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## A STUDY OF THE MISSING MIDDLE IN KENYA

by

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## ABSTRACT

This paper outlines a proposed study of the so-called "missing-middle" in Kenya's industrial structure. It has been argued that there is a relative under-development of enterprises of a middle-scale in Kenya. This under-development, it is argued here, is of significance for Kenya's overall industrial development. In this study, the aim is to examine in detail the possible causes of the missing middle in the manufacturing sector. Any such study also needs to account for the form of the middle found in Kenya. In particular this entails explaining the relative and conspicuous success achieved by entrepreneurs of Asian ethnic origin in developing middle-scale enterprise.

It is argued that existing approaches to the question of the middle, especially those based within the framework of neo-classical economics, have paid insufficient attention to the micro-analytics of enterprise operation and socio-cultural factors. Working within a broad background of the new institutional economics, a framework has been developed for examining and interpreting exchange processes which it is argued are at the core of enterprise development. A detailed argument is constructed within this framework seeking to explain the various phenomena of the middle observed in Kenya. The essence of this argument is that the general exchange environment faced by would-be middle-scale entrepreneurs in Kenya is very difficult. However it is suggested that entrepreneurs of Asian origin have been able to exploit elements of their socio-cultural structure in order to effectively find solutions to problems created by this environment. A number of case-studies are now proposed to both test and develop the specific hypotheses advanced.

## A STUDY OF THE "MISSING MIDDLE" IN KENYA

### Rationale for the study

The term "missing middle" is usually taken to refer to the distinctive distribution of enterprise scale in Kenya. It has been found that the size of the small and medium sized enterprise sector, in the Kenyan economy is relatively small by comparison with both the micro and large scale enterprise sectors<sup>1</sup>, measured in terms of numerical strength and contribution to employment and output.<sup>2</sup> This feature of Kenya's economy it has been argued is highly significant.

The absence of a significant middle sector is of interest since there are good empirical and theoretical reasons for supposing that such a sector would play an important role in Kenya's economy. It is a striking fact that in the most highly industrialised market economies, small and medium enterprise continues to occupy a significant role. Indeed there is some evidence of a resurgence in the importance of smaller-scale industry in these countries. A significant small and medium enterprise sector has been observed during the rapid industrialisation of a number of the "miracle" economies of East Asia. Whilst there is a considerable danger in attempting to draw too much from such facts, they do suggest that the middle sector may play an important role in industrialised market economies.

The general arguments made in favour of smaller-scale industry in both industrially developed and developing countries are numerous, though not all controversial. Amongst the most prominent is the claim that smaller-scale enterprise has a relatively high income generating potential. Whilst applied to all types of economy, the argument is particularly pressing from countries such as a Kenya, where generating employment is a critical national objective. At a theoretical level, smaller-scale industry characterised by less capital-intensive, more labour-intensive processes can become more economically viable in the face of the relatively lower factor price of labour compared with capital, compensating for any disadvantages in terms of economies of scale. A number of studies have tended to confirm the relative efficiency in some industries of smaller scale enterprise by comparison with larger more capital intensive firms.<sup>3</sup> The conclusion drawn from this somewhat simplistic argument is that not only may smaller-scale industry deliver the benefit of greater employment, it can do so in a more economically efficient manner. Beyond this argument there is an extensive literature which claims many other putative benefits for smaller-scale enterprise.<sup>4</sup>

A more interesting question which has emerged is that of the possible dynamic role of smaller-scale enterprise in the process of economic development. The argument has its origins in the flexible specialisation concept brought to prominence by Piore & Sabel (1984). Without attempting to reproduce the reasoning here it has been claimed that industrial organisation based on, or incorporating a significant number of smaller-scale enterprises can give rise to a form which is highly conducive to the process of industrialisation. A capacity for relatively rapid endogenous innovation, and high flexibility in the face of uncertainty are held to be characteristic of collections of enterprises forming industrial clusters or districts.<sup>5</sup> Now

although such clusters will not simply arise out of any collection of smaller-scale enterprises, the significance of the conception is the description of a possible growth path based on smaller-scale industry which indicates how both the technological and social change at the heart of the industrialisation process can occur. Drawing on his studies of small-scale enterprises in Africa, Sverrisson (1993) constructs and contrasts two distinct paradigms of industrialisation. On the one hand there is the linear path towards mass-production techniques which implies rapid and rapidical change in both the technological and social basis of production. On the other there is gradual, flexible mechanisation based on evolutionary technological and social change which is continuous with pre-existing arrangements. Arguably it is the latter which represents the more robust route towards industrial development, and one in which the smaller-scale enterprise moves from the margins to centre stage.

These represent a few of the reasons why smaller-scale industry in general may have an important role in Kenya. Set against this it is important not to over-generalise regarding smaller-scale industry, taking it to represent a single homogeneous entity. Although the contribution of the micro-scale sector to Kenya's economy is now more fully and widely acknowledged, the sector does not represent a panacea to the nation's problems, now or in the future.<sup>9</sup> Much micro-enterprise is necessarily limited in its scope and to many involved in such enterprise the essential aim is survival rather than accumulation (Boomgard 1989, p.8). It is that part of the smaller-scale enterprise economy, demonstrably a step away from informal survival activity, involved in accumulation and technological and organisational innovation which is of greater import in the context of economic development. This is the "middle" with which we are concerned here.

Data concerning the middle-scale sector is somewhat sparse. On the basis of the most recent survey data for 1993, the lower middle-scale (employing between 10 and 49 workers inclusive) only accounts for 0.17 million or 5% of a total estimated workforce of 3.19 million.<sup>7</sup> Figures concerning the upper middle-scale (employing between 50-100 workers) are not available. However the average number of employees in establishments employing over 50 is 486, suggesting that the upper middle-scale is similarly relatively small. Focusing on the manufacturing sector, the position appears to be more stark. The lower middle employs only 13 thousand or less than 2% of the total of 688 thousand in the sector. The average number of employees in establishments employing over 50 is 378, again suggestive of a relatively stronger upper-middle scale. If it is accepted that the middle-scale has a potentially highly significant role in development then the fact of its apparent comparative absence is of considerable interest. At the very least, explaining why the middle is missing represents an essential part of a comprehensive understanding of Kenya's present industrial situation. However a more pessimistic interpretation would be to see the absence of the middle as indicative of a systemic or structural weakness in the economy. It could be construed as *both* a cause and effect of stagnation in the process of industrialisation. The widespread emergence of a "middle" might be seen as the sign that a capitalist-based means of production has truly emerged across Kenya and not merely in isolated pockets.

It is a widely recognised, though surprisingly sparsely documented feature of the economy that a very large proportion of the industrial capital in the formal sector is owned and

controlled by entrepreneurs of Asian descent, primarily from the Indian sub-continent. Although precise figures are difficult to find, Himbara (1994, p.94) found in a recent study that 75% of a sample of 100 medium and large-scale manufacturing firms were owned by Asian Kenyans, whilst a mere 5% were privately owned by African Kenyans.<sup>8</sup> Putting this in context, according to the 1989 census, the combined Asian population constituted just 0.4% of the total Kenyan population (Republic of Kenya 1994, p.19). This number still only represents less than 4% of the total population found in large urban areas (towns with population greater than 100,000), where the Asian communities are believed to be concentrated.<sup>9</sup>

Whether this pattern of industrial ownership is repeated generally throughout the middle sector is not known, though informal observations tend to confirm the picture drawn by this study. A widespread view and the obvious conclusion to be drawn from such figures and observations is that African Kenyan entrepreneurs face greater constraints in the middle-scale than others.

The underlying, broad rationale for this study is that any progress in the understanding of the causes of the missing middle represents a useful contribution to the comprehension of Kenya's current economic position. More specifically, it is believed that the current picture of Kenya's "missing middle" is at best incomplete. An explanation, in analytical detail, of why different types of entrepreneur apparently face somewhat different prospects is particularly needed.

### **Objectives of the Study**

The objectives of this study are at once ambitious and necessarily somewhat limited. Broadly the aim is an improved understanding of the causes of the missing middle. Given the obvious complexity of such a question, this study can only represent one modest contribution towards unravelling the problem. It is a more specific goal to work towards constructing a coherent explanation of the actual, particular features of Kenya's middle-scale industry. This entails producing an argument which is able to explain not only why many entrepreneurs are unable to enter the middle-scale or why many middle-scale enterprises fail, but also why other entrepreneurs are successful and their enterprises flourish. Identifying constraints is only one part of the story. Where such constraints clearly do not apply to some enterprises or entrepreneurs then there is evidently a more complex situation to be understood.

It is a primary aim to at least start to produce a convincing explanation of the marked differences between the position of indigenous and non-indigenous entrepreneurs. The relative success of Asian entrepreneurs in Kenya is well-known and there is much, what might be termed "folk-explanation" of the phenomenon. However the subject has received comparatively little rigorous analytical attention. The purpose here is to proceed beyond the broad generalisation and macro-theory (however valid these might turn out to be) and examine the micro-analytics<sup>10</sup> of the process by which an entrepreneur is either constrained or able to succeed.

The study is to be directed at the manufacturing sector of industry. In the first case this is a matter of convenience. It is necessary in any limited study that boundaries are imposed on its scope. More pertinently, there is a broad consensus of its importance in the economics of development literature. The manufacturing sector is frequently attributed the role of the engine of economic development.

