Factors Affecting Growth of Micro and Small Enterprises in Kenya

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Abstract

The study analyzes the current status of micro and small enterprises (MSEs) in Kenya and the factors affecting their growth. Analysis of the 1999 MSE National Baseline Survey data is done using multiple regression, where firm growth is the dependent variable. The overall aim of the study is to identify mechanisms that would enable the sector make significant contributions in employment creation, innovation, industrial development, economic growth and poverty reduction. The study established that those enterprises that are registered; those that sub-contract; those where the owner has at least secondary school education, those operating in the services sector, and those with a large capital base achieve higher levels of growth. The study recommends different policy approaches that could be considered to encourage the growth and development of MSEs in Kenya.

Abbreviations and Acronyms

CBS	Central Bureau of Statistics
DfID	Department for International Development
DMSED	Department of Micro and Small Enterprise Development
ERSWEC	Economic Recovery Strategy for Wealth and Employment Creation
GDP	Gross Domestic Product
ICEG	International Centre for Economic Growth
ICT	Information and Communication Technology
ILO	International Labour Organization
JBIC	Johannesburg Business Information Centre
KEBS	Kenya Bureau of Standards
KIRDI	Kenya Industrial Research Development Institute
KIE	Kenya Industrial Estates
KIPI	Kenya Industrial Property Institute
LPE	Law of Proportionate Effect
MDG	Millennium Development Goal
MFI	Micro Finance Institution
MSE	Micro and Small Enterprise
NCSE	National Council for Small Enterprises
OLS	Ordinary Least Squares
SME	Small and Medium Enterprise
SMEA	Small and Medium Enterprise Agency
SSI	Small Scale Industry
UN	United Nations

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1. Introduction

The Kenyan economy has been on a recovery path since 2003, achieving 6.1 per cent GDP growth in 2006 (Government of Kenya, 2007). However, increasing unemployment is still a major concern. Micro and Small Enterprises (MSEs) emerged two decades ago and have been increasing gradually and employing a big number of the working population in Kenya. MSEs are formal or informal non-primary enterprises employing 1-50 workers. As of 1999, the MSE sector employed 2.3 million people (CBS *et al.*, 1999), while the informal sector employed 3.7 million people in the same year (Government of Kenya, 2000). The number of people employed in the informal sector has doubled since 1999 when the National Baseline Survey on MSEs was carried out. In 2007, the informal sector employed about 6.8 million people (Government of Kenya, 2007) despite the fact that a large number of MSEs operate informally.

Over the years, the government has recognized the importance of the MSE sector as a source of employment, income and inexpensive goods and services, making a contribution to the country's social and economic development and poverty reduction. As a result, the government has introduced policies to develop the micro and small enterprises, for instance Sessional Paper No. 2 of 1992 on Small Enterprise and *Jua Kali* Development in Kenya, and Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth Employment Creation for Poverty Reduction, which recognized the need to create an enabling environment for MSEs.

According to Patricof *et al* (2005), small and medium scale enterprises in high income countries contribute more than 50 per cent of Gross Domestic Product (GDP) and are an important source of employment. In low income countries, however, the contribution to GDP averages 16 per cent while in most low income African countries, this contribution is usually less than 10 per cent. A study by Liedholm (2001) revealed that MSEs are a major source of employment in African countries. Over 70 per cent of the population in Kenya, Botswana, Lesotho, Malawi, Swaziland and Zimbabwe, which are low and middle income countries, were engaged in MSE activities. In fact, total persons employed by micro and small enterprises is almost double that of large enterprises. In Kenya, micro and small enterprises contributed approximately 18.9 per cent of GDP, providing employment for 2.3 million people as mentioned earlier (CBS *et al*, 1999), thus accounting for approximately 42 per cent of the total employed persons in Kenya in 1999.[1] Therefore, considering that 42 per cent of Kenya's total recorded employed persons were in the MSE sector, a sector which has an estimated annual growth rate of 24.0 per cent annually with an overall annual MSE new start average of 21.2 per cent (Liedholm, 2001), it is clear that MSEs are a key and growing sector.[2]

The Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) targeted creating 500,000 new jobs in Kenya annually between 2003 and 2007. The 2006 Economic Survey reveals that in 2005, Kenya almost met this target by creating 458,900 jobs, 90 per cent of which were in the informal sector. As of 2006, 87 per cent of all new jobs outside small scale agriculture were generated from the informal sector (Government of Kenya, 2007). It is important to note that although the MSE sector and the informal sector are two distinct terms, there are overlaps between the two sectors, which results in the terms being used interchangeably in the literature and in some of Kenya's policy papers. The statistics provided in the annual Economic Survey, for instance, are on enterprises that operate in the informal sector but are often used to represent MSEs. "The Kenyan informal sector covers all small scale activities that are normally semi-organized, unregulated and use low and simple technologies and employ few persons. Majority of the small businesses such as retailers, hawkers and other service providers fall in this sector" (Government of Kenya, 2007:90). Both terms, however, exclude large incorporated enterprises.

1.1 Research Problem

According to Liedholm (2001), 50 per cent of MSEs in Kenya (as well as in Botswana, Swaziland and Zimbabwe) closed within the first three years of operation. Of the MSEs that survived, only 34.8 per cent grew at an annual rate averaging 24.0 per cent. The MSE sector, therefore, has low survival rates. Majority of MSEs are owner-operated and lack adequate human capital, have limited financial capital and workspace,

[1] This per cent is obtained from the 2000 Economic Survey, which estimates that the total recorded employment in 1999 was 5.4 million, while the 1999 National MSE Baseline Survey estimates that 2.3 million persons are employed in the MSE sector. Therefore, the MSE sector accounted for 42 per cent of the total number of employed persons.

[2] Liedholm (2001) calculated the compound growth rate as follows: [(current employment/ initial employment) $^{(1/\text{firm age})}$]-1.

and are at risk of occupational hazards (Omolo and Omiti, 2005). The 1999 MSE National Baseline Survey revealed that majority of MSEs operate informally, with a large number of them do not have permanent worksites and do not keep proper records. The survey also revealed that most MSEs were not technologically advanced. Many started as micro enterprises, with a small per cent graduating to small enterprises. A study by Biggs and Srivastava (1996) found that the manufacturing sector is the fastest growing sector among MSEs in Kenya, yet only 26 per cent of them graduated from 1-9 employees to 10-49 employees. In summary, the sector is largely under-developed.

There have been several policies in Kenya that address micro and small enterprises. The ERSWEC, for instance, targets the creation of 500,000 jobs annually and spells out several measures to enhance the role of MSEs in generating economic growth, creating jobs and reducing poverty. The Sessional Paper No. 2 of 1999 and Sessional Paper No. 2 of 2005 specifically address the challenges faced by the sector and lay down policies to stimulate the growth of MSEs. However, due to innapropriate design and poor implementation, these policies do not seem to encourage the sector to achieve its full potential. The MSE policies are designed to apply to the MSE sector as a whole and do not specify which MSEs are being targeted by the policies, yet MSEs in Kenya are distinctly different. Therefore, the contribution of MSEs in Kenya to economic growth has been insignificant compared with other developing countries. Peru, for example, with a lower middle income economy with a population of 27.6 million, which is comparable to Kenya's population of 33.5 million, achieved GDP growth of 4.8 per cent in 2004, which is slightly higher than Kenya's GDP growth in the same year at 4.3 per cent (World Bank, 2006). MSEs in Peru generate 75.9 per cent of the country's GDP and account for 42.1 per cent of employment (Francisco, 2004; Tarmidi, 2005). In South Africa, an upper middle income country with a population of 47 million, small enterprises contribute 35 per cent of the country's GDP, which is significant compared to the MSE contribution in Kenya at 18.9 per cent.[3]

It is, therefore, important to establish the factors that lead to low contribution of MSEs in economic growth and identify the factors that would promote growth in MSEs to a stage where they can make significant contributions to the economy. It is also important to identify,

[3] According to Small Enterprise Development Agency available from http://www.seda.org.za

design and implement appropriate policies for the two types of MSEs: growth-oriented enterprises, and survivalist enterprises, based on their needs and requirements. Previous policy papers have failed to do so. The policies should focus on creating a favourable environment for nurturing MSEs and to ensure that they meaningfully contribute to growth, create jobs and contribute to poverty reduction.

