

CONTRACT DISCIPLINE

THE CASE OF SMALL SCALE MANUFACTURING
ENTERPRISES IN NAIROBI

By

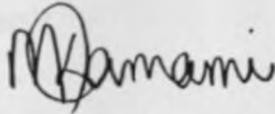
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A Management Project Submitted in Part Fulfilment of the Requirements
for the Award of the Master of Business Administration (MBA) Degree
of the University of Nairobi

July, 1998

This Management Project is my original work and has not
been presented for a degree in any other university.



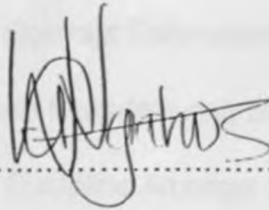
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I. Introduction

KAMAMI CHRISTINE MICHIRA

II. Literature Review

This Management Project has been submitted for examination
with my approval as university supervisor.



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MS. CATHERINE NGAHU

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Acknowledgements

The MBA programme has been a long and difficult journey, the successful completion of which has been the result of support and encouragement from many quarters. To all the people who have given me support, I would like to say a heartfelt thank you.

I would specifically like to thank the University for giving me a scholarship; My lecturers, particularly Dr. Wainaina and Julius Kipnetich who went out of their way to create a conducive learning atmosphere and who gave us a lot of encouragement; My supervisor, Ms Ngahu, for her guidance throughout the management project and particularly for sharing with me her considerable experience in qualitative market research which proved invaluable in the data collection and analysis stages. My appreciation also goes out to K-REP staff particularly Kimanthi Mutua, AleKe Dondo, Stephen Mirero, Oloo Oketch, Carol Kudwoli, Beatrice, Muthama, Roseline and Banda for their assistance. Very special thanks to my aunt Harriet for her never-ending support and encouragement.

Asante sana and godspeed to the MBA Class of '98 and especially my study group, Apaka and Osewe who provided the challenge that kept me going when the going got tough.

I would like to say a heartfelt thank you to my family for both moral and financial support. A special thank you to my Mum for constantly providing me with a shoulder to cry on and to Carol and all her friends who made my two-year stay in Lower Kabete bearable.

Finally, to Patrick, my best friend, thank you for everything.

Abstract

Small scale enterprises are generally viewed as lacking contract discipline in terms of the quality of products, meeting of deadlines and cost. This negative perception of the enterprises as lacking respect for contractual obligations deters people from doing business with these firms, limiting their stability and growth.

This study sought to examine this view with regard to small scale manufacturing enterprises in Nairobi to identify the possible causes of the indiscipline. Not much research has been conducted in this area and little is known about the subject. The study was thus exploratory in nature. Data was collected from small scale manufacturing enterprises as well as their customers by way of in-depth interviews using questionnaires. The data collected was then analysed at three levels. The first level involved a summary of the main characteristics of the enterprises sampled, to provide background information on the enterprises. At the second level, the data was analysed in terms of the three issues of quality, cost and deadlines. The final analysis comprises the reactions of the customers of the small scale enterprises to the three issues.

Both the small scale enterprises and their customers readily admitted to problems in contract discipline with regard to the three aspects of quality, cost and deadlines. However their reaction to the causes and effects of the indiscipline were varied. The enterprises largely blamed economic hardship – what many described as a hand to mouth existence, limited education, lack of practical training and myopia on the part of the proprietors.

All the customers interviewed reported at least one negative experience in their dealings with small scale enterprises. They attributed the inability of the enterprises to meet their contractual obligations to lack of appropriate training, laxity, and greed. They all confirmed that the indiscipline on the whole made them hesitant in dealing with the small scale enterprises. Many admitted that they only went to the enterprises when they had no alternative or when the transaction was not crucial and they could afford the luxury of something going wrong.

CHAPTER 1

INTRODUCTION

1.1 Background of the study

Small scale enterprises are emerging as a salient element of African development because of their potential in both employment and productivity. These enterprises account for 60 per cent of the urban labour force in sub-Saharan Africa and contribute 20 per cent in GDP.¹ Specifically, small scale enterprises are important in that they:

- make a significant contribution to the economy in terms of output of goods and services
- enable the creation of jobs at a relatively low capital cost, especially in the fast growing service sector
- aid in the development of a pool of skilled and semi-skilled workers who are the base for future industrial expansion at low cost to society
- strengthen forward and backward linkages among socially, economically and geographically diverse sectors of the economy
- create demand as well as supply, as it has been established that 90 per cent of

¹ United Nations Office of the Special Coordinator for Africa and the Least Developed Countries, 1994, p. 1.

the products from rural small scale enterprises are marketed directly to rural households

- contribute to increased participation of indigenous Kenyans in the economic activities of the country

- offer excellent opportunities for entrepreneurial and managerial talent to mature, the critical shortage of which is often a great handicap to economic development

- support industrialisation policies that promote rural-urban balance
- increase savings and investment by local Kenyans; and
- encourage better use of resources as they are often more efficient in total resource use than larger enterprises.² They utilise lower levels of investment and less demanding skills, and handle relatively simpler products. As the majority have their root in traditional activities, they also make use of resources that may otherwise not be drawn into the development process.³

Despite their importance in development, these enterprises face myriad problems.

The major problems afflicting them⁴ include a weak policy environment, inadequate infrastructure; insufficient institutional support; lack of access to appropriate technology; insufficient training of human capital; lack of access to

2 United Nations Office of the Special Coordinator for Africa and the Least Developed Countries, 1994, p. 5.

3 Government of Kenya, 1992, p. 2.

4 The problems afflicting small scale enterprises have been addressed in numerous writings. Examples are Abuodha, C., 1996; Gichira, 1991; Mc Cormick, 1992b; Ongile and Mc Cormick, 1996.

credit; and the negative perception that the enterprises do not meet customer requirements particularly in terms of the quality of products, deadlines and cost. Consequently, these enterprises are unable to grow and remain stuck at the lower end of the economic stratum.

1.2 The Research Problem

If small scale enterprises are to realise their full potential as a means of accelerating development, the problems afflicting them must be extensively researched and addressed. To date, some of the major problems such as those pertaining to access to credit, appropriate technology, and the policy environment have been well researched and the relevant recommendations made. However, little research has been conducted on the issue of meeting customer requirements.

Meeting customers' requirements is critical to the success of any commercial undertaking. By satisfactorily meeting customers' needs, enterprises are able to hold their existing customers and attract new ones. This enables them to become viable entities, producing profits which are sufficient to enable the owners to expand the business.