### Review of Existing Work<sup>11</sup>

Much of the literature directly relevant to the question of the middle may be considered conveniently in three parts: (i) high level theory predominantly in the realm of political-economy, (ii) the more immediate external constraints to enterprise, and (iii) internal constraints, focusing around the question of entrepreneurship.<sup>12</sup> It is argued that it is a general lack of a clear connection between these three levels of work which is the least satisfactory feature of the current literature which relates to the questions at issue here.

#### Political-economy

There has been much debate in the political-economy literature which is clearly relevant to the question of the middle. The issue is framed in terms of examining the prospects for the emergence of an African bourgeoisie. Dependency theory, notably has been applied to the Kenyan situation by Leys (1975) and others.<sup>13</sup> Crudely, the basic proposition of dependency theory, evolving from neo-Marxist themes, is that the position of the economically developing economies at the periphery of the global capitalist system in relation to the developed at its core is such as to retard the emergence of genuine capitalist development in these developing economies. A subsequent revision of his position by Leys (1982), arguing that a productive bourgeoisie had emerged in Kenya, gave rise to the so-called "Kenya debate" in the literature.<sup>14</sup> The whole debate was criticised by Kitching (1985) who pointed to the unwarranted determinism in much of the argument which simply could not be supported by the available or indeed any accessible evidence. The supposition that all the complexities of the specific situation and history of Kenya could be subsumed within a single overarching theory of the historical process of capitalism invites scepticism at the very least. In essence the argument entailed fitting the evidence to the theory rather than the theory to the evidence.

A recent study by Himbara (1994) adopts a more pragmatic line, explicitly rejecting the theoretical frameworks which characterised much of the earlier debate. His work is particularly interesting since the significance of Asian Kenyan capitalists in Kenya's industrial development is finally acknowledged. However Himbara does not offer a convincing explanation for the economic success of the Asian community in Kenya. Eschewing "theoretical hair-splitting arguments", he asserts that East African Indians were simply the first in the field (Himbara 1994, p.xiv). Later he hints at some of the factors which may have been at work: political and social isolation forcing self-reliance, especially in the market place, and the formation of a protective social network (Himbara 1994, p.69). However nowhere is the detailed logic of this argument developed.

### External constraints

We now turn to the more grounded, empirical work aimed at identifying constraints on the external environment to smaller scale enterprise. Since the International Labour Office report of 1972 (ILO, 1972), the informal sector and micro-enterprise in Kenya has received enormous attention. The involvement of government, foreign donor and other agencies in efforts to support the sector have resulted in the production of a number of studies which are relevant to the question of the middle.<sup>15</sup> There has been considerable attention directed at identifying (and alleviating) the general constraints affecting the informal-sector and micro-enterprise. A particular question often raised concerns graduation; what prevents micro-enterprises evolving into the middle?<sup>16</sup> The question is sometimes expressed in terms of a putative barrier between the informal and formal sector.<sup>17</sup>

Much work is based on an at least tacit assumption of an orthodox (neo-classical) micro-economic framework. Constraints are frequently assumed to derive essentially from some form of broadly construed market failure. There is an implicit belief in the counter-factual: *if* markets were able to operate freely *then* the middle would emerge. Such a position is emphatically supported by Marsden (1990) on the basis of his examination of the middle across sub-Saharan Africa. Levy (1993) in a recent assessment of obstacles to small and medium scale enterprises in Sri Lanka and Tanzania considered four groups of constraint - lack of access to finance, regulatory constraints, constraint on access to non-financial inputs and cost constraints. The World Bank (1989, pp. 136-8) in its long-term perspective study of sub-Saharan Africa attributes the missing middle to demand-side constraints, adverse regulatory environment, access to finance and infrastructure. The negative impact of regulation particularly and the need for a "climate for enterprise" is emphasised in the subsequent World Development Report 1991 (World Bank, 1991). Gichira & Onyango (1991) in their research into the barriers to growth faced by the informal sector in Kenya considered the legal environment, physical infrastructure, market (demand-side) constraints and access to technology. An interesting proposition put forward by Liedholm (1991) is that whilst micro-enterprises can remain "invisible" to regulation, the middle cannot. This creates a discontinuity as enterprises reach the stage at which they become "visible", suddenly incurring all the cost associated with conforming to regulation - tax, registration, employment legislation, not to mention rent-seeking by public sector officials.

Clearly this work is useful and identifies important features of the middle-scale economic situation. However the question which is rarely addressed in such literature is why do these constraints arise. If, for example, an entrepreneur perceives that she is unable to access finance then the pertinent question is surely why not? Such a question becomes more focused when a comparative approach is taken: Why can one entrepreneur not access credit, where another can or at least is not constrained by it? There must surely be a pertinent difference.

Kerre (undated) hints at an explanation of the different circumstances faced by Asians and Europeans compared with African entrepreneurs. He mentions the importance of the social and community based networks of the former, from which Africans have been excluded but does not elaborate. In an early post-independence study of smaller scale enterprise, Marris &



Somerset (1971) argued that African entrepreneurs frequently find themselves, as innovators, cut off from supporting networks. By contrast, it is argued Asian entrepreneurs are part of a highly cohesive community in which physical resources and less tangible support are readily accessible.

There has been a recent increase in analysis at what might be termed the "meso-level", at which enterprises are seen as a part of a wider production system. The recent literature on industrial districts is illustrative of this approach (see note 5). The potential for middle-scale enterprise is strongly related to the existence or possibility of production systems in which such enterprises can be embedded. The concept of linkages between firms is crucial to the analysis. Middle-scale enterprises are only able to play a role in more complex production systems where adequate linkages can be formed between firms (Mead, 1994). There is some evidence that the linkages between smaller and large enterprises in Kenya are particularly weak (Coughlin, 1988; Masai, 1991; Masinde, 1994). Coughlin observes, for example, that smaller-scale enterprises were sometimes found to be discriminated against when sourcing inputs from large-scale producers. In comparison the study by Sverrisson of indigenous small-scale wood-working enterprises in Nakuru shows that linkages between small-scale firms both horizontally and vertically are important, though still not characterisable as strong (Sverrisson 1989, pp.31-2). Whilst a certain degree of co-operation was seen, the linkages did not seem to permit the extension of credit or explicit sharing of technical information.

Sverrisson and a number of others,<sup>16</sup> have emphasised the importance of the social basis of linkages between enterprises. The origins of such thought may be found in the work of writers such as Courlet & Pecqueur who contend that concepts such as the industrial district must not be seen as a simple arithmetic-economic sum of enterprises.<sup>19</sup> Rather it includes a "social atmosphere in which human relations, both within and outside production activities, during the accumulation phase and the moment of consumption, are seen as an indissociable entity" (Courlet & Pecqueur 1991, p.308). Interestingly however, amongst the enterprises he observed, Sverrisson (1993, p.172) found that social relations, such as kinship and friendship, appeared to have *relatively* little impact on business relations. He suggests that the "atomisation" of African enterprises could be contrasted with the tightly knit socially base networks of Asian enterprises, but presents no firm evidence to support the contention.

A study by McCormick (1988, 1991) of urban manufacturing micro-enterprises offers an interesting perspective. She concludes that capital accumulation within a single enterprise is avoided since it presents an unacceptably high risk to the entrepreneurs. The preferred approach is to remain "small-and-flexible", a strategy which is held to be more effective at mitigating risk. It is important to note that this explanation does not presume that entrepreneurs are in some way intrinsically more strongly "risk-averse".<sup>20</sup> Rather the environment and situation of entrepreneurs presents a particularly high risk situation which it is rational to avoid. The question which has yet to be investigated is whether successful middle-scale entrepreneurs (whether African or Asian) found a means to reduce risk, allowing the path of capital accumulation to become an acceptable option.

### Entrepreneurship

We now turn to the question of internal constraint - entrepreneurship. Entrepreneurship is often cited by economists as the fourth factor of production. The question of entrepreneurship and entrepreneurial supply is the subject of a vast literature in which there is little consensus. The meaning of entrepreneurship itself is fiercely debated.<sup>21</sup> We can distinguish two major aspects of the entrepreneurial role relevant to the question of the middle. First, the broadly Schumpeterian sense - the entrepreneur as innovator - the "carrying out of new combinations of means of production" (Schumpeter, 1934). Second, the entrepreneur as organiser or manager.

The importance of the entrepreneur *qua* innovator was emphasised in much early economic theory. There was some concern as to whether there would be an adequate supply of this perceived essential factor. This doubt emerged from the perception by theorists of many traditional cultures as being inimical to the idea of change and innovation itself (see Leff, 1979). Hagan (1963), for example, argued that traditional societies give rise to an "authoritarian" personality type which is held to be the direct antithesis of the "creative" entrepreneurial type. Latterly there has been significantly less interest in the question, not least because of the outstanding success of some economies (predominantly in East Asia) presumed to be deficient in entrepreneurial supply. Marsden (1990, p.21) is unequivocal in his conviction that there is no shortage of entrepreneurship throughout sub-Saharan Africa. The World Bank (1989, p.136) follows a similar line. Certainly the extraordinary degree of entrepreneurial activity in the informal sector throughout Africa would seem to justify economist treating "entrepreneurship as a slack variable" (Leff 1979, p.60). Whilst not denying the importance of the entrepreneur as an input in economic activity, the conclusion is that there is no supply problem in Africa.