This study draws from best practices from selected countries, literature review and empirical studies to try and realize growth possibilities of MSEs in Kenya.

1.2 Study Objectives

The overall objective of this study is to develop a framework that would promote the effective and efficient development of all MSEs in Kenya. The specific objectives are to:

(i) Review and analyze the features and characteristics of MSEs in Kenya;

(ii) Identify factors that affect the growth of MSEs in Kenya; and

(iii) Suggest mechanisms and structures that need to be put in place to encourage growth-oriented enterprises.

MSEs in Kenya have an important role to play in employment creation, income generation, promotion of innovation and competition and provision of inexpensive goods and services. The sector also develops indigenous and entrepreneurial skills, thus making a significant contribution to Kenya's industrial development, economic growth and poverty reduction. There is need to tackle the issue of unemployment and poverty in Kenya in the MSE framework through the development of dynamic MSEs that promote efficient allocation of resources. This is especially important with the introduction of financial initiatives targeting the micro, small and medium sector, such as the Youth Fund and Women Enterprise Fund, which have been recently introduced by the Government. For these resources to be utilized effectively and efficiently, it is important to understand the most efficient growth pathway for profitable, productive, competitive micro and small enterprises in order to develop appropriate and effective policies that have a positive contribution to MSEs and the economy.

2. Micro and Small Enterprises in Kenya

2.1 Characteristics of MSEs in Kenya

For purposes of this study, micro and small enterprises (MSEs) are defined as non-primary enterprises employing 1-50 workers (Government of Kenya, 1992; CBS *et al.*, 1999). MSEs in Kenya have unique characteristics and features, which are expounded on in this section.

Historical perspective

Many of the MSEs in Kenya originated from the Indian labour that stayed behind and became entrepreneurs on completion of the construction of the Mombasa-Lake Victoria railway. Many MSEs adopted Indian technologies to develop their products (Bigsten et al., 2004). The initial growth of the sector came about after Kenya attained independence and the government introduced policies aimed at 'Africanization' to allow Kenyan Africans establish businesses (Ronge *et al.*, 2002). Rural-urban migration has further contributed to the growth of MSEs. The sector was brought into the limelight by the 1972 International Labour Organization (ILO) report and has since been subject of development debate (Mullei and Bokea, 1999).

Informal operations in the MSE sector

According to the 1999 National MSE baseline survey data, the majority of Kenyan MSEs operate informally, with 88.6 per cent of them having no business registration and 60.7 per cent of them operating without any licence. The most rapid growth of the informal sector, commonly referred to as the *Jua Kali* industry was in the 1960s and 1970s when Kenya was experiencing high population growth, poor economic growth, increasing unemployment and a shrinking public sector due to the effects of liberalization and structural adjustment programmes.[4] The formal sector was inadequate in absorbing the growing labour force due to low demand, poor infrastructure, inadequate human capital and poor governance (Bigsten *et al.*, 2004).

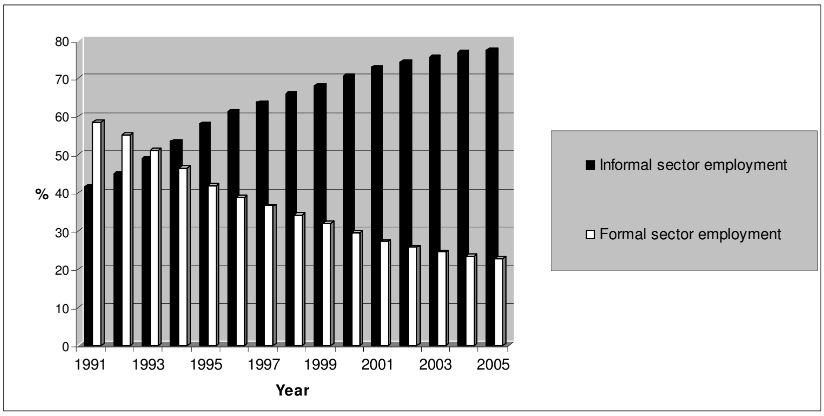
[4] The term '*Jua kali*' is 'hot sun' in Swahili. The term refers to the informal artisans who work under the hot sun.

The informal sector was often regarded as a traditional sector that would die out with economic and industrial growth (Chen, 2003). Proper recognition was only given to the informal sector in 1972 after an International Labour Organization (ILO) employment mission to Kenya, the first of a series of "employment missions" to various countries, started addressing the issue of unemployment (ILO, 2002). The official report that resulted from this mission emphasized the growing importance of the expanding informal sector. [5] The report used the term 'informal sector' rather than 'traditional sector' and referred to the sector in a positive note, implying that the sector was here to stay and was not a marginal activity that would eventually disappear. The view embraced by ILO of the informal sector is regarded as the dualist view, one of the three schools of dominant thought regarding the informal sector that emerged over the years. Dualists generally view the informal sector as distinct from the formal sector and only existing due to limited formal job opportunities, slow economic growth and high population growth (Chen *et al.*, 2004). The other schools of thought are the structuralists and legalists. Structuralists regard the informal sector as micro firms that co-exist with larger formal firms by providing them with inputs and labour, while the legalists perceive the informal sector as consisting of entrepreneurs who chose to work informally to avoid cumbersome and costly government rules and regulations. In contrast to the dualists who believe people operate in the informal sector out of necessity, the legalists believe people operate in the informal sector by choice. Dualists also believed that the informal sector would die out but it has, in fact, been growing over the years as shown in Figure 2.1.

Over a period of 14 years, employment in the informal sector in Kenya has almost doubled in size from 40 per cent of total employment in 1991 to almost 80 per cent in 2005, while formal employment share has declined significantly (Figure 2.1), illustrating the importance of the sector in filling in for the shrinking formal sector. The growth of the informal sector was not only felt in Kenya. In the 1980s, a new pattern emerged in Northern American and Europe, where production shifted to small-scale production units. Asia also witnessed a growth in the informal sector after the economic crisis (the Asian Crisis of 1997/8) when many people lost their jobs and had to rely on the informal sector for employment (ILO, 2002). Many developing countries and countries

[5] ILO (1972), *Employment, incomes and equality: A strategy for increasing productive employment in Kenya*. Geneva: International Labour Organization.

Figure 2.1: Employment in the informal and formal sector in Kenya, 1991-2005



Source: Economic Survey (various)

Table 2.1: Comparison of informal sector employment in different regions

Region	Informal sector labour force (%)	Population (in 2004)	% GDP growth (in 2004)
Sub-Saharan Africa	70	725,820,096	4.8
South Asia	50-80	1,446,798,848	6.7
Latin America & the Caribbean	55	545,923,520	5.9

Source: Hafkin (2002) and World Bank (2006)

undergoing transition experienced, and are still experiencing, the expansion of the informal sector, and it is now considered to be a growing, permanent, modern, capitalist sector (Chen *et al.*, 2004). In India, the informal sector employs 93 per cent of the total workforce, accounting for 60 per cent of Net Domestic Product (Chen, 2003), while in Kenya employment in the informal sector accounted for 77 per cent in 2006 (Government of Kenya, 2007). Table 2.1 gives informal sector employment statistics in different regions.

It is costly and time consuming to formally start a business in Kenya. This may be part of the reason why MSEs choose to operate informally. According to the Doing Business (World Bank, 2007), 12 procedures taking an average of 44 days had to be followed to start a business in

Kenya in 2007. In India, the procedures to be followed are 13. However, the time it takes to start a business is 11 days less than in Kenya. In Thailand, South Africa and Japan, there are only 8 procedures to start a business, covering a period of 33 days, 31 days and 23 days, respectively. The Doing Business survey ranked Kenya at position 72 in 2007 (out of the 175 countries) in terms of ease of doing business, which is better than Tanzania (ranked at 130) and Uganda (ranked at 118) but lags behind countries such as South Africa (35th).

