FACTORS THAT INFLUENCE THE GROWTH OF MICRO AND SMALL ENTERPRISES IN NAIROBI CENTRAL BUSINESS DISTRICT

BY

WACHIRA LOISE WANGUI

A RESEARCH THESIS SUBMITTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION IN PARTIAL FULFILMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (FINANCE OPTION), KENYATTA UNIVERSITY.

Wachira Loise Wangui
Factors that influence the growth of micro and small enterprises in Nairobi Central Business District

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DECLARATION

I, the undersigned declare that this project is my original work and has not been submitted to any other University or Institution of higher learning for academic credit. Information from all the other sources both primary and secondary data has been duly acknowledged.

Signature:........................................ Date:........................

Name: Wachira Loise Wangui
Reg. No: D53/OL/13419/04

This research project has been submitted with my approval as the University Supervisor.

Signature:........................................ Date:........................

Dr. M. Namusonge
Department of Business Administration
Kenyatta University

This research project has been submitted with my approval as the Chairman, Accounting & Finance Department.

Signature:........................................ Date:........................

Mr. F.W.S. Ndede
Chairman
Department of Accounting & Finance
Kenyatta University
ACKNOWLEDGEMENT

First and foremost I am deeply indebted to God my creator. He is blessed me with the true essentials of life: Good health, a brave heart and endless love.

I wish to particularly thank my supervisor Dr. Namusonge for her guidance and concern during my study. I also want to sincerely acknowledge the contributions of the lecturers and fellow students in the Business Administration Department. My family and parents deserve a special mention for their selfless sacrifices that they made just to be sure that I completed the course.

To all you, I say thank you very kindly. God bless.
DEDICATION

I want to dedicate this project to my family who supported and stood by me throughout my studies.
DEFINITION OF TERMS

GROWTH
Refers to the process of improving some measures of an enterprise’s success. Growth can be achieved either by boosting the top line or revenue of the enterprise with greater product sales or service income or by minimizing costs.

ENTREPRENEUR
Entrepreneur is a person who is willing and able to convert a new idea or invention into a successful innovation. Entrepreneurs are risk takers who expect to earn profits if they enterprises succeed but incur losses if the business ventures do not succeed.

MICRO ENTERPRISE
A business which employs less than 10 employees and has a sales turnover of less than Kshs2 million.

SMALL ENTERPRISE
A business which employs less than 50 employees and has a sales turnover of less than Kshs10 million.

SALES TURNOVER
This is the total amount sold within a specified time period, usually a year. Sales turnover is often expressed in monetary terms but can also be expressed in terms of the total amount of stock or products sold.

VALUE CHAINS
A value chain refers to the full range of activities which are required to bring a product or service from conception, through the different phases of production, delivery to final consumers, and final disposal after use.

SOCIAL NETWORKS
This refers to refer to relationships between individuals. Connections across different groups may enhance mobility and greater market access.
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<tr>
<th>Acronym</th>
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<tr>
<td>CBD</td>
<td>Central Business District</td>
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<td>CBS</td>
<td>Central Bureau of Statistics</td>
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<td>ERS</td>
<td>Economic Recovery Strategy</td>
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<td>MSME</td>
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<td>Poverty Reduction Strategy Paper</td>
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<td>SIDO</td>
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ABSTRACT

The study was an attempt to investigate the factors that influence the success of micro and small enterprises in Kenya. The objectives of the study were to determine the characteristics of entrepreneurs and firms which contribute to the growth of micro and small enterprises in Kenya, assess how social networks and value chains affect the growth of micro and small enterprises in Kenya, and establish the role played by inter firm co-operation and government policies such as taxation and infrastructure development on the growth the success of MSEs in Kenya. The study methodology was descriptive survey; the location of the study was the Nairobi Business District with the target population being micro and small enterprises. Using a multi-stage stratified random sampling a sample size of 97 MSE enterprises which is 10 percent of the approximately 970 MSE enterprises in Nairobi, Central Business District was arrived at. The researcher used a questionnaire as the main data collection instrument. Descriptive statistics was used to analyze data with the assistance of the SPSS software. The expected output was in the form of tables of frequencies and percentages and statistical charts such as pie charts and bar graphs. The study findings indicate that the locals are of the opinion that although the government and agencies including the local authority had done a lot in the area of provision of business friendly environment there was still a high number of discrepancies which led to many enterprises to operate informally. The size of capital and the type of business may contribute to the growth of small and micro enterprises. It was also revealed that access to finance and the type of capital influence MSE’s growth in the town. The connectivity of the business and the chain that it has influences its growth. Social network is important in business and from the study, information is important to business in overcoming contract enforcement and overcoming transaction costs. Family and friends network help in business. The contextual factors influencing the MSEs are like good infrastructure in the region and the government support in things such as licenses for business. The researcher recommends the establishment of an effective process to ensure issues like company registration and a well-entrenched VAT system are institutionalized to assist existing and upcoming MSE operate optimally. The government can follow this lead and continue improving and expanding the available infrastructure so as to fully support most small scale enterprises. The study indicated that access to loans by small and medium size enterprises was still very limited as such it is upon the government and its agencies to fine-tune working modalities that will ensure that even MSEs have adequate access to credit instruments just like their bigger counterparts.
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1.1. Background of the Study

Micro and small enterprises (MSEs) are defined as those enterprises which engage between one (1) and twenty (20) persons (SIDO, 2002). During the past two decades, the perception of MSEs and their role in economic development has changed substantially. MSEs have shown great resilience during the time of crisis. They usually utilize local resources like capital (such as family savings), as skills amassed to produce a variety of products for the market and utilize local material resources often to a greater extent (Anderson, 1996).

An attitude towards private sector development has become more positive and in this context the role of MSEs as a seedbed for large-scale entrepreneurship is receiving greater recognition. They have proven to be efficient and dynamic in countries which have given them the opportunity to develop and access appropriate support (Kimuyu, 2002). MSEs are just the basis for sustainable growth, but are also critical for poverty and inequality reduction (Sidea, 2006).

The role of MSEs is getting famous since the United Nations declared the year 2005 to be the International Year of Micro Credit to promote small business and financial institutions that provide loans and other financial services broadly known as Micro-Financial the broader aim of the year was to put a spotlight on the fortunes of their communities and focus on bringing more capital to entrepreneurs in developing nations (ILO, 2006). To accelerate growth and reduce poverty, the World Bank Group and other international aid agencies provide targeted assistance to MSEs in developing economies. MSE policy is based on the fact that MSEs enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, innovation and aggregate productivity growth. These proponents of this theory argue that MSE expansion boosts employment more than large firms because MSEs are more labor intensive. From this perspective, subsidizing MSEs may represent a poverty alleviation tool (Ross, 2004).

Data on the MSE sector in Kenya is scarce; the National MSE Baseline survey (1999) indicates that contribution of MSE sector to GDP increased from 13.8% in 1993 to 18.4% enterprises of
less than 10 workers while only 1% comprised of firms with 10-50 employees (Central bureau of statistics, 1999).

The Federation of Kenya Employers (FKE) started getting involved in informal small-scale activities back in 1989. At that time, unemployment in the country was rising due to reduction in the private sector formal employment. Formal employment fell from 42 percent in 1985 to 19 percent in 1998. It was against this background that the FKE revised its work with support from the ILO and it did so in line with the Kenyan Government policy framework for small and medium sized enterprise development completed in 2004 (FKE, 2005).

The FKE has played an active role in the consultations leading to the new policy framework, which relates to be the overall goal of developing a vibrant MSE sector capable of promoting the creation of durable, decent and productive employment opportunities, stimulating economic growth, reducing economic disparities and strengthening linkages between firms (FKE, 2005).

In the past, the MSEs were seen as competition for larger companies. But the FKE and the government now see them as an opportunity to enable the informal sector to contribute towards industrialization and the creation of decent jobs and wealth (Alala, 2004).

Based on the need to increase its membership and maintain credit representation, the FKE launched an MSE strategy to make the Jua Kali sector part of an integrated economy with potential of building stronger inter-firm linkages among its membership and Jua Kali enterprises (Nyang'ute, 2005).

Between 1986 and 1996, the labour force on average grew over 4 percent yet employment only increased between two (2) and (3) three percent annually from 1986 to 1995. As a result, more than 2 million out of 33 million Kenyans (growing yearly at 21 percent) are unemployed. Average unemployment is currently estimated at 23 percent not counting those no longer seeking formal employment (Central Bureau of Statistics, 1999).

1.2 The Micro and Small Enterprise Sector In Kenya

The Kenya government has made various attempts to enhance the success of the micro and small enterprises in Kenya by providing policies and a regulatory framework that is supportive of the enterprises. While several factors have been identified as the success variables to micro and
small enterprises among access to credit, management, competition, infrastructural (GoK 2002),
the Kenyan government prepared a poverty reduction strategy paper (PRSP) that outlined key
policies and strategies for poverty reduction. The main objectives of the PRSP were to identify
national development objectives, link policy planning and budgeting, ensure rational public
expenditure, harmonize the financing system, and establish and effective monitoring and
evaluation system.

The PRSP was based on five key principles: giving a voice to the poor, participation and
ownership, transparency, openness and accountability and equitable distribution of national
resources and development initiatives. The PRSP developed strategies for the revitalization of
the following sectors: Agriculture and rural development, human resource development, physical
infrastructure, trade including tourism, public safety, law and order and information and
communication technologies.

The PRSP was developed through a participatory process that started at the district level and was
scaled up to the national level. At the district level, initial stakeholder discussions were organized
with political, administrative, religious, private sector, and social and civil society leaders. The
leaders identified the key causes of poverty in their respective districts and prioritized their
development needs, as well as appropriate poverty reduction strategies. At the end of the district
consultations, a national stakeholder conference was convened during which the results from
each district were verified and combined to form the national poverty reduction strategy.
According to the World Bank, the PRSP provided a sound basis for IMF concessional assistance.
However, this PRSP was not implemented owing to the 2002 elections, which ushered in a new
government.

In 2003, the new government, elected on a platform of reform, developed its own Economic
Recovery Strategy for Wealth and Employment Creation (ERS) drawing heavily on the PRSP
developed by the previous administration, but also reflecting its own priorities. Unlike the PRSP,
the ERS is based on a strong reform agenda in all the key sectors as well as articulating strategies
aimed at tackling corruption and strengthening political and economic governance. In his first
address to Parliament, President Mwai Kibaki said: "microenterprises are expected to play a
crucial role in the creation of jobs in Kenya. However, we recognize that the sector's growth
potential is inhibited by several constraints. These include: poor access to markets, lack of credit
and a poor policy environment. My government will soon be presenting to the House, a sessional paper on the development of micro and small enterprises for poverty reduction and employment creation.

1.3 The Statement of the Problem
Micro and small enterprises in developing countries experience stunted growth especially during their first year of operation (Karekezi and Mjoro, 2002). Surveys of over 28,000 MSEs in Africa and Latin America reveal that less than three percent of MSEs expand by four or more employees after startup (Liedholm, 2002). Instead, nearly three out four of micro and small enterprises stagnate or even contract. Yet there are also remarkable examples of MSE growth across the developing world. A small subset of MSEs known as “gazelles” in the US literature (Birch, 1987; Boston and Boston, 2007) demonstrates impressive growth rates that eclipse those of even highly performing larger firms.

Although some limited studies have been done on MSEs in Kenya on particular sectors of the economy to find out the factors that determine their growth, no study has been across the board encompassing various sectors of the economy in general (Ng’ang’a 2004). Past studies on MSEs in Kenya include (Mwangi, 2005) on the Effect of Training on MSEs in the Mount Kenya region and (Ng’ang’a, 2004) on the factors that affect growth of MSEs in the dairy industry in Kenya. (Mwangi,2005) found that training of staff of MSEs enhances their performance and profit growth positively because training increases MSE competitive edge and facilitates customer satisfaction due to quality improvement of their products( Mwangi,2005). Ng’ang’a on the hand concluded that although the MSE entrepreneurs in the dairy industry in Nairobi were well educated and exposed with a highly competitive spirit, most of them did not have business plans. Added to this, infrastructural facilities such as roads and electricity let them down with the local authorities harassing them even with their single business permits.

None of these studies however focused on the factors that affect the growth of a wider spectrum of MSEs in the various sectors of the economy such as food, clothing and apparels, electronics, and telecommunications. The researcher intends to exhaustively study the possible factors but have not been empirically verified.
1.4 The Objectives of the Study

(a) General Objectives
The general objective of the study was to investigate the factors which may affect the growth of micro and small enterprises in Kenya.

(b) Specific Objectives
1. To determine the characteristics of entrepreneurs which may contribute to the growth of micro and small enterprises in Kenya.
2. To determine the characteristics of the MSE firms which may contribute to the growth of micro and small enterprises in Kenya.
3. To establish how social networks affect the growth of micro and small enterprises in Kenya.
4. To determine the effect of value chains on the growth of micro and small enterprises in Kenya.
5. To establish the contextual factors that influence business growth in Kenya.

1.5 Research Questions
1. What are the characteristics of entrepreneurs which contribute to the growth of micro and small enterprises in Kenya?
2. What are the characteristics of MSE firms which contribute to the growth of micro and small enterprises in Kenya?
3. How do social networks affect the growth of micro and small enterprises in Kenya?
4. What is the effect of value chains on the growth of micro and small enterprises in Kenya?
5. What are the contextual factors that influence business growth in Kenya?

1.6 Significance of the Study
This study is significant to current and potential entrepreneurs who will benefit from a wealth of information collected, analyzed and documented on the economic and social factors which influence the growth and success of MSEs in Kenya.

The results of the study will also be useful to the government and other decision makers to formulate policies that will facilitate the growth of business enterprises. This will enable the government achieve the vision 2030 goals.
The study will excite more interest in the study of entrepreneurship and expose areas that need more research and exploration. Future researches students may fill up the gap in the areas not covered and thereby contribute to the frontiers of knowledge in this area of entrepreneurship development.

1.7 The Scope
The study was carried out in Nairobi, Kenya; it was confined only to the micro and small enterprises within the Central Business District in Nairobi. The study is not an exhaustive review of all factors linked to MSE growth, but instead aims to provide an overview of important economic and social factors that influence the growth of MSEs.

The study considered only economic, social and macro-economic factors that affect MSEs growth. Other factors which do affect the growth of businesses which includes political issues will be beyond the scope of this research. The study categorized the MSEs into restaurants, cyber cafes, boutiques and mobile shops.