If entrepreneurial behaviour is taken with a social and cultural context, the position perhaps does not appear as clear cut as earlier analyses suggest. Rather than attempt to explain the origin of mystery "ingredient X" or (Kilby's "heffalump"<sup>22</sup>) which is entrepreneurship or Schumpeterian creativity, the more useful question is to examine what barriers to be overcome by the entrepreneur (see also note 18). In other words what degree of innovation is actually demanded in any change. Tieleman (1991), following Barth, argues that innovation should not be construed in a purely economic or technical sense but also as a social process. The entrepreneur needs to secure social justification for the changes wrought: this Tieleman terms "ideological innovation". Returning to the question of the middle, we might consider whether the gap between micro-scale and the middle, construed in a wider, socially embedded sense, presents a greater barrier to some entrepreneurs. The height of such a barrier is determined by the ideology or socio-cultural situation of the entrepreneur. McCormick (1991, pp.348-53) found in her study of urban micro-entrepreneurs some interesting differences between the relatively few who were accumulators and perhaps heading towards middle-scale and those who were not. Amongst accumulating men there was a weaker, though still present, rural-urban link, whilst amongst accumulating women there was evidence of a correlation with middle-class social status. Both of these features are suggestive of the accumulator (and hence potential middle-scale entrepreneur) moving further away from the social institutional and ideological background of the majority of the Kenyan population. Marris & Somerset (1971,

pp.77-102, 132-50) emphasise this sense of a gap between the traditional society of the indigenous entrepreneur and that of the modern capitalist. They point to such features as the perceived need to escape the traditional obligations of kinship. Other aspects may be the high value placed on ownership of land or stock potentially diverting resources from expanding a capitalist enterprise.<sup>23</sup> By contrast, it is argued that the Asian entrepreneur belongs to a society which has already evolved with and absorbed many aspects of the social implications of production based on a capitalist enterprise economy (Marris & Somerset, 1971, p.144)

Kilby (1971, 1988) takes a more prosaic approach to entrepreneurship and considers the activities which entrepreneurs must undertake within a small or middle-sized enterprise. He identifies four groups of activities: managing exchange relationships, political administration, management control and technology. Following a study of indigenously-managed enterprises supported by an enterprise agency in Kenya, Kilby (1988) concluded that the major source of difficulties in the enterprises was in the area of management control and technology. He theorises that these weaknesses could be traced to social structure: an absence of transmutable antecedent roles and inhibitory social structures. In essence there is no continuity between the social structure associated with traditional means of production and that associated with capitalist enterprise.

#### **Summarising the argument**

In this broad sweep of a somewhat diverse literature various ideas have emerged which suggest reasons for the particular size-structure of Kenya's manufacturing industry. A number of specific constraints on both the growth of micro-scale enterprise and emergence of the middle are suggested.

Fafchamps (1994) presents one of the few attempts to combine a number of these arguments (and others) to form a coherent explanation of industrial structure in Africa. He proposes that the shape of the curve mapping final effective production costs against enterprise scale will be bell-shaped. Such a shape emerges from two major elements. First, large-scale firms are presumed to enjoy economies of scale in relation to production costs and reach the level of political "critical mass" needed to capture various economic rents. It is assumed that such scale economies do not significantly apply to the middle-scale when compared with the micro-scale. Second, the micro-scale enjoys various cost benefits due to its "invisibility" to regulation (following the same point put forward by Liedholm, 1991) and improved labour productivity (associated with owner-management). Such benefits are held to drop away very rapidly with scale. The combination of these two serves to place the middle-scale at a cost disadvantage (hence the "bell-shape") and a constraint on middle-scale enterprise activity.

There remains, however, no convincing, coherent account of the various phenomena of the "missing middle" in Kenya. Much of what is put forward in Fafchamps's argument, which remains somewhat hypothetical, has yet to be tested in the Kenyan context. Furthermore there is a distinct absence of studies and explanations for the success of the relatively few entrepreneurs in the middle-scale. An obvious lacuna exists regarding the putative success of Asian entrepreneurs.

## Research Approach

Turning away from explanations focused on the nebulous concept of entrepreneurial ability, a deeper understanding is required of the particular task environment faced by enterprises or potential entrepreneurs. The phenomena with which this study is concerned demands that such a task environment be construed broadly to include features of socio-cultural structure, beyond the immediately apparent economic context.

Institutional economics offers a framework within which a broad-based analysis of the task environment can be constructed. The theoretical basis of this study draws heavily on the recent work by Douglass North (1990)<sup>24</sup>, which forms an important strand within what is commonly termed the new institutional economics (NIE). Central to this approach, and indeed institutional economics more generally, is the proposition that institutions are essential in understanding the performance of economies:

Institutions are the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction. In consequences they structure incentives in human exchange, whether political, social or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change. ... Institutions include any form of constraint that human beings devise to shape human interaction. Are institutions formal or informal? They can be either, and I am interested both in formal constraints - such as rules that human beings devise - and in informal constraints - such as conventions and codes of behaviour.

North (1990, pp.3-4)

Institutions are distinguished from organisations in this conception, although both structure human interaction. North uses a competitive sports analogy to illustrate the point. Institutions define the rules of the game, determining the way in which the game is to be played. Organisations by contrast are the teams of players, possessing particular skills, strategies and means of co-ordination (*ibid*).

Transactional analysis offers a means of showing how it is that institutions play such a major role in the development of economies and more generally, societies. The primary reason that institutions matter can be reduced to the simple fact that exchanges or transactions are never costless.<sup>25</sup> The total cost of production is the sum of transformation costs (the cost of transforming material inputs into outputs) and transaction costs. North argues that the cost of both transaction and, to a lesser degree transformation, is strongly affected by the institutional context in which it takes place.

## Theoretical framework

This study uses a modified Northian approach to explore the nature of the "missing middle" in Kenya. As a basis for this approach, a simple framework has been developed for analysis of the main influences on the exchange process. The framework is depicted in figure 1. It is

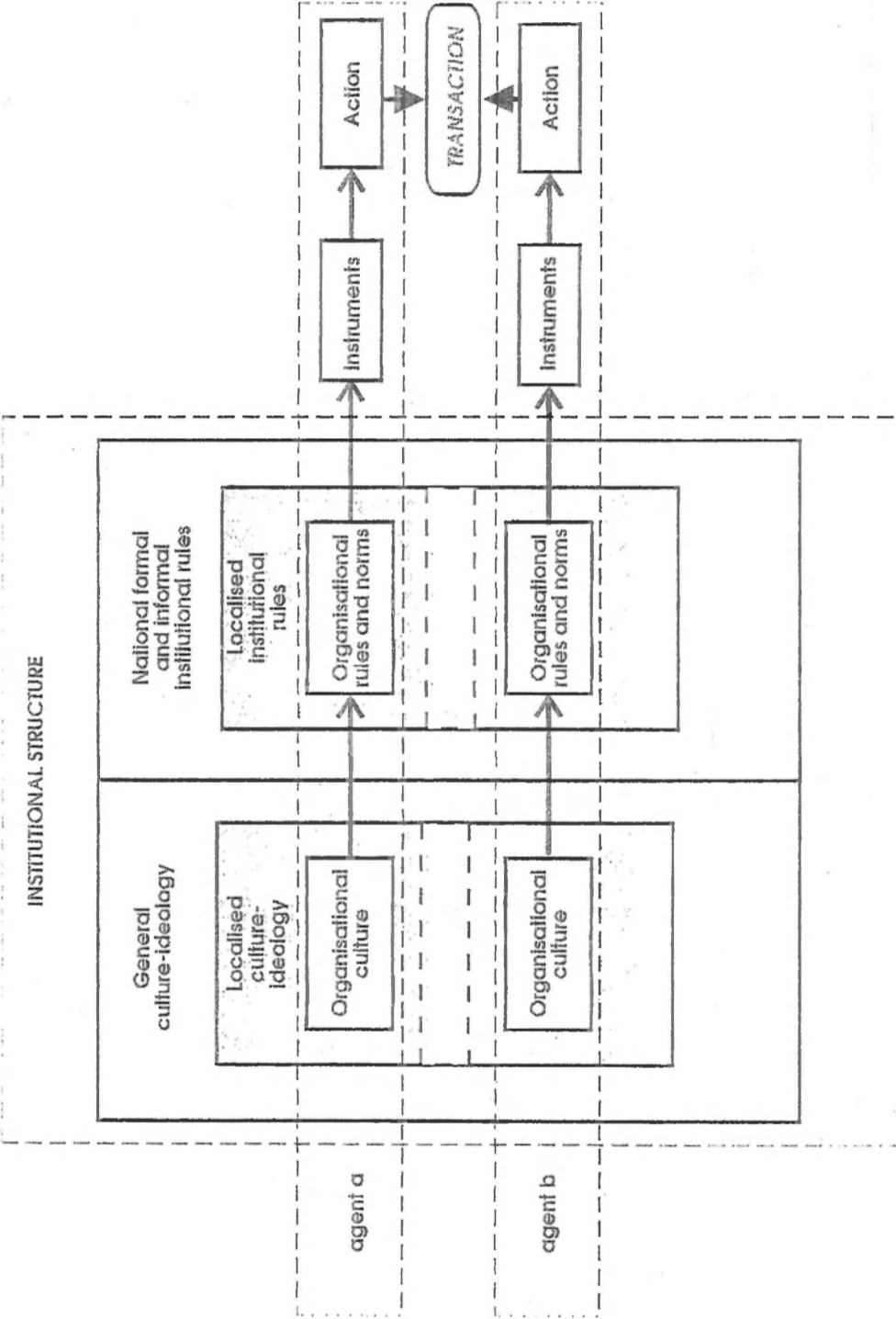
important to note that the diagram is not intended to directly represent causality: the arrows do not represent flows of cause and effect. Rather this a schematic representation of how a process of exchange, manifested most tangibly in a transaction resulting from the actions of agents, can be interpreted in terms of elements of social structure. Institutional structure is an essentially instrumental conception used to represent particular regularities of human interaction. It is held to consist of two key elements, culture/ideology and rules.