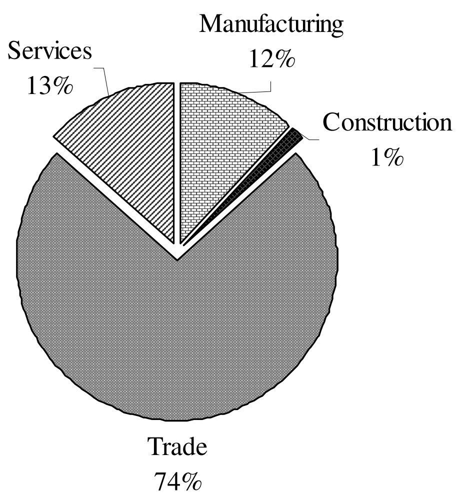
Composition of MSE activities

MSEs in Kenya are heterogeneous, with a majority operating in trade. Figure 2.2 below shows the breakdown of the different economic activities MSEs in Kenya operate in.

Spatial dimension of MSEs

According to the National MSE Baseline Survey (1999), 74 per cent of enterprises are located in rural areas, 29 per cent of them operate in the open market, open ground or *Jua Kali* sheds while 57 per cent own or rent their worksites. About 36 per cent of MSEs operate from temporary structures, which are usually erected in a haphazard manner. MSEs

Figure 2.2: Economic activities of MSEs in Kenya



Source: 1999 National MSE Baseline Survey operating in temporary worksites or open ground have limited access to water and electricity and other public services and amenities, consequently limiting their technological abilities.

Size and ownership

About three quarters (72%) of MSEs in Kenya are run by a sole proprietor, the rest are family owned businesses and partnerships, with a small number of them operating as a co-operative or corporate business. Consequently, majority (99%) of MSEs in Kenya are micro enterprises (employing 1-10 persons). The MSEs that employ between 11-50 persons only make up 0.7 per cent of the total number of MSEs in Kenya (CBS *et al.*, 1999). Kenya operates in a dual industrial structure with large formal enterprises and micro enterprises. The large and the micro enterprises are more in number and employ majority of Kenya's labour force, but small and medium scale enterprises are few. This is characteristic of the 'missing middle' phenomenon (Bigsten *et al.*, 2004). There are a number of large enterprises because industrial policies in Kenya favour larger enterprises in terms of access to credit, export opportunities, support services, market information, subsidies, price controls and so on (Kahuthu, 2005). Micro enterprises are also more in number due to ease of entry, which makes the process of starting and operating a micro enterprise relatively easier.

Markets and marketing

The market segments for MSEs are those that are not well served by the formal sector or the government in some instances (for example provision of waste collection services). These markets are usually small in size because they are often localized to meet specific local tastes (Fafchamps, 1994). Generally, there is poor market information and research within the sector, which renders the marketing services for MSEs inadequate (Moyi *et al.*, 2006).

Technology

The level of productivity and use of technology among MSEs is low. According to the National MSE Baseline Survey (1999), 93.1 per cent of MSEs do not own machines. The ones that use machines use outdated machinery, and traditional or intermediate technology.

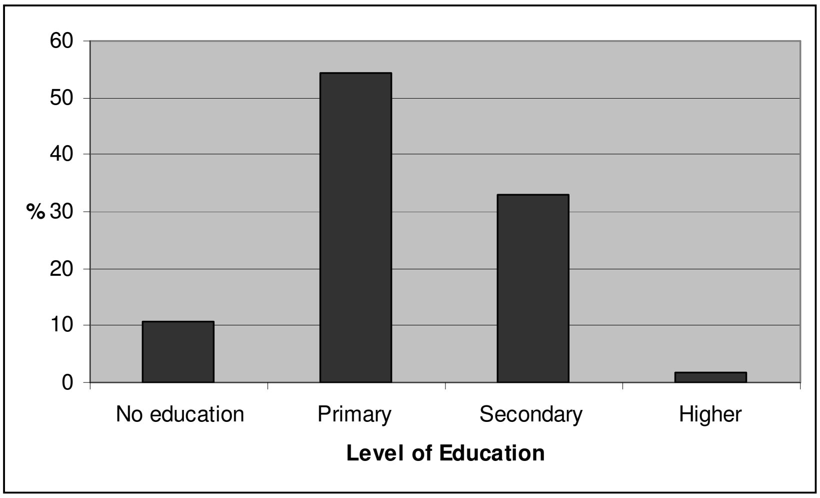
Labour force

The labour force and labour costs of most MSEs are low, because majority of MSE operators are self-employed. Other MSEs have access to family manpower and young unskilled, inexperienced people who want to acquire some skills and do not mind low or no pay (Fafchamps, 1994). Majority (65%) of MSE owners have not received formal education after primary school level (Figure 2.3) and 58 per cent of them have not received further training in management, technical training, marketing or counselling (CBS *et al.*, 1999).

Finance and income levels

According to the National MSE Baseline Survey (1999), only 3.2 per cent of MSEs have a complete set of accounts records. Majority (64.2%) do not keep proper business records, thus rendering them unattractive to credit facilities. This is probably why only 10.6 per cent of the credit sources is from commercial banks. The main source of capital (90.7%) is from the family and entrepreneur's own funds. Lack of capital is one of the major constraints faced by MSEs (CBS *et al.*, 1999).

Figure 2.3: Levels of education attained by MSE owners



Source: 1999 National MSE Baseline Survey data

The average income for Kenyan entrepreneurs in 1999 was Ksh 6,008 per month (CBS *et al.*, 1999). However, over half (59.1%) of MSEs received a net income of Ksh 3,000 or less per month, according to the National MSE Baseline Survey data. The income from MSEs is often insufficient in fighting poverty, especially in situations where the MSEs are operating out of necessity.

In summary, majority of MSEs in Kenya are small, operate informally, have low levels of technology and business skills, have limited markets and lack finance. They are largely underdeveloped, with a majority of them operating in survivalist activities. There is a high closure rate among MSEs, with many of them starting and staying small (Liedholm, 2001). Moreover, MSEs in Kenya have a tendency of growing horizontally as opposed to vertically. According to Moyi (2005), horizontal growth refers to the emergence of new MSEs while vertical growth is the graduation of small enterprises into medium scale enterprises. This brings about a vicious cycle where, due to their characteristics and operations, MSEs lack the resources and opportunities to grow and expand.

2.2 Legal and Regulatory Framework

When Kenya gained independence in 1963, "Kenyanization" polices to promote the country's entrepreneurs and enterprises were adopted. These policies have been addressed in policy papers such as Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya. Ikiara *et al* (2004) gives an example of one such policy where serving civil servants were encouraged to undertake entrepreneurial activities as provided in the Ndegwa Commission.[6] The "Kenyanization" policies introduced during this post-independence period were also geared at encouraging the establishment of parastatals such as the Industrial and Commercial Development Corporation (ICDC), the Development Finance Company of Kenya (DFCK), the Kenya Industrial Estates (KIE) and the Industrial Development Bank (IDB) to support indigenous entrepreneurs with their financial and infrastructure needs (Ikiara *et al.*, 2004).

The micro and small enterprise sector received official recognition following the 1972 ILO mission to Kenya. The National Development

[6] The Ndegwa Commission of Inquiry, 1970-1971, findings report.

Plan of 1974-1978 was the first policy paper to spell out measures to promote the MSEs sector, which included stopping the official harassment of small industry operators; provision of direct assistance to small industry operators; introduction of extension services; and provision of loan facilities and training for MSEs. The 1979-1983 Development Plan had several policies that sought to promote small-scale industries: the expansion of Kenya Industrial Estates (KIE), the encouragement of sub-contracting and exporting, the introduction of training programmes; and credit guarantee schemes for enhanced commercial bank loans.