1.8 Assumptions
There are a number of assumptions that the researcher made in this study. A very important assumption is that the respondents will give honest information. This implies that the quality of the analysis depended on the accuracy of the responses of the sample respondents. The researchers assumed further that time to collect the data will be adequate. Given that most of the potential respondents are in the CBD, this was a reasonable assumption for the researcher to make. The cooperation of the respondents is of paramount importance if the researcher is to succeed in obtaining all the relevant information. The availability of the secondary data will further enhance the success of the research undertaking.

1.9 Limitations
Business information was regarded as confidential business secrets by the respondents and entrepreneurs were reluctant to give honest responses. This inhibited the data collection process. In order to overcome this predicament, the researcher however assured the respondents that the information would be used exclusively for academic purposes.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction
The chapter begins by outlining the role of MSEs in developing economies such as Kenya. The section further explores the factors which influence the growth and success of MSEs. These include individual entrepreneur characteristics such as education, work experience and gender, firm characteristics such as age, formality and access to finance. Other factors are social networks, value chains, inter firm cooperation and macro-economic factors such as government policy and taxation. Empirical reviews of similar studies in the past as well as a critical review of the above factors are also explored. The conceptual framework of the study outlining the independent and dependent variables is also presented. The summary of the main issues and research gaps finalizes the chapter.

2.2 The Role of Micro and Small Enterprises
Micro and small enterprises play an important role across the world. Following previous studies, we define MSEs as firms with up to 20 workers, which engage in non-primary activities and sell at least half of their output. In both developing and developed countries, the vast majority of firms are MSEs. For example, approximately 97 percent of firms in Mexico and Thailand are MSEs (Kantis, Angellini, and Koenig, 2004; Simmons, 2004). In the U.S over 96 percent of businesses similarly have fewer than 50 employees (US Small Business Administration and Census Bureau, 2004). Official statistics frequently underestimate the number of micro and small enterprises, leading some researchers to argue that actual figures may be twice as high as what is reported (Mead and Liedholm, 1998).

The MSE sector generates substantial employment and economic output in many countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production (Tybout, 2000). Studies in five African countries (Botswana, Kenya, Malawi, Swaziland, and Zimbabwe) found that MSEs generate nearly twice the level of employment as registered, large-scale enterprises and the public sector (Mead and Liedholm,
1998). In many Latin American countries, micro and small enterprises employ over half the working population. An ILO study (2003) examining firms with fewer than 10 workers found that they generated 58 percent of total employment in Paraguay, 54 percent in Mexico, and 53 percent in Bolivia. With respect to economic output, the contribution of the MSE sector varies considerably across countries. MSEs contribute approximately 31 percent of overall GDP in the Dominican Republic, 13 percent in Kenya, and 11 percent in Pakistan (IDB, 1998; Daniels, 1999; SMEDA, 2002). Official statistics may underestimate MSEs contribution to GDP for example; some experts argue that Kenyan MSEs actually generate 40 percent of GDP, not 13 percent (Daniels, 1999; Gamser, 2003).

What explains small firm growth? Many commonly held beliefs about small firm growth are shaped by well-publicized stories about a few extraordinarily successful entrepreneurs. According to these stories, firm growth is propelled by the almost single-handed efforts of a dynamic, hardworking entrepreneur (usually male) who slaves around the clock for years in his garage—until one day, “the big break” comes. At this point, some combination of investors and customers recognize the value of the entrepreneur’s unique product idea and “poof,” the fledgling business expands rapidly and becomes a household brand name.

The truth is that very little is known about micro and small enterprises growth. Research suggests that even in the United States, high-growth companies rarely begin with a “winning product idea” that catapults the lone entrepreneur from garage to swanky boardroom (Collins and Porras, 1994). And if the above scenario is unlikely when the garage in question is located in Palo Alto, California, it becomes downright implausible if the start-up is based in a place like La Paz, Bolivia; Nairobi, Kenya; or Dhaka, Bangladesh.

Regardless of one’s convictions about the role of smaller firms in economic development, a closer look at MSE growth patterns reveals intriguing contrasts. This paper defines firm growth as an increase in the number of employees over time. At an aggregate level, MSEs demonstrate impressive growth, especially when compared with larger firms. Based on the 28,000 MSE surveys mentioned above, Mead and Liedholm (1998) find that aggregate employment growth in the MSE sector averaged nearly 17 percent annually, generally at least double the overall rate of
GDP growth in each country. Yet their analysis of individual MSEs reveal a remarkably different picture, with most firms stagnating or contracting (Mead and Liedholm, 1998; Liedholm, 2002).

Similarly, another rigorous study in Mexico finds that in a given year just 12 percent of owner-only firms expand, and that larger microenterprises have a higher probability of contracting than expanding (Fajnzylber, Maloney and Rojas, 2006). Thus, impressive aggregate growth rates of the SME sector are fueled by a narrow group of firms. These “gazelles” vastly outperform their peers and drive aggregate employment growth for the small business sector.

Why do some MSEs expand rapidly, while others stagnate? What factors account for the wide variation observed in MSE growth rates? Some of the factors discussed are individual entrepreneur characteristics, the firm characteristics, social networks, value chains, inter-firm cooperation, and macro-economic factors.

2.3.1 Individual Entrepreneur Characteristics

For centuries, theorists have hypothesized about various personal characteristics of individual entrepreneurs that might lead to firm growth and success. A body of practice in private sector development as well as venture capital continues to examine such characteristics.

(a) Education

Intuitively, one might expect higher levels of formal education to spur MSE growth by enhancing firm capabilities. For example, formal education may provide entrepreneurs with a greater capacity to learn about new production processes and product designs, offer specific technical knowledge conducive to firm expansion, and increase owners’ flexibility. While most empirical evidence indeed suggests that firms with better-educated owners and managers are more efficient (e.g., Burki and Terrell, 1998; Tan and Batra, 1995), greater complexity emerges when examining the relationship between education and MSE growth in developing countries.

Developing-country MSE owners and workers often have relatively low levels of education. One reason is that despite recent advances, primary education completion rates remain only 55 percent in Sub-Saharan Africa, 78 percent in South Asia, and 89 percent in Latin America (World Bank, 2001). In addition, MSEs tend to have less-educated owners and workers than larger firms
(Orlando and Pollack, 2000; Soderbom and Teal, 2001). Educational disparities across firm size are especially striking at the university level: for example, 21 percent of micro enterprise owners in Chile have Bachelor’s degrees, compared to 42 percent of small firm and 55 percent of medium-firm owners (Alvarez and Crespi, 2003). The lower level of educational attainment among MSE owners and workers is remarkable when contrasted with developed countries, where those with higher education are more likely to be self-employed (Woodruff, 1999). One reason for this contrast is that the poor in developing countries often create survival-oriented MSEs due to a lack of alternative employment opportunities.

Given the relatively low level of education within the MSE sector in developing countries, do MSEs with more highly educated owners tend to grow more quickly? On the surface, the evidence appears contradictory. For example, an Inter-American Development Bank (IDB) study found that secondary school attainment had no discernible impact on firm growth in Latin America (Kantis, Angellini and Koenig, 2004). On the other hand, numerous studies in Sub-Saharan Africa suggest that entrepreneurs completing secondary school have more rapidly growing firms in Kenya and Zimbabwe, but find no significant effect of primary education on MSE expansion (McPherson, 1991; Parker, 1995; Mead and Liedholm, 1998).

Some clarity emerges when recognizing the threshold effect of education. MSEs with more highly educated owners tend to grow more quickly, but a country-specific threshold must be reached to observe this growth effect. For example, whereas a threshold of secondary education may identify high growth potential in the African countries just mentioned, a higher threshold of university education appears to exist in Latin America. Although the IDB study found that secondary school attainment has no effect on MSE growth, it also reveals that six of every ten Latin American entrepreneurs with high-growth firms are university graduates (Kantis, Angellini and Koenig, 2004).

Despite various potential benefits, education may also harm MSE performance if owners divert their attention to other attractive opportunities. Research on small manufacturing firms in Chile found that university education did not induce higher efficiency. Some highly educated owners, distracted by other activities, paid little attention to monitoring their labor force due to alternative activities (Alvarez and Crespi, 2003).
(b) Work Experience

Any development practitioner or businessperson can attest that MSE owners acquire a substantial amount of skills and knowledge while operating their firms. Work experience may contribute to MSE growth in at least two ways: directly, by expanding the capabilities of MSE owners and employees through the acquisition of skills and knowledge; and indirectly, by expanding entrepreneurs’ social networks. Entrepreneurs with more years of work experience typically have faster-growing MSEs. For example, one empirical study found that Kenyan entrepreneurs with at least seven years of work experience expanded their firms more rapidly than those without such experience (Parker, 1995).

While the benefits of on-the-job experience are frequently mentioned, the importance of prior work experience may be even more helpful, especially if that experience came within the same sector or in small to medium-sized enterprises. Prior experience proves to be important in developed countries; for example, a panel survey of 1,000 entrepreneurs in the Netherlands found that entrepreneurs’ prior experience, when in the same industry as their startups, improves firm growth, survival and profitability (Bosma et al, 2004). An IDB study of high-growth entrepreneurs provides telling insights about the importance of not only skills, but also business contacts gained during past employment (Kantis, Angellini and Koenig, 2004). Among Latin American and East Asian entrepreneurs, contacts were found to be a key benefit of work experience, helpful in identifying business opportunities, obtaining financing and other resources, and alleviating management challenges.

Unfortunately, some developing regions are characterized by a systematic lack of opportunities to gain relevant work experience. In particular, Africa has few medium-sized companies for entrepreneurs to gain work experience, a phenomenon known as “the missing middle.” For this and other reasons, MSE owners and workers in Ghana have an average of only five years of work experience, compared to ten years for their counterparts in larger firms (Barr, 1998).

(c) Gender and Household

Women own and operate the majority of MSEs in many developing countries, in part because of the ease of entry and their limited access to alternate opportunities (Rubio, 1991). Studies across nine countries in Africa and Latin America found that on average 61 percent of MSEs are owned
by women, ranging from 46 percent in Malawi, Kenya and the Dominican Republic to 84 percent in Swaziland (Mead and Liedholm, 1998). Yet women often face particularly difficult challenges that suppress the growth of their firms. In some cases, women may also choose not to grow their firms.

There are numerous gender-related challenges to MSE growth. All too often, women face asymmetrical rights and obligations limiting their labor mobility and burdening them with disproportionate household responsibilities (Downing and Daniels, 1992). One econometric study based on Guatemalan data suggests that the high marginal value of home time for women during certain periods of their lives is the principal constraint to growth of female-owned firms (Kevane and Wydick, 2001). In some countries, women face relatively greater problems with illiteracy, and lack of business skills (ILO, 1999). In addition, women commonly have unequal access to markets. Research in Ahmedabad, a city in the Indian state of Gujarat provides evidence of this unequal access and reduced bargaining power. 36 percent of female entrepreneurs sold their products to retailers, wholesalers and middlemen who came directly to their homes, compared to only 20 percent of males (Kantor, 2002, 2005). As a result of such factors, women also frequently focus their MSEs on a relatively narrow range of industries.

At the same time, women-owned MSEs often play a crucial role in increasing and diversifying household incomes. Women may operate MSEs with small but regular contributions to income, thus enabling their husbands’ entrepreneurial aspirations. Following such survival strategies, women may strive to grow laterally; instead of specializing in their MSEs by expanding their size, they may opt to diversify by creating additional firms (Downing and Daniels, 1992).

2.3.2 Firm Characteristics

Certain firm characteristics may correlate positively or negatively with MSE growth tendencies. This section explores the relationship between MSE growth and three widely studied firm-level factors: firm age, formality (or informality), and access to finance.

(a) Firm Age

The relationship between firm age and growth in the MSE sector is particularly interesting. Young SMEs grow substantially more rapidly on average than their older counterparts. Studies in
both Africa and Latin America show that young MSEs are more likely to show high rates of growth compared with SME's that have been in existence longer (Parker, 1995; Mead and Liedholm, 1998). An IDB study reveals that the major expansion of dynamic enterprises occurs during their third year of operation (Kantis, Angellini and Koenig, 2004), and other studies suggest that the average growth rate of firms decreases with age (e.g., Burki and Terrell, 1998).

Why might young MSEs grow more quickly than old MSEs? A seminal theoretical paper by Jovanovic (1982) offers one possible explanation. Jovanovic proposes a learning model in which firm owners discover their efficient sizes of operation gradually. This theory predicts that a firm will expand quickly at first, and then taper off its growth as the firm approaches its optimal size. Although growth slows, productivity is expected to increase as the firm ages and the owner comes to learn the company’s optimal size of operations (through learning-by-doing).

On the other hand, some studies in developing countries suggest that firms actually suffer productivity losses as they age (Burki and Terrell, 1998). Firms may fail to invest sufficiently in existing or emerging technology, leaving them with relatively outmoded equipment and hindering productivity levels relative to younger firms.

In reality, a firm’s growth rate is likely to fluctuate as it has both positive (learning-by doing, increases in productivity) and negative (crises, decreases in productivity) experiences during its lifetime. Recognizing that the relationship between firm age and growth may be more complex, several researchers have developed frameworks based on a life-cycle approach:

(i) Stages of development: Churchill and Lewis’s (1983) model breaks the growth continuum into six stages of development: existence, survival, success—disengage, success—growth, takeoff, and resource maturity. At each stage of a firm’s growth, different factors become important, such as owner objectives, managerial skills, access to capital, technology, and human resources.

(ii) Family or women-owned firms: Several typologies (e.g., Mitra and Pingali, 1999; Mitra, 2002) integrate issues specific to family or women-owned firms into the Churchill and Lewis model, such as: 1) a strong identification of individuals with the business itself; 2) the challenge of establishing a balance between family and business concerns; and 3) the link between an entrepreneur’s source of motivation the growth trajectory of her firm.

(iii) Crisis: The crisis approach is based on identifying dominant crisis types faced by firms over
time and coordinating the solution to these problems with different growth stages. Examples are starting and cash crises, delegation and leadership crises, finance and prosperity crises, and succession crises (Patel, 1995).

(b) Formality (or Informality)
As is well known, informality is rife in many world regions, the ILO (2004) reports that the share of the informal economy in the non-agricultural workforce reaches 55 percent in Latin America, 45 to 85 percent in Asia, and nearly 80 percent in Africa. For the purposes of this study, informality refers to businesses that are unregistered yet derive income from the production of legal goods and services. In terms of sheer quantity, the number of informal firms often dwarfs the number of officially registered enterprises. Not only does informality in itself reduce the chances for growth, but it is also associated with several other characteristics that make growth difficult.