The use of the term culture here requires some care. The concept of culture, following Geertz, is held to be a semiotic one: "culture is not a power, something to which social events, behaviors, institutions, or processes can be *causally* attributed; it is a context, something within which they can be intelligibly — that is, thickly — described." [*emphasis added*] (Geertz, 1973 p.14). In attempting to describe how aspects of culture *inform* institutions we can focus on the beliefs and value sets held in common by a group of agents. The institutions found can only be understood by considering the social context, both local and more general, in which they are embedded. The rules of the game only acquire significance when we understand the *weltanschauung* of the actors to whom they apply.<sup>26</sup>

It is useful to distinguish various levels of culture from the highly general, belonging to (and to some extent defining) a particular society down to those belonging to more specific groups or organisations such as firms. Culture informs the rules arising at various levels. Such rules are broadly distinguished as being formal or informal. At the level of the nation-state there are the formal institutional rules of the legal system which define the explicit political and economic rules of the state and economy.<sup>27</sup> The effective institutional rules will however be a function of these rules conjoined with the informal institutional rules which affect the implementation of such formal rules. Formal and informal institutions will exist through a number of levels, with regional formal rules and local informal practices. Highly specific formal arrangements are made between actors in the form of particular contracts (dependent on the possibilities defined by the higher level institutions). Within specific groups there are particular *organisational rules and norms*. It is notable that whilst the macro-level structure is presumed to apply across all organisations in an economy, such presumptions may not apply between more local structures and particularly not across organisations.

This institutional structure provides the basis for the instruments that agents use to engage in exchange activity. These are effectively the tools available to agents by which exchange may

Figure 1: Framework for analysis of the exchange process



be achieved. Such instruments will cover a very wide range of possibilities. Examples include standard contracts, terms and conditions of exchange, formal appraisal mechanisms for exchange partners and simple routines of behaviour. Many such instruments become habitual through use, or matters of custom to the extent that the parties to an exchange may scarcely be aware of their use. However it is analytically possible to identify the instruments deployed, as derivatives of the institutional structure and giving rise to actions through which transactions are manifested.

The ability of an agent to engage in transactions with the various possible agents in the task environment can be analysed using this simple schema. As suggested by the diagram, the actions of agents are shaped by a hierarchy of social structure extending back to the most deeply embedded social beliefs. The model proposes that we understand this by considering how aspects of culture inform the generation of rules which in turn provide the instruments with which agents engage in the exchange process.

The term *discontinuity* is introduced to describe, in a functionalist sense, features of the institutional structure in relation to the exchange process. A discontinuity is defined as occurring where the institutional structure is systematically dysfunctional with respect to the problem of exchange. It will be most clearly manifested in the inability of agents to engage in transactions as a consequence of the nature of institutional structure. Less obviously, a discontinuity may result in exchange between two agents becoming more difficult, or resulting in higher transaction costs, than would otherwise be the case.

A *horizontal discontinuity* arises between the sets of structure in which each agent is embedded. Most commonly we expect to see it arise being elements of organisational culture or rules and norms. (Illustrated in the diagram by the clear separation of the boxes representing these aspects for agents a and b). One highly pertinent example of this may be in the differences found in the generic organisational cultures of smaller-scale and larger-scale organisations (Manu, 1988; Gibb, 1992). The former are held to be characterised by an archetypically entrepreneurial culture, the latter bureaucratic (in the Weberian sense). This gives rise to rules and norms which more clearly appear to prevent exchange between the two. Larger-scale organisations, for example, may have rules intended to produce a significant degree of control over supply sources. This might result in the use of various formal pre-qualifications for suppliers, which smaller-scale enterprises may not readily fulfil. Various instruments may be seen. A common illustration is the requirement in large contracts for guarantees backed by formal-sector banks. Horizontal discontinuities can also exist between localised structures where two agents are embedded in different structures, local to each agent (illustrated in the diagram by the dashed lines and lighter shading within the "localised" boxes). Variations between formal and informal institutional rules in regions can give rise to discontinuities. A clear example is found at the international level, where tariff barriers represent formal institutional rules specifically designed to inhibit trade between states.

A *vertical discontinuity* arises where the institutional structure does not support the construction of instruments which could enable particular types of transaction. It can arise

between any of the elements of structure shown for a given agent: for example - between an organisational culture and the more general cultural context, between national rules and local rules or between formal institutional rules and the cultural context. Formal institutional rules may be subject to relatively rapid change by comparison with aspects of culture giving rise to these discontinuities. (One effect of this may be to question the perceived legitimacy of such rules and thus undermine their effective implementation.) Localised, largely informal rules might also conflict with formal rules. One such possible conflict may arise between traditional community-based property rights and those defined by formal statute.

The special case of a vertical discontinuity located between the whole institutional structure and classes of exchange actions can be typified as a vertical *functional discontinuity*. Here the identification is of a structure which simply does not support particular economic activities. This is probably most likely to arise as a consequence of exogenous effects producing sharp changes in relative prices, shifting incentives in the economy.<sup>28</sup> It has been argued that the putative "moral" economy of some African societies is to a significant degree inimical to the capitalist means of production. One strand of this theme emphasises the nature of property rights which it is suggested are incompatible with accumulation.<sup>29</sup> If such an argument can be substantiated then it represents a profound case of a functional discontinuity between capitalist enterprise and institutional structure.

In order to identify and locate discontinuities, it is analytically useful to consider two generic, interlinked aspects of the problem of exchange: *co-operation* and *co-ordination*. The viability of exchange, measured in transactional outcomes of cost, benefit and uncertainty, for a particular transaction type is a function of how co-operation and co-ordination is achieved using the derived instruments.

Co-operation is taken formally to refer to solutions to the problems raised by the non-coincidence of aims amongst agents in an exchange (which includes the *possibility* of opportunistic behaviour<sup>30</sup>). We need to consider the effectiveness of the instruments available to each agent in a particular potential exchange situation. Each situation is essentially agent relative.

Co-ordination concerns the essential compatibility of agents. It is postulated that co-ordination is partially dependent on the predictability of one agents actions by another. This in turn has a partial dependency on the density of information exchange between parties. Co-ordination may underpin co-operation: solutions to the problems of co-operation may be constructed from relations which are essentially dependent on the possibility of co-ordination. Analysis must therefore focus on the extent to which instruments permit strong co-ordination enabling the creating of local dyadic relational structures which solve the problem of co-operation.



### The argument : major hypotheses and questions

Using the framework outlined, a particular argument is developed to attempt to explain and explore aspects of Kenya's "missing middle". A number of major hypotheses are presented which together start to account for the observed phenomena. The argument is not presented as a complete thesis at this stage, but includes a number of more speculative, exploratory ideas which only empirical work can clarify and substantiate or refute.

Broadly the argument is that the phenomenon of the missing middle in Kenya can be understood as arising from the problems of exchange. The emergence of middle-scale enterprise is retarded by the general difficulties of entrepreneurs in finding efficient solutions to these problems. Orthodox neo-classical reasoning would suppose that the presence of the difficulties posited here for a particular class of firm would result in their "de-selection" from the population in a broadly evolutionary process. In its simple form this argument has a number of problems. Most immediate of these is that markets in Kenya do not resemble perfect competitive markets and therefore cannot be assumed to generate the necessary selection pressures.<sup>31</sup> The argument relied on here is primarily a dynamic one; where entry barriers are placed in the way of the initial emergence of middle-scale enterprises, whether from start-up or growth, then such enterprises are unlikely to appear. Furthermore entrepreneurs themselves will act according to the view they have of the task environment. Where it is seen to involve excessive cost or uncertainty (translating into risk) they will seek alternatives.<sup>32</sup> The problems of exchange will both prevent entry and be perceived by potential entrepreneurs resulting in their avoidance. In the cases where middle-scale enterprise is found then we expect to observe that entrepreneurs have effectively managed to locate specific solutions.

#### Exchange-by-contract

The term "exchange-by-contract" is used to refer to exchange which is based on instruments deriving predominantly from state-maintained, formal, institutional rules. A classic example of such exchange is a supply contract in which the precise terms of the exchange are explicitly laid out in a legal document. Such terms would include what is to be supplied, including perhaps even its quality specification, when payment is due and so forth. Various contingencies are often dealt with. The form which the agreement can take is determined by the provisions of contract and company law. In case of conflict, the terms of the contract are enforceable by appeal to an appropriate court of law. Contract may be implicit as well as explicit. Consumer protection laws may automatically imply that the vendor undertakes to meet some minimum obligations (in the UK for example, goods must be of "marketable quality"). If these are not met the purchaser again has recourse to the courts.