Prior to the 1984-1988 Development Plan, the terms small scale, micro and small enterprise, informal sector and *Jua Kali* enterprises were used interchangeably in policies. The 1984-1988 Development Plan introduced the concept of cottage industries and went on to give a definition to distinguish between small and cottage industries, which considered cottage industries as a smaller unit of small scale industries and often employing fewer workers and with a fixed investment of less than Ksh 50,000. The Development Plan encouraged the development of handicraft and cottage industries through support services to help them diversify, and the development of small scale industries by reserving certain production items to be developed by such small scale industries. These policies were, however, not properly implemented, resulting in policy recommendations being repeated in several subsequent policy papers (Ronge *et al.*, 2002).

The Sessional Paper No. 2 of 1985 on Unemployment and the Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth both postulated policies to promote an enabling environment for the MSE sector (Mullei and Bokea, 1999). The Sessional Paper No. 1 of 1986 was the first policy paper to recognize the importance and problems of the small scale enterprises and was the first policy paper to provide proper programmed support. The policies proposed were aimed at improving the supply of goods and services, supply of finance, improving market information, improving production techniques and improving technical training programmes (Ronge *et al.*, 2002). The 1989-1993 National Development Plan used the term small scale and informal sector jointly and considered the two types of enterprises as one and the same. The policies proposed were geared at developing an enabling environment for the sector through policy restructuring and liberalization of the price structure, trade regime liberalization, foreign exchange management, wages, capital and investment policies that would provide incentives for development of MSEs.

The Sessional Paper No. 2 of 1992 on Small Enterprise and *Jua Kali* Development in Kenya concentrated on three main areas: creating an enabling environment; providing credit; and developing non-financial promotional programmes (Ronge *et al.*, 2002). The strategies set out in this policy paper were more focused and had a specific timeframe, 12-24 months (Mullei and Bokea, 1999). Although the strategies postulated in the Sessional Paper targeted both the *Jua Kali* and small enterprises together as one sector, as indicated in the policy paper's title, a definition for the sector was introduced. It defined the small and *Jua Kali* enterprises as all enterprises employing between 1-50 employees. The Sessional Paper, however, did not make the distinction between small scale and *Jua Kali* enterprises.

The 1994-1996, 1997-2001 and 2002-2008 Development Plans all refer to the Sessional Paper No. 2 of 1992 on Small Enterprise and *Jua Kali* Development in Kenya and reaffirm the government's commitment in supporting MSEs though appropriate policies that would provide an enabling environment for MSEs.

In the 1994-1996 Development Plan and the Sessional Paper No. 2 of 1997 on Industrial Transformation to the Year 2020, the government reiterated its commitment to providing an enabling business environment for MSEs. The Sessional Paper on Industrial Transformation proposed to review government policies on procurement to allocate some level of government procurement to MSEs. The Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction, the Sessional Paper No. 7 of 2005 on Employment Policy and Strategy for Kenya, and the Economic Recovery Strategy for Wealth Creation and Economic Recovery 2003-2006 also put emphasis on the MSE sector as having an important role in promoting economic growth, reducing income equality and creating employment.

These policies have brought about many benefits to the MSE sector. However, due to poor implementation, many of the planned activities have stalled or failed due to lack of resources, such as technical expertise, infrastructure, funding, lack of political will and the lack of clear measurable results (Karingithi, 1999). The Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth Employment

Creation for Poverty Reduction observes that inappropriate policies, weak policy design and poor coordination and implementation have been a major challenge. The Sessional Paper also acknowledges that there were no mechanisms for coordination, monitoring and evaluating the effect of previous policies.

Many of the previous policies also failed to define the roles of different government organs that dealt with the MSE sector. Additionally, there was no central coordinating body prior to the establishment of the Department of Micro and Small Enterprise Development (DMSED). There were MSE policies and programmes developed for the Ministry of Trade and Industry (formally Ministry of Commerce and Industry), Ministry of Planning, Ministry of Labour and Human Resource Development, Ministry of Education, Science and Technology and Ministry of Gender, Sports, Culture and Social Services, to name a few, but there was no coordinating or monitoring body. This lack of coordination contributed to poor implementation, wastage of resources and poor targeting (Omolo and Omiti, 2005).

To ensure that this did not happen again, Sessional Paper No. 2 of 2005 provided a breakdown of coordination and implementation mechanisms to be followed, which indicated the roles and responsibilities of the different institutions as well as the timeframe. The policy paper also called for strengthening of DMSED and establishment of a National Council for Small Enterprises (NCSE) to improve coordination, implementation and monitoring mechanisms. The policy spells out appropriate measures to promote the sector, focusing on the following key areas: legal and regulatory environment; marketing; business linkages; financial services; skills and technology; infrastructure development; gender equity and health and safety in workplaces. The Sessional Paper also introduced a more tangible procurement policy where 25 per cent of public procurement is allocated to MSEs.

Another weakness with the government policies on the MSE sector is that they provided uniformly, generic interventions to the sector as a whole. The policies did not adequately define the target group for the policies. They, therefore, did not distinguish between small enterprises and informal enterprises. For policy purposes, a further distinction for micro and small enterprises should be made between survivalist and growth-oriented enterprises.

3. Theoretical and Empirical Literature

3.1 Theoretical Literature

According to McMahon (1998), existing theory on small and micro enterprise (SME) growth can be summarized into four main groups. The first classification is the Static Equilibrium Theory that concentrates on the achievement of economies of scale and minimization of long-run unit average costs. The theory denotes that growth is achieved by larger firms. The Stochastic Model of firm growth is the second theory, which suggests that there are random factors that contribute to firm growth. The third theory is the Strategic Management Perspective, whereby SMEs respond to the motives, policies and strategies of the owner or manager. In this context, not all enterprises aim or desire for growth; some are developed for subsistence purposes and are comfortable maintaining their size. Their aim is, therefore, to survive. In such instances, the entrepreneur is 'pushed' into survival activities in the search for income generating activities to support family income (Harvie, 2003). The last category as presented by McMahon (1998) is the enterprise Life-Cycle Theory, which is widely used to explain growth of SMEs. The main life-cycle stages are start-up or launch, expansion or growth, maturity then diversification or regeneration or decline. Jovanovic's Learning Model is an important theory based on the life-cycle theory. [7] It states that firm growth is inversely related to firm age and size; younger firms grow faster than older larger firms (Elhiraika and Nkurunziza, 2006).

However, the most sighted firm growth theory is Gibrat's Law. [8] It is the oldest (published in 1931) and most referred to theory of firm growth. Gibrat's Law of Proportionate Effect-LPE states that firm growth is independent of the firm's initial size. Gibrat's law is, therefore, a Stochastic Model that infers that the growth of firms is based on random factors (Elhiraika and Nkurunziza, 2006).

Other than the Static Equilibrium Theory, the Stochastic Model and Strategic Management Perspective and the Life-Cycle Theory of firm growth, there are other theories explaining the growth of micro and small enterprises as presented by Green *et al* (2006). Green *et al* (2006) bring

[7] The model was presented in Jovanovic's article, "Selection and the evaluation of industry", *Econometrica 50, pp649-670.*

[8] Gibrat's Law was published in *Les Inégalités Economiques,* Paris Sirey, 1931.

out the three main theories regarding the growth of MSEs. The first is based on the Lewis Theory, which postulates that MSEs grow due to the inability of the public sector or large private enterprises to absorb the surplus labour. These surplus labourers are, therefore, forced into MSE activities. According to the Lewis model, a developing economy has two sectors; the traditional rural subsistence sector with surplus low productivity labour and the modern urban industrial sector with high labour productivity (Todaro, 2000). The second theory, according to Green *et al* (2006) is based on market output and demand. It states that there must be a market and demand for products and services that are sourced from MSEs, thus introducing competition and growth. The third theory is known as Firm Growth Theory, which states that industrialization and economic growth will lead to the growth of modern large scale industries and the disappearance of micro and small enterprises.