Customer needs are ordinarily expressed through contracts which form the basis of most transactions in commerce and industry. For trade to thrive thus, businesses must have contract discipline, that is, consistently honour their contractual obligations. The perception that a business lacks respect for contractual obligations can seriously curtail its access to markets and in so doing constrain its growth and long term viability. It has long been established that small scale enterprises are perceived as lacking contract discipline, specifically in terms

of the quality of the products, meeting of deadlines and cost. This negative perception makes people reluctant to deal with these enterprises, undermining their stability and constraining their growth.

This study seeks to identify the possible causes of contract indiscipline in terms of meeting deadlines; achieving the required quality standards and; working within the established budgets amongst small scale manufacturing enterprises. The study focuses on the manufacturing subsector because of its potential for

economic development⁵ and because the products in this sector are tangible making indiscipline easier to establish.

1.3 Objective of the Study

The purpose of the study is to explore the issue of contract discipline amongst small scale manufacturing enterprises. Specifically, the study aims to identify possible causes of the indiscipline.

1.4 Significance of the Study

The study will highlight the problem of contract indiscipline as a serious issue in the stability and growth of small scale manufacturing concerns. In doing so, it will bring into focus a problem that has not been addressed previously. Specifically, the study will be of value to:

- The government and which can then take note of this problem in its efforts to assist small scale enterprises achieve their full potential.

⁵ Daniels et. al., 1995, p.15.

- Organizations involved in the development of small scale manufacturing enterprises such as Non Governmental Organisations (NGOs), development agencies who can then assist the enterprises address these shortcomings and in so doing promote their growth.
- Small scale manufacturing enterprises which will be sensitised to the importance of business predictability through contract discipline. These enterprises can then take the necessary steps to address the problem.

1.5 Overview of the Report

The project report will be presented in five chapters.

The report starts off with the introduction which gives a background of the study, states the research problem, the objective as well as the significance of the study. A review of the literature relevant to the study is contained in chapter 2. Chapter 3 describes the research design to be applied in the study including the selection of the study units, methods of data collection and analysis while the results of data analysis and the findings of the study are presented in the subsequent chapter. The final chapter presents the conclusions, recommendations and limitations of the study and makes suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Contract Discipline

Contracts form the basis of most transactions in commerce and industry. They spell out the obligations governing each party to the transaction. For trade to prosper, businesses must consistently fulfil their obligations, that is, honour the contracts they enter into. Contract discipline refers to the consistent honouring of contractual obligations.

2.1.1 Essential Elements of a Contract

A contract is defined as an agreement between two or more legal entities giving rise to legal obligations.⁶ It is a long established common law principle that contracts need not take a particular form.⁷ They may be oral or written. The basis of a legally binding contract is the agreement between the parties to the transactions. However, to be valid, a contract must have the five essential elements. These are:

- **Consensus ad idem**: Roughly translated, this means 'a meeting of the minds'. For a contract to subsist, the parties to the contract must be of one mind. This is achieved through offer and acceptance. A contract is thus legal where a

6 Furmston, 1986, p. 27.

7 Furmston, 1986, p. 27.

definite offer is made and that offer is subsequently unconditionally accepted.⁸

The offer may be oral or in writing, subject to statutory requirements as to form.⁹ It may include conditions so long as reasonable notice of their existence is given to the offeree. Acceptance of an offer must be unconditional. The attachment of conditions to acceptance amounts to a counter-offer which the original offeror is at liberty to accept or reject.¹⁰ Secondly, it must be communicated to the offeror. An offer can be terminated by revocation or lapse of time. To amount to a legal termination, revocation must occur before the offer is accepted and it must be communicated to the offeree.

- **Legal Intention:** That the agreement should give rise to legal obligations must be the specific intention of the parties. This is because, agreements are made daily in domestic and social life, where the parties do not intend to invoke the assistance of the courts should the engagement not be honoured. Thus in *Balfour v Balfour*,¹¹ a wife who sued her husband for failing to make periodical payments for her maintenance as agreed upon was held not to have a cause of action as this was solely a domestic agreement not intended to have legal consequences.

8 Offers must be distinguished from invitations to treat. An invitation to treat is an invitation to make an offer. A good example of this is tendering where a company invites interested parties to tender for supply of goods and services.

9 Cheshire, Fifoot and Furmston, 1986, p. 28.

10 In *Hyde v Wrench* [1840] 3 Beav 334, the defendant offered to sell his farm to the plaintiff for 1,000 pounds. The plaintiff accepted to buy the farm but offered the sum of 950 pounds instead. The defendant declined. The plaintiff then offered to pay 1,000 pounds which the defendant similarly declined. In a suit for specific performance or damages, it was held that the plaintiff could not succeed as his offer of 950 pounds amounted to a counter offer and effectively terminated the original offer by the defendant.

11 [1919] 2 KB 571.

Whether the intention to create legal relations exists is determined from the specific circumstances of the transaction in question.¹² Commercial agreements are as a general rule presumed to give rise to legal obligations.

- **Consideration:** In *Currie v Misa*, consideration was defined as:

[S]ome right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.¹³

More simply, it has been defined as the act or promise offered by the one party and accepted by the other as the price of that other's promise.¹⁴ It may be executory, where a promise is made in return for a counter-promise; or executed where the promise is made in exchange for the performance of an act.¹⁵

Consideration must be real, that is, it must have some real value. At the same time, it must move from the promisee. This means that one can only enforce a contract if consideration has been given; and further that the consideration must have been supplied by other contracting parties and not by a stranger to the contract. This requirement forms the basis of the doctrine of privity.¹⁶

12 In *Simpkins v Pays* [1955] 3 All E.R. 10, three persons informally agreed that they would contribute towards the expenses of entering a newspaper competition and to share the prize in the event that they won. Therefore, although the entry was in the name of one of them, it was held that the others were entitled to one-third each of the prize.

13 [1875] LR 10 Exch. 153.

14 *Price v Easton* [1833] 4 B & Ad 433.

15 Where a promise is made in return for an act which has already been performed prior to the contract without the expectations of the contract, this is referred to as past consideration. Past consideration is not considered to be consideration for legal purposes.

16 The doctrine states that, as a general rule, the only people who have a right to sue on a contract are the parties to the contract. Thus, even where a contract benefits a third party, the third party cannot legally enforce the contract.

