

## Constraints Faced By Micro and Small Enterprises in the Liberalised Markets

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### **Abstract**

The essence of this paper is to explore the major constraints that influence the development of Micro and Small Enterprises (MSEs) in Kisumu, Western Region part of Kenya. The study conducted was guided by the following hypotheses: constraints, which affect MSEs result from lack of skills; MSEs requires institutional support to overcome these constraints; and many constraints facing MSEs result from poor implementation and lack of co-ordination of policies set by the government. A literature review having preceded our empirical test clearly indicates a strong positive relationship between constraints affecting MSEs and the growth of MSEs in the region. Primary data were collected from 100 Micro and Small entrepreneurs in Kisumu town. Structured questionnaires were administered to the entrepreneurs and their employees. The findings of this study indicate that MSEs face many constraints that result from lack of skills; Institutional support from the organizations; and poor implementation and co-ordination of policies by the implementing agencies. These factors results to moribund of enterprises hence slow development of MSEs in the region. The paper concludes by recommending that the environment of MSEs should be enhanced through introduction of support programmes such as training, consultancy, counselling among others to enable MSEs grow and develop.

**Key words:** Constraints, Institutional support, liberalised markets; pro-SME

### **1. Introduction**

In recent years, Micro and Small Enterprises (MSEs) part of informal sector have achieved an increasingly important role in developing countries. In Kenya, MSEs have been regarded as offering the best alternative to economic growth including industrialization, especially with the advent of economic reforms that have led to the liberisation of the economy (Ikiara, 2001). With these achievements brought about by MSEs, many pro- MSE proponents have been advocating for assistance to ameliorate this sector (Beck et al, 2003). This assistance they opined should be inform of a package popularly referred to as support programs. These support programs entails financial aid, training, consultancy services, market services, technology, and association building (Kantor, 2001; Ayiamba et al, 2001; Kenya, 1996; ILO, 1986). Despite these MSEs support programs and other institutional policies being put in place in Kenya, MSEs continue to experience many constraints which limit their operations hence growth. Support programmes are put in place to pulverize the constraints that affect MSEs and enable them operate successfully.

Recent studies have shown that MSEs in both developed and developing countries are affected by similar constraints though to different extents (Levitsky, 1996). Schiffer et al, (2001) and Beck et al, (2002) in their surveys of 80 developed, developing and transitional economies, found out that small enterprises experience significantly higher growth obstacles in several areas, such as financing, taxation and regulation, exchange rate management, corruption, anti- competitive practices, legal and street crimes.

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In Kenya, many scholars who have researched on the constraints affecting MSEs have identified lack of finance, training, consultancy services, marketing, insecurity, taxation procedures, bureaucratic procedures, assets among others, as major constraints inhibiting MSEs from expanding and developing (Kibas, 1995; Kinyanjui, 1993). These studies are enough evidence to support the fact that the high moribund of MSEs in many regions of Kenya are caused by these constraints.

Rather than relying upon the information from documents and literature on the informal sector, this paper uses responses from a survey of over 100 entrepreneurs in Kisumu to analyse the constraints affecting MSEs. If these constraints are identified, then the key players in MSEs, that is, the pro- MSE proponents will be able to identify the type of support to give them. Thus, the analysis will be able:

- To identify if the constraints affecting MSEs result from lack of skills,
- Identify if MSEs require institutional support to overcome the constraints, and
- Analyse if poor implementation and lack of coordination of policies set by the government result to many constraints affecting MSEs.

The remainder of the paper is organized as follows. Section 2 describes the research problem statement. Section 3 gives the hypotheses of the study. Section 4 reviews the literature, and constraint model. Section 5 describes the methodology. The empirical results are presented in Section 6. Section 7 concludes.

### **Research Problem**

Despite the concern that MSE researchers have devoted on the subject of constraints affecting MSEs, little consideration has been directed towards exploring the nexus of constraints and lack of training. This paper empirically determines the constraints affecting MSEs in Kisumu. The paper also tries to identify if the constraints affecting MSEs results from lack of skills; if MSE requires institutional support to overcome the constraints; and if poor implementation and lack of coordination of policies set by the government result to many constraints affecting MSEs.