It is argued that this is an inherently limited form of transacting taken *alone* and it is hypothesised that it is not relied on by enterprises in Kenya. It is contended that such contracting is both perceived to be and is actually a relatively costly means of contracting and sustaining few benefits (*a general functional discontinuity*).<sup>33</sup> Ultimately the successful construction of an institutional economic framework is undermined by *vertical discontinuities* between general cultural values and beliefs and the rules. Such a framework depends on

achieving legitimacy through the internalisation of values which support it. Relatedly, there may be a *discontinuity* between the informal rules which are a highly significant part of the whole institutional framework and the formal rules. Where the institutional framework is itself subject to any uncertainty then clearly transactions reliant on this framework will similarly be uncertain.

Many micro- and middle-scale entrepreneurs are particularly unlikely to use such methods. This is a consequence of the *vertical discontinuity* between the typical rules and norms of the smaller-scale enterprises (SSEs) in Kenya and the formal institutional framework.

#### **Relational exchange**

The term "relational-exchange" or "relational contracting" is taken to refer to forms of exchange which are reliant on the specific relationship between transacting parties. Returning to the simple example of supply, the desire on the part of both parties to continue trading with one another indefinitely can bind them together to solve potential problems with individual transactions. A late delivery or delayed payment may even be ignored by the "injured" party in the interests of the on-going relationship. The minimal basis of the relation is that the one party is able to supply the basic goods or services that the other requires. However where the relation is to some degree substituting for the clear assurances which can be obtained from explicit contract (and hence potential third party - court - enforcement), then the transacting partners may need to know and understand a great deal about one another to be assured of appropriate co-ordination and co-operation. This can partially derive from repeated transactions - if a customer always pays invoices on or before due date, a supplier will become increasingly confident in her credit-worthiness and feel comfortable supplying more goods on credit. However the question of the basic compatibility (beyond the simple material requirements of the exchange) between transacting partners logically precedes whatever can be gained from experience. If one company relies on the experience of its foreman to determine the adequate quality of its product, it will have difficulties in supplying another which prefers to see explicit measures of established quality tests.

It is argued that the relational form of exchange will be hampered by *horizontal discontinuities* at the level of the agent or organisation. Differences between organisations at the level of the rules and norms they employ and more profoundly in terms of culture give rise to instruments which fail to satisfactorily solve the problem of co-operation. This may be manifested in either:

- (a) the direct incompatibility of the resultant instruments with the problem presented, or
- (b) the difficulty of co-ordination which then undermines the evolution of relational structures which could facilitate co-operation.

Given a generally high perceived level of background uncertainty in the task environment it is argued that this is causally significant. It is held to be explanatory of the general effective isolation of SSEs from numerous actors in the SSE's task environment and a major factor retarding the development of MSEs.

#### **Embedded exchange - the case of the Asian entrepreneur**

It is hypothesised that the problem of co-operation may be "solved" by the grafting of economic relations onto existing socio-cultural structures. (This may result in the effective transmutation of structures to support a greater density of exchange activity and ultimately economic development within a community.) Such structures may permit co-operation by:

- (a) enabling the construction of economically rational co-operative relations, within simple dyads or a group, backed by either implicit or explicit economic incentive (a positive benefit from co-operation which is foregone by non-co-operation) or sanction (a negative impact which arises from non-co-operation),<sup>24</sup>
- (b) enabling the construction of socially rational co-operative relations, in simple dyads or a group, backed by either implicit or explicit, social or economic, incentive or sanction.
- (c) internalised informal rules or culturally based (moral) values which permit or encourage co-operation,
- (d) facilitate greater compatibility on the basis of shared values and beliefs (localised culture-ideology), improved communication/information exchange and hence (a).

Broadly it is hypothesised that the Asian community possesses such structures and these are utilised by successful middle-scale entrepreneurs to escape the generic problems of the middle outlined in the previous two paragraphs.

#### **Embedded exchange - the case of the African entrepreneur**

It is suggested that by contrast the potential indigenous African middle-scale entrepreneur does not have recourse to structures which permit the solution of exchange problems. How do we explain this? Clearly the African entrepreneur is predicted to be excluded from Asian networks insofar as such networks are based on socio-cultural structures. Membership of the specific social group is held to be an *a priori* condition for access and participation in the network. However why do effective networks not form *within* African communities? Elements of traditional African socio-cultural structures bear at least superficial similarity to aspects of Asian socio-cultural structure. Most obviously some form of "moral economy" is discernable in both communities.

This leads to a number of tentative, *exploratory* hypotheses which singly or combined may offer an explanation as to the inefficacy of African socio-cultural structures in solving exchange problems:

- (a) There are important instrumental differences between the Asian and African socio-cultural structures. It is hypothesised that the African situation is not readily utilisable in the way described above. There is a *vertical functional discontinuity* between localised cultural structures, rules and the actions implied by a capitalist mode of production. Particular areas for exploration are property rights and the detailed rules of the "moral economy" in operation.
- (b) The *content* of networks is relevant. The hypothesis is advanced that African networks generally have a poor resource endowment, both in terms of physical capital and intangible

capital such as production, managerial and organisational technologies. Thus whilst there may be the potential for strong co-operation, it *still* yields relatively little benefit to the African entrepreneur. The relatively short history of African capitalism therefore constitutes a constraint. Sufficient resources have yet to be accumulated.

- (c) The *scale* of the network is critical to its effectiveness. A small network possesses insufficient resources or fails to offer significant external economies. By contrast a very large network might impose an excessive drain on resources through consumption, preventing rapid accumulation.<sup>55</sup> The optimal network scale is to be found somewhere in the middle. The Asian community is relatively small and isolated in Kenya and thus may be close to such an optimum scale. This is a further *vertical functional discontinuity*.<sup>56</sup>

### Methodology

The argument which has been sketched demands a substantial, broad-based study to both build and substantiate the approach taken. Available resources determine that only a rather more limited inquiry can be conducted at this stage. In the light of such limitations, the approach is to be rather more exploratory than conclusive. The most significant outcome of the study will be an indication of the fertility or otherwise of the theoretical direction.

The major hypotheses described above give rise to a number of more concrete hypotheses and exploratory questions (detailed in appendix 1). The hypotheses are established in mutually-exclusive disjunctive pairs, consisting of a null (acceptance of which would undermine the argument put forward) and its alternate (which needs to be established in order to support it). These hypotheses are organised into groups relating to the three major components: exchange-by-contract, relational exchange and embedded exchange. In each case they are further divided into those which relate to the actual behaviour and activities of enterprises (referred to as *explanandum* - though these are actually intermediate entities in the argument; the study's central explanandum is of course the research question) and other agents and those which are held to explain such activities (referred to as *explanans*). The outcome of investigations of the explanandum hypotheses is more critical than those of the explanans. The specific explanandum hypotheses are key elements in the construction of the overall argument; if these basic facts fail to agree with the theory then it must be challenged. By contrast, the explanans hypotheses and questions can be modified more readily without undermining the overall direction of the work.

The investigation of such specific hypotheses and questions will not provide strong *inductive* support for the argument advanced. Even in the situation where all the null hypotheses can be firmly rejected in favour of the alternate, it is conceivable that an entirely different argument could be constructed to account for such evidence. As with most, if not all, theoretical explanation, there is an implicit reliance on the already established (and yet to be established) fecundity of the theoretical stance and its logical consistency with other well established theory. The specific hypotheses represent some of the key deductions from the argument and thus represent a stiff test for its validity. If a significant proportion of the null

hypotheses must be accepted then the argument can be judged to have foundered as currently expressed. If, on the contrary, many of the alternate hypotheses are established then the argument advanced gains credence by its capacity to organise such discovered facts into a coherent form.

It is important to note that the fieldwork in this study cannot hope to establish in an inductively satisfactory manner some of the core causal relations posited. In part this is an intrinsic methodological limit since it is not possible to test individual enterprises in a controlled experimental manner. If we say that enterprises are constrained by their exchange environments, whilst we can observe individual enterprises either failing or succeeding, we cannot observe the counterfactual - what *would* have happened to each enterprise *if* the environment had been different for them. A further limitation is derived from the way in which the fieldwork is to be conducted - based on a single shot study. Ideally, time-series data or observations would be obtained. Tracing the history of an enterprise would enable a comparison to be made between relative performance and the exchange environment faced. This would provide powerful evidence regarding the explanatory force of the argument. Regrettably the time and resource constraints of this particular study do not enable this route to be taken.

Consideration of the specific hypotheses provide effective potential failure points for the theoretical argument (or falsification tests, following Popper). However the theory also represents an abstract description of the process by which enterprises engage in exchange. A further test of validity is to consider the extent to which a description of the processes by which enterprises are found to engage in exchange fits within this conceptual schema. This more qualitative enquiry is important in the context of the difficulty outlined above of directly quantitatively testing the relation between enterprise success and the exchange environment.

#### **Sources of data and interpretation**

A combination of sources and approaches to data collection can fruitfully be used to test the specific hypotheses. Official government publications and statistics provide a source of much information concerning the nature of the formal institutional environment.<sup>37</sup> News reports and other secondary sources may also be useful in this respect. However primary data collection from existing middle-scale enterprises will be at the core of the work. Ideally it will be useful to investigate directly other agents who help to form the exchange environment faced by middle or potential middle-scale enterprises.