Consideration must be lawful. It must not be something that the promisor is already legally bound to do. A contract entered into by a police officer to apprehend a robber for instance cannot be enforced.

- **Capacity:** For a contract to be legally binding, the parties to the contract must have the capacity to contract. Generally, any person may enter into any kind of contract. However, certain groups of persons such as minors, persons of unsound mind, married women, aliens and corporations are governed by special rules with regard to their capacity to contract.¹⁷
- **Legality:** Illegality negates the validity of a contract. This is based on the maxim, *ex turpi causa non oritur actio* meaning that no cause of action can arise upon a wrongful ground.

Illegality may be criminal or *contra bonos mores* that is, against public morality. In the former, contracts are rendered void by the law—such as contracts in restraint of trade.¹⁸ In the latter, contracts are deemed to be illegal as they prejudice the social or economic interests of the community, that is, they are contrary to public policy. Examples of such contracts are contracts that pervert the cause of justice, contracts contrary to morality, contracts to defraud public revenue, etc.

2.1.2 Breach of Contract

Breach of contract occurs when any of the terms of a contract are not honoured.

¹⁷ The only contracts that can be enforced against minors for example are contracts for necessity.

¹⁸ Contracts in Restraint of Trade Act, Chapter 24 of the Laws of Kenya.

The terms of a contract define the extent of the obligations that the contract creates. Based on their relative importance, they fall into two categories namely, conditions and warranties.

A condition is a term which goes to the root of the contract. Where a condition has been breached, a party can repudiate the contract and sue for damages.¹⁹ A warranty on the other hand is a term that does not go to the root of the contract. It entitles the aggrieved party to damages but not to repudiation of the contract.²⁰

It is primarily for the parties to set their own value on the terms that they impose upon each other. As such, in determining what is a condition and what is a warranty, the court is influenced not only by the language of the instrument, but also by the circumstances under which and the purposes for which the contract was entered into.²¹

The terms of a contract can be expressly agreed upon and reduced into writing. They may also be implied. Implications may be derived from statute or custom. The Sale of Goods Act for example states that in contracts for the sale of goods, the condition that the seller has the right to sell the goods is implied.²² Terms may

19 In *Poussard v Spiers* [1876] 1 QBD 410, an actress contracted to play in an opera. She was unable to perform for the first week due to illness. The contract was repudiated and a substitute was engaged instead. The actress brought a suit for damages, claiming breach of contract. It was held that the lapse of time amounted to a breach of condition which entitled the producers to repudiate the contract.

20 In *Bettini v Gye* [1876] 1 QBD 183, a singer was contracted for a whole season. It was also agreed that she would appear for rehearsals six days in advance of the actual performance. Instead, she appeared only three days in advance. The court held this to be a breach of warranty which only gave rise to an action for damages.

21 *Williams J in Behn v Burness* [1863] 3 B & S 751.

22 Section 14(1), Chapter 35 of the Laws of Kenya. This is in line with the principle *Nemo dat quod non habet* meaning that one cannot give what one does not have.

also be implied by custom because. This is because contracts are not isolated acts. They occur in the conduct of business or in the framework of some relationship such as that of landlord and tenant. They are set against a background of usage, familiar to all who engage in similar negotiations. Baron Parke in the case of *Hutton v Warren* observed that:

It has long been settled, that, in commercial transactions, extrinsic evidence of custom and usage is admissible to annex incidents to written contracts . The same rule has also been applied to contracts in other transactions of life, in which known usages have been established and prevail.²³

Terms may also be implied by the courts. Courts will for example consider it to be a condition implicit in a contract for the lease of a furnished house that such a house shall be reasonably fit for habitation at the date fixed for the beginning of the tenancy.

2.1.3 Contract Enforcement

Contractual obligations cannot and are not respected unless economic agents are both able and willing to comply with the obligations. Ability is enabled by the prevailing economic environment in which the enterprise is operating. Willingness on the other hand is the result of the existence of enforcement mechanisms that penalise breach. Enforcement mechanisms are numerous but stem from three main premises, namely:

- **Guilt:** This affects persons of an honest nature, the result of the combined effects of upbringing, cultural values and religious beliefs. Consequently, it

²³ [1836] 1 M & W 466.

varies with societies and even with individuals.

- **Coercion:** This may be either legitimate or illegitimate. Legitimate coercion stems from the state's monopoly over legitimate force. It is achieved by way of the established legal machinery, usually the court system. Illegitimate force refers to tactics like insults, threats and violence, either directly or by use of hired thugs. Coercion, legitimate or otherwise is costly and will be resorted to when all else has failed.
- **Quid pro quo:** This is a latin phrase meaning 'I do as you do'. The threat of retaliation induces compliance with contractual obligations. Such a mechanism works where parties interact repeatedly over time. In its simplest form, it involves refusal to further transact. It can become even more intricate where the information about non-compliance is circulated to other prospective customers who similarly refuse to transact any business with the enterprise. This can be very damaging to an enterprise as it will not only be unable to hold existing customers, it will also be unable to attract new ones threatening its stability and growth.

2.2 Small Scale Manufacturing Enterprises

Small scale enterprises exist in most regions of the world. In Africa, they are deeply rooted in customs and culture and are engaged in a wide range of activities. This heterogeneous nature of the enterprises makes it difficult to define them. An apt definition is made even more difficult by the fact that 'small' is a relative concept -- what may be considered to be small in one region, country or even community may be considered to be large in another.

Consequently, many measures including total assets; number of employees; sales turnover or a combination of the above have been used to define 'small'. For purposes of this project, we shall employ the definition provided by the Government of Kenya which defines small scale enterprises as all enterprises employing between one and fifty workers.²⁴ This definition is preferable as employment is a simple concept that is relatively easy to measure accurately and it is a readily available indicator of comparative size.

Manufacturing on the other hand is defined by the United Nations as:

The mechanical or chemical transformation of inorganic or organic substances into new products whether the work is done in a factory or in the worker's home, and whether the products are sold at wholesale or retail.²⁵

SSMEs are thus enterprises employing between one and fifty people that are engaged in the transformation of inorganic or organic substances into new products.

Although highly heterogenous, small scale manufacturing enterprises have some distinct characteristics.²⁶ The majority are privately owned and are organised as sole proprietorships. Most use technology that is labour intensive, and employ workers with limited formal training. They require modest start-up capital and often make use of resources that may otherwise not be drawn into the production process.