The literature on the role of the MSE sector on development emphasises their importance in contributing to a more equitable allocation of resources, poverty reduction and economic growth. Micro and small enterprises provide specialized goods and services using minimal capital and locally available material. They are innovative, flexible, and willing to experiment and exploit new markets compared to larger enterprises (Fafchamps, 1994). MSEs are able to be flexible and exploit new markets because they are able to respond to demand and consumption (Ranis and Stewart, 1999). The sector provides inexpensive goods and services, which are not offered by the formal sector (Bigsten *et al.*, 2004) and promotes competition and innovation, which is necessary for industrialization, employment creation, poverty reduction and economic growth (Government of Kenya, 2005). The MSE sector can also encourage the development of entrepreneurial skills and creativity, which brings about innovation, productivity, creativity and introduces competition (UN, 2004).

Literature on the MSE sector further reveals that the sector has two distinctly different types of enterprises. Harvie (2003) described micro enterprises as being involved in either livelihood (survival or subsistence) activity of growth (viable) activity. Ranis and Stewart (1999) also distinguishes between the two types of enterprises, indicating that dynamic enterprises produce intermediate, capital or modern consumer goods; have linkages with the formal sector; have skilled workers with competitive incomes; are capital intensive; and are predominantly a family enterprise employing 10 workers. According to DfID (2000), dynamic MSEs can contribute to income distribution, poverty reduction, the achievement of Millennium Development Goals (MDGs) and can contribute to economic growth. The traditional enterprises, on the other hand, produce simple goods; have no significant link with the formal sector; have low incomes; utilize low capital; and employ 3 or less workers, usually unskilled family workers who are unable to find formal employment (Ranis and Stewart, 1999). Table 3.1 summarizes the typical characteristics of the two types of enterprises based on the literature reviewed.

The study analyzed the 1999 MSE Baseline Survey data to determine if a similar distinction can be made for MSEs in Kenya. The study also examines if Gibrat's Law holds for MSEs in Kenya.

3.2 Empirical Analysis

There are a number of other empirical studies that try to analyze the determinants of firm growth. This review specifically looks at studies of MSEs in Kenya and other African countries. Studies by Mead and Liedholm (1998) and Liedholm (2001), which estimated the determinants of enterprise growth in six African countries using annual jobs generated since start-up as the dependent variable, found that younger enterprises are more likely to grow and generate employment opportunities, suggesting that Gibrat's Law does not always hold. The study by Liedholm (2001) also found that young growing enterprises have greater chances of surviving than enterprises that have remained the same size. Some studies (Bigsten *et al.*, 1999; Kimuyu, 2002), however, discovered a positive age efficiency or productivity relationship in older, more experienced enterprises and that productivity improves with age.

Omolo and Omiti (2005) used a growth model to analyze the relationship between firm growth in terms of sales and factors such as ownership of the enterprise, effects of entrepreneurship training, security and membership to a MSE association. Kimuyu (2002) used a Cobb-Douglas production model to show the relationship between an assortment of micro level institutional variables and revenue. All the studies reviewed applied the Ordinary Least Squares (OLS) methodology and made various observations.

Table 3.1: Differences between survivalist and growth-oriented enterprises

Survivalist/Traditional enterprises	**Growth-oriented enterprises**
Grows mainly horizontally with multiple enterprises to compensate for seasonality and low returns	Grows vertically and horizontally; expand and branch into new enterprises
Non-profitable	Profitable and sustainable
Stagnant	Dynamic and entrepreneurial
Self employed	Employs more than three people
Exits or dies out; average lifespan of four years	Grows and expands
Generally unskilled labour	Skilled labour
Low productivity	Productive
Low income	Competitive wages
Use traditional, simple or obsolete technology	Use modern technology
Haphazard development	Organized development
Disguised employment/Informal employment	Decent employment
Unregulated, with a majority operating without registration, licenses or permanent worksites	Operate with the necessary registration, licenses or permanent worksites

Compiled by author from various sources: Ranis and Stewart (1999); Harvie (2003), Bigsten et al (2004) and Kahuthu (2005)

Kimuyu (2002), Omolo and Omiti (2005) and Liedholm (2001) discovered that owner-operated, self-employed enterprises, one employee enterprises are inefficient, least remunerative, and less likely to grow or create further employment opportunities. The returns per hour for enterprises with 2-5 workers is significantly higher than those with only one person working (Mead and Liedholm, 1998).

Enterprises located in urban centres, those that have a permanent worksite, those that operate on a regular basis and those that belong to MSE associations have higher revenue, are more productive and have a higher potential for creating employment (Omolo and Omiti, 2005; Kimuyu, 2002). Access to finance and access to formal training (improved human capital) have a positive influence on enterprise growth (Liedholm, 2001 and Omolo and Omiti, 2005). On gender, Mead and Liedholm (1998), Liedholm (2001) and Kimuyu (2002) found that male-owned enterprises are more likely to grow or have higher revenues compared to female-owned enterprises. Bigsten *et al* (1999) and Kimuyu (2002) found that informal enterprises are less efficient, are financially restricted and have less educated managers compared to formal enterprises, which were more productive.

The study by Liedholm (2001) goes on to conclude that the economic environment of a country also plays an important role in the growth of an enterprise. In Botswana, one of the six countries surveyed, MSEs were found to grow at a faster rate than MSEs in other countries, including Kenya. The reason may be due to high levels of per-capita income and growth in per capita income that Botswana experienced at the time of the study. The study also concludes that MSEs that operate in the manufacturing and service sector seem more likely to grow and that MSEs operating in retail trading are less likely to grow. About 30 per cent of the MSEs operating in retail trade are likely to close in a year (Liedholm, 2001). MSEs in manufacturing sector grow at a faster rate with some even graduating into SMEs as detailed in the study by Biggs and Srivastava (1996). The study found that in Kenya, less than 5 per cent of MSEs grow into the 100 and more employee size. This means that in Kenyan manufacturing, enterprises with 1-9 employees have the greatest potential of creating employment opportunities as indicated in Table 3.2.

Table 3.2: Firm mobility between start and present in Kenya

Current size	Start-up size (%)			
	1-9	10-49	50-99	100+
1-9	55	14	0	11
10-49	26	29	14	11
50-99	14	27	21	0
100+	5	30	65	78
N	43	62	26	31
Interpretation: Of the enterprises that started with 1-9 employees, 55% of them remained and 26% graduated to 10-49 employees, 14% graduated into enterprises with 50-99 employees and 5% into larger enterprises with 100+ employees				

Source: Biggs and Srivastava (1996)

This study builds on this existing empirical analysis to determine the effect of certain factors previously estimated on the growth of MSEs in Kenya. Using the 1999 National MSE survey dataset, the study included additional factors that were not previously estimated. These factors are extracted from the lessons learnt in countries that have a successful MSE sector.

3.3 Best Practices from Selected Countries

There are important explanatory variables that are not brought out in the theoretical literature and empirical studies reviewed, which can be extracted from countries such as India, Peru, and Japan. These countries have thriving small and medium scale enterprises. Small scale enterprises in Japan account for 87 per cent of all enterprises and SMEs, employing 77.6 per cent of the population (Tarmidi, 2005). It is, therefore, important to analyze the unique features available in Japan that support the growth of the sector. Japan, for instance, has Prefectual, Regional and SME/Venture SME support centres, which provide business support services such as marketing, and assist small and medium enterprises to grow and become more competitive (SMEA, 2002).[9]

[9] According to the World Bank Micro, Small and Medium Enterprises; A Collection of Published data (2007), Japan small and medium scale enterprises have 4-299 employees.

The Government Stores Purchase Programme in India is aimed at providing market support by reserving certain products for exclusive purchase by small scale sector. There is also a price preference of up to 15 per cent for items produced in large scale and small scale units. This has contributed to the growth of the sector to a point where 40 per cent of the country's industrial output comes from the sector, which also contributes 45 per cent of total direct exports and 34 per cent overall exports.[10]

In Japan, the government is legally obligated to place a certain number of orders with small and medium enterprises (SMEA, 2002), as well as Peru, which has in place legal measures that favour enterprises with less then 40 workers (Francisco, 2004). [11] Peru also has a thriving MSE sector where 98.6 per cent of all enterprises in Peru are micro and small enterprises accounting for 75.9 per cent of total employment and 42.1 per cent of GDP as of 1997 (Tarmidi, 2005). Linking with the public and private sector through sub-contracting, for instance, is important for the development of a thriving MSE sector.