Although small informal MSEs may be able to circumvent government regulations and taxation, as they grow they risk becoming more visible, creating disincentives to expand beyond a certain size (Snodgrass and Biggs, 1996). Informal firms may therefore need to “keep their heads down,” ruling out large size and rapid growth, as well as close relations with formal firms (winter, 1995). Contracts with international or government buyers, for example, may be off limits for many informal firms because they require legal documentation that these MSEs lack. And while many firms in developing countries have problems accessing financial and legal systems, informal enterprises face even greater difficulties in obtaining formal credit and assistance from law enforcement agencies and courts.

For these and other reasons, informal MSEs tend to grow more slowly than do their formal counterparts. An econometric study in Côte d’Ivoire found that formal status has a positive effect on firm growth, even when using instrumental variables and controlling for efficiency, size and age of firms (Sleuwaegen and Goedhuys, 2002). Analysts at McKinsey and co. argue that informal companies tend to be subscale, sub invested and sub skilled, and that they also tend to produce substandard products and services (Capp, Elstrold and Jones Jr., 2005). While such an assessment may be overly pessimistic, the Côte d’Ivoire study suggests that formal firms are more efficient for two reasons: formal firms enjoy a larger range of production factors and
broader choice of input suppliers (Sleuwaegen and Goedhuys, 2002).

Certain MSE characteristics make it particularly likely that they will operate in the informal economy, a point underscored by McPherson and Liedholm's (1996) empirical research in Africa. Even though their study focused on countries with divergent policy and regulatory environments, evidence surprisingly suggested that the likelihood of registration did not depend on country. Rather, they found that certain types of SMEs are less likely, ceteris paribus, to be registered. These are one-person firms, rural, owned by women, operated within the household, or located in certain sectors.

(c) Access to Finance

For various reasons ranging from a lack of collateral to bias against small firms, MSEs tend to face greater financial constraints than do larger firms. An IFC study of 10,000 firms across 80 countries found that credit is mentioned more frequently by smaller firms as a constraint on growth (Schiffer and Weder, 2001). MSEs in developing countries apply for and receive formal bank loans relatively infrequently, and thus typically rely on other types of credit such as trade credit, overdrafts, and informal loans (Bigsten et al, 2003). Microfinance institutions also provide important sources of financing for MSEs, but their outreach is typically more limited than that of traders, suppliers, middlemen, and/or buyers who frequently provide working capital in cash or kind, especially in rural areas (Von Pischke, 1991; Swinnen, 2005).

Across the world, entrepreneurs typically start firms primarily through their own savings because of limited access to startup capital (Mason, 1998). For example, a study of over 14,000 micro enterprises in Mexico found that owners mostly used their own resources and savings (61 percent) or those of their family and friends (14 percent) to launch their firms (Hernandez-Trillo, Pagan and Paxton, 2005). Even after MSEs overcome the start-up hurdle, a lack of credit frequently hinders their growth during earlier years, because younger firms tend to find financing even more difficult than older firms (Schiffer and Weder, 2001). Over the life of the firm, growth also can be hindered by credit constraints that curb investments for maintaining or improving technology. In some contexts, evidence suggests that micro enterprises funded through external sources (e.g., bank loans and credit from buyers or suppliers) are more efficient, but it remains unclear whether this finding simply reflects ex ante screening by selective creditors (Hernandez-
Trillo, Pagan and Paxton, 2005).

2.3.3 Social Networks
This section explores the relationship between social networks and MSE growth. The term “social networks” is used here to refer to relationships between individuals. Connections “across” different groups may enhance mobility and be especially useful for MSEs trying to overcome regulatory or other obstacles.

Having an extensive social network is a valuable asset, which can help an entrepreneur obtain access to information (e.g., leads about profitable business opportunities) as well as resources (e.g., credit). While social networks can enhance MSE growth in any context, they can be critical to firms’ growth prospects in environments with pervasive market failures. The literature points to the role social networks can play in helping entrepreneurs overcome obstacles related to transaction costs, contract enforcement, and regulation. Examples include buyer-seller bargaining with acquaintances in Morocco’s bazaar economy (Geertz, 1978); the overwhelming preference of Ghanaian firms to do business with individuals they already know (Fafchamps, 2000); Jewish diamond merchants in New York lending gems to each other overnight for inspection without contracts to save lawyer fees (Portes and Landolt, 1996); and SME owners turning to experienced neighbors for help in registering a new business.

Entrepreneurs often take advantage of opportunities to invest in social networks when there is an apparent payoff in terms of SME growth. For example, a family may opt to perform specific ceremonies when planting cocoa, given that it will later depend on additional labor and resources from others within the social network (Berry, 1993). Quantitative studies confirm the importance of social networks—for example, an econometric study of small-scale manufacturing in Ghana found that entrepreneurs with larger and more diverse sets of networks are more productive (Barr, 1998).

Social networks also have numerous potential downsides for MSE growth. In some cases, social networks may be too expensive for or inaccessible to the poorest entrepreneurs, or systematically exclude or provide unequal access to resources for marginalized entrepreneurs such as women.
Social networks may be deeply rooted in societal traditions, making them difficult for outsiders to gain entrepreneurial opportunities. Other potential downsides of social networks include requests for profit distributions, unequal access to resources, and a lack of stability. For example, research in Bali showed that social networks can actually serve to hinder economic production, as social claimants preferred profit distributions instead of reinvestment necessary for growth (Geertz, 1978). Last, the sustainability of social networks is also an issue. If a network grows, a greater number of participants offer increased resources for MSEs, but the network’s usefulness may also decline as it becomes more inclusive. Partially for this reason, immigrant groups often segregate by spatial location to avoid overloading duties on network members (Luo, 1997).

2.3.4 Value Chains
Value chains also play an important role in MSE growth. A value chain refers to the “full range of activities which are required to bring a product or service from conception, through the different phases of production, delivery to final consumers, and final disposal after use” (Kaplinsky and Morris, 2001). Within a given value chain, MSEs may be involved in any number of activities, including primary production, assembly, and service provision.

Value chain characteristics influence the type and nature of opportunities for MSE growth. Conventional wisdom tells us that chains need to grow quickly to provide opportunities for all included firms, while stagnant or shrinking chains are likely to exhibit trends such as consolidation and “weeding out” of less-competitive firms. However, value chain growth may be necessary but insufficient to guarantee MSE participation or to ensure that MSEs benefit from growth.

An important dimension of growth or potential growth in a value chain is strong demand from the end market, whether local, regional, or international. While an increase in the volume of goods demanded by the end market may provide opportunities for MSE growth, the type of goods demanded can be just as important. A sophisticated consumer in local markets is one of the best indicators to predict whether developing country firms and by implication; MSEs are likely to participate in the value-added functions of production. Fairbanks and Lindsay (1997) refer to the ways in which demanding customers in the home market give international producers
their competitive edge. According to Fairbanks, “if you can sell shoes to an Italian woman, you can sell shoes anywhere in the world.” A lesser-known example is the success that Brazilian bikinis have had in markets around the world (Informar, 2005). Brazilians possess a large, diverse, and sophisticated consumer base for bikinis, and producers, both large and small, have turned that to their advantage when selling in distant markets.

Without demanding local consumers, it is less likely that developing-country firms, much less MSEs, can access the higher margins and value-added functions associated with international high-end market segments. Often, lead firms use MSEs as sources of flexible, low cost wage labor (Nadvi, 1995; Carr and Chen, 2003). MSEs may not interact directly with developed country firms but rather act as subcontractors to large developing-country manufacturers. In such cases, the pathways to growth may be blocked.

In addition to the characteristics of demand, certain sectorial tendencies (i.e. labor intensity or seasonality) have shown to favor the participation and survival over time of MSEs. Additional characteristics may be industry or product-specific. In agriculture, for example, specific crop strains may offer advantages to smallholders, depending on the inputs, land conditions, and other requirements associated with their cultivation. Also important is the organization of the value chain, especially inter-firm relationships and power dynamics. Models range from buyer-driven (top-down and not very conducive to MSE participation) to producer-driven (usually seen in high-tech chains where producers are relatively sophisticated) to network or non-hierarchical chains where power relationships are more balanced (Pietrobelli and Rabelloti, 2004; Gereffi, Humphrey and Sturgeon, 2005). Overall, it is clear that relationships between firms contribute significantly to MSE growth.

2.3.5 Inter-Firm Cooperation

Almost all firms interact with other firms. This section explores the concept of inter-firm cooperation as a driver of MSE growth, with emphasis on three aspects: vertical linkages, horizontal linkages, and supporting markets.
(a) Vertical Linkages
Individual firms form vertical linkages with their buyers and suppliers. A number of mechanisms are used, ranging from loose and informal understandings to rigid buyer-supplier agreements known as subcontracting or outsourcing. Contracts may be exclusive and legally binding, and include precise specifications regarding price, quantity, delivery dates, raw materials, and production processes.

Vertical linkages can facilitate MSE growth by expanding a firm’s set of viable business opportunities and improving firm capabilities. Agreements with buyers can decrease the risks and costs associated with entering new markets by providing a guaranteed flow of orders, critical information about market requirements, and, in some cases, a reduced need for capital investments (Aw, 2002). Sometimes, relationships with larger firms can help link rural industries to urban and international markets. In addition to fostering growth through expanded business opportunities, vertical linkages can lead to improved firm capabilities by providing opportunities for learning and innovation such as when corporate buyers assist with quality, maintenance, and technical issues (Berry, Rodriguez and Sandee, 2002) or when input suppliers offer training or information related to the use of improved technologies.

(b) Horizontal Linkages
Similar firms may group themselves or be organized by an outside party to work together these are referred to as horizontal linkages. Among the many legal and organizational options to institutionalize horizontal cooperation are cooperatives, associations, consortia, producer groups, and other collaborative structures. Horizontal linkages can help MSEs overcome many of the disadvantages of being small, such as providing a way to consolidate production, improve their negotiating position with buyers or suppliers, access market information or services, or lobby for political or regulatory changes (Goldmark and Barber, 2005; Steen, Magnani and Goldmark, 2005).

Clusters (geographic and sectorial agglomerations of enterprises) may also facilitate MSE growth by enhancing horizontal linkages. Clusters inevitably involve external economies: one firm’s investments spill over to other firms in the cluster (Schmitz, 1999). In addition, clusters may involve consciously pursued joint action, such as sharing machinery or developing a product
together (Schmitz, 1999). In cases where clustered firms seek to serve the same market, both competition and cooperation can drive innovation critical to firm performance. However, the mere presence of clusters does not guarantee dynamic growth for MSEs (McCormick, 1999). The advantages from participation in clusters relate directly to the strength of horizontal as well as vertical linkages, and relationships with supporting organizations.

(c) Supporting Markets

Services provided through supporting markets such as finance; consulting, legal, and tax advice; market information; and skills training are often directly related to improvements in capacity. For example, skills training may allow firms to offer new products, while finance may allow them to produce greater volumes. Access to market information or new technologies, on the other hand, may help firms respond to new opportunities. Supporting services may be offered directly to MSEs on a fee-for-service basis, or embedded in firm relationships; that is, delivered through vertical or horizontal linkages. While the absence or weakness of supporting markets has often been identified as a constraint to MSE growth (Field et al., 2000; Gibson, Hitchins and Bear, 2001, Lusby and Panlibuton, 2002), whether dynamic supporting markets act as a stimulus to growth remains uncertain and widely debated.

2.3.6 Macro-Economic factors.

Contextual factors play a major role in shaping the opportunities of MSEs in developing countries. Most obviously, the overall state of the economy directly influences the availability of profitable business opportunities. Growth opportunities wax and wane as the business cycle evolves. It is hardly a surprise, then, that MSEs tend to grow more quickly during periods of overall economic growth (Liedholm, 2002). There are, however, some important nuances in the relationship between MSE growth and the business cycle: the overall MSE sector often expands during economic downturns due to an increase in survivalist-type activities, although individual MSEs may stagnate or contract (Liedholm, 2002). An econometric study found evidence of a push and pull dynamic in Nicaragua: individuals become self-employed and start up micro enterprises during bad economic times, and then leave for salaried jobs when the economy is strong (Pisani and Pagan, 2004). During severe economic crises, MSEs may be more resilient than their larger counterparts. During the East Asian economic crisis, many small-scale firms...
fared better than larger companies in Indonesia (Berry, Rodriguez and Sandee, 2002), and microenterprises were the most likely to repay their loans to Bank Rakyat Indonesia (Patten, Rosengard and Johnston, 2001).

Macroeconomic and relative price volatility is also an important issue for MSE growth, as experience has shown in Latin America and Sub-Saharan Africa (Tybout, 2000). Surveys of 10,000 firms in 80 countries by the IFC found that both inflation and the exchange rate tend to afflict MSE’s more than larger firms (Schiffer and Weder, 2001). The regulatory and institutional environment in developing countries is notoriously burdensome when compared with developed countries (World Bank, 2006), frequently hampering small enterprise growth. An econometric analysis of firm-level data in 54 countries suggests that financial, legal and corruption challenges disproportionately constrain the growth of smaller firms (Beck, Demirguc-Kunt and Maksimovic, 2005). For instance, strict regulations and high taxes may keep firms small and informal (De Soto, 1989). Regulatory and institutional challenges may deter MSE owners from making growth-enabling investments, while special subsidies and trade protection offer greater benefits to larger firms, who are often more capable of lobbying (Tybout, 2000). Smaller firms more frequently report government policies to be unpredictable, and this uncertainty may be yet another factor reducing growth-enabling investments (World Bank, 2005).

While there appears to be consensus on what constitutes a negative business environment, much less has been written about what a positive one looks like. There are a few generally agreed-upon characteristics, however: consistency, so that business owners know what to expect and can assess risks; a stable macroeconomic environment, since knowing what to expect from the future can be as or more important than having a low inflation rate or favorable currency position today; the existence of mechanisms for contract enforcement and dispute resolution; an uninhibited flow of capital for foreign and domestic investment; a flexible labor regime; access to information, and investment in education and technology.
2.3.7 Growth Variables

(a) Return on Investments
ROI analysis is one of several approaches to building a financial business case (Pandey, 2004). The term means that decision makers evaluate the investment by comparing the magnitude and timing of expected gains to the investment costs. Decision makers will also look for ways to improve ROI by reducing costs, increasing gains, or accelerating gains.

In the last few decades, this approach has been applied to asset purchase decisions. MSEs in developing countries rarely keep proper financial records so that calculations of ratios such as ROI and Net Asset values are mostly not done.