24 Government of Kenya, 1992, p. 1.

25 United Nations, 1994, p. 10.

26 Aleke-Dondo, 1990, pp 3-5.

Hence, small scale manufacturing enterprises play an important role in the development process. They are a source of employment and income as well as skills, knowledge and new entrepreneurial talent. They also ensure the efficient use of scarce economic resources. There is strong evidence that they save capital and foreign exchange and produce greater value added per unit of capital than larger firms.²⁷

Given their importance in development, it is not surprising that there is a considerable amount of both theoretical and empirical literature in existence addressing various aspects of small scale manufacturing enterprises in Nairobi.

The importance of small scale manufacturing enterprises was underscored in the 1995 Gemini Baseline Survey on Small and Micro-Enterprises.²⁸ This study addresses issues such as the contribution of small scale enterprises to employment and income as well as the problems and constraints faced by the entrepreneurs. The study concludes that manufacturing contributes 37 per cent of the total contribution by small scale industries to GDP; and 34.5 per cent of total contribution to employment.

On the problems faced by the entrepreneurs, access to credit is given as the most pressing problem followed by access to markets. The latter is simply described as by the enterprises as 'not enough customers'. No elaboration is provided on this.

Obuon²⁹ discusses a wide range of background issues regarding SSMEs including

27 Aleke-Dondo, 1990, pp 3-5.

28 Daniels, et. al., 1995.

29 Obuon, 1990.

the distribution and structure of the industries; financing, development and growth of firms; and business requirements. The survey on which the paper is based identified 8,000 manufacturing enterprises in Nairobi engaged in four main activities namely carpentry, leatherwork, metalwork and tailoring. These activities account for 99 per cent of the enterprises in the subsector. Other activities include electronics, embroidery, carving, and weaving. The distribution of firms by activities is shown in Table 1.

Table 1 *Distribution of Informal Sector Manufacturing Firms in Nairobi by Activity*

ACTIVITY	NO. OF FIRMS	PROPORTION (%)	ACTIVITY	NO. OF FIRMS	PROPORTION (%)
Tailoring	927	39.62	Electronics	001	00.04
Carpentry	627	26.70	Carving	006	00.26
Metalwork	417	17.82	Weaving	021	00.90
Leatherwork	336	14.36	Embroidery	004	00.17
Rubber Stamp Making	001	00.04			

Source: Obuon, 1990, p. 13

McCormick³⁰ has published extensively on the issues affecting small scale manufacturing enterprises. In one study, she seeks to establish whether small

30 McCormick, 1986.

manufacturing enterprises contribute positively to Kenya's economic development. She concludes that the businesses do actually contribute substantially in terms of labour and development and concludes that promoting these enterprises would benefit the Kenyan economy by providing more jobs and increasing overall income levels.

In a second study³¹, she tackles the issue of gender. She argues that there are significant differences between men and female business owners. Women are less likely to have a profitable business but paradoxically more likely to accumulate capital than their male counterparts. Women also have less choice of occupation than men. They remain blocked from many activities as manufacturing remains predominantly the domain of men. However, those who manage to surmount the barriers to entry perform as well as their male counterparts. She concludes that promoting women's businesses would benefit the Kenyan economy by providing more jobs and increasing overall income levels. Furthering women's businesses also has positive development side effects because most of the women entrepreneurs are heads of households or married women who are responsible for their families' basic needs.

In yet another study,³² McCormick observes that despite abundant literature on the social and economic benefits of encouraging microenterprises, the vast majority of such firms do not grow beyond six workers. She argues that the one significant reason why small firms stay small is risk. The economic and social consequences of business failure are extremely high. Consequently, entrepreneurs try to protect

31 McCormick, 1992a.

32 McCormick, 1992b.

themselves from failure by employing risk management strategies such as flexibility, use of family labour and minimal capital. This is all aimed at minimising fixed costs and maximising revenues. Such strategies unfortunately inhibit growth which in turn constrains the development of a dynamic manufacturing sector.

Abuodha³³ on the other hand addresses the question of the determinants of investments in Nairobi's small scale manufacturing sector. He posits that development of the informal sector has gained recognition as a development strategy in the last few years. Almost all policies presently applied are aimed at increasing output and employment through initial investment, capital formation and overhead investments. His study seeks to provide knowledge of the factors influencing investments and investment decisions in the sector, so as to assist policy-makers assess the appropriateness of prevailing policies and effectiveness of recommended policies so as to formulate constructive policies. He found that investment in this sector is low. However, output, labour potential and entrepreneur incomes were not any lower than those of other sectors.

Nderitu³⁴ tackles the question of the educational standards of the entrepreneurs in the small scale manufacturing sector in Nairobi. Her findings are that 60 per cent of them have at least secondary school training. She concludes that possibly due to this factor, the sector is male dominated.

The problems faced by small scale entrepreneurs are well elucidated by the United

33 Abuodha, 1989.

34 Nderitu, 1992.

Nations.³⁵ They include weak policy environment, inadequate infrastructure as well as lack of access to appropriate technology, training and credit.

2.3 Contract Discipline Amongst SSMEs

Despite the abundance of literature on SSMEs in Nairobi, there is very little literature that deals with legal issues in general and contract discipline in particular.

The only literature of a legal nature available is a study by Gichira³⁶ which identifies government regulatory policies, modes of implementation and the actions taken with regard to the informal sector with a view to identifying the constraints hindering the development of the informal sector and the appropriate measures that should be taken to overcome them.

The regulatory policies studied include, legislation which gives legality to business enterprises such as the Trade Licensing Act;³⁷ Legislation that imposes standards on the sector such as the Public Health Act;³⁸ and by-laws of local authorities through which the authorities are able to regulate and control the operations of the informal sector and by extension, small scale industries.

The author's findings are that there is very little legislation that is specifically geared towards the informal sector. Under the existing laws, the informal sector is at best, tolerated. Often, the entrepreneurs in the sector are harassed due to the

35 United Nations, 1994.

36 Gichira, 1991.

37 Chapter 497, Laws of Kenya.

38 Chapter 247, Laws of Kenya.

existing by-laws and legislation such as the Vagrancy Act. They are squatters on government or other empty land and without title to the land, cannot put up permanent structures due to stringent property laws. Their temporary structures are constantly pulled down as they do not meet the requirements of the Public Health Act or by laws. The author concludes that there is a need for the government to repeal, amend, and review existing by-laws to conform with the needs and role of the informal sector.

The only literature that touches on the issue of contract discipline is a study that was carried out in Ghana on the enforcement of commercial contracts. The study by Fafchamps³⁹ does not focus on small scale manufacturing enterprises but on manufacturing and trading firms generally.