It can, therefore, be concluded that forming business partnerships and networks such as sub-contracts with the private and public sector is important for encouraging growth.

[10] Information from the Office of Development Commissioner (MSME), Ministry of Micro, Small and Medium Enterprise, Government of India available online from www.smallindustryindia.com

[11] MSEs in Peru employ 0-50 people, according to the World Bank Micro, Small and Medium Enterprises: A collection of published data (2007).

4. Methodology

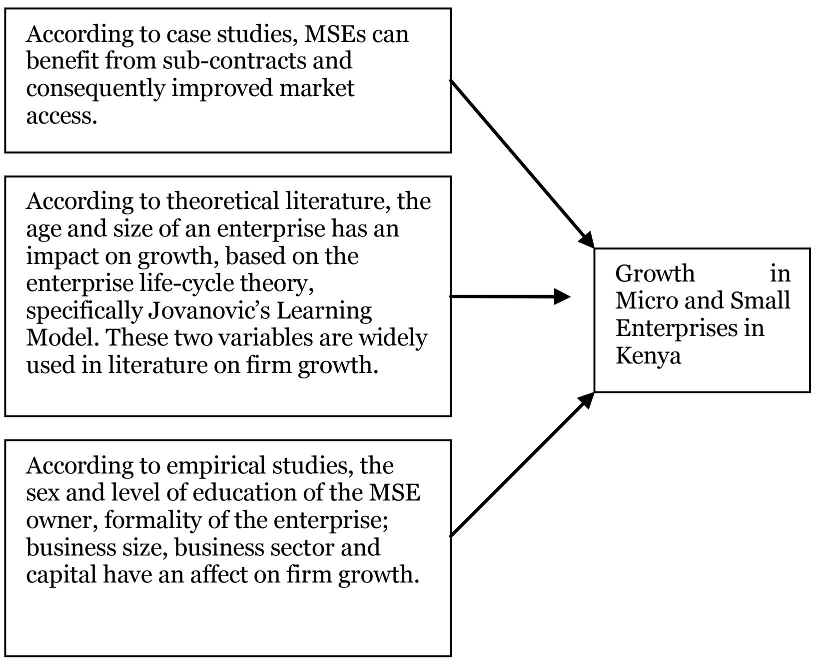
The main aim of this study is to determine the factors affecting the growth of MSEs in Kenya. A multiple regression analysis using Ordinary Least Squares (OLS) was undertaken to establish this.

4.1 Model Specification

To determine the growth of MSEs in Kenya, the study used change in employment of the firm as a measure of firm growth. Due to data limitations, this study will not use revenue or sales as the measure of growth. Change in number of workers since start-up or acquisition of the business will give an adequate indication of the direction of the firm's growth.

As summarized in Figure 4.1, literature, empirical analysis reviewed and best practices from countries with a thriving MSE sector reveal several factors that affect firm growth.

Figure 4.1: Firm growth



Jovanovic's Learning Model theory states that firm growth is inversely related to firm age and size. This study tested this theory by analyzing the effect of age and size of an enterprise on growth to assess if the theory will stand for micro and small enterprises in Kenya. Empirical analysis reveals several factors that contribute to the growth and development of small scale enterprises. The study measured the effect of some of the factors on growth of MSEs in Kenya. These include the sex and level of education of the owner, formality of the enterprise (enterprises that are registered with the registrar of companies), business sector that the MSE operates in, and access to capital. The effect of sub-contracting on MSEs' growth is one factor that is not included in the literature and empirical evidence reviewed, yet the case studies reveal that it has a positive impact on the growth of MSEs. It is, therefore, expected that MSEs that sub-contract will have a positive effect on growth of MSEs.

The study adopts the firm growth relationship postulated in Evans (1987) study, which examines the relationship between firm growth, size and age of manufacturing enterprises in the US. This relationship can be specified as:

$$G = f(CA_{t'} S_t) + u_t \qquad (1)$$

Where:

G = a growth function

A = the age of the enterprise

S= the size of the enterprise, in this study measured by the number of employees

t=start-up year or first year of operation

t'=1999 (year when the MSE survey was conducted)

u_t = is the error term

The model (1) can therefore be expanded, taking non-lineality by including the squares of size and age. The interaction term (lnsize * lnage) is also included to access the joint effect of age and size of the MSE on growth. The age and size variable will be in log form (Evans, 1987).

[12] Bigsten et al (1999) use a similar measure of firm growth given as log (L_t/L_{t-1}) where L=No. of workers and t=the measurement period.

The dependent variable is given as the difference between the logarithm of firm size in 1999 (the time of survey) and when the firm started, or was acquired (Briy and Kohaut, 1999).[12]

The model (1) can further be developed by including other explanatory factors summarized in Figure 4 derived from theoretical and empirical literature reviewed earlier. This yields a growth model of the form:

Firm growth=f(size, age, sex of owner, formality of the enterprise, business linkages, education level of MSE owner, secto, capital) (2)

The estimated equation is therefore given as follows:

$$Growth = \beta_0 + \beta_1 \, lnsize + \beta_2 \, lnage + \beta_3 \, (lnsize)^2 + \beta_4 (lnage)^2 + \beta_5 (lnsize*lnage) + \beta_6 \, dfemown + \beta_7 dbusreg + \beta_8 dsubcont + \beta_9 deduc + \beta_{10} \, dservice + \beta_{11} lncapital + \mu \quad (3)$$

Where:

- *growth* is employment growth given asthe difference between logarithm size of the enterprise as of the time of the survey and the size of the time the business started or was acquired ($lnS_{t'}$-lnS_t.
- *lnage* is the natural log of the age of the enterprises representing the number of years the enterprise has been in operation.
- *lnsize* is the natural log of the initial size of the enterprise representing the initial number of employees at the start of business.
- *dfemown* is a dummy variable representing the sex of the MSE owner where 1 is for female owner(s) and 0 male.
- *dbusreg* is a dummy variable indicating whether or not the MSE has a business registration, where 1 is for registered business and 0 for no business registration.
- *dsubcont* is a dummy variable denoting whether or not the MSE sub-contracts for inputs, orders, products or services from MSEs, non-MSEs, farmers and the government, where 1 is for sub-contracting and 0 for those that do not sub-contract.
- *deduc* is a dummy variable representing the level of education of the MSE owner where 1 is MSE owner with at least secondary school education and 0 otherwise.

- *dservice* is a dummy variable representing the sector the business operates in, where 1 is MSEs operating in the services sector.
- *lcapital* is the natural log of the total capital injected into the MSE.

4.2 Data

The data used is obtained from the 1999 National Micro and Small Enterprise Baseline Survey conducted by the Central Bureau of Statistics (CBS) in collaboration with the International Centre for Economic Growth (ICEG) and K-Rep Holdings Kenya. The cross-sectional dataset consists of 1,945 micro and small enterprises, which were obtained using a detailed structured questionnaire applied to a sample of households in 37 districts in Kenya to capture different economic activities. The dataset contained detailed information but was mainly descriptive. Therefore, dummy variables are created to represent the important qualitative variables. Apart from capital, age and size, the five other independent variables were entered as dummy variables, which are used to represent important non-quantitative variables. The data used was collected in 1999 and may, therefore, not be representative of the situation but is the most comprehensive dataset available to date.

5. Results and Discussions

Approximately half of the MSEs are female-owned, while less than 6 per cent of MSEs sub-contract. Annex Table 1 and 2 present more summary statistics of the variables. Diagnostic tests (detailed in Annex Table 4) were carried out on the data and the model. The tests suggest that multicollinearity was not present. Moreover, the correlation matrix in Annex Table 3 suggests that there is no strong correlation between the independent variables. The Breush-Pagan test for heteroskedasticity was applied on the results (Annex Table 4), and the constant variance null hypothesis was rejected, indicating that the assumption of homoskedasticity was not fulfilled. To contain the heteroskedasticity, robust regression was run. The results of the robust regression analysis are presented in Table 5.1 below.

