three others where other types of dynamic information are available (Niger, Nigeria and Jamaica). Adding all these countries with some type of dynamic survey information, we reach a total of nearly 65,000 responses in twelve countries. This is a very large sample indeed!

It is obvious that the achievement of such wide coverage has involved important trade-offs, severely limiting the type of information it was possible to collect. There are a great many questions about which all of us would like to know more; but the collection of such information was seen as not feasible in fast-moving, one-shot questionnaires using enumerators who often had only limited understanding of the

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topics being examined. Efforts are currently under way to push out these frontiers, particularly to provide a better understanding of patterns of income earned in different types of micro and small enterprises.

TABLE 1
MICRO AND SMALL ENTERPRISE SURVEYS
WITH SIGNIFICANT DYNAMIC DIMENSIONS:
NUMBERS OF RESPONDENTS COVERED BY SURVEYS

Country	Survey dates	Modified baseline survey	Closed enterprise survey	Repeat baseline and panel surveys	Retrospective survey	Tracer survey
A. Core countries: Nation-wide surveys with comprehensive data on enterprise dynamics						
Botswana	Feb-Mar 1992	1,362	153			
Kenya	Sept-Oct 1993	5,353	1,998	May-June 1995	79	
Malawi	June-July 1992	9,672	2,809			
Swaziland	March-Apr 1991	2,759	650			
Zimbabwe	Aug-Sept 1991	5,575	1,101	Sept-Oct 1993	40	
Dominican Republic	March 1992	4,568	916	Sept. 1992, March 1993 March 1994		
B. Other surveys with significant information about enterprise dynamics						
Guinea (one prefecture)	May-June 1993	4,262				
Jamaica	1979-80 to 1994			April, 1993- Dec. 1994		142
Lesotho (nationwide survey)	July-Aug 1990	7,267 (630)				
Niger (two Departments)	Oct-Nov 1989	18,650				
Nigeria	1961 to 1993					220
South Africa (two townships)	Oct-Nov 1990	5,253				

Sources: Botswana: Daniels and Fisseha, 1992. Kenya: Parker with Torres, 1994; Parker, 1995 (for retrospective); Daniels, Mead, and Musinga, 1995 (for repeat baseline). Malawi: Daniels and Ngwira, 1992. Swaziland: Fisseha and McPherson, 1991. Zimbabwe: McPherson, 1991, and (for repeat survey) Daniels, 1994; Mead and Kunjeku, 1993, for retrospective survey. Dominican Republic: Cabal, 1992 and 1993. Guinea: Wierda, 1993; this study was sponsored and funded by the Christian Reformed World Relief Committee. Jamaica: Fisseha, 1994 (for tracer); Gustafson and Liedholm, 1995 (for panel). Lesotho: Fisseha, 1991. Niger: Fisseha, 1990. Nigeria: Kilby, 1994. South Africa: Liedholm and McPherson, 1991.

Notes: For all surveys in part A of the table, the baseline questionnaire included information about starting year and employment at start-up. This was also true for the surveys in the Dominican Republic, Guinea and South Africa. The surveys in Guinea, Niger and South Africa covered only selected regions or locations, while the surveys in the Dominican Republic and Lesotho were nation-wide. In Lesotho, dynamic questions were asked only in the supplementary questionnaire (numbers shown in parentheses). The retrospective investigation in Kenya was limited to woodworking and footwear enterprises; that in Zimbabwe focused on leather and footwear, garments, and metal products.

TABLE 2
PERCENTAGES OF NEW STARTS - BY INITIAL SIZE

Country	Enterprise Size (Number of Workers)			
	1	2 - 9	10 +	All Sizes
Botswana	74.9%	24.2%	0.4%	100%
Kenya	71.2%	28.1%	0.7%	100%
Malawi	76.1%	23.0%	0.9%	100%
Swaziland	85.6%	14.1%	0.3%	100%
Zimbabwe	83.2%	15.8%	1.0%	100%
Average	78.2%	21.1%	0.7%	100%

Sources: computed from individual country survey data

TABLE 3
REASONS FOR CLOSURE OF MICRO AND SMALL ENTERPRISES
(in percent of enterprises)

Reason	Botswana	Kenya	Malawi	Swaziland	Zimbabwe	Dominican Republic	Average
Business conditions Ead	43%	36%	54%	56%	47%	53%	47%
Better Options	21%	9%	8%	6%	7%	4%	10%
Personal Reasons	28%	31%	21%	22%	28%	27%	26%
Government Action/Natural Disaster	2%	6%	3%	4%	6%	2%	4%
Other	15%	18%	14%	12%	12%	14%	14%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Survey data

Note: average is unweighted

TABLE 4
AGE DISTRIBUTION OF CLOSED ENTERPRISES

Age at Closure (Years)	Botswana	Kenya	Swaziland	Zimbabwe	Overall average
<1	16%	17%	21%	13%	15%
1	11%	22%	16%	18%	15%
2	10%	16%	12%	17%	13%
3	11%	11%	7%	10%	9%
4	6%	7%	8%	9%	8%
5	6%	5%	4%	6%	6%
6	4%	3%	4%	5%	4%
7	7%	2%	3%	4%	4%
>7	29%	17%	25%	18%	26%

Sources: survey data.