The model and specific hypotheses do not immediately lend themselves to quantitative survey work. A number of concepts have been introduced which cannot be operationalised readily. Most obvious of these is that of culture - whether organisational or the wider social context. The focus of the theoretical reasoning here is on institutions as explaining exchange. However at the core of an approach which seeks to explain diversity within a given setting is the notion that the institutions do not exist in a vacuum but are embedded within culture. Now as stated earlier culture is understood here as being an essentially semiotic concept. Even

where we narrow our focus to that of beliefs and value held in common, such a conception cannot be operationalised. We cannot hope to exhaustively analyse the behaviour of a social group to discover an all-inclusive description of its values and beliefs. Rather it is a question of interpretation. It is argued that there are serious problems raised by attempts to operationalise culture.<sup>38</sup>

The core of this work is based on case-studies which are to be interpreted within the theoretical framework advanced. Within each case, various types of exchange activity are to be explored. The essence of interpretation is to make sense of the *process* by which each activity occurs within the context of the theoretical approach. These interpretations of process then form the basis for constructing case-study analyses. Based on this analysis, it is possible to consider the support for each of the hypotheses and its alternate. Many of these should be relatively straight-forward; the reliance or otherwise of an enterprise on its use of law in the settlement of contractual dispute should be immediately clear from a fairly simple description of exchange processes. However the consideration of differences in organisational culture demands both a rich (or thick) description of both the processes and cases together with a carefully argued analysis.

A further stage of empirical investigation is tentatively suggested, contingent both on the outcome of the case-study work and limitations of time available for research. It is hoped that following the findings from the case-study work it will then be possible to conduct a limited amount of quantitative work. Such quantitative work depends on being able to construct a relatively simple questionnaire which can be administered readily to a statistically significant sample. Although this quantitative work evidently cannot address hypotheses concerned with aspects such as culture, it can generate useful inductive support for a number of the other hypotheses. Furthermore any quantitative survey work cannot precede the more qualitative case-studies since there is *ex ante* insufficient understanding from which to construct a satisfactory instrument.

#### **Populations**

As enterprise case-studies are the initial focus, there is no requirement to consider problems of statistical significance and stratification. Cases must however be selected from enterprise populations in which the factors considered in the theoretical approach are not likely to be swamped by factors not considered here. In particular it is important to avoid enterprise sub-sectors in which the process technology is known to be subject to significant indivisibilities. Oil refining is one obvious such sub-sector. Other sub-sectors which though technically feasible at the middle-scale, such as sugar processing, but where there has been strong, direct government involvement will also be avoided. To avoid the possibility of other extraneous factors "swamping" the data, enterprises will be sought in sub-sectors in which there is known to be an at least moderately well-developed middle-scale sector (defined as one in which at least 10% of employment is within the sector).<sup>39</sup>

Cases, minimally, need to cover enterprises in the middle-scale owned and managed by entrepreneurs of both African and Asian ethnic origin. One case at least is required for each within a sub-sector in order to permit easier comparability of results by controlling for process related phenomena. Beyond these middle-scale cases, it will be useful and relevant to consider enterprises in both the micro-scale and large-scale. To eliminate the possibility of not finding enterprises with entrepreneurs of both African and Asian origin within a sub-sector who are also prepared to be the subject of a case-study, candidate sub-sectors are chosen in which there are known to be at least 10 middle-scale enterprises. A number of manufacturing sub-sectors fulfil all these criteria. The two initially selected are manufacture of wearing apparel and manufacture of soap and cleaning preparations. The former is selected owing to the considerable work already carried out within the Institute for Development Studies in Nairobi (McCormick 1988, McCormick *et al* 1994, etc) This work will both benefit from the existing understanding of the sector and contacts with entrepreneurs. Furthermore it is hoped to be broadly complementary in further widening our understanding of this sub-sector. Soap and cleaning manufacture is chosen on the basis of convenience - the researcher has useful contacts with an enterprise involved in this sub-sector which is facilitating access. Although questions of location and gender are anticipated to be relevant variables, at the case-study stage it is not anticipated that there will be the opportunity to explore relevant cases. The study will for convenience therefore most likely consider enterprises within Nairobi. A later quantitative stage would enable these variables to be explored.

#### **Instruments and data gathering**

The major instrument to be used in the case-study is a research protocol. This case-study protocol consists of five sections, each relating to a particular type of exchange activity: supply, demand, labour, process technology acquisition and finance. Whilst each of these is different, based around the nature of the particular activity under question, they share a common logical, exploratory basis (for illustration, the first section on supply is attached in Appendix 2). It should be noted that whilst these activities are believed to cover the primary functional exchange activities of the enterprise, it is not supposed nor necessary that the set is exhaustive.

The protocol aims to ask open-ended questions in order to effectively explore the exchange process. It is essential that each issue is left sufficiently open so that the richest data can be captured and theory is not imposed on the data at collection. However as the pilot work has shown, leaving questions too open can fail to probe effectively the question at issue. In principle, with sufficient time in the field with an enterprise, this should not pose a problem. Practically a full-scale ethnographic study of each case is simply infeasible. Entrepreneurs in successful middle-scale companies are, not unexpectedly, extremely busy individuals and access time can be expected to be relatively limited. Consequently the instruments have to be highly productive of relevant data over a relatively short interview period. The instruments produced represent an attempt to resolve the conflict between openness and productivity.

Each section in the protocol is to be administered in a separate meeting to avoid problems of interviewee fatigue and access problems again. Consequently each case will range over at least five meetings. Beyond the direct use of the protocol, observation will be sought of each enterprise. Minimally this will involve observing the work of the enterprise in practice. This unstructured observation should help to fill some of the gaps created by the reliance on semi-structured interviews.

A serious constraint already noted through the pilot case study is the difficulty in capturing all the data which emerges in the course of an interview. Where the instrument is most successful, it has been found that very useful material is offered by the respondent - most especially with the relating of actual events in the history of the enterprise as interpreted by the respondent. Unfortunately it is considered impossible to record these responses verbatim for later detailed coding and analysis. Both experience in the field and the expressed opinion of a respondent indicate that the use of a tape recorder would constitute a barrier to free expression by respondents. Business people in Kenya have a natural reticence and are very unwilling to commit themselves to statements or opinions in a tangible form (on paper or recorded).

#### **Application of results**

The proposed study must be seen primarily as a modest contribution to knowledge, and only the preliminary stage of a particular research approach. However as discussed earlier, the question which this work seeks to address is believed to be of great significance in the context of Kenya's economic developments. Considerable practical efforts have already been directed at mitigating the problems of the "missing middle". Any improvement in understanding of its causes will be valuable in rendering such efforts more effective. It is believed that in some areas, notably finance, more radical designs of intervention may be demanded. The conclusions from this study, it is hoped, will provide some firm indications of directions for such designs.



## Notes

<sup>1</sup> Definitions of scale abound in the literature. Based on the recent detailed GEMINI study of smaller-scale enterprises in Kenya (Parker & Torres 1994). I use the following definitions: micro: 10 or less employees. small: 11-50. medium: 51-100 and large: more than 100. which also broadly accords with usage in official Government of Kenya publications. Such definitions are obviously a matter of instrumental convenience. There is a clear danger that such somewhat crude quantitative definitions can mask more significant qualitative differences between enterprises. What is referred to here as the "middle" is equated with small and medium sized enterprises, as defined above. However the essential intended reference of the term is enterprises which is qualitatively more sophisticated in terms of organisation or technology than the least sophisticated type of enterprise, typically within the micro-scale or informal sector (see Brooksbank (1991) for a discussion of some of these difficulties). Finally I use the term "smaller-scale" to refer to all enterprises which are not large; that is micro, small and medium enterprise.

<sup>2</sup> The recent GEMINI study found that 1.8 million workers were employed in micro-enterprises, 0.15 million in middle-scale enterprises (Parker & Torres 1994). By comparison, the large-scale sector employed 1.6 million (Republic of Kenya).

<sup>3</sup> Stewart (1990) summarises a number of such studies.

<sup>4</sup> Schmitz (1989, pp.2-3) lists some of the main benefits.

<sup>5</sup> There is a rapidly developing literature in this area. Recent collections are: Rasmussen *et al* (1992), UNCTAD (1994) and Pedersen *et al* (1994). Other important articles are Schmitz (1989, 1995) and Nadvi & Schmitz (1994).

<sup>6</sup> House *et al* (1993) and McCormick (1991) argue this point convincingly.

<sup>7</sup> The estimated size of the *formal* sector workforce in Kenya in 1993 was 1.47 million. of which only 0.17 million or 11% were employed in lower middle-scale enterprises employing between 10 and 49 employees inclusive (Republic of Kenya, 1994, p.145). A survey of small-scale enterprise in 1993 produced an estimate of total employment in enterprises with up to 50 employees of 1.99 million (Parker & Torres, 1994). The estimated employment in lower middle-scale enterprises (employing between 11 and 50 employees inclusive) was 0.14 million according to this survey. The variance in the estimates of the size of the sector is clearly significant, but not unexpected given the very different aims and methodologies of the two surveys.