Fafchamps observes that Africa is perceived as having a laid back culture. Consequently, commercial transactions in this part of the world are characterised by delay, unreliable quality and late payments, rendering necessary complex, enforcement mechanisms. This raises the cost of conducting business as firms must hold precautionary stocks, inspect supplies carefully and spend time and money on payment collection deterring investment by foreign firms who can find a more disciplined business environment elsewhere such as in East Asia. This hurts Africa's capacity to export manufactured products to the west.

The study employs a descriptive, case study approach. A small sample of 58 firms is employed to allow for in-depth interviews and thus richness of data. The sample was constructed in such a way that firms of all sizes except the very small ones

39 Fafchamps, 1996.

CHAPTER 3

RESEARCH DESIGN

3.1 Research Design

The study was exploratory in design. It emphasised the identification and in-depth exploration of variables to enable the researcher to gain insights into the issue of contract discipline and consequently to generate hypotheses on the causes of indiscipline. Data was collected from both small scale entrepreneurs and their customers.

3.2 Selection of the Study Units

The population of interest comprised small scale manufacturing enterprises operating in Nairobi and their customers. A total of thirty (30) interviews were conducted, ten (10) being of proprietors of small scale manufacturing enterprises and twenty (20) of their customers.

The study was limited to Kawangware and Kibera areas of Nairobi. This is because small scale manufacturing enterprises are widely dispersed throughout the city and it would be difficult to visit all the areas where they operate. Furthermore, it has been observed⁴⁰ that small scale manufacturing enterprises do not vary significantly from area to area in terms of characteristics and demographics. The

40 McCormick, 1986, p. 17.

two areas are thus representative of small scale manufacturing enterprises in Nairobi.⁴¹

The enterprises interviewed were selected by the researcher judgementally from K-REP's register of clients, to represent the key activities in the manufacturing sector. These activities, namely tailoring, carpentry and metal fabrication account for 99 per cent of the enterprises in the sector.⁴² Approaching the entrepreneurs through K-REP was necessary to gain their confidence and trust to ensure the sincerity of the answers given.

3.3 Data Collection

Data was collected by way of depth interview. The researcher introduced the subject and invited discussion in line with the general guidelines provided by the data collection questionnaires, minimizing their participation.⁴³ The interviews employed unstructured and unpredetermined questions and respondents were encouraged to talk freely. The depth interviews provided the researcher with an opportunity to observe the respondent; persuade the interviewees to answer all the questions; explain the questions clearly where the respondent did not understand what was being asked; and to probe where necessary so as to gain insights into the issue of contract discipline.

All the interviews were conducted by the researcher to ensure uniformity.

41 The Kenya Rural Enterprise Programme is a Non Governmental Organisation that is involved in the development of small scale enterprises primarily through advancing of credit.

42 Obuon, 1990, p. 13.

43 . Please see Annexes

Two types of questionnaires providing the general guidelines were employed. One was administered to the entrepreneurs (see Annex 1) and the other to the clients (see Annex 2). Both questionnaires are divided into four main parts. The first comprises general information including the location, name, type and size of the enterprise and the designation of the respondent. The second part tackles general issues concerning small scale enterprises such as what the respondents think of these enterprises and what problems they think the enterprises face. The third part specifically addresses the three issues of deadlines, quality of work and cost and zeroes in on the enterprise in question. The last part records the interviewer's observations with regard to the enterprise and the entrepreneur.

The researcher closely observed the respondents and recorded her impressions of the enterprise and entrepreneur. The entire response was recorded by the researcher during the interview in as much as possible the words used by the respondents. These records were studied in detail after the interview and the data relevant to the study extracted.

3.4 Method of Data Analysis

The method of analysis employed was content analysis and subjective qualitative interpretation.

The data obtained was analysed descriptively at three levels. The first level comprises a summary of the main characteristics of the enterprises interviewed. This provides background information to ease understanding of the type of

enterprises visited. At the second level, the responses given by all the respondents were grouped together and analysed in the context of the three major issues of quality, deadlines and cost. The final level gives an analysis of the customers' perspective of contract discipline amongst small scale manufacturers.

4.1 Introduction

The breakdown of the responses presented in terms of the issue of the work and the gender of the engineer is as follows:

Table 3. Anticipations experienced by Discrimination and Gender

Discrimination	Gender		
	Male	Female	TOTAL
Capacity	1	2	3
Material procurement	3	-	3
Labouring and cutting	3	2	5
High cost	-	1	1
TOTAL	7	5	12

CHAPTER 4

FINDINGS OF THE STUDY

4.1 Introduction

The breakdown of the enterprises interviewed in terms of the nature of the work and the gender of the proprietor is as follows:

Table 2 Entrepreneurs Interviewed by Occupation and Gender

Occupation	Number		
	Male	Female	TOTAL
Carpentry	1	1	2
Metal fabrication and Welding	3	—	3
Tailoring and knitting	2	2	4
Handicrafts	—	1	1
TOTAL	6	4	10

4.2 Enterprises

4.2.1 Summary Information

ENTERPRISE						RESPONDENT	
<i>Name and Location</i>	<i>No. of Permanent Employees</i>	<i>Nature of Business</i>	<i>Age (Years)</i>	<i>Main Products</i>	<i>Target Market</i>	<i>Name</i>	<i>Age</i>
—*; Kibera Line Saba	1	Carpentry	5	Household furniture	Low to middle income households	Nelson Betty	30
Morena; Kibera Line Saba	1	Handicrafts	3	Barkcloth purses, mats, etc	Orgs that sell handicrafts e.g. Undugu Society	Regina Mbatha	48

ENTERPRISE						RESPONDENT	
<i>Name and Location</i>	<i>No. of Permanent Employees</i>	<i>Nature of Business</i>	<i>Age (Years)</i>	<i>Main Products</i>	<i>Target Market</i>	<i>Name</i>	<i>Age</i>
Kabanje Tailoring; Kibera Line Saba	2	Tailoring	13	Men's suits	Working men	Martin Ohuru	33
Harrison Tailoring; Kibera Line Saba	1	Tailoring	8	School uniforms	Students	Harrison Manyasi	26
Lisa Knitting; Kawangware Market	2	Knitting	13	Cardigans	Retail shops	Malky Nyamache	35