(b) Net Profit
In simplistic terms, net profit is the money left over after paying all the expenses of an endeavor (Brockington, 1993). In practice this can get very complex in large organizations. The bookkeeper or accountant must itemize and allocate revenues and expenses properly to the specific working scope and context in which the term is applied.

Definitions of the term can however vary between the UK and US. In the US, net profit is often associated with net income or profit after tax.

(c) Net Asset Value
This is a term used to describe the value of an entity's assets less the value of its liabilities. The term is commonly used in relation to collective investment schemes (Maheshwari, 2002). It may also be used as a synonym for the book value of a firm.

(d) Sales Turnover
The total amount sold within a specified time period, usually a year (Van Horne, 2003). Sales turnover is often expressed in monetary terms but can also be expressed in terms of the total amount of stock or products sold.
Sales force retention is a key element in attainment of competitive advantage and increased profitability. In a case study created to assess the impact of sales force turnover, it was found that companies which minimize turnover create the opportunity for up to 10% additional long-term profit.

2.4 Empirical Review and Previous Research

Entrepreneurship is characterized by uncertainty and typically occurs in the presence of imperfect information, unknown production functions and market failure. According to Leibenstein (1995), entrepreneurship arises to make-up for a market deficiency.

Kilby suggests that entrepreneurship has been largely over looked in economics. He claims that entrepreneurship exists only in the lower realms, where imperfect knowledge and market failures are granted an untidy presence (Kilby, 1983).

This more realistic view of economic markets allows entrepreneurs to stand out as one of the leading sources of market transformation and economic growth and development.

Leibenstein maintains that there are two simultaneous steps in the process of economic development; economic and market transformation. In order for a country to increase its per capital income, it must have a shift from less productive to more productive techniques per worker (Leibenstein, 1985). This shift is the process of market transformation, and it can be manifested in the creation of new goods, new skills and new markets. Without entrepreneurs, there would be no new innovation or creative imitation in the market place, hence, the transformation to new production methods and goods in the country would not take place.

As the entrepreneurs transform the market, not only do they provide new goods and services to the domestic and international market, but also provide a new source of employment to the economy (Praag, 1995). As a result, entrepreneurship is a necessary ingredient in the process of economic development. It serves as a catalyst for market transformation and provides new opportunities for economic growth, employment and increase per capital income.

Research carried by Cunningham (in Meng& Liang, 1996) on 178 entrepreneurs and professional managers in Singapore shows that success is closely connected with individual traits

The aforementioned individual traits are creativity and innovation. Holt (1992) underlines both traits as necessary conditions to become a successful entrepreneur. Because innovation is a special means for entrepreneurs to reach success, Drucker (1985) considers it necessary for an entrepreneur to innovate systematically or habitually.

The MSE sector generates substantial employment and economic output in many countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production (Tybout, 2000). Studies in five African countries (Botswana, Kenya, Malawi, Swaziland and Zimbabwe) found that MSEs generate nearly twice the level of employment as registered, large-scale enterprises and the public sector (Mead and Liedholm, 1998). In many Latin American countries, micro and small enterprises employ over half the working population. An ILO study (2003) examining firms with fewer than 10 workers found that they generated 58 percent of total employment in Paraguay, 54 percent in Mexico, and 53 percent in Bolivia.

With respect to economic output, the contribution of the MSE sector varies considerably across countries. MSEs contribute approximately 31 percent of overall GDP in the Dominican Republic, 13 percent in Kenya, and 11 percent in Pakistan (IDB, 1998; Daniels, 1999; SMEDA, 2002). Official statistics may underestimate MSEs contribution to GDP, for example, some experts argue that Kenyan MSEs actually generate 40 percent of GDP, not 13 percent (Daniels, 1999; Gamser, 2003).

The data, however, do not hold up as strongly as these arguments suggest. Although smaller firms are widely recognized as contributing to growth in many developed economies (including the U.S., Italy, Japan, and the East Asian “tigers”), the presence of large numbers of MSEs in developing economies often carries a stigma, especially when the firms are informal and concentrated in markets with low barriers to entry. A recent McKinsey study defends the proposition that informal firms are far less productive than formal enterprises (Capp, Elstrold and Jones Jr., 2005). In addition, evidence from various sectors suggests that small firms (both formal and informal) are neither more efficient nor more likely to create jobs than larger firms.
(Hallberg, 2000). With respect to economic output, recent analyses suggest that a higher
correlation by smaller enterprises is associated with, but not a cause of, higher GDP growth
(Beck, Demirci-Kunt and Levine, 2005).

The strongest arguments for providing support to small firms may well focus less on efficiency,
employment growth or GDP growth, but rather on a more nuanced understanding of their role in
developing economies. For example, small firms may have a competitive advantage in particular
sectors (Steen, Magnani and Goldmark, 2005), offering a flexible and low-cost production
platform for specific products that target niche markets. In addition, the smallest firms in
developing countries often provide an important social safety net, offering temporary
employment to vulnerable segments of the population (Lustig, 2001).

At an aggregate level, MSEs demonstrate impressive growth, especially when compared with
larger firms. Based on the 28,000 MSE surveys mentioned above, Mead and Liedholm (1998)
find that aggregate employment growth in the MSE sector averaged nearly 17 percent annually,
generally at least double the overall rate of GDP growth in each country. Yet their analysis of
individual MSEs reveals a remarkably different picture, with most firms stagnating or
contracting (Mead and Liedholm, 1998; Liedholm, 2002). Similarly, another rigorous study in
Mexico finds that in a given year just 12 percent of owner-only firms expand, and that larger
microenterprises have a higher probability of contracting than expanding (Fajnzylber, Maloney
and Rojas, 2006). Thus, impressive aggregate growth rates of the MSE sector are fueled by a
narrow group of firms. These “gazelles” vastly outperform their peers and drive aggregate
employment growth for the small business sector.

2.5 Critical Review
The vast majority of micro and small enterprises in developing countries never expand beyond a
few employees. But a few highly performing MSEs experience rapid and substantial growth. The
expansion of these “gazelles” drives most of the aggregate growth in the MSE sector. Although
existing studies provide considerable evidence about which factors are linked to MSE growth, it
remains less clear how these factors shape firm growth. Investigating the mechanisms by which
these factors affect firms can provide insight into whether they actually cause MSE growth, or
are just associated with other growth determinants. There are various plausible mechanisms, but we highlight two channels that we believe deserve emphasis in future research opportunities and capabilities. Factors can enhance MSE growth by: expanding profitable business opportunities, or enhancing firm capabilities to harness opportunities.

Opportunities for profitable business activities shape the ability of an entrepreneur to expand his or her firm. Yet, profitable business opportunities are a necessary but insufficient condition for firm growth. To take advantage of business opportunities, entrepreneurs must also possess appropriate capabilities, such as skills, resources, or technology. Based on the evidence discussed above, Table 1 provides initial hypotheses about how each factor may affect firm growth through opportunities, capabilities, or both (Columns 2 and 3). Further research should pay close attention to how factors shape firms’ opportunities and capabilities, as well as to other mechanisms by which factors potentially affect MSEs growth.

Table 1: Growth Factors and SME Growth, Opportunities and Capabilities

<table>
<thead>
<tr>
<th>Growth Factor</th>
<th>Link to MSE Growth (Observed)</th>
<th>Impact on Opportunities (Hypothesized)</th>
<th>Impact on Capabilities (Hypothesized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education of owner (Above Threshold)</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Work experience of Owner</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Gender (Female-owned)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Location of business (Firm located in household)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Firm age (Older)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Informality</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Access to Finance</td>
<td>+</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Social networks (Strong, Diverse)</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Value chains (Favorable)</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>
Inter-firm cooperation + + +
Business environment (Favorable) + + +

Source: Adapted from *Small Firm Growth in Developing Countries* by C. Liedholm & D. Mead 2008

Many MSEs lack profitable business opportunities as well as capabilities such as skills, resources, and technology. These firms demonstrate the least proclivity toward growth, and their owners may focus instead on firm survival. Despite their lack of growth, these MSEs frequently play important social and economic roles. Even if they do not experience employment growth, they often provide essential sustenance for their owners and workers. In some cases, slow or nonexistent firm growth is attributable to entrepreneurs’ competing interests rather than a lack of capabilities. Women MSE owners, for example, may be especially likely to use business proceeds to purchase household necessities, to invest in parallel enterprises, or to assist their offspring in launching new firms.

What are the implications for development programs aiming to stimulate the growth of small firms? Should development projects try to “pick winners,” focusing on those firms most likely to grow? For example, should programs avoid informal, female-owned firms located in the household? We emphatically answer no. Many development practitioners—and most developing country policymakers find the “picking winners” formula to go against the very principles and goals around which their programs are conceived, not to mention being politically difficult to implement.

Even if “picking winners” were the goal, how would one weigh the different factors examined in this study or anticipate how they interact? For example, it is clear that young firms are more likely to become fast-growing gazelles than older firms. But how important is firm age relative to access to finance or educational attainment of the owner? One hypothesis is that factors influencing both opportunities and capabilities offer more powerful levers for development programs. If further research supports this hypothesis, development practitioners may want to focus on “dual-mechanism” factors such as work experience, inter-firm cooperation and social networks (Table I).
The MSE sector is large and heterogeneous. Development policies and programs that include "small enterprise growth" among their explicit or implicit objectives may in fact be targeting the majority of firms in a country. Thus, we emphasize the need for MSE development programs to be clear about their objectives and what they can expect to achieve. Development practitioners should be careful when designing small enterprise support projects because it may be unrealistic to expect broad-based MSE expansion. Designers of enterprise development programs might want to segment the small enterprise sector according to certain variables to target those firms more likely to grow, or to match specific interventions and services to certain populations. Where firm growth is not the objective, programs could be designed with an explicit recognition of the important role that survivalist MSEs play in maintaining employment and income among poor populations. Another goal might be to increase the competitiveness of MSEs or of the value chains in which they operate, a strategy that need not depend on individual firm growth.

2.5 Summary of Missing Gaps
The growth of MSEs is affected by many variables. Although Hisrich et. al. (2008) defined entrepreneur as an individual who takes risks and starts something new, it has not been clearly understood why some enterprises grow while others collapse within their first year of operation.

Although some limited studies have been done on MSEs in Kenya on particular sectors of the economy no study has been across the various sectors of the economy. These studies include theses by Mwangi J.M (2005) on the Effect of Training on MSEs in the Mount Kenya region and Nyaga-Ng’ang’a (2004) on the factors that affect growth of MSEs in the dairy industry in Kenya. Mwangi found out that training of staff of MSEs enhances their performance and profit growth positively because training increases MSE competitive edge and facilitates customer satisfaction due to quality improvement of their products (Mwangi J.M., 2005). Nyaga-Ng’ang’a on the hand concluded that although the SME entrepreneurs in the dairy industry in Nairobi were well educated and exposed with a highly competitive spirit, most of them did not have business plans. Added to this, infrastructural facilities such as roads and electricity let them down with the local authorities harassing them even with their single business permits.

It is the thinking of the researcher that none of these studies has focused on the factors that affect
the growth of a wider spectrum of MSEs in the various sectors of the economy such as food, clothing and apparels, electronics, and telecommunications. The researcher intends to exhaustively study the factors that affect growth and are common across these industries in with particular emphasis to MSEs in Nairobi Central Business District.

This researcher envisages that through the study, a better understanding of the interplay of these economic factors in the midst of other factors which may be equally or even more germane and pertinent such as political stability and the global economic outlook such as the current global economic recession and financial crisis will be arrived at.

2.6 Conceptual Framework

**Independent variables**

- INDIVIDUAL ENTREPRENEUR
- FIRM CHARACTERISTICS
- SOCIAL NETWORKS
- VALUE CHAINS
- MACROECONOMIC FACTORS

**Dependent variables**

- GROWTH PARAMETERS:
  - Net profit
  - Net asset value
  - Sales Turnover

![Figure 2.1: Conceptual Framework](Source: Researcher 2012)
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction
This chapter outlines the research design which is a descriptive survey. The study area was the Central Business District of Nairobi with the target population being the owners and or managers of micro and small scale enterprises. The researcher opted to use a stratified random sampling technique in order to capture a wide range of views from the potential population of entrepreneurs. The main data collection instrument was the questionnaire and data analysis was done using descriptive statistics with the aid of SPSS. This chapter is organized systematically to cover the research design, the study locale, target population, sampling procedure and data collection instruments, the data collecting procedure, sampling, data gathering and analysis, and expected output results.

3.2 Research Design
The study adopted a descriptive survey design to investigate the factors which lead to growth of Micro and Small size enterprises in Kenya. Descriptive survey designs are used in preliminary and exploratory studies (Luck and Ruben, 1992). This is to allow researchers to gather information, summarize, present and interpret for the purpose of clarification (Orodho, 2002). Borg and Gall (1989) note that descriptive survey research is intended to produce statistical information about entrepreneurship in Kenya. Qualitative and Quantitative data will be collected.

The study employed a descriptive study. This method seems to have a clear advantage of being an effective way of collecting data from a large sample cheaply and faster. Mugenda and Mugenda (1999) notes that survey research is probably the best method available to researcher who are interested in collecting original data for the purpose of describing a population which is too large to observe properly.

Kothari (2004) describes descriptive research studies as those studies, which are concerned, with describing the characteristic to particular individual or of a group. The study will employ a
descriptive survey study. Descriptive research is a process of collecting data in order to test hypothesis or to answer questions concerning the current status of the subject of the study. It is in light of this observation that the researcher settled on this research design in this study.

3.3 Area of Study
The locale of the study was Nairobi Central Business District. The study categorized the MSEs into restaurants, cyber cafes, boutiques and mobile shops.

3.4 Target Population
The target population of study was 970 Micro and Small size enterprises including restaurants, cyber cafes, typing bureaus, and mobile shops (Nairobi City Council Licensing Records). This study targeted business owners and/or managers of the MSEs in Nairobi CBD that were experiencing growth with the main parameters of growth being net profit, net asset value, sales turnover and return on investment. The owners and/or managers were expected to have firsthand information about the enterprises. The researcher targeted restaurants, cyber cafes, boutiques and mobile shops.

In a descriptive survey study, two categories of respondents are crucial, namely informed specialists and users (Luck and Ruben, 1992). The entrepreneurs and managers are expected to have information at their fingertips concerning their businesses.