<sup>8</sup> Kerre (undated draft, p.2) suggests significant proportions of total industrial *and* commercial activities in the major centres are controlled by non-Kenyans or Kenyans of non-indigenous descent: Nairobi 41%, Mombassa 80%, Eldoret 68% and Kisumu 98%.

<sup>9</sup> The figures in the census will slightly under-report the population of those of Asian descent since it is known that some will hold British and other nationalities. However the number will not be very large - the total number of British nationals shown resident in Kenya was only 15,000 of which only a proportion will be Britons of Asian rather than European descent.

<sup>10</sup> This term is borrowed from Williamson (1992).

<sup>11</sup> This brief review of the literature is clearly incomplete. A more complete review occupies many pages and is omitted for the sake of brevity.

<sup>12</sup> The distinction between internal and external constraints is made by Schmitz (1982). He does not imply however that the two can be regarded as mutually exclusive.

<sup>13</sup> Other dependency theorists who have written specifically on Kenya are Brett (1973), Langdon (1977) and Kaplinsky (1978).

<sup>14</sup> Amongst the revisionists are Leys (1982) and Henley (1982) drawing on Cowen (1982) and Swainson (1980). The dependency thesis has been defended by Kaplinsky (1982) and Langdon (1980) amongst others.

<sup>15</sup> The Kenyan government explicitly committed itself to active support of the informal sector in a sessional paper in 1986 (Republic of Kenya, 1986). This support has been reiterated subsequently in development plans, sessional papers and specific reports (for example: Republic of Kenya (1989a, 1989b, 1992).

<sup>16</sup> See for example Wright (1989, pp.15-6).

<sup>17</sup> See for example Kilele & Sinclair (1991, p.20)

<sup>18</sup> For example Rasmussen (1992) and Pedersen (1994) writing on Zimbabwe, Aroo (1992) on Tanzania and Schmitz (1993) on Brazil.

<sup>19</sup> A number of writers from various disciplines have emphasised the important of the social linkages, for example Granovetter (1985, 1992), Storper (1990) and Jonannisson *et al* (1994).

<sup>20</sup> The original definition of "entrepreneur", attributed to Cantillon, is as a bearer of risk. This gives rise to the theory that some individuals possess a greater or lesser innate capacity or taste for risk. The absence of enterprise can therefore be attributed to an under-supply of such risk-taking entrepreneurs. However such arguments can only be empirically supported once it has been conclusively demonstrated that individuals behave in a consistently more or less risk averse fashion when confronting identical situations. This is very hard to find in practice and the danger in assuming the argument without proof is that it may obscure important, relevant differences between entrepreneurs. The notion of risk-aversion as being an innate, irreducible (to social conditioning factors, for example) psychological property of individuals does not seem a priori especially convincing.

<sup>21</sup> A good review of some of the theories is contained in Kilby (1971).

<sup>22</sup> See Kilby (1971, p.1).

<sup>23</sup> Granovetter (1995) argues that the widely observed economic success of various immigrant groups throughout the world may be attributed in part to their ability, through sheer distance, to escape the drain of numerous obligations to kin, whilst retaining strong ties within the isolated immigrant community. A similar argument is taken up within this study.

<sup>24</sup> Ensminger [1992] has used this new institutional approach in a study of the development of a market economy amongst the Orma.

<sup>25</sup> North's transactions costs approach should be distinguished from Williamson's (1975, 1985) which is better known. Although these two strands are largely complementary, differing mainly in terms of emphasis, there remain important differences. Most significant of these is that Williamson holds that institutions (and organisations) are economically efficient, shaped by the pressure to economise on transaction costs. North explicitly repudiates this view, contending that some institutions are highly economically inefficient and uses this as a central idea in explaining poor economic performance.

<sup>26</sup> This conception of culture does not, of itself, assert a position on the question of the *degree* to which distinguishable aspects of culture across social groups can be held to account for differences in those groups at the economic level. There is a vigorous debate over the extent to which culture is a

major explanatory element in cross-national comparison. Writers such as Hofstede (1980) claim a very major influence for specific elements of culture whilst others taking a strongly "structuralist" stance, as noted by Sorge (1996), assert that it is the institutions alone in an economy which are the key to differences. The stand taken, though not substantiated here, is that neither position alone is theoretically or empirically satisfactory. Although institutional rules (both formal and informal) can be determined by analysis as explaining economic phenomena, understanding the rules requires that we interpret them in cultural context; how do these rules make sense to the people who follow them?

<sup>27</sup> Supra-national formal institutional rules may also exist: trading blocs such as the EU, NAFTA and so forth implement such rules. At a global level the WTO/GATT provides similar such rules.

<sup>28</sup> Changes in relative prices alter incentives in interaction. Relative price shifts include: factor prices, information costs and technology change (see North, 1990, p.84).

<sup>29</sup> See for example Marris & Somers (1971) and Bates (1989) for arguments in this vein concerning Kenya.

<sup>30</sup> The problem of co-operation arises not because agents are *generally* opportunistic (*pace* Williamson, 1985) but because in the face of non-coincident aims there is the *possibility* of opportunism which undermines co-operative behaviour. The prisoners' dilemma arises because neither player can be *certain* regarding the actions of the other (see also Hodgson, 1988).

<sup>31</sup> The general problems associated with the neo-classical conception of economic rationality and selection have been discussed at length in the literature. A useful discussion of these issues is found in Langlois (1986).

<sup>32</sup> This view of agent behaviour follows the notion of "bounded rationality" put forward by Simon (1957)

<sup>33</sup> It is argued that the perceived and actual inherent general uncertainty in the formal institutional structure is partially responsible. This may be traced to a form of macro-level discontinuity between the structure and logic of Kenya's political economy and the institutional framework.

<sup>34</sup> The literature on these issues is vast and cannot be discussed here. Game theory is frequently used to model these problems. Useful discussions pertinent to the treatment here are found in Williamson (1993), North (1990) and Gambetta (1988).

Often referred to in the literature is the hostage model, in which a specific negative outcome is triggered by defined events of non-co-operation. The most obvious example of this is the performance bond: one party is required to pay a certain bond in advance of delivering a particular service/product. It is understood that if the service/product does not conform with the pre-defined requirements of the purchaser then the bond is foregone (typically in construction projects this might be completion of the project by a defined date). Asset-backed or securitised lending is another example of the hostage model (though clearly the security pledged also offers the lender with an alternative means of repayment in addition to diffusing the problem of moral hazard).

<sup>35</sup> A similar argument is put forward by Granovetter (1992) in relation to entrepreneurs in minority communities in SE Asia.

<sup>36</sup> A similar argument is implied by Granovetter (1995) where he refers to the necessity for a balance between coupling and decoupling amongst members of a community in order to achieve economic advantage.

<sup>37</sup> Notably: Kenya Gazette which provides a rich source of information regarding changes in formal (legal) institutions and the annual Statistical Abstract and Economic Surveys for macro-economic data.

<sup>38</sup> It is argued that attempts to operationalise culture, exemplified by the work of Hofstede (1980, 1991), strip the concept of its essential reference. At best what is referred to by such operationalisations are the consequences of culture, at worst they posit the existence of entities in social reality which are under-determined by the evidence. Hofstede himself only intends his operationalisation to produce useful constructs - "a tool for analysis" (quoted in Hodgetts, 1993). Whilst this avoids the charge of ontological extravagance, it *a priori* robs the concept of its richness in which lies the very possibility of explaining diverse phenomena.

<sup>39</sup> This is currently based on CBS published data (Republic of Kenya, 1995). The data is known to be flawed, under-estimating the micro-scale sector in most sub-sectors. Work is in progress to integrate data from other surveys to produce a more accurate size distribution.

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## APPENDIX 1 : SPECIFIC HYPOTHESES AND EXPLORATORY QUESTIONS

## 1. Exchange-by-contract

*Explanandum***Hypothesis**

1.1	<i>Null</i>	Enterprises frequently place strong reliance, either implicitly or explicitly by the use of formal contract, on the state-maintained economic institutional framework in solving the problem of cooperation in exchange.
	<i>Alternate</i>	Enterprises rarely place much reliance on the institutional framework for solving the problem of cooperation in exchange.
1.2	<i>Null</i>	Enterprises regard exchange based on the state-maintained economic institutional framework as an efficient (in terms of transaction costs, benefit and uncertainty) mechanism for solving problems of cooperation.
	<i>Alternate</i>	Enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of cooperation.
1.3	<i>Null</i>	SSEs are no less likely to rely on the state-maintained economic institutional framework for solving the problem of cooperation in exchange than LSEs.
	<i>Alternate</i>	SSEs are significantly less likely to rely on the institutional framework than LSEs.

*Explanans***Hypothesis**

1.4	<i>Null</i>	Enterprises perceive the institutional framework in Kenya, consisting of formal and informal rules, as reliable, being relatively stable and predictable.
	<i>Alternate</i>	Enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.
1.5	<i>Null</i>	There are no signs of instability in the institutional framework in Kenya.
	<i>Alternate</i>	There is evidence of instability in the institutional framework: with rapid changes in formal rules, (strongly influenced by the bargaining power structure), discontinuities between formal and informal rules and localised, variable informal rules of implementation.