ENTERPRISE						RESPONDENT	
<i>Name and Location</i>	<i>No. of Permanent Employees</i>	<i>Nature of Business</i>	<i>Age (Years)</i>	<i>Main Products</i>	<i>Target Market</i>	<i>Name</i>	<i>Age</i>
Wakulima Hardware Stores; Kawangware Market	2	Metal fabrication	5	Gates, furniture	Schools	Onesmus Ndung'u	40
—; Kawangware Market	5	Metal fabrication	6	Jikos and boxes	Students and Households	Thomas Atiti	53
Baraka Tailoring; Kawangware Market	1	Tailoring	5	Men, women children wear	Men, women and children	Regina Mukoch	48

ENTERPRISE						RESPONDENT	
<i>Name and Location</i>	<i>No. of Permanent Employees</i>	<i>Nature of Business</i>	<i>Age (Years)</i>	<i>Main Products</i>	<i>Target Market</i>	<i>Name</i>	<i>Age</i>
Salamba High Class Furniture; Kawangware Market	3	Carpentry	15	Office and Household furniture	Retail outlets as well as homes and offices	Isaiah Salamba Isigi	41
NM Investments; Kawangware Market	2	Metal fabrication	8	Boxes	Students	Njoroge Njenga	36

* Some of the enterprises do not have trading names.

4.2.2 Quality Issues

All the respondents readily admitted to problems with quality as evidenced by customer complaints. Although on average, they approximated the complaints to their individual enterprises at 2 or 3 for every 10 transactions, they approximated the complaints to fellow entrepreneurs at between 4 and 5.

Complaints seem more frequent amongst those in carpentry and tailoring. The reasons given for the problems with quality are as follows:

- Limited formal education and lack of practical training: It is interesting to note that some of the entrepreneurs are involved in enterprises requiring a high level of technical competence such as tailoring and carpentry yet, they lack training in this field. This makes them almost entirely reliant on their employees, who themselves are not highly trained, compromising the quality of their products. Furthermore, the proprietors were adamant that they would not decline work even where they may suspect at the time the order is made that it is so complicated as to be beyond their abilities. This problem is compounded by a lack of formal education and thus no understanding of basic business principles such as marketing, pricing, etc.
- Lack of effective supervision of employees: In almost all the enterprises, the proprietors admitted to being at their premises less than two hours every day. This is because, they are the ones who go out looking for orders, they carry out all the purchasing as well as the deliveries. This means that the employees who do the actual production are largely left unsupervised. The employees are usually neither highly trained nor well remunerated. As such,

they do not care about the quality of the work that they produce.

- Lack of quality management systems: During the interviews, it emerged clearly that none of the enterprises have any form of quality management programmes. Two of the enterprises, namely Lisa Knitting and Salamba High Class Furniture have a rudimentary quality control programme. In these two enterprises, no products are released to the customers without the approval of the proprietor. This gives the proprietor an opportunity to look at the finished products for conformity with customer requirements before their release to clients. However, on further probing, it was clear that the proprietors only hold back products with severe defects. What were termed as 'minor' defects such as poor finish did not merit rejection.
- Limited resources: Most of the enterprises lack sufficient personnel to handle the workload as well as working and storage space. Employees are rushed in their work in anticipation of new orders or so as to get the materials delivered so as to create room for other work.
- Lack of funds: This was a reason given by every enterprise without exception. The respondents claimed that they lacked the financial resources necessary to procure good and reliable equipment; hire well-trained artisans and buy good quality raw materials all of which are crucial to the production of high quality goods. This lack of funds stems from a variety of factors, the main ones being poor collection of debts and diversion of funds meant for business.

On the whole, the enterprises seemed to have a big problem with the collection of debts. Many complained that customers were not forthcoming

with payments. Sometimes, they took over a month to settle their dues.

This has a negative impact on the cashflows which are already poor.

At the same time, no distinction is made between the finances of the enterprise and the personal finances of the entrepreneur. Consequently, funds are often diverted to defray the personal expenses of the proprietors causing shortages in the business.

4.2.3 Cost

All the entrepreneurs interviewed have persistent cashflow problems. These problems seem to stem from two factors namely poor pricing and undercutting.

- **Poor pricing policy**: The entrepreneurs who seemed most advanced in terms of pricing policy were those in carpentry, tailoring and welding. They have developed to a point where they have fixed prices for almost all products. These prices are then adjusted regularly for inflation and for rises in the prices of raw materials.

The other entrepreneurs do not have fixed systems of determining their prices. The majority simply consider the main expenses namely raw materials and labour and then add a profit margin. Many times, in a bid to secure orders the profit margins are so narrow as to be insufficient. In the event of unanticipated occurrences, they are without insurance. Despite the fact that the entrepreneurs are employed full-time and depend entirely on the small businesses for their livelihood, they ordinarily do not consider their contribution in determining prices.

- **Undercutting**: Small scale manufacturing enterprises face cutthroat

competition not only from the large enterprises but also from fellow small scale entrepreneurs. Some of the small scale entrepreneurs lower their prices abysmally in a bid to attract customers. This forces others to lower their prices so as to be competitive. Often, the end result of this is that the quoted prices are so ridiculously low that the entrepreneurs are forced to renegotiate the cost.

4.2.4 Meeting of Deadlines

Of the three aspects of contract discipline selected for investigation, the time factor is the one that is taken with least seriousness amongst small scale enterprises. Almost all the proprietors interviewed brushed off the issue of the importance of working within set deadlines. They admitted without any sense of remorse that they seldom met their deadlines. They justified this by saying that the customers themselves were not serious when they asked the entrepreneurs to deliver within certain time-frames, only giving a time to ensure that work was commenced on their orders immediately.

One entrepreneur (a tailor) however stated that she always did her best to meet her deadlines so as not to dissappoint her customers. She explained that she is a committed Christian and did her best in all her undertakings to ensure that she did not offend people. Her efforts to ensure that she meets her deadlines thus do not stem from an understanding of the benefit of timeliness in her business, but from her religious convictions.

Asked why they do not give much weight to deadlines, the entrepreneurs gave the following reasons:

- Unpredictability of business: Business is not stable. There are periods when they have many orders and other periods when they are without work. All of them depend solely on the enterprises for survival. Consequently, they cannot afford to turn away any work whatever the workload they have, causing problems with meeting deadlines.
- Delays by suppliers: Most of the enterprises do not stock raw material but buy the material as the need arises. Sometimes, they are unable to obtain the material in good time which results in delays.
- Lack of funds: The enterprises do not have ready cash to procure the materials that are necessary for production. They rely on the deposits paid by the customers. Where the customers are unable or unwilling to pay a deposit, they have to raise the funds usually through borrowing from fellow artisans, rotating savings and credit associations and non governmental organisations that extend credit to small scale enterprises. Raising the funds required can take time especially if the enterprise has already borrowed for other purposes. This delays production and subsequently delivery.