3.5 Sample Design
The researcher used a stratified random sampling technique in order to capture a wide range of views from the potential population of entrepreneurs. The researcher went to Nairobi City Council licensing department and obtained the list of the number of small and medium size enterprises. Preliminary pilot survey indicates that these MSEs in the CBD in Nairobi are about to be 970. According to Mugenda and Mugenda (1999) a representative sample is that which 10% of the population is. This was indicated in the table below. Therefore, the sample in this study comprised of 10% of the 970 Micro and Small size enterprises in the restaurant, cyber cafes, boutiques and mobile shops businesses. Stratified random sampling was used to select 10% of the employees. This enabled the researcher to control the sample size in the strata. This
increases statistical efficiency and provides data to represent and analyze sub-groups and enables use of different methods in the strata.

Table 3.1 Sample design growing SMEs in Nairobi CBD

<table>
<thead>
<tr>
<th>Category</th>
<th>Population</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Restaurants</td>
<td>320</td>
<td>32</td>
</tr>
<tr>
<td>2. Boutiques</td>
<td>240</td>
<td>24</td>
</tr>
<tr>
<td>3. Mobile shops</td>
<td>250</td>
<td>25</td>
</tr>
<tr>
<td>4. Cyber cafes</td>
<td>160</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>970</strong></td>
<td><strong>97</strong></td>
</tr>
</tbody>
</table>

Source: Nairobi City Council Licensing Department

3.6 Data Collection Procedure

The first step was to seek a letter of introduction from Kenyatta University, a step which helped the researcher to get information easily. After this, the researcher created time to the contact people in the ministry where the research was being done. With the help of an assistant, the researcher distributed the questionnaires to the sampled enterprises and where possible collected the answered questionnaires the same day. The researcher spent two weeks in the data collection process. Using good rapport the researcher convinced the respondents to fill the questionnaires and assisted them where they did not understand. This was made easier by an accompanying letter which not only introduced the researcher but indicated the value of the research to the respondents.

3.7 Data Collection Instruments

The main data collection instrument was a questionnaire. It was distributed to the sampled enterprises, owners and managers. The entrepreneurs and managers were expected to have information concerning their businesses. The researcher chose this method because it is cheap to administer since it does not require a trained researcher to distribute and collect the
questionnaire. Secondly, it eliminates interaction between the interviewer and the respondents which reduces biases. Moreover, the person filling the questionnaire is anonymous and therefore may be willing to give information especially over sensitive issues. It is a useful method, particularly when the questions are straightforward enough to be comprehended without verbal explanation. However, the researcher cannot probe for further information, cannot control who fills the questionnaire and the response rates may be low (Kothari, 2004). The questionnaire was expected to gather the following information:

- The characteristics of entrepreneurs and firms which contribute to the growth of micro and small enterprises in Kenya.
- The characteristics of MSE firms which contribute to the growth of micro and small enterprises in Kenya.
- How social networks and value chains affect the growth of micro and small enterprises in Kenya.
- The Macro economic factors that affect the growth of MSEs in Kenya.

Interview guide is another tool which the researcher used in the study. It enabled the researcher to probe for further information. This method allowed face to face interaction between the interviewer and the respondent. The former had an opportunity to observe the reactions of the respondents which may be used to confirm the spoken word. According to Welman (1994) it is a good approach for senior officers as it implies consultation which is friendlier and less intimidating compared to structured questionnaires.

3.8 Data Analysis

The data collected using the questionnaire was analyzed by descriptive statistics. In explaining processes studies have shown that both quantitative and qualitative data are suitable especially for circumstances relating to changes over time. The researcher used Statistical Package for Social Sciences (SPSS). This is computer software used to analyze quantitative data.

The relationship between variables such as individual entrepreneur characteristics, firm characteristics, social networks, value chains, inter firm cooperation and macro-economic factors and growth variables such as sales growth, net profits asset values was correlated using the Karl Pearson’s coefficient of correlation. If they are few they may be ignored during the analysis as
missing values. The data was analyzed by frequencies and percentages to establish the significance of the responses.

3.9 Expected output

The study was expected to produce results on the factors that affect MSEs. The expected output results were in form of tables of aggregates, frequencies and percentages. The researcher used these in analyzing the study findings according to the research questions and in writing the report. Interpretations of the mean, standard deviation, Karl Pearson’s co-efficient of correlation was done to establish any statistical significance in the relationship between factors such as individual entrepreneur characteristics, firm characteristics, social networks, value chains, interfirm cooperation and macro-economic factors and growth and success variables such as sales growth, net profits, return on investments and asset values and make conclusions on the study findings and further enrich the report.

The researcher intended to make the findings more presentable by incorporating statistical charts such as pie charts, bar graphs and line graphs. The study is expected to culminate in a research paper and the resultant document will be kept in the university library and other resource centers for future reference and further studies.
CHAPTER FOUR
DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter discusses the analysis and interpretation of the results obtained from the field research. Data obtained from the field was analyzed to investigate the factors that influence the growth of micro and small enterprises in Nairobi Central Business District. From a sample of 97 respondents there were 95 returned valid questionnaires and thus study response rate was 97.9%.

4.2 Respondents Background Information

The study sought to establish respondents’ background information; the findings are presented in Table 4.1.

Table 4.1: Background Information

<table>
<thead>
<tr>
<th>Education level</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary level</td>
<td>28</td>
<td>29.5</td>
</tr>
<tr>
<td>Secondary level</td>
<td>54</td>
<td>56.8</td>
</tr>
<tr>
<td>Graduates</td>
<td>10</td>
<td>10.5</td>
</tr>
<tr>
<td>Post graduate</td>
<td>3</td>
<td>3.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>95</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 20</td>
<td>9</td>
<td>9.5</td>
</tr>
<tr>
<td>21 – 30</td>
<td>47</td>
<td>49.5</td>
</tr>
<tr>
<td>31 – 40</td>
<td>19</td>
<td>20.0</td>
</tr>
<tr>
<td>41 – 50</td>
<td>10</td>
<td>10.5</td>
</tr>
<tr>
<td>51 – 60</td>
<td>10</td>
<td>10.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>95</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
Most of the respondents 54(56.8%) had secondary education, 28(29.5%) had primary level education, 10(10.5%) were graduates, while 3(3.2%) had postgraduate education. According to Burki and Terrell, (1998); Tan and Batra, (1995) they agree that levels of formal education spur MSE growth by enhancing firm capabilities. For example, formal education may provide entrepreneurs with a greater capacity to learn about new production processes and product designs, offer specific technical knowledge conducive to firm expansion, and increase owners’ flexibility. While most empirical evidence indeed suggests that firms with better-educated owners and managers are more efficient (e.g. greater complexity emerges when examining the relationship between education and MSE growth in developing countries).

Most of the respondents 47(49.5%) were aged between 21-30 years, 19(20%) were aged between 31-40 years. This could mean that the entrepreneurs do not have work experience, Bosma et al, (2004) findings support this, they agree that benefits of on-the-job experience are frequently mentioned, the importance of prior work experience may be even more helpful, especially if that experience came within the same sector or in small to medium-sized enterprises. Prior experience proves to be important in developed countries; for example, a panel survey of 1,000 entrepreneurs in the Netherlands found that entrepreneurs’ prior experience, when in the same industry as their startups, improves firm growth, survival and profitability An IDB study of high-growth entrepreneurs provides telling insights about the importance of not only skills, but also business contacts gained during past employment.
According to the study data, 43 (45.3%) were females while 52 (54.7%) were males. Gender-based cultural barriers also impede women's access to training. Key informants reported that husbands often object to their wives or daughters participating in training delivered by male facilitators. Since 90 per cent of the people involved in micro and small enterprise development work are men, and sometimes women consultants are not listened to and this is a major issue. Training is offered by some women-focused organizations, such as WEEC, and efforts are made by other training agents to involve husbands in the training as well, but this issue remains a constraint for many women in MSEs. According to certain male key informants, “unless something can be done to address this, there really isn’t much else we can do”. Majority of the respondents 71 (74.7%) were the sole proprietors in their businesses while 24 (25.3) were in partnership as shown in table 4.1.

### 4.3 Firm Characteristic

One of the study objectives was to establish the characteristics of enterprises which may contribute to the growth of micro and small enterprises in Kenya and the findings are presented in this in table 4.2.

<table>
<thead>
<tr>
<th>Nature/core business</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurant</td>
<td>6</td>
<td>6.3</td>
</tr>
<tr>
<td>Mobile shop</td>
<td>24</td>
<td>25.3</td>
</tr>
<tr>
<td>Stall shop</td>
<td>16</td>
<td>16.8</td>
</tr>
<tr>
<td>Cyber café</td>
<td>30</td>
<td>31.6</td>
</tr>
<tr>
<td>Boutique</td>
<td>19</td>
<td>20.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>95</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
The respondents who participated in the study were spread as follows; 30(31.6%) operated cyber café, 24(25.3%) operated mobile shops, 19(20%) had boutique, 16(16.8%) operated stall shops and 6 (6.3%) owned restaurants as shown in table 4.2.

Table 4.3: Age of the Enterprise

<table>
<thead>
<tr>
<th>Age of the Enterprise</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5 years</td>
<td>58</td>
<td>61.1</td>
</tr>
<tr>
<td>6 – 15 years</td>
<td>33</td>
<td>34.7</td>
</tr>
<tr>
<td>16 – 20 years</td>
<td>2</td>
<td>2.1</td>
</tr>
<tr>
<td>5</td>
<td>2</td>
<td>2.1</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

When asked how long the enterprises have been on operation, 58(61.1%) have been operating for less than five years. However, study by Parker, (1995) found that work experience may contribute to MSE growth in at least two ways: directly, by expanding the capabilities of MSE owners and employees through the acquisition of skills and knowledge; and indirectly, by expanding entrepreneurs' social networks. Most of the entrepreneurs in Nairobi still have little experience apart from the 33(34.7%) who have been operating between 6 to 15 years as shown in table 4.3. Parker, (1995) findings argue that entrepreneurs with more years of work experience typically have faster-growing MSEs, the study found that entrepreneurs with at least seven years of work experience expanded their firms more rapidly than those without such experience.

However, a study by Burki and Terrell, (1998) shows that in developing countries firms actually suffer productivity losses as they age. Firms may fail to invest sufficiently in existing or emerging technology, leaving them with relatively outmoded equipment and hindering productivity levels relative to younger firms. Having established the years in business study further sought to establish the amount of startup capital which is shown in figure 4.1.
From the study findings it was revealed that 50(52.6%) of the respondents started their business with a capital of less than Ksh. 50,000 while 34(35.8%) started their business with capital of Ksh. 50,000 to Ksh. 100,000. The above findings are in agreement with views of Schiffer and Weder, (2001), who found that even after MSEs overcome the start-up hurdle, a lack of credit frequently hinders their growth during earlier years, because younger firms tend to find financing even more difficult than older firms. Over the life of the firm, growth also can be hindered by credit constraints that curb investments for maintaining or improving technology. In some contexts, evidence suggests that micro enterprises were funded through external sources. Study further sought to establish the sources of capital and findings are presented in figure 4.2
Study sought to establish the sources of start capital for businesses and from the findings; 51(53.7%) used own savings, 23(24.2%) got loan from Saccos, (15(15.8%) used money from rotating savings and loans while 6(6.3%) loan from banks as shown in figure 4.2. This finding is supported by Hernandez-Trillo, Pagan and Paxton, (2005) who established that across the world, entrepreneurs typically start firms primarily through their own savings because of limited access to startup capital. A study of over 14,000 micro enterprises in Mexico found that owners mostly used their own resources and savings (61%) or those of their family and friends (14%) to launch their firms.

However, Schiffer and Weder, (2001) study shows that various reasons ranging from a lack of collateral to bias against small firms. MSEs tend to face greater financial constraints than do larger firms and in a study of 10,000 firms across 80 countries it was found that credit is mentioned more frequently by smaller firms as a constraint on growth, Bigsten et al, (2003). The study also shows that MSEs in developing countries apply for and receive formal bank loans relatively infrequently, and thus typically rely on other types of credit such as trade credit, overdrafts, and informal loans. This is true in the current study since most of the respondents did not favour commercial banks loans as shown in figure 4.2.
Table 4.4: Enterprise Ownership Structure

<table>
<thead>
<tr>
<th>Enterprise Ownership Structure</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole proprietorship</td>
<td>64</td>
<td>67.4</td>
</tr>
<tr>
<td>Partnership</td>
<td>29</td>
<td>30.5</td>
</tr>
<tr>
<td>Private company</td>
<td>2</td>
<td>2.1</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

It was revealed in table 4.4 that most of the enterprises 64(67.4%) are sole proprietorship while 29(30.5%) are owned in partnership. Only 2 (2.1%) were private companies. As above data confirms, McComick (2001) study also found that the larger the group of enterprises, the fewer women entrepreneurs one will find. Over 85 per cent of the enterprises owned by women did not have any employees except the owner. Of the 9,041 small enterprises (1999) with 11-50 employees, it is estimated that women owned fewer than 20% this amounts to less than 0.3% of all women-owned MSEs. In this study it was established that most entrepreneurs were the sole proprietors who support the above findings.

Table 4.5: Enterprise Loans that can be accessed

<table>
<thead>
<tr>
<th>Enterprise Loans that can be accessed</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>SACCO loans</td>
<td>53</td>
<td>55.8</td>
</tr>
<tr>
<td>Rotating savings and loan</td>
<td>32</td>
<td>33.7</td>
</tr>
<tr>
<td>Commercial Bank</td>
<td>10</td>
<td>10.5</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the analyzed data 53(55.8%) of the enterprises can access SACCO loans, 32(33.7%) rotating savings and loans, 10(10.5%) commercial Bank loans as shown in table 4.5. Gordon,
findings supports that small enterprises over the last ten years have been recognized to be the major force in job creation, innovation and economic development. On the same breathe according to the financial Access Survey 2007 by the FSD Kenya, the banking sector serves only 19% of the Kenya’s bankable population with 8% being served by other financial services providers such as MFIs and SACCOs. 38% is totally excluded and 35% rely on the informal financial service providers such as ROSCAS. The indication is that access to financial services is limited which is in line with above findings. The study further sought to establish if business is registered and findings are presented in figure 4.3.

Figure 4.3: Business registration

Most business can only access credit if registered from financial institutions. From the findings, 86(90.5%) are registered with only 9(9.5%) being not registered as shown in figure 4.3. This could mean that the enterprises can access formal loans. Past studies supports this for example, Winter, (1995) argues that, although small informal MSEs may be able to circumvent government regulations and taxation, as they grow they risk becoming more visible, creating disincentives to expand beyond a certain size. Informal firms may therefore need to “keep their heads down,” ruling out large size and rapid growth, as well as close relations with formal firms Contracts with international or government buyers, for example, may be off limits for many informal firms because they require legal documentation that these MSEs lack. And while many
firms in developing countries have problems accessing financial and legal systems, informal enterprises face even greater difficulties in obtaining formal credit and assistance from law enforcement agencies and courts.