TABLE 5
AVERAGE ANNUAL GROWTH RATE - BY GENDER OF ENTREPRENEUR
(Percentage)

Country	Sector - Annual Growth Rate - Linear			
	Manufacture (ISIC 3)	Trade (ISIC 6)	Service (ISIC 9)	All Sectors
BOTSWANA				
Female	11%	4%	6%	7%
Male	11%	11%	38%	12%
KENYA				
Female	26%	21%	7%	22%
Male	32%	27%	21%	32%
MALAWI				
Female	5%	13%	14%	9%
*Male	12%	11%	14%	12%
SWAZILAND				
Female	5%	7%	13%	6%
Male	14%	11%	5%	11%
ZIMBABWE				
Female	5%	11%	10%	6%
Male	8%	14%	20%	10%
DOMINICAN REPUBLIC				
Female	3%	7%	4%	6%
Male	15%	8%	4%	9%

Source: Survey data

TABLE 6
 PRINCIPAL PROBLEM
 AT THE TIME OF THE SURVEY:
 BY GENDER OF OWNER

	Female owners	Male owners
Percent with no problems	9.4	11.3
What was the most important problem? (percent among those reporting any problem)		
Working capital	12.7	14.6
Fixed capital	2.3	5.2
Other capital	7.7	4.0
Capital, total	22.6	23.7
Markets	26.7	21.6
Inputs	29.1	30.5
Governmental regulations	3.0	5.3
Other problems	14.7	11.5

Source: survey data

TABLE 7
CHARACTERISTICS OF MICROENTERPRISES:
CONTRIBUTION TO SELF-CONFIDENCE AND EMPOWERMENT OF THE INDIVIDUAL

	New starts	Non-growing enterprises	Enterprises experiencing small growth	Enterprises that had Graduated	Total, all enterprises
i. What did you do before starting this business?					
Ran another business		13.1	18.6	9.3	14.8
Employed (wage work)		42.6	47.7	68.2	45.4
Unemployed		28.7	19.2	2.5	24.9
New entrant to labor force/just out of school		4.9	7.5	17.4	5.7
Other		10.7	7.0	2.8	9.2
ii. How was the business started?					
Started from scratch		89.3	87.2	78.1	87.9
Purchased as a going concern		0.8	1.6	12.5	1.4
Inherited		5.3	6.5	6.3	6.1
Other		4.6	4.8	3.1	4.6
iii. Why did you choose this particular activity? (Kenya data only)					
Appeared profitable		56.4	72.3		
Fits with family constraints and limited resources		26.7	13.8		
Personal and other reasons		16.9	13.9		
iv. Are you a member of a business association? (% answering yes; Swaziland data only)					
	0.8%	7.2%	21.8%	47.1%	10.7%

Source: Survey data

TABLE 8
CREDIT AND TRAINING RECEIVED

	New starts	Non-growing enterprises	Enterprises experiencing small growth	Enterprises that had graduated	Total, all enterprises
i. What was the principal source of money to start the business? (only most important source reported)					
Household & personal savings	85.6	82.1	82.6	65.6	82.5
Loans from family & friends	2.0	4.0	2.8	12.5	3.5
Loans from formal financial institutions	2.2	1.9	2.4	6.2	2.4
Loans from moneylenders	3.7	3.8	2.8	0	3.4
Other sources of finance	6.4	6.9	6.9	15.7	7.2
ii. Have you received any credit since start-up?					
No credit received	84.0	87.4	84.2	62.2	85.3
Loans from family & friends	10.8	8.5	7.1	12.0	8.7
Loans from formal financial institutions	1.6	1.2	3.6	2.5	2.2
Loans from moneylenders	0.9	0.9	1.1	0.3	0.9
Other sources of credit	1.3	0.8	1.6	22.8	1.3
iii. Have you received any training since start-up? (% responding "yes")					
	11.7	14.0	22.5	31.3	16.4
iv. What type of training would you wish to receive?					
Management training	24.9	21.4	29.2	16.7	24.3
Technical/production training	11.8	14.3	15.4	16.7	14.5
Training in marketing	14.4	13.3	13.0	16.7	13.4
Training in bookkeeping	8.1	7.6	9.6	16.7	8.3
Other, including "don't know"	13.3	18.3	13.5	0	16.6
None desired	27.5	24.8	19.3	33.3	22.9

Notes: sections i and iii refers to Botswana, Malawi, Swaziland and Zimbabwe. Section ii is for all five African core countries. Section iv is from Botswana, Kenya and Malawi.

Source: Survey data

TABLE 9
GROWTH PATTERNS AND MARKETING ARRANGEMENTS
FOR MICROENTERPRISES

	Sells primarily to individuals	Sells primarily to traders	Sells primarily to other manufacturers
Percent of all enterprises in different growth categories			
No-growth enterprises	94.6%	1.5%	0.1%
Small growth enterprises	94.7%	4.0%	0.2%
Graduates	73.4%	20.8%	2.3%
Percent of all enterprises in the category that had grown	18%	56%	23%
Average growth rate in employment (percent per year)	7%	60%	17%

Note: these data are based on surveys in Malawi, Swaziland and Zimbabwe.

Source: Survey data

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