Besides the responses provided by the respondents, the researcher made some observations during the discussions:

- Inadequate planning skills: The entrepreneurs do not have systems of scheduling their work so that they ensure that orders are ready as and when required. This problem is exacerbated by the entrepreneurs unwillingness to turn down orders, even those which are very urgent. Taking on such orders causes confusion in the production process as work in progress has to be stopped so that these new orders can be fulfilled.

- Inward focus: The enterprises focus almost exclusively on themselves – their needs and their problems and do not give much consideration to their customers. This is contrary to the general trend worldwide which is to treat customers and particularly their needs as paramount. This trend is a reaction to research findings which indicate enterprises that are responsive to the needs of the customers perform better. Consequently, many businesses are restructuring operations so as to put the customer at the centre of everything they do.

The inward focus on the part of small scale enterprises to a large extent explains the nonchalance with regard to meeting deadlines. None of the entrepreneurs interviewed seemed to have any understanding on the implications of late deliveries on long-term survival of their enterprises and seem to view each case as isolated and with no impact on them.

- General Apathy: There is on the whole a bad attitude towards the issue of time. While the entrepreneurs understand the need for quality work and make some effort towards achieving the same, they do not seem to comprehend the impact of late deliveries on their customers and in the long run their businesses. Consequently, they do not treat the issue of time with the seriousness it deserves. This is clearly evident in some of the comments made by the entrepreneurs some of whom said that they are able to determine customers who are serious about timely deliveries. This determination is usually based on the extent to which the customer 'insists' that a delivery be on time.

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4.2.5 Dealing with Customer Complaints

As observed in the discussion of quality issues, small scale manufacturing enterprises lack effective quality management systems. Consequently, complaints by customers are plenty. All the enterprises deal with customer complaints as and when they arise. They do not have established systems of handling complaints and learning from past mistakes. Dissatisfied customers speak to whoever they find on the premises at the time of registering the complaint. This is usually an employee. If the employee is unable to sort out the matter, it is then forwarded to the proprietors.

The proprietors insisted that they are always willing to rectify whatever defects that the customers point out to them. On further discussion however, it emerged that they are only willing to do this to the extent that they do not have to incur additional expenses. Otherwise, they would rather lose the customer than 'lose' money rectifying the problem. They do not seem to understand that just like a satisfied customer is the best advertisement, a dissatisfied customer is a great danger. Not only do the enterprises lose all future business from that customer but also any business that the customer may have brought their way by speaking well of the enterprise. The net result of this is that small scale manufacturers are constantly attracting new customers but they are seldom able to hold them. The businesses thus find it difficult to expand and grow.

4.3 Customers

Discussions were held with twenty customers of small scale enterprises who were

interviewed individually on their views regarding small scale entrepreneurs. The discussions were conducted in line with the customer's questionnaire (see Annex 2). They revolved around the three issues of time, quality and cost and sought to establish dissatisfaction over time as opposed to a once off disappointment.

All the customers interviewed faced at least one of the three problems with the small scale enterprises with which they dealt. Eighteen out of the twenty faced two while eight faced all three problems.

On the specific problems, only 3 out of the 20 respondents did not report any problem with quality. Similarly, 9 had no problem with cost while only one had no problem with time.

When asked to rate the three attributes in order of importance, all the customers said that in normal circumstances, quality was their most important consideration followed by cost and finally time. Quality was said to be important as many of the goods bought from this sector such as furniture are durable goods, meant to last a long time. They are also costly. It is thus crucial that the quality be good so that they last a long time and justify the money that is spent on them.

Cost was deemed important as it was one of the main motivators for going to the informal sector in the first place. Many of the customers are from the low and middle income brackets and find the products of the informal sector enterprises affordable.

While many did not view time to be an issue critical enough to make them move from one entrepreneur to the other, they placed considerable significance on both quality and cost.

When asked to elaborate on what they thought to be the reasons why the entrepreneurs in the informal sector did not honour their obligations in the first place, they gave a variety of largely inter-related reasons.

Customers explained that many of the entrepreneurs were so desperate to clinch orders and greedy for money that they did not stop to consider their capacity and finances before committing themselves to orders. The result of this is that more often than not, they could not deliver the orders at the cost initially agreed upon and have to resort to renegotiation. At the same time, they are forced to find ways of cutting corners to save money which compromises on the quality of the work. Because of not taking their capacity into consideration, they are unable to meet their deadlines and end up hurrying orders thus further compromising the quality.

Another reason raised by the customers is poor education and training. Customers pointed out that many of those who resorted to starting up small scale enterprises were there by default and not out of choice. Many had very little formal education and business training. As a result, they did not attach much significance to issues of quality, cost and time much less the importance of honouring contractual obligations. All this resulted in contract indiscipline amongst the enterprises.

Despite this negative perception of small scale enterprises, almost all the customers interviewed were quick to reiterate that despite their shortcomings, small scale enterprises have certain unique qualities which if exploited can ensure their stability and growth. Being small, they are flexible and are able to provide highly personalized services. At the same time, their prices and terms are very reasonable providing low and middle income people with access to some facilities they might otherwise have been unable to afford.

The customers also said that although the quality of their products currently was still not up to the expected standards, it had greatly improved over the years. The enterprises thus have a lot of promise in terms of future prospects. This is especially so if they are made aware of their shortcomings in good time and the right measures are taken to address them.

From speaking to the entrepreneurs, the researcher also noticed that the entrepreneurs in this sector are very resilient and extremely innovative. This is most evident in the fact that they are willing to attempt things which appear to be difficult even in very daunting circumstances. It also shines through in the way they go about raising funds to meet their expenses and improvising equipment where they are unable to procure the necessary equipment to perform their work.

CHAPTER 5

CONCLUSION

5.1 Conclusions and Recommendations

On the whole it can be said that small scale manufacturing enterprises have a problem honouring their contractual obligations. This is due to three main reasons.

Firstly, many entrepreneurs view the sector as a place of last resort. Six of the ten entrepreneurs interviewed claimed that they were in the sector by default – as a result of having nothing else to do. Even though many of these had been in the sector for more than five years, they still viewed it as a stop-gap measure as they looked for something better to do, such as employment.