### 4.3 Social Networks

In business world competition and globalization require entrepreneurs to be connected to ensure that they remain relevant in the competitive market. Establishing the role of social networks was one of the study objectives and results are presented under this section.

#### Figure 4.4: Social Networks

<table>
<thead>
<tr>
<th>Activity</th>
<th>Most Important</th>
<th>Very Important</th>
<th>Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Help in registering new business</td>
<td>62.1</td>
<td>33.7</td>
<td></td>
</tr>
<tr>
<td>To overcome contract enforcement</td>
<td>91.6</td>
<td>8.4</td>
<td></td>
</tr>
<tr>
<td>To access business information</td>
<td>86.3</td>
<td>13.7</td>
<td></td>
</tr>
<tr>
<td>To overcome transaction cost obstacles</td>
<td>88.4</td>
<td>11.6</td>
<td></td>
</tr>
<tr>
<td>To access business information</td>
<td>85.3</td>
<td>14.7</td>
<td></td>
</tr>
<tr>
<td>To overcome regulatory obstacles</td>
<td>78.9</td>
<td>13.7</td>
<td>7.4</td>
</tr>
</tbody>
</table>

The study sought to establish importance of some of the social networks in business growth, the results are shown in figure 4.4; when asked importance of networks in overcoming regulatory obstacles, 75 (78.9%) agreed to be most important, 13 (13.7%) felt that it's very important while, 7 (7.4%) thought it's important. When asked about access to business information, 81 (85.3%) thought it is most important while, 14 (14.7%) thought it was very important. In relation to overcoming transaction costs, 84 (88.4%) agreed that social networks were most important while 11 (11.6%) thought it was very important. When asked about overcoming contract enforcement, 87 (91.6%) agreed that social networks were most important and 8 (8.4%) agreed they were very
important. When asked about help during registration of new business 59(62.1%) felt it was most important while 32(33.7%) agreed it was very important as shown in figure 4.4. Past studies also show that family members help in acting as source of labour in business, this is supported by National Micro and Small Enterprise Baseline Survey 1999; in 1999, the survey findings revealed that the average size of an MSE was 1.8 persons. The owners themselves accounted for almost 75% of total MSE employment. In fact, 80% of total SME employment involved only owners and their family members. The group of employees, referred to as “regular hired workers” accounted for only 11.6% of total SME employment. Ninety-six point seven (96.7%) of SMEs employed no more than five employees, with another 2.6% employing 6-10 persons, meaning that 99.3% of MSEs have no more than 10 employees.

<table>
<thead>
<tr>
<th>Table 4.6: Friends and Relatives Provide Importance to Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Friends and Relatives Provide Importance to Business</td>
</tr>
<tr>
<td>Leads about profitable business opportunities</td>
</tr>
<tr>
<td>Information about loans</td>
</tr>
<tr>
<td>Sources of inputs</td>
</tr>
<tr>
<td>New markets</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

The Study sought to establish the importance of friends and relatives on business growth, from the findings; 31(32.6%) indicated that they help to create new markets. They also help in information about loans as indicated by 27(28.4%). Inputs are sources from various parts of country and friends and relatives help in furnishing information where quality and cheap inputs can be accessed as supported by 19(20%) sources of inputs.

<table>
<thead>
<tr>
<th>Table 4.7: Problems/demerits Associated with Friends and Relatives in Enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>What problems/demerits are associated to friends and relatives in your enterprise</td>
</tr>
</tbody>
</table>

44
Majority of the respondents 36(37.9%) agreed that the problems associated with friends and relatives in business provides unequal resources for marginalized entrepreneurs such as women, this true especially in Kenya. 22(23.2%) of the respondents further agreed that they are too expensive to maintain while 9(9.5%) agree that they have deeply rooted societal notions as shown in table 4.7.

4.4 Value Chains

Finding out the effect of value chains on enterprise growth was one of the study objectives and its findings are presented in this section.

<table>
<thead>
<tr>
<th>Sources for Inputs to Enterprise</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within Nairobi</td>
<td>33</td>
<td>34.7</td>
</tr>
<tr>
<td>Outside Nairobi but within the Country</td>
<td>29</td>
<td>30.5</td>
</tr>
<tr>
<td>Within East Africa</td>
<td>11</td>
<td>11.6</td>
</tr>
<tr>
<td>International (Outside East Africa)</td>
<td>19</td>
<td>20.0</td>
</tr>
<tr>
<td>No response</td>
<td>3</td>
<td>3.2</td>
</tr>
</tbody>
</table>
From the data it was revealed that 33(34.7%) of the respondents source their inputs within Nairobi, 29(30.5%) get inputs from outside Nairobi but within Kenya, 19(20%) source outside East Africa, 11(11.6%) source within East Africa countries as shown in table 4.8. The research study describes value chains as the full range of activities that are required to bring a product or service from conception through the different phases of production, these findings are in agreement with Kaplinsky and Morris, (2001) that delivery to final consumers and final disposal after use, several factors come into focus when determining value chains issues such as location of business, type of products, production cost, and customer satisfaction. However, Nadvi, (1995); Carr and Chen, (2003) findings are in agreement that one of the competitive advantages that MS's have is that leading firms usually opt for them as sources of flexible, low cost wage labour. This is true since the nearer the source of inputs the business the better the profit. In this study the respondents prefer to get their products within Nairobi to lower costs. The table 4.9 presents competitive advantages of the business.

<table>
<thead>
<tr>
<th>Enterprise Competitive Advantage</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>High quality products</td>
<td>14</td>
<td>14.7</td>
</tr>
<tr>
<td>Lower prices</td>
<td>9</td>
<td>9.5</td>
</tr>
<tr>
<td>After sales services</td>
<td>42</td>
<td>44.2</td>
</tr>
<tr>
<td>Efficient/Quick services</td>
<td>30</td>
<td>31.6</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the study 42 respondents (44.2%) agreed that they offer after sale services to their customers, 30 respondents (31.6%) offer efficient and quick services, 14 respondents (14.7%)
offer high quality products while 9 respondents (9.5%) lower their prices as shown in table 4.9. Steen, Magnani and Goldmark, (2005); Lustig, (2001) findings also agree with above findings, they found that offering a flexible and low-cost production platform for specific products gives them an advantage that enables them target niche markets. In addition, the smallest firms in developing countries often provide an important social safety net, offering temporary employment to vulnerable segments of the population.

Table 4.10: Enterprises Description Expressions

<table>
<thead>
<tr>
<th>Enterprise Competitive Advantage</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyer - driven</td>
<td>51</td>
<td>53.7</td>
</tr>
<tr>
<td>Social network - driven</td>
<td>44</td>
<td>46.3</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

When asked to describe their enterprises most of them i.e.51 respondents (53.7%) described it as buyer-driven while 44 respondents (46.3%) described it as social network –driven as shown in table 4.10. This shows that most of the enterprises are buyer driven. This findings are in agreement with Pietrobelli and Rabelotti, (2004); Gereffi, Humphrey and Sturgeon, (2005) findings which argues that models range from buyer-driven (top-down and not very conducive to SME participation) to producer-driven (usually seen in high-tech chains where producers are relatively sophisticated) to network or non-hierarchical chains where power relationships are more balanced.

4.5 Inter-Firm Co-Operation
The inter-firm cooperation was one of the study objectives and data collected was analyzed and its results presented under this section.
<table>
<thead>
<tr>
<th>Firms/Industries Linked Backwards.</th>
<th>Cooperation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurants:</td>
<td>Agricultural Farms, Supermarkets, Butcheries</td>
</tr>
<tr>
<td>Boutiques:</td>
<td>Large scale merchandise dealers</td>
</tr>
<tr>
<td>Mobile Shops:</td>
<td>Retail Goods Wholesalers.</td>
</tr>
<tr>
<td>Cybercafés:</td>
<td>Computer and office furniture dealers, Stationery stores</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Firms/Industries Linked Forward</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurants:</td>
<td>General public, tourist and organizations</td>
</tr>
<tr>
<td>Boutiques:</td>
<td>General public, General merchandise dealers</td>
</tr>
<tr>
<td>Mobile Shops</td>
<td>General public</td>
</tr>
<tr>
<td>Cybercafés</td>
<td>General public</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Firms/Industries Linked Horizontally</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurants:</td>
<td>Staffing corporations,</td>
</tr>
<tr>
<td>Boutiques:</td>
<td>Merchandise dealers</td>
</tr>
<tr>
<td>Mobile Shops</td>
<td>Large scale merchandise stockiest</td>
</tr>
<tr>
<td>Cybercafés</td>
<td>Schools and colleges</td>
</tr>
</tbody>
</table>
This study was based on three aspects: vertical linkages, horizontal linkages and support markets. The vertical linkages go across from buyers and suppliers, these linkages can facilitate growth in areas such as finding new market, expanding scope of products and reducing business risk also a guaranteed flow of order, market information and reduction in capital need. This is in agreement with Aw, (2002) findings that established that business enterprises do not exist own their own right, and for them to operate optimally and effectively they require other firms around their operations.

Horizontal linkages mean that similar firms may group themselves or be organized by an outside party to work together. Supporting markets include utility support mechanisms such as finance, consulting, legal, tax advice and market information.

The research study shows that restaurants are linked backwards through industries such as agricultural farms, butcheries and supermarkets as areas they sought their raw materials, Boutique shop owners gave their sources of raw materials as horticultural firms and large scale merchandise dealers. Mobile shop operators sought their raw materials from retail goods wholesalers and from much larger soft drink manufacturers, cybercafé entrepreneurs a service oriented industry mentioned computer, office furniture dealers and stationary stores as their source markets.

The research study indicates that restaurants are linked horizontally through staffing agencies which assist in staffing operations, boutique operators are linked horizontally through merchandise dealers both of which are buyers and seller. Mobile shop entrepreneurs are linked horizontally through large scale stockiest some of whom are producers of both raw and finished products while cybercafé operators according to the research are linked horizontally through schools and colleges where the need for service provision and expert attention may be needed.

The study also suggest a uniformity in the types of supports industries required for the smooth running of MSEs, the most common responses included; Government agencies, Banks, SACCO societies, Accounting firms and Lawyers. The mentioned sources go a long way in providing financial support, legal advice and an enabling environment for trade and growth.
4.6 Macro Economic Factors

Infrastructure is one of the basic components for ensuring growth and success of any business enterprise. Studies have shown that MSEs stand to grow more quickly during periods of overall economic growth (Liedholm, 2002). Good infrastructure is key to sustainable development and it can come through many ways, both in material undertaking and business friendly incentives.

Although research studies have shown that smaller firms more frequently report government policies to be unpredictable, and may impede growth prospects diluting the business environment (World Bank, 2005), it is upon government agencies and local authority to see through that an enabling environment is setup to enhance trade. This was one of the study objectives and its results are presented under this section.

When asked if they can say that the infrastructure surrounding the enterprise is conducive for business, 89 respondents (93.7%) agreed while 6 respondents (6.3%) did not respond as shown in figure 4.5. The latest draft Sessional Paper on development of MSE acknowledges that a number of constraints need to be addressed if the MSE sector is to realize its full potential, among which are: a deteriorating infrastructure which negatively impacts on MSE competitiveness, a high cost of credit and unavailability of long and medium term financing, a
burdensome and costly regulatory environment, an unfavorable tax regime, an inefficient legal and judicial system; limited access to reliable market data and trade-related information, poor access to markets, limited opportunities for international linkages and linkages with large enterprises, scarce IT resources, poor coordination of SME association and institutions, inadequate access to business skills and technology, insecurity of tenure, gender inequality and insufficient business development service providers.

Table 4.12: Rating Satisfaction of Infrastructure Conduciveness

<table>
<thead>
<tr>
<th></th>
<th>Worst</th>
<th></th>
<th>Bad</th>
<th></th>
<th>Good</th>
<th></th>
<th>Very good</th>
<th></th>
<th>Excellent</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Freq</td>
<td>%</td>
<td>Freq</td>
<td>%</td>
<td>Freq</td>
<td>%</td>
<td>Freq</td>
<td>%</td>
<td>Freq</td>
<td>%</td>
</tr>
<tr>
<td>The road network</td>
<td>4</td>
<td>4.2</td>
<td>6</td>
<td>6.3</td>
<td>67</td>
<td>70.5</td>
<td>18</td>
<td>18.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone service</td>
<td>15</td>
<td>15.8</td>
<td>69</td>
<td>72.6</td>
<td>8</td>
<td>8.4</td>
<td>3</td>
<td>3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>4</td>
<td>4.2</td>
<td>61</td>
<td>64.2</td>
<td>26.3</td>
<td>5</td>
<td>5.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water supply</td>
<td>78</td>
<td>82.1</td>
<td>1</td>
<td>1.1</td>
<td></td>
<td>16</td>
<td>16.8</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

According the findings relating to infrastructure satisfaction; 67 respondents (70.5\%) agreed that road network was good, 69 respondents (72.6\%) agreed that telephone services was good, 61 respondents (64.2\%) agreed that electricity supply was good but according to 78 respondents (82.1\%) the water supply was bad. These findings are in agreement with Nyaga-Ng’ang’a (2004) findings that concluded that the SME entrepreneurs did not have good infrastructural facilities such as roads and electricity.
Figure 4.6: Local Authority Services Satisfaction

<table>
<thead>
<tr>
<th>Service</th>
<th>Worst</th>
<th>Bad</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy implementation</td>
<td>63.2</td>
<td>36.8</td>
</tr>
<tr>
<td>Legislation</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>Policy formulation</td>
<td>63.2</td>
<td>36.8</td>
</tr>
<tr>
<td>Licensing procedures</td>
<td>63.2</td>
<td>36.8</td>
</tr>
<tr>
<td>Waste disposal</td>
<td>64.2</td>
<td>35.8</td>
</tr>
</tbody>
</table>

The responses to local authority services provision to the enterprises were; 61 respondents (64.2%) agreed that waste disposal was worse, 60 respondents (63.2%) agreed that licensing procedures and policy formulation was worse, 57 respondents (60%) agreed that legislation was worse while 60 respondents (63.2%) also agree that policy implementation was worse. The above findings are in agreement with Mwangi (2005) study which found out that training of staff of MSEs enhances their performance and profit growth positively because training increases MSE competitive edge and facilitates customer satisfaction due to quality improvement of their products. However, Nyaga-Ng’ang’a (2004) on the other hand concluded that although the SME entrepreneurs in the dairy industry in Nairobi were well educated and exposed with a highly competitive spirit, most of them did not have business plans. Added to this, infrastructural facilities such as roads and electricity were not good with the local authorities harassing them even with their single business permits.
Table 4.13: Government Support

<table>
<thead>
<tr>
<th>Support</th>
<th>Offer support</th>
<th>Do not offer support</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Freq</td>
<td>%</td>
</tr>
<tr>
<td>Export promotion of your products</td>
<td>90</td>
<td>94.7</td>
</tr>
<tr>
<td>Subsidizing inputs</td>
<td>82</td>
<td>86.3</td>
</tr>
<tr>
<td>Access to credit finance</td>
<td>69</td>
<td>72.6</td>
</tr>
<tr>
<td>Training in entrepreneurship</td>
<td>80</td>
<td>84.2</td>
</tr>
</tbody>
</table>

According to table 4.13 90 respondents (94.7%) agree the government does not offer export promotions, 82 respondents (86.3%) agreed the government does not subsidize inputs, 69 respondents (72.6%) indicate the government does not help in access of credit while according to 80 respondents (84.2%) of them it does not also train them in entrepreneurship. In Uganda (UNIDO Document, 2003) women entrepreneurs in rural areas suffer from a lack of training and advisory services that would allow them to upgrade their managerial and technical skills and solve immediate production problems, thus improving productivity and increasing profitability. More than 70% of enterprises employ less than 20 people. Micro and small enterprises play an important role in the economic and social life of the majority of citizens. However, the growth and the competitiveness of this sector are hampered by a lack of managerial and technical skills, weak infrastructure, difficulties in accessing loans, and complicated company registration processes. Also Mwangi (2005) findings agree with above findings that training of staff of MSEs enhances their performance and profit growth positively because training increases MSE competitive edge and facilitates customer satisfaction due to quality improvement of their products.