From the results summarized in the above table, MSEs that have the following characteristics were found to have a significant determinant of growth:

- That have registered their business

Table 5.1: Regression results

Variable	Coefficient	t
Initial Size (lnsize)	0.2601992**	-2.33
Age (lnage)	- 0.004757	0.06
$(\text{lnsize})^2$	0.139475	-1.59
$(\text{lnage})^2$	0.0058117	-1.40
Interaction term (lnage*lnsize)	- 0.0078006	-0.24
MSEs owned by a female or female partner	- 0.0610839**	-2.49
MSEs with a business registration	0.2026407***	4.33
MSEs that sub-contract	0.1434818**	2.20
MSE owners with at formal education	0.0589538**	2.57
MSEs in the service sector	0.0893307*	1.92
Capital	0.0307131***	4.59
Constant	- 0.0889129	-1.52
Number of observations		1586
R^2		0.2043
***Significant at 1% **Significant at 5% *Significant at 10%		

- That sub-contract
- Operating in the services sector
- Whose owner has at least secondary school education.

On the other hand, MSEs owned by females and those that start large are most likely to experience declining growth.

5.1 Age and Size of the Enterprise

The initial size of the firm is significant and inversely related to growth. This confirms the findings of the study by Liedholm (2001), which found that smaller enterprises during starting up tend to grow faster than the other bigger firms. This result contradicts Gibrat's Law, which stated that firm growth is not dependent on the initial size of the firm. The effect of the age of the enterprise on growth is insignificant, contrary to other studies of business in developing countries, which show that younger firms are more likely to grow.

5.2 Sex of the Entrepreneur

The results reveal that female-owned enterprises are growing less. The National MSE Baseline Survey (1999) indicates that 47.7 per cent of the enterprises are female-owned, 74.7 per cent of which operate in trade. This could be an important statistic in explaining the lower growth of female-owned enterprises as the literature reviewed indicates that retail traders are least likely to survive. Looking at more statistics, we find that only 3.7 per cent of the MSEs registered by the Registrar of Companies were female-owned. Additionally, women face more constraints than men when it comes to business, especially due to limited access to education, finance and land. From the data, we find that of the MSEs surveyed, only 27 per cent of those that had capital of Ksh 10,000 and over were female-owned. Further, women usually have more family commitments and responsibilities compared to men, which may lower their productivity in business.

5.3 MSEs with a Business Registration

MSEs with a business registration are likely to grow more, yet only 13 per cent of MSEs surveyed have a business registration. MSEs that have their business registered by the Registrar of Companies are legal entities, which are recognized formally. They, therefore, have improved access to finance, water, electricity, worksites and other services that are important for growth of enterprises. Informal enterprises, on the other hand, face problems due to their lack of legal status, including problems with access to credit, land and social or public goods or services. They may also come into problems with the local authorities, which could affect their operations and productivity.

5.4 Partnerships and Networks

Forming partnerships and networks through sub-contracts was found to be an important contributor to the growth of MSEs. Sub-contracting creates linkages and partnerships that are important for transferring skills, knowledge and technology, which would enhance productivity and improve quality of MSE products, hence promoting competitiveness. MSEs partnering with each other can also transfer information, experiences and skills between themselves. At the moment, less than 6 per cent of MSEs sub-contract and the ones that do, do so with other MSEs. Only 0.3 per cent of the purchases made to MSEs came from the government. Currently, the MSE sector that benefits the most from sub-contracts, tenders or other partnerships are *Jua Kali* furniture makers who manufacture and supply furniture to households, the private sector and the government. Sub-contracting would improve market access and fill market demand for goods or services required by other larger enterprises.

5.5 Education Level of Owner

Results reveal that there is a significant positive relationship between the growth and the level of education of the MSE owner. Owners with higher levels of skills are more beneficial to the MSE.

5.6 Business Sector

According to the results, MSEs operating in the services sector are more likely to achieve growth. This is an interesting finding given that the labour market in Kenya is largely labour-intensive. Additionally, MSEs benefit from low labour costs.

5.7 Capital

Capital was found to have a positive impact on the growth of MSEs. Lack of capital had been a major problem facing MSEs, with majority (89.6%) of them having not received any form of credit and 88.6 per cent of them sourcing their initial business capital from family, friends and their own contributions. The 1999 National Micro and Small Enterprise Baseline Survey reported that lack of collateral for credit is one of the major constraints being faced by MSEs in Kenya.

5.8 Growth-Oriented and Survivalist Enterprises

The distinction between growth-oriented and survivalist enterprises, according to literature, was summarized in Table 2. It is now possible to test the contents of Table 5.2 from the findings of this study using the 1999 National Micro and Small Enterprise Baseline Survey data. The findings reveal that growth-oriented enterprises are registered, have capital and have owners with formal education, which is in accordance with literature. A further discovery is that growth-oriented enterprises sub-contract and participate in marketing, as summarized in the table below.

Table 5.2: Characteristics of growth-oriented enterprises in Kenya

Description	Growth-oriented enterprise
Initial size of the firm	Starts small
Legal form	Is registered with relevant authorities
Ownership	Solely female-owned enterprises tend to achieve negative growth
Business contracts and linkages	Sub-contracts for inputs and orders
Education level of owner	MSE owner had formal education (at least secondary school education)
Business sector	Service Sector
Capital base	Has a high capital base

Source: Author's compilation

6. Conclusions and Recommendations

6.1 Conclusions

The aim of the study was to establish the factors affecting growth of MSEs in Kenya in order to identify mechanisms and structures for ensuring growth of enterprises. This is especially important in ensuring that resources are utilized efficiently to achieve national development goals. Well developed MSEs can create employment opportunities, lead to industrial development and innovation, reduce poverty reduction and ensure economic growth, while providing inexpensive quality goods and services to local, regional and international markets.

The study established that the factors affecting MSEs' growth in Kenya include the legal status of the enterprise, where those that had a business registration grew more than those that did not. Sub-contracting has a positive effect on growth of MSEs, while those owned by women were found to be less likely to grow. An interesting finding, which can make an important contribution to employment creation opportunities, is that enterprises that start small, that sub-contract and in the services sector have a positive impact on the growth of MSEs. Lastly, the findings also confirm that MSEs with capital and a more educated owner achieve more growth.

The study established that MSEs in Kenya are very heterogeneous and face different problems, have different needs, and make different contributions to the economy. Growth-oriented enterprises participate in viable activities that make a contribution to economic growth and development. Survivalist enterprises participate in subsistence, low value adding activities, and provide low quality goods and services, thus having low growth potential. It is important for the government to clearly define the MSE sector and ensure that policies are targeted. Further, there is need to make a distinction between enterprises with growth potential and those that are survivalist when it comes to policy formulation and distribution of resources. This is because their needs and requirements differ. For instance, there are some enterprise owners who may not want to grow and are comfortable with their size. Such enterprises may not use the resources allocated to them effectively. Policies should, therefore, be developed to target the appropriate enterprise group to ensure that scarce resources are used effectively.

6.2 Recommendations

The following policy recommendations could be considered to encourage the growth of MSEs.

Empower women entrepreneurs: Women have an important role to play in the economy but they face many obstacles in running a business. The government should, therefore, support women entrepreneurs further to enable them access credit, access education, access land and worksites while addressing other factors that may discriminate against women entrepreneurs. The Department of Micro and Small Enterprise Development (DMSED) should strengthen collaboration with Department of Gender in the Ministry of Gender, Sports, Culture and Social Services and other relevant stakeholders, such as women self-help groups, to address issues and concerns unique to women entrepreneurs. The Women Enterprise Fund and other similar sources of finance for women should also include a component of capacity building in order to support women in entrepreneurial initiatives.

Business registration: The government should reduce red tape, time and costs to registering a business. The government should also hasten the computerization of the Registrar of Companies' office and the decentralization of the business registration process. Currently, businesses can register only in Nairobi with the Registrar of Companies, which means that businesses located outside Nairobi bear additional compliance costs brought about by having to travel to Nairobi to register.