The other problem cumbering the small scale manufacturing is the lack of education. Many of the proprietors and their employees have very limited formal education. This renders them unable to appreciate the negative impact of indiscipline on the growth and stability of their businesses. The lack of education also constrains their ability to make important management decisions such as planning, organizing, staffing, directing and controlling as well as pricing decisions, marketing, and quality management.

The entrepreneurs in this sector focus almost exclusively on themselves as in contrast to the global trend of focusing on the customer. They believe that they face insurmountable odds in the form of the competition from the large formal

sector enterprises. They also are convinced that they cannot compete effectively as they are handicapped by lack of resources. As such, they honestly believe that they cannot break out of the cycle of poverty and hand to mouth existence that many are steeped in. This is best exemplified by the fact that despite the fact that some of the enterprises have borrowed from Non Governmental Organisations for a long time, they seldom grow. This is because the funds are borrowed not with concrete plans for developing the enterprises, but as a means of extending the cycle. The money is used to settle debts. More money is then borrowed to pay those loans and the cycle goes on.

5.3 Suggestions for Future Research

These factors in combination have resulted in a general distrust of the enterprises by the general populace and low esteem amongst the entrepreneurs. Nevertheless, the entrepreneurs in the sector appear to be resilient and innovative. Customers concede that the enterprises have improved over time and there is definitely potential for even greater improvements. The customers also feel that unique attributes of the small scale enterprises such as flexibility can go a long way in ensuring their survival in the long term.

5.2 Limitations of the Study

This study faced a variety of limitations.

Firstly, there was very little information available on contract discipline in general and small scale manufacturers in particular. This made designing the study difficult and rendered changes in the course of the study necessary to adapt to the circumstances.

Due to the need for trust amongst the entrepreneurs, the researcher had to approach them via an institution which already had credibility. As such, there is the danger that the results obtained may be biased as the enterprises were drawn from a specific pool of somewhat enlightened entrepreneurs.

The method used in analysing the data was content analysis by way of qualitative interpretation. This means that the results provided are largely subjective and stem from the perceptions and interpretations of the researcher.

5.3 Suggestions for Future Research

The problem of contract discipline is clearly one that merits further study. This study being exploratory in nature has provided insights on the problem of contract indiscipline amongst small scale manufacturing enterprises and identified the probable causes of the indiscipline. These causes include lack of formal education; lack of practical training; lack of basic business education such as marketing, planning, etc; ignorance of the effect of indiscipline on the future of their business; and the lack of commitment to their businesses.

This study is however not conclusive. It does not provide the nature and significance of the various causes. As such, there is a need for studies of a quantitative nature. Such studies should cover the entire sector. They should seek to clearly identify the specific reasons for the lack of contract discipline in individual subsectors; discern their magnitude; as well develop suggestions of viable ways of addressing the problem.

Parallel studies should also be undertaken amongst the customers of the small scale enterprises to determine the relative importance of the various elements of contract discipline to them. The results of the studies can then be used to put

together a programme of tackling the problem of indiscipline amongst small scale enterprises to enable them achieve their full potential.

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**Contract Discipline Amongst Small Scale
Manufacturing Enterprises In Nairobi**

Enterprise Questionnaire

My name is Christine Michira. I am a final year masters student from the University of Nairobi. I am studying small scale enterprises and their customers for my final year project and would like to interview you. Would you accept to be interviewed?

1. Name of the Enterprise
 2. Number of Employees
 3. Name and Designation of the Respondent
-
4. How long have you been in this business?
 5. What are your main products?
 6. Who are some of your clients? [REMEMBER TO GET THEIR CONTACTS].
 7. Do you face much competition from the other small scale entrepreneurs? Why?
 8. How do you perceive your fellow entrepreneurs in terms of their commitment and dedication to their work as well as the quality of their products? Why?
 9. What are the problems that the entrepreneurs in this kind of business face? Why?
 10. What are the problems you face? Why?
 11. How do these problems affect your business?
-
12. How do you go about negotiating a piece of work?
 13. Do you put the end result into writing?
 14. To what extent are you involved in every step of the production process?
 15. Do you have a quality control system?
 16. How do you go about costing prospective projects?
 17. Do you sometimes end up going above or below the projected costs? Why?
 18. How do you deal with this?
 19. How busy are you?
 20. Are you always able to deliver your products on the date agreed upon?
 21. Why?

Thank you for your time. I would very much like to speak to some of your customers. I hope that this will be in order.

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FACULTY OF COMMERCE
MBA MANAGEMENT PROJECT

**Contract Discipline Amongst Small Scale
Manufacturing Enterprises In Nairobi**

Customer Questionnaire

My name is Christine Michira. I am a final year masters student from the University of Nairobi. I am studying small scale enterprises as well as their customers for my final year project and would like to interview you. Would you accept to be interviewed?

1. Name of the Customer
 2. Name and Designation of the Respondent
-

3. What do you do for a living?
 4. How long have you dealt with small scale enterprises?
 5. What is it that you buy from the small scale entrepreneurs?
 6. How do you view these enterprises, generally?
 7. Why do you deal with small scale enterprises as opposed to the bigger enterprises?
 8. What do you like about these enterprises?
 9. What do you not like?
 10. In your dealings with small scale enterprises, have you been disappointed?
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11. You deal with enterprise XYZ. How do you go about negotiating a piece of work?
12. Do you put the end result into writing?
13. Has the enterprise ever disappointed you?

Thank you for your time.

Details of Customers Interviewed

<i>Name</i>	<i>Occupation</i>
1. Hawi Ambala Oduor	Proprietor, Tauhid Kenya Ltd
2. Boniface Macharia	Accountant
3. Robin Waudu	Marketer
4. Anne Wanjiru	Nurse
5. Justus Maingi	Garage owner
6. Wanja Wanjohi	Housewife
7. Rose Awour	Data analyst
8. Nancy Mburu	Teacher
9. Lucy Musau	Kiosk owner
10. Paul Mbugua	Bursar
11. David Wanjala	Cook
12. John Ochieng	Teacher
13. Grace Awinja	Tailor
14. Phoebe Achieng	Hawker
15. Muthoni Gituma	Salesgirl
16. Peter Langat	Carpenter
17. Musa Amukobole	Construction worker
18. Salome Wanjiru	Kiosk owner
19. Sofia Osman	Housewife
20. Charles Ndirangu	Newspaper vendor

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