Namusonge (1999) findings also agree that entrepreneurial, management, and technical training is very important to enterprise development. Business start-up, survival and growth training is offered by a wide array of Kenyan government agencies, private consulting firms and NGOs, (including the ILO’s Start and Improve Your Business (SIYB) training). However, only a few
entrepreneurs in Kenya access any sort of such training. Only 7% of MSEs in the 1999 Baseline Survey had received any form of non-financial assistance in the previous four years, despite the increasing number of formal and informal organizations in the country offering all types of non-financial assistance by way of training in business skills and entrepreneurship, practical skills, technical assistance, and marketing support.

Figure 4.7: Cost of Trading Permit to NCC

<table>
<thead>
<tr>
<th>Cost Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below Ksh 10,000</td>
<td>16.8%</td>
</tr>
<tr>
<td>Between Ksh 10,000 and Ksh 20,000</td>
<td>72.6%</td>
</tr>
<tr>
<td>Between Ksh 20,000 and Ksh 50,000</td>
<td>8.4%</td>
</tr>
<tr>
<td>Over Ksh 50,000</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

When asked about the cost of trading permit 69 respondents (72.6%) indicated they pay between Ksh 10,000 and Ksh 20,000. 16 respondents (16.8%) indicated they pay below Ksh 10,000 while 8 respondents (8.4%) pay between Ksh 20,000 and Ksh 50,000 as shown in figure 4.7. Past studies by Nyaga-Ng’ang’a supports that local authorities charge a lot of fees which discourage entrepreneurs from investing. This could be the reason for low profit.

4.7 Growth and Success Variables

Growth and success variables include business tools that are used in order to gauge an enterprise's performance, and in this study growth is an increase in capacity of an enterprise to
produce goods and services over a periodical analysis. Some of these tools include return on investment analysis (ROI) which is used to build a financial business case (Pandey, 2004).

Net profit is described as the money left over after paying all the expenses of an endeavor (Brockington, 1993), the net asset value is used to describe the value of an entity's assets less the value of its liabilities. The sales turnover is described as the total amount sold within a specified time period, usually a year (Van Home, 2003) and it usually expressed in monetary terms.

Table 4.14: Total Annual Taxes and Licensing Fees

<table>
<thead>
<tr>
<th>Total Annual Taxes and Licensing Fees</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Ksh 20,000 and Ksh 50,000</td>
<td>28</td>
<td>29.5</td>
</tr>
<tr>
<td>Over Ksh 50,000</td>
<td>67</td>
<td>70.5</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

When asked their total annual taxes most respondents 67(70.5%) pay taxes of over Ksh 50,000 while 28(29.5%) pay taxes of between Ksh 20,000 and Ksh 50,000 as shown in table 4.14.

Table 4.15: Value of monthly sales/turnover on average

<table>
<thead>
<tr>
<th>Value of monthly sales/turnover on average</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Ksh 100,000</td>
<td>48</td>
<td>50.5</td>
</tr>
<tr>
<td>Between Ksh 100,000 and 500,000</td>
<td>46</td>
<td>48.4</td>
</tr>
<tr>
<td>Between Ksh 500,001 and Ksh 2,000,000</td>
<td>1</td>
<td>1.1</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>
According to Van Horne, (2003) the total amount sold within a specified time period, usually a year. Sales turnover is often expressed in monetary terms but can also be expressed in terms of the total amount of stock or products sold. The value of monthly sales turnover for 48(50.5%) of the enterprises is under Ksh 100,000 while for 46(48.4%) it's between Ksh 100,000 and 500,000 as shown in table 4.15. This shows that businesses are not performing well due to some factors such as access to capital and taxes.

Table 4.16: Monthly Average costs/Expenditure

<table>
<thead>
<tr>
<th>Monthly Average costs/Expenditure</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Ksh 100,000</td>
<td>65</td>
<td>68.4</td>
</tr>
<tr>
<td>Between Ksh 100,000 and 500,000</td>
<td>30</td>
<td>31.6</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

When asked about their monthly expenditure 65 respondents (68.4%) agreed that it is under Kshs 100,000 while 30 respondents (31.6%) agreed that it is between Ksh 100,000 and 500,000.

Table 4.17: Monthly Gross profit

<table>
<thead>
<tr>
<th>Table 4.17: Monthly Gross profit</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Ksh 100,000</td>
<td>56</td>
<td>58.9</td>
</tr>
<tr>
<td>Between Ksh 100,000 and 500,000</td>
<td>39</td>
<td>41.1</td>
</tr>
<tr>
<td>Total</td>
<td>95</td>
<td>100.0</td>
</tr>
</tbody>
</table>

According to study data, 56(58.9%) of the firms earn a gross profit of under Kshs 100,000 while 39(41.1%) earn gross monthly profit of between Ksh 100,000 and 500,000 as shown in table 4.17. The above findings are in agreement with Greenwood and Jovanovich (1990) model, which
agrees that financial intermediaries help agents to choose projects with higher returns. Without financial intermediaries agents could not invest in these projects because of the lack of the information and low liquidity of the project.

Table 4.18: Annual Return on Investment for selected enterprises

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Net Profit</th>
<th>Capital Invested</th>
<th>Return on Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restaurant</td>
<td>1,000,000</td>
<td>7,000,000</td>
<td>14.3%</td>
</tr>
<tr>
<td>Boutique</td>
<td>550,000</td>
<td>1,500,000</td>
<td>36.7%</td>
</tr>
<tr>
<td>Mobile Shop</td>
<td>240,000</td>
<td>500,000</td>
<td>48%</td>
</tr>
<tr>
<td>Cybercafé</td>
<td>320,000</td>
<td>1,700,000</td>
<td>18.8%</td>
</tr>
</tbody>
</table>

The return on investment (ROI) was calculated using the formula.

\[
\frac{\text{Net Profit}}{\text{Capital Invested}} \times 100
\]

The research study sampled each individual enterprise under each of the categories that undertook the study, the categories of enterprise were namely; Restaurant, Boutiques, Mobile Shop and Cybercafé. The first respondents were a restaurant with an annual net profit amount of Ksh 1,000,000 and invested capital amount of Ksh 7,000,000.

The second respondent is a boutique shop with an annual net profit amount of Ksh 550,000 and an invested capital amount of Ksh 1,500,000, the third respondent is a mobile shop with an annual net profit return of Ksh 240,000 and an invested capital amount of Ksh 500,000 and lastly a cybercafé with a net profit amount of Ksh 320,000 and an invested capital amount of Ksh 1,700,000. Table 4.8.5 shows The Annual Return on investment.
How social networks affect the growth of micro and small enterprises in Kenya

In order to establish the general effect social networks affect the growth of micro and small enterprises the multiple regression analysis was conducted as depicted by the equation.

\[ Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \varepsilon \]

Table 4.19: Social networks affect the growth of micro and small enterprises

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Change Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>R Square Change</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>F Change</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>df1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>df2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Sig. F Change</td>
</tr>
<tr>
<td>1</td>
<td>.5</td>
<td>.320</td>
<td>.177</td>
<td>1.363</td>
<td>.320</td>
</tr>
<tr>
<td>6</td>
<td>6a</td>
<td></td>
<td></td>
<td></td>
<td>2.240</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), friends and relatives assistance to business, friends and relatives provision to business, friends and relatives demerits

b. Dependent Variable: Growth of small enterprises

This table is important. The Adjusted R Square value tells us that our model accounts or 32.0% of variance in the effects of small enterprises growth.
Table 4.20: Coefficients of Regression Model between social networks affect the growth of micro and small enterprises

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>95.0% Confidence Interval for B</th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Lower Bound</td>
<td>Upper Bound</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>3.79</td>
<td>1.825</td>
<td>2.076</td>
<td>.052</td>
<td>-.030</td>
<td>7.609</td>
</tr>
<tr>
<td>Friends and relatives assistance to business</td>
<td>.717</td>
<td>.430</td>
<td>.370</td>
<td>1.669</td>
<td>.021</td>
<td>-.182</td>
</tr>
<tr>
<td>Friends and relatives provision to business</td>
<td>.649</td>
<td>.326</td>
<td>1.311</td>
<td>.003</td>
<td>-.508</td>
<td>2.210</td>
</tr>
<tr>
<td>Friends and relatives demerits</td>
<td>-.758</td>
<td>.525</td>
<td>-.348</td>
<td>-1.443</td>
<td>.036</td>
<td>-1.857</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Growth of small enterprises

From data, $x_1$, Friends and relatives' assistance to business, $x_2$, Friends and relatives provision to business, $x_3$, Friends and relatives demerits. It is therefore concluded that the three independent variables influence enterprises growth. The three factors contribute to $R = 0.566$ and $R^2 = 32.0\%$, this implies that $32.0\%$ of the change in organization growth is explained by the four independent variables. These results are significant as explained by the F-ratio of 2.240 at a p-value =.003.

According to Hair et al (2006) if the coefficient of the independent variables are really not all zero then the F-ratio should be significantly greater 1.00 which in this case F-ratio =2.224 with
a p-value <.003 hence independent variables of social networks have a significant effect on organization growth. Hence the multiple regression equation \( Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \epsilon \), can be explained as \( Y = 3.790 + 0.370x_1 + 0.326x_2 - 0.348x_3 + 1.825 \).

Effect of value chains on the growth of micro and small enterprises in Kenya
In order to establish the general effect value chains on the growth of micro and small enterprises the multiple regression analysis was conducted as depicted by the equation.

Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.690</td>
<td>.353</td>
<td>.107</td>
<td>.1452</td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Enterprise growth

ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.168</td>
<td>1</td>
<td>.168</td>
<td>7.964</td>
<td>.07</td>
</tr>
<tr>
<td>Residual</td>
<td>1.202</td>
<td>94</td>
<td>2.109E-02</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1.370</td>
<td>95</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Enterprise growth
b. Dependent Variable: Value chains
The regression analysis shows a strong relationship $r=0.69$ and $r^2=0.353$ which shows that 35.3% of the change in enterprise growth is explained by the value chains. Further on the beta coefficient of the resulting regression model $t=2.822$ indicates that the beta coefficient is significantly greater than 0, $p=0.007$ which is less than $p=0.05$ the test statistic. This confirms that essentially there is a strong relationship between value chain and enterprise growth.
CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This section presents the summary of findings, conclusions and recommendations of the study.

5.2 Summary of Findings
The cumulative data was analyzed using qualitative and quantitative analysis with presentations done in form of tables and graphs. The objective of this research was to look at the factors that influence the growth of micro and small enterprises in the Nairobi central business district and establish ways in which the government, local authorities, private and public companies can improve the business environment especially among small and medium size enterprises. Below is the summary of findings organized along the study objectives.

5.2.1 Characteristics of Entrepreneurs Which May Contribute to the Growth of Micro and Small Enterprises in Kenya.
The findings show that most of the respondents were drawn from cyber café at 25.3%, mobile shop with 20%, boutique with 16.8%, and restaurants with 6.3%. Also it was shown that most of the enterprises 61.1% have been operational for less than five years while some 34.7% have been operating for between 6 and 15 years. This could be correlated with the age of the respondents which could mean that most of the small enterprises are young ventures.

Findings further revealed that most of the business according to their startup capital can be classified as small enterprises. 52.6% of the respondents started their business with a capital of less that Ksh. 50,000 while 35.8% started their business with capital of Ksh. 50,000 to Ksh. 100,000 and very few started with a capital >Kshs 100,000. As illustrated in figure 4.2 most of the respondents 53.7% favoured their own savings, 24.2% got their capital from loan from Sacco, 15.8% loan from merry go round while 6.3% loan from banks. This implied that entrepreneurs prefer their own source of funds, loan from SACC0 or rotating savings and loans.
This is true in the current Kenyan context since majority of the small enterprises are either solely owned or in partnership as was shown by 67.4% are sole proprietorship while 30.5% partnership.

The study further shows that enterprises in the region can access 55.8% SACCO loans, 33.7% rotating savings and loans and 10.5% commercial banks loans. This further supports the findings in figure 4.2 where respondents favour SACCO loans. The findings as shown in figure 4.3 showed that most of the enterprises were registered in the City.

5.2.2 How Social Networks Affect the Growth of Micro and Small Enterprises in Kenya

The study sought to establish importance of family members helping some of the business factors and as shown in figure 4.4. When asked importance of overcoming regulatory obstacles 78.9% agreed that they are most important, 13.7% felt it was very important while 7.4% thought it’s important. When asked about access to business information 85.3% thought it was most important while 14.7% felt it is very important. In relation to overcoming transaction costs 84(88.4%) agreed it was most important while 11.6% thought it was very important. When asked about overcoming contract enforcement 91.6% agreed it was most important and 8.4% agree it was very important. When asked about help during registration of new business 62.1% felt it was most important while 33.7% agreed it was very important as shown in figure 4.4.