**Hypothesis**

1.6	<i>Null</i>	Both those involved in the execution of formal rules and those using or susceptible to such rules believe that such rules are legitimate, should always take precedence over traditional local community or tribal rules and should only exceptionally be subject to change or modification in practice.
	<i>Alternate</i>	Both those involved in the execution of formal rules and those using or susceptible to such rules believe that such rules are not necessarily equitable, should not always take precedence over traditional rules and may legitimately be modified according to the particular situation.
1.7	<i>Null</i>	SSEs do not perceive the institutional framework as inaccessible to them or incompatible with their needs.
	<i>Alternate</i>	SSEs perceive the institutional framework as inaccessible to them or incompatible with their needs

**2. Relational contracting***Explanandum***Hypothesis**

2.1	<i>Null</i>	LSEs and public sector bodies find no particular difficulties in engaging in any type of exchange activities with SSEs.
	<i>Alternate</i>	LSEs and public sector bodies find engaging in exchange activities with SSEs systematically more difficult than other groups.
2.2	<i>Null</i>	SSEs do not regard the formation of relations with exchange partners as significant to their businesses.
	<i>Alternate</i>	SSEs regard the formation of relations as an important means of informally solving problems of exchange.
2.3	<i>Null</i>	SSEs find no particular difficulties in engaging in any type of exchange activities with any groups found in the task environment.
	<i>Alternate</i>	SSEs find engaging in all but the simplest exchange with LSEs and public sector bodies difficult.

*Explanans***Hypothesis**

2.4	<i>Null</i>	There is no significant instability in Kenya's recent economic performance at the macro-level.
	<i>Alternate</i>	There is significant instability in Kenya's recent economic performance at the macro-level.
2.5	<i>Null</i>	Enterprises do not perceive the general economic operating environment in Kenya as characterised by significant instability.
	<i>Alternate</i>	Enterprises do perceive the general economic operating environment in Kenya as characterised by significant instability
2.6	<i>Null</i>	The effective instruments deployed by SSEs and LSEs & public sector bodies in relation to exchange are not systematically discernibly different.
	<i>Alternate</i>	The effective instruments deployed by SSEs and LSEs & public sector bodies appear to be different in kind and undermine the formation of exchange relations.
2.7	<i>Null</i>	The organisational rules and norms (including strategies, structures and broad processes) adopted by SSEs, LSEs and public bodies are not significantly, systematically different.
	<i>Alternate</i>	The organisational rules and norms adopted by SSEs, LSEs and public bodies are significantly, systematically different.
2.8	<i>Null</i>	The organisational culture (values and beliefs) of SSEs, LSEs and public bodies are not significantly, systematically different.
	<i>Alternate</i>	The organisational culture (values and beliefs) of SSEs LSEs and public bodies significantly, systematically different.

*Explanandum***Hypothesis**

3.3	<i>Null</i>	Entrepreneurs find it no more difficult to solve problems of cooperation in exchange with members of other ethnic groups.
	<i>Alternate</i>	Entrepreneurs find it more difficult to solve problems of cooperation in exchange with member of other ethnic groups.
3.3.1	<i>Null</i>	Asian entrepreneurs find it no more difficult than Africans to solve problems of cooperation in exchange with members of other ethnic groups.
	<i>Alternate</i>	Asian entrepreneurs find it more difficult than Africans to solve problems of cooperation in exchange with member of other ethnic groups.

*Explanans***Exploratory question**

3.4	<p>If entrepreneurs rely on ethnic based socio-cultural structure, how is the effectiveness of this structure best understood ?</p> <p>(a) Rational economic action - backed by incentive/sanction</p> <p>(b) Rational social action - backed by incentive/sanction</p> <p>(c) Internalised informal rules and moral values.</p> <p><i>Is there sense of a "moral economy" within the ethnic group ?</i></p> <p><i>What rights, obligations and values are imposed and how do these relate to exchange ?</i></p> <p>(d) Strong communication, based on shared values/beliefs supporting (a)</p> <p>(e) Other</p>
3.5	<p>If entrepreneurs make no use of ethnic based socio-cultural structure, why ?</p> <p>(a) Social networks in which they are involved are generally resource poor</p> <p>(b) Social networks in which they are involved are insufficiently large</p> <p>(c) Relationships within the networks are insufficiently strong and therefore offer little contribution to solving the problem of cooperation or coordination</p> <p>(d) Competition for scarce resources amongst members of the same ethnic group is too strong to permit cooperation</p> <p>(e) Significant elements of socio-cultural structure are repudiated in the process of entering the modern exchange economy</p> <p>(f) Other</p>
3.5.1	<p>If relationships appear to offer little contribution to solving the problem of cooperation and coordination, how is this best understood ?</p> <p>(a) Simple absence of supporting or mutable structures</p> <p>(b) Structures are inimical to the required forms of exchange</p> <p>(c) The relationships, on balance, imply a greater liability or risk than asset or potential reward leading to their repudiation as a whole</p>

## APPENDIX 2: INTERVIEW PROTOCOL (SUPPLIER SECTION)

**1. REGULAR SUPPLIERS**

Do you have any regular suppliers ? YES  NO

**1.1 KEY REGULAR SUPPLIERS**

Do you have *key* regular suppliers who are very important to you ?

⇒ Why do you use or not use key regular suppliers ? YES  NO

**1.1.1 Description**

- Can you describe your most important suppliers ?

[Prompt : size, location, ownership, main business activities, position in market, direct manufacturers, wholesales, local, national, importers, international, ethnic origin of owners of firms]

- Where do materials come from originally

**1.1.2 Items supplied**

- What do they supply to you ?
- Is it important to use regular suppliers for these items?
  - ⇒ How is it important that these are supplied by a regular supplier ?

**1.1.3 Importance**

- How important do you feel each of these suppliers is to you ?

[Prompt: loss of one or more of these suppliers would involve some problems for you]

- ⇒ Can you describe how they are important to you ?

[Prompt :supplies hard to find elsewhere, used to dealing with them]

- How important do you feel you are to these suppliers ?

- ⇒ Can you describe how you are important to them ?

[Prompt :supplies hard to find elsewhere, used to dealing with them]

## 1.2 OTHER REGULAR SUPPLIERS

Do you have other regular suppliers (other than those identified above) ?

⇒ Why do you use or not use these other regular suppliers ? YES  NO

### 1.2.1 Description

- Can you describe some of these suppliers ?

[Prompt : size, location, ownership, main business activities, position in market]

### 1.2.2 Items supplied

- What do they supply to you ?
- Is it important to use regular suppliers for these items?
  - ⇒ Why is it important that there are supplied by a regular supplier ?

### 1.2.3 Importance

- How important do you feel these suppliers are to you ?

[Prompt : loss of these suppliers would involve some problems for you]

⇒ Can you describe how they are important to you ?

[Prompt : supplies hard to find elsewhere, used to dealing with them]

- How important do you feel you are to these suppliers ?

⇒ Can you describe how you are important to them ?

[Prompt : supplies hard to find elsewhere, used to dealing with them]



### 1.3 ESTABLISHING RELATIONSHIPS WITH REGULAR SUPPLIERS

How did you start working with your current regular suppliers and how has the relationship developed ?

#### 1.3.1 Initial contacts

- How did you first hear about each supplier ?
- How did you first make contact ?

#### 1.3.2 Meeting requirements

- What were the key things you were looking for in a supplier ?  
⇒ *Why were there things important ?*
- How were you able to judge whether the supplier would meet your requirements ?

#### 1.3.3 Initial difficulties

- What problems did you envisage when dealing with a supplier ?  
⇒ *Why did you envisage such problems ?*
- What did you do to guard against these problems ?  
⇒ *Why would such strategies/approaches solve these problems ?*
- What immediate or initial problems did you actually encounter when dealing with your current regular suppliers?  
⇒ *How do you explain such problems ?*
- If there were such problems, how were they resolved ?  
⇒ *How would you explain the success of their resolution ?*

#### 1.3.4 Relationship development

- How has the way in which you deal with your regular suppliers changed since initiation ?  
⇒ *How would you explain this development ?*

#### 1.4 PROCESS OF SUPPLY

Can you describe how supplies are obtained from your regular suppliers ?

##### 1.4.1 Day-to-day process of obtaining supplies

- How do you go about getting supplies from your regular suppliers?

[Prompt: *elements include initiation of order, confirmation of order, lead times, delivery, quality inspection, payment and credit periods*]

##### 1.4.2 Achieving effective regular supply

- What are the most important things in relation to achieving regular supply?

[Prompt: *stable prices, competitive prices, assuring quality of product, on-time delivery, size of deliveries (maximum and minimum), credit periods*]

- Do you have any difficulties in achieving these elements with your regular suppliers ?
- What potential problems can you see in relation to achieving these elements ?
- What active strategies or procedures do you use to overcome these actual or potential difficulties or problems ?
- When dealing with your regular suppliers what do you feel, in general. You can rely on to overcome or mitigate potential problems ?

1.4.3

**Dealing with change**

- In what ways does the detail of the process of obtaining supplies change often ?

[Prompt: *items supplied (quantities, quality etc.), changes in administration of order, lead times, delivery, rejection, payment and credit periods*]

⇒ *Why do these things change ?*

- How do you deal with such changes with your regular suppliers ?

⇒ *Why do you deal with it in this way ?*

- Do you find such changes can be accommodated satisfactorily?

⇒ *Why is this the case (satisfactory or unsatisfactory) ?*