Promoting partnerships and linkages: Forward and backward linkages and partnerships with the private sector, development agencies and the government should be encouraged through sub-contracts and tenders. This could include purchase orders by local, regional and international markets for locally manufactured products such as ceramic jikos, hurricane lanterns, local handicrafts, apparels, accessories and other local products. Sub-contracting is beneficial because it would improve the quality and standards of goods and services. Large companies should also be encouraged to sub-contract certain services to MSEs. The Sessional Paper No.2 of 2005 suggests that incentives should be put in place to encourage partnerships with the MSE sector, one of which mandates the government to allocate 25 per cent of its procurement requirements to MSEs. However, the mechanisms and modalities for the incentives for partnerships with the private sector are not well spelt out. The incentives should be formulated and institutionalized to encourage business partnerships and linkages. Apprenticeships, internships and mentorship programmess between larger or more experienced enterprises or industry should be encouraged. The government and the private sector should continue striving to form partnerships with MSE operators. Examples of such partnerships include the Coca Cola shipping containers used by Coca Cola wholesalers, the Coca Cola Kiosks, or the Safaricom and Celtel booths observable throughout Kenya.

Level of education: Given that education of the MSE owner has a positive effect on the growth of the enterprise, it is important for schools and universities to be encouraged to impart entrepreneurial skills and knowledge to the students. Continued training and technical assistance should also be provided to entrepreneurs.

Business sector: Kenya's services sector is an important and growing sector, especially the tourism sector. However, a number of sub-sectors such as business process outsourcing (BPOs) are emerging, where investments are increasingly being made in labour-intensive industries such as call centres. The government should continue encouraging the growth and development of such industries locally as there is a lot of potential growth. Businesses locally and internatinally are increasingly opting to outsource certain processes to firms that have the relevant skills in order to improve overall efficiency.

Access to capital: Supply of credit to MSEs has been increasing with the emergence and growth of micro finance institutions (MFIs), which have improved entrepreneur's access to capital. The MFIs should be encouraged to provide integrated financial advice and business advisory services to ensure that the credit is utilized properly.

Business support services: The DMSED should take a central role in supporting and coordinating business support and technical services provided to MSEs. This would encourage the growth and expansion of MSEs by improving their access to land, capital, inputs, markets, information (for instance on intellectual property rights, international trade requirements) and technology. One important function of such business support services would be to provide access to suitable worksites and in a planned and coordinated manner. Business support centres should encourage the development of small scale formal enterprises by providing special tax reductions or subsidies, providing raw materials and conducting research on behalf of MSEs, as is the case in India and Japan. This would lower production and operation costs. The business support centres should have resources and should be located at the district level to offer direct essential services to cater for the specific needs of enterprises. Countries such as Japan have decentralized business support services for small and medium enterprises.

6.3 Issues for Further Research

It is important to understand the problems facing growth-oriented and survivalist enterprises at the different stages within the firm cycle. Such a study would be very useful in assisting policy makers in understanding the different needs for the different types of enterprises at their different stages of maturity. Secondly, since 1999, there have been several changes that may have impacted on MSEs growth. These include advancements in information and communication technology, such as mobile telephones and the Internet. It would be important to assess, using up to date data, the impacts of such factors on MSEs' growth.

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Annex

Annex 1: Summary Statistics

Variable	Observations	Mean	Std. Dev	Min	Max
growth	1857	.1331863	.500184	-2.99	3.61
lnsize	1871	.1729189	.4043179	0	3.61
lnage	1910	.9718664	1.405267	-2.30	4.38
(lnsize)2	1871	.1932866	.7065873	0	13.03
(lnage)2	1910	2.918267	2.990375	0	19.20
lnsize*lnage	1843	.1860762	.7381485	-3.71	7.07
dfemown	1878	.498935	.500132	0	1
dbusreg	1868	.132227	.3388281	0	1
dsubcont	1749	.0520297	.2221505	0	1
deduc	1894	..436114	.4960328	0	1
dservice	1945	.1321337	.3387231	0	1
lncapital	1805	8.471539	2.207943	2.30	18.29

Annex 2: Tabulation of Dummy Variables

Dummy	Variable	Frequency	%
dfeown	0	941	50.11
	1	937	49.89
dbusreg	0	1,621	86.78
	1	247	13.22
dsubcont	0	1,658	94.80
	1	91	5.20
deduc	0	1,068	56.39
	1	826	43.61
dservice	0	1,688	86.79
	1	257	13.21

Annex 3: Correlation matrix

	growth	lnsize	lnage	(lnsize*lnage)	$(\text{lnsize})^2$	$(\text{lnage})^2$	dfemown	dbusreg	dsubcont	deduc	dservice	lncapital
growth	1.0000											
lnsize	-0.3146	1.0000										
lnage	0.0353	0.0252	1.0000									
lnsize*lnage	-0.1887	0.6362	0.3301	1.0000								
$(\text{lnsize})^2$	-0.3348	0.8713	0.0295	0.5844	1.0000							
$(\text{lnage})^2$	-0.0001	0.0087	0.5001	0.1891	-0.0052	1.0000						
dfemown	-0.0855	-0.2068	-0.1356	-0.1549	-0.1306	-0.0760	1.0000					
dbusreg	0.1628	0.1686	0.0785	0.1729	0.1377	0.0392	-0.1680	1.0000				
dsubcont	0.0719	0.0819	0.0131	0.0709	0.0650	-0.0302	-0.0758	0.1136	1.0000			
deduc	0.1124	0.0941	-0.0508	0.0653	0.0582	-0.1423	-0.1334	0.1865	0.0460	1.0000		
dservice	0.0869	0.0991	0.1307	0.1207	0.0686	0.0891	-0.1835	0.1570	0.0183	0.0350	1.0000	
lncapital	0.1509	0.2481	0.2983	0.2646	0.1899	0.2265	-0.3697	0.3849	0.1058	0.2964	0.2263	1.0000

Annex 4: Diagnostic tests

4.1 Heteroskedasticity

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of growth

$chi^2(1) = 50.24$

$Prob > chi^2 = 0.0000$

Explanation: The Breusch-Pagan test will detect any linear form of heteroskedasticity. Since the p-value is <0.05, we reject the null hypothesis of constant variance. Therefore, there is heteroskedasicty. A robust regression was run to contain the heteroskedasticity.

4.2 Muticollinearity

Variable	VIF	1/VIF
lnsize	4.95	0.202015
$(lnsize)^2$	4.24	0.235591
(lnsize*lnage)	2.05	0.488934
lncapital	1.62	0.616450
lnage	1.59	0.628343
$(lnage)^2$	1.40	0.714413
dbusreg	1.21	0.827377
dfemown	1.21	0.829571
deduc	1.17	0.855371
dservice	1.08	0.924481
dsubcont	1.02	0.975803
Mean VIF	1.96	

Explanation: The variance inflation factor (VIF) values are less then 10 and the 1/VIF values are over 0.1, which indicates there is no collinearity. Therefore, there is no risk of multicollinearity.

Annex 5: Small scale industries in India

Estimated No. of units	3.57 million	12.3 million
Employment	19.96 million	26.5 million
Share in industrial value added	39%	
Share in total exports (overall)	34%	34%
Total number of items produced	Over 8000	
Number of reserved items	675	
Figures for the years	2002-2003	2005-2006
Size of small scale industries in India	Employing 6-9 workers	

Source: http://www.smallindustryindia.com and World Bank (2007)

Annex 6: Small and medium scale industries in Japan

Estimated No. of units	4.69 million (99.7% of all enterprises)
Employment	29,960 thousand (70.2% of all employed persons)
Value of exports in manufacturing	137,776 (51.1%)
Figures for the year	2002
Size of Small and Medium Industries	Employing 4-299 workers

Source: http://www.chusho.meti.go.jp and World Bank (2007)

Annex 7: Micro and small scale industries in Peru

Percentage of MSEs in Peru	98.3% of all enterprises
Employment	75.9% of total employment
GDP contribution	42.1%
Figures for the year	1997
Size of Micro and Small Scale Industries	Employing 1-50 workers

Source: Tarmidi, L (2005) and World Bank (2007), World Bank

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