Family and friends help enterprise in the following ways according to the study data; 32.6% help to create new markets, 28.4% help in information about loans, 20% help in sources of inputs and 14.7% help with leads about profitable business opportunities as shown in table 4.6. Family and friends cause unequal distribution of resources especially to women as supported by 37.9% of the respondents. 25.3% of respondents agreed that family and friends request for profit sharing, 23.2% agreed that they are too expensive to maintain while 9.5% agree that they have deeply rooted societal notions.
5.2.3 Effect of Value Chains on the Growth of Micro and Small Enterprises in Kenya

The main source of inputs for the entrepreneurs was largely from Nairobi (34.7%), 30.5% from outside Nairobi but within Kenya, 20% source outside East Africa, 11.6% source within East Africa countries was shown in table 4.8.

It could be summarized that the major strategy for competitive advantage for businesses is through offering after sale services which is offered by most of them 44.2% followed by efficient and quick services 31.6%, 14.7% through quality products and 9.5% through lower cost of products.

Data analysed showed that most of the enterprises 53.7% in Nairobi city are buyer driven while others 46.3% depend mainly on the social networks for it survival. The research also indicates that restaurants are linked horizontally through staffing agencies which assist in staffing operations, boutique operators are linked horizontally through merchandise dealers both of which are buyers and seller. Mobile shop entrepreneurs are linked horizontally through large scale stockiest some of whom are producers of both raw and finished products while cybercafé operators according to the research are linked horizontally through schools and colleges where the need for service provision and expert attention may be needed.

The study also suggest a uniformity in the types of supports industries required for the smooth running of MSEs, the most common responses included; Government agencies, Banks, SACCO societies, Accounting firms and Lawyers. The mentioned sources go a long way in providing financial support, legal advice and an enabling environment for trade and growth.

5.2.4 Contextual Factors that Influence Business Growth in Kenya

Most of the respondents are happy with infrastructure in their business areas. The provision of following services according to the study findings was good; 70.5% road network was good, 72.6% telephone services is good, 64.2% electricity supply was good, but according to 82.1% felt that water supply was bad.

The entrepreneurs are not satisfied with council services provision as supported by 64.2 who agreed that waste disposal was worse, 63.2% agreed that licensing procedures and policy
formulation was worse, 60% agreed that legislation was worse while 63.2% also agree that policy implementation was worse. It could be concluded that government does not support in; export promotions, 86.3% government does not subsidize inputs, 72.6% does not help in access of credit while 84.2% agreed that it does not also train them in entrepreneurship.

The findings further show that most of the small enterprises in Nairobi 72.6% pay trading fees of between Ksh 10,000 and Ksh 20,000. On taxes, most of the small enterprises within Nairobi central business district pay taxes of over Kshs50,000. For monthly sales turnover for the small enterprises 51.6% is under Kshs 100,000 while for between Ksh 100,000 and 500,000 is 48.4%. On monthly expenses 68.4% of the enterprises in the region spend less that Kshs 100,000 in a month while 31.6% between Ksh 100,000 and 500,000, this is true since expenditure correlates with capital. The monthly gross profit for most of the firm’s 58.9% is under Kshs 100,000 followed by those earning between Ksh 100,000 and 500,000 at 41.1% as shown in table 4.17. It was also deduced that return on investment for selected firms range between Kshs 240,000 to Kshs 1,000,000; this could mean that most of the small enterprises as earnings return to the investors.

Although most of the entrepreneurs were satisfied with services regarding infrastructure they were not happy with water supply, and they were generally not happy with licensing procedure, policy formulation, waste disposal and the legislation. The government does not also help in access of credit and training in entrepreneurship.

5.3 Conclusions
The study findings indicate that most MSEs are of the opinion that although the government and its agencies including the local authority had done a lot in the area of provision of business friendly environment there was still a high number of discrepancies as there were still a large number of enterprises that were operating, without proper infrastructural development.

The size of capital and the type of business may contribute to the growth of small and micro enterprises. It was also revealed that access to financial source and the type of capital source accessible influence MSEs growth in the town.
The connectivity of the business and the chain that it has influences a lot about its growth, from the study some of the business get their good locally while others can get them from abroad through export. Also access to services like banking, lawyers and government support influences the MSEs growth.

Social network is important in business and from the study, information is important to business, overcoming contract enforcement and overcoming transaction costs is very important to business development. Family and friends network help in business.

The contextual factors influencing the MSEs are good infrastructure accessibility in the region and the government support in form of licenses for business, training, and exposure of the MSEs. The study also revealed that government should provide support services such as electricity, water and waste disposal for the smooth running of MSEs.

The main sources of inputs for enterprises is within Nairobi, the enterprises are buyer driven and to gain competitive advantage the enterprises are offering after sale services, offering efficient services, quality products and reducing cost of products.

5.4 Recommendations

From study findings the study recommends the establishment of an effective process to facilitate the processes such as company registration and a well-entrenched VAT system are institutionalized to assist existing and upcoming MSE operate optimally.

Most of the respondents thought that provision of efficient infrastructure was the single most important policy support they required from the government; it is upon the government to follow this lead and continue improving and expanding the available infrastructure so as to fully satisfy the wishes of most small scale enterprises that do business in Nairobi.

An improved infrastructure will ensure adequate security to consumers and sellers, a good waste disposal mechanism infrastructure will ensure that there is proper hygiene and a good road infrastructure will open up the entire CBD for business.

The study indicated that access to loans by small and medium size enterprises was still very limited as such it is upon the government and its agencies to work on modalities that will ensure that even MSEs have adequate access to credit instruments just like their bigger counterparts.
5.5 Recommendations for Further Study

Arising from the study findings, the researcher proposes the following areas for further study:

1. The role of the government agencies in formalization of unregistered MSEs
2. The impact of new infrastructural policy on existing ones.
3. The importance of consolidation of sources finance/credit to smaller businesses.
4. The role of the local authority and government in the upgrade of MSEs
REFERENCES


OECD, Brookings Institution Press, USA.


APPENDIX I: LETTER OF INTRODUCTION

Wachira Loise Wangui
P.O. Box 48231 -- 00100
GPO, Nairobi

Dear Respondent,

FACTORS THAT INFLUENCE THE GROWTH OF MICRO AND SMALL ENTERPRISES IN NAIROBI CENTRAL BUSINESS DISTRICT

I am currently a student in Kenyatta University pursuing a course in Master in Business Administration (Finance Option). It is a requirement to write a report as a partial fulfillment of the course. I am currently conducting the above mentioned research with an aim of understanding the economic factors which affect micro and small size enterprises in Kenya.

You have been randomly selected to participate in the study. Enclosed herein is a copy of the questionnaire, which I kindly request you to take a little of your time and complete.

The information you will provide in this questionnaire is for academic purpose only, and will be treated with utmost confidentiality. This information is meant to contribute to an important study whose results are likely to provide insight on how your organization can manage change to your benefit.

I thank you for your cooperation and participation.

Yours faithfully,

WACHIRA LOISE WANGUI
APPENDIX II: QUESTIONNAIRE

FACTORS THAT INFLUENCE THE GROWTH OF MICRO AND SMALL ENTERPRISES IN NAIROBI CENTRAL BUSINESS DISTRICT

Please answer the following questions by ticking the appropriate box

(A) INDIVIDUAL ENTREPRENEUR CHARACTERISTICS

1. What is your level of education?
   a) None [ ]
   b) Primary level [ ]
   c) Secondary level [ ]
   d) Undergraduate [ ]
   e) Post graduate [ ]

2. Indicate your age group among the following:
   a) Under 20 [ ]
   b) 21 – 30 [ ]
   c) 31 – 40 [ ]
   d) 41 – 50 [ ]
   e) 51 – 60 [ ]
   f) Over 60 [ ]

3. Indicate your gender
   a) Male [ ]
   b) Female [ ]

4. What is your position in the firm?
   a) Proprietor/Owner [ ]
   b) Manager [ ]
   c) Other (specify) .................................................................
(B) FIRM CHARACTERISTIC

5. What is the nature/core business of your enterprise?
   a) Restaurant [  ]
   b) Mobile shop [  ]
   c) Stall shop [  ]
   d) Cyber café [  ]
   e) Boutique [  ]
   f) Other (Specify) .................................................................

6. How old is your enterprise:
   a) Less than 5 years [  ]
   b) 6 – 15 years [  ]
   c) 16 – 20 years [  ]
   d) Over 20 years [  ]

7. What was your start-up capital?
   a) Less than Ksh. 50,000 [  ]
   b) Ksh. 50,000 to Ksh. 100,000 [  ]
   c) Ksh. 100,000 to Ksh. 200,000 [  ]
   d) Ksh. 200,000 to Ksh. 500,000 [  ]
   e) Ksh. 500,000 to Ksh. 1,000,000 [  ]
   f) Over Ksh. 1,000,000 [  ]

8. What was the source of the startup capital?
   a) Own savings [  ]
   b) Loan from SACCO [  ]
   c) Loan from Merry Go Round [  ]
   d) Loan from bank [  ]
   e) Loan from IMF [  ]
   f) Part savings part loan [  ]
   g) Other (Specify) [  ]

9. Indicate the ownership structure of your enterprise
   a) Sole proprietorship [  ]
   b) Partnership [  ]
10. What type of loans can your enterprise access?
   a) SACCO loans
   b) Merry Go Round
   c) Commercial Bank
   d) NGO
   e) Micro Finance Institution
   f) Other (Specify) ..........................................................

11. Is your business registered?
   a) Yes
   b) No

(C) SOCIAL NETWORKS

12. Rank the following ways in which friends and relatives assist your business according to importance. Use the ranking criteria below.
   Most important 5, Very important 4, Important 3, Less important 2, Not important 1

   a) To overcome regulatory obstacles
   b) To access business information
   c) To overcome transaction cost obstacles
   d) To overcome contract enforcement
   e) Help in registering new business

13. What do friends and relatives provide you and your business?
   (Tick where appropriate please)

   a) Leads about profitable business opportunities
   b) Information about loans
c) Sources of inputs

d) New markets

e) Other (Specify) .................................................................

14. What problems/demerits are associated to friends and relatives in your enterprise?
(Please select one which is most relevant)

a) They are too expensive to maintain

b) They provide unequal access to resources for
   Marginalized entrepreneurs such as women

c) They are deeply rooted in societal traditions

d) Request for profit distributions

e) Other (Specify) .................................................................

(D) VALUE CHAINS

15. Where are the sources of inputs to your enterprise?
   (Tick where appropriate please)

a) Within Nairobi

b) Outside Nairobi but within the Country

c) Within East Africa

d) International (Outside East Africa)

16. Indicate whether you have customers in the following areas/regions
   (Tick where appropriate please)

a) Within Nairobi

b) Outside Nairobi but within the Country

c) Within East Africa

d) International (Outside East Africa)
18. What is the competitive advantage of your enterprise?  
(Please select one which is most relevant)  

a) High quality products  
b) Lower prices  
c) After sales services  
d) Efficient/Quick services  
e) Lower production costs  
f) Other (Specify)  ________________  

19. Which of the following expressions best describes your enterprise?  

a) Buyer – driven  
b) Producer – driven  
c) Social network - driven  
d) Other (Specify)  ________________  

(E)  INTER – FIRM CO-OPERATION  

20. Which firms/industries are your enterprises linked backwards?  
(Source of raw materials)  ____________________________  

21. Which industry is your enterprise linked forward?  
(Source of market)  ____________________________  

22. Which industry is your firm linked horizontally?  
(At the stage of production)  ____________________________  

23. Which other industries support your enterprise?  ____________________________
(F) MACRO ECONOMIC FACTORS

24. Would you say that the infrastructure surrounding your enterprise is conducive for business?
   a) Yes [ ]
   b) No [ ]

25. Indicate by ranking the level of satisfaction conduciveness of the following infrastructural facilities around your enterprise. Use the ranking criteria below.
      a) The road network [ ]
      b) Telephone service [ ]
      c) Electricity [ ]
      d) Water supply [ ]
      e) Other (Specify) ........................................

26. Indicate by ranking the level of satisfaction/conduciveness of the following government/local authority services. Use the ranking criteria below.
      a) Waste disposal [ ]
      b) Licensing procedures [ ]
      c) Policy formulation [ ]
      d) Legislation [ ]
      e) Policy implementation [ ]

27. Indicate whether the government and its agencies support your enterprise in the following? (Please tick where relevant)
   a) Export promotion of your products [ ]
   b) Subsidizing inputs [ ]
   c) Access to credit finance [ ]
   d) Training in entrepreneurship [ ]
28. Is your enterprise VAT registered?
   a) Yes [ ]
   b) No [ ]

29. How much do you pay Nairobi City Council for the Trading Permit?
   c) Below Ksh 10,000 [ ]
   d) Between Ksh 10,000 and Ksh 20,000 [ ]
   e) Between Ksh 20,000 and Ksh 50,000 [ ]
   f) Over Ksh 50,000 [ ]
   e) None [ ]
   f) Other (Specify) ..............................................

30. How much in taxes and licensing fees in total do you pay annually?

31. What is the single most important policy support you would expect from government and its agencies for the growth and success of your enterprise?

(G) GROWTH AND SUCCESS VARIABLES

32. What is the value of your monthly sales/turnover on average?
   i. Under Ksh 100,000 [ ]
   ii. Between Ksh 100,000 and 500,000 [ ]
   iii. Between Ksh 500,001 and Ksh 2,000,000 [ ]
   iv. Between Ksh 2,000,001 and Ksh 10,000,000 [ ]
   v. Over Ksh 10 Million [ ]

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33. What is the value of your monthly costs/expenditure on average?
   a) Under Ksh 100,000  [  ]
   b) Between Ksh 100,000 and 500,000  [  ]
   c) Between Ksh 500,001 and Ksh 2,000,000  [  ]
   d) Between Ksh 2,000,001 and Ksh 10,000,000  [  ]
   e) Over Ksh 10 Million  [  ]

34. Estimate your gross profit on a monthly basis (sales – cost of sales)
   a) Under Ksh 100,000  [  ]
   b) Between Ksh 100,000 and 500,000  [  ]
   c) Between Ksh 500,001 and Ksh 2,000,000  [  ]
   d) Between Ksh 2,000,001 and Ksh 10,000,000  [  ]
   e) Over Ksh 10 Million  [  ]

35. Estimate your net profit on a monthly basis (Gross profit – expenses)

36. What is your return on investment on annual basis?

\[
\frac{\text{Net Profit}}{\text{Capital Invested}} \times 100
\]