### **Hypotheses**

On the basis of the above research problem, our main research hypotheses are:

H1 Constraints, which affect MSEs result from lack of skills.

H2 MSEs require institutional support to overcome these constraints.

H3 Many constraints facing MSEs result from poor implementation and lack of coordination of policies set by the government.

## **2. Existing Literature and Constraint Model**

### **➤ Existing Literature**

This section reviews the existing constraints affecting MSEs in liberalised markets and the intervention mechanisms that have been instituted by the key players in the informal sector.

### **➤ Constraints**

As noted in the introduction, MSEs in different regions whether developed, developing, or developed countries face somehow similar constraints. However, these constraints vary in magnitude depending on the countries (Levitsky, 1996; Beck et al, 2003). These researchers report that developing countries MSEs face many constraints than those in developed countries.

In Kenya, however, the extent to which economic growth and poverty alleviation is achieved through MSE sector is limited by various constraints on entrepreneurship development. Many constraints have been identified which inhibit the growth of MSEs. These include:

- **Access to Credit**

Entrepreneurs often have difficulty gaining access to credit (Abuodha, 1996; Mahot 1998; ILO 1999). In some cases this is due to the smaller loans requested by entrepreneurs, which are not profitable for the formal financial institutions to deliver. In other instances banks may not have enough information about clients making them unwilling to lend money due to the perceived risks involved. Lack of collateral and small credit requested also make banks not to lend to MSEs.

- **Lack of Relevant Skills and Knowledge**

Lack of relevant skills and knowledge constraints the growth of potential of MSEs (Mayoux, 1995; Levitsky 1996). This is compounded by deficiencies in basic education. Many entrepreneurs tend to be less likely to have had education and experience relevant to starting and managing a business and thus less potential for success.

- **Modern Equipment and Resources**

Micro and Small-Scale Entrepreneurs often lack access to modern equipment, which could improve their productivity (Levitsky, 1996; Dawson, 1997). This may be due in part to other constraints such as those on financing and information.

- **Access to Market and Market Saturation**

Access to markets for both final goods and inputs for MSEs results from lack of information (Downing, 1990; Loucks, 1999). Market saturation is also a major problem for MSEs related to a lack of innovation (MacIsaac, 1996; Dawson, 1997). Many entrepreneurs are located in low value markets where there are few barriers to entry. This leads to saturated markets and a little room for growth. Without innovation through new product development and access to higher value markets, the potential for success for MSEs in these sectors is low.

- **Compliance Costs**

These costs relate to the time and money involved in learning about and meeting government regulations and the cost of meeting informal penalty costs from things like favours requested by government officials (OECD, 1998).

Other constraints which have been cited include, high interest rates on loans charged by commercial banks, high taxation levels, low level skills in management, failure to acquire new technology and politically instigated disruptions such as the recent demolition of kiosks and other informal sector enterprises in urban areas in Kenya (Sisule, 2001; Ikiara, 2001).

➤ **Intervention Mechanisms**

Many intervention mechanisms have been put in place in order to counter the constraints, which affect the MSEs. In his intervention mechanism named a framework for judging the current capability and interest of the society in new small business development, Gibb, (1981) identifies four interventions, namely, 1. Policies 2. Assistance activities 3. Recognised needs of entrepreneurs, and 4. Institutional framework.

Policies refer to the explicit statements made by the government and other organizations in support of informal sector. Such statements tend to depict this sector as a vehicle for economic development. In this, it is a source of employment and income. Examples of such statements include Sessional Papers and Development Plans.

In Kenya, the government came up with Sessional Paper No. 1 of 1994, Sessional Papers No. 2 of 1992, and Sessional Paper No. 2 of 1996. The Sessional Paper No. 2 of 1992 on Small Enterprise and Jua Kali Development in Kenya (Kenya, 1992) in chapter six, identifies constraints affecting MSEs as lack of coherent policy guidelines and unfavourable regulatory environment; inadequate physical infrastructure; limited market for sector products and services; a weak institutional infrastructure; poor

information gathering, dissemination and lack of adequate extension services; lack of policy on gender specific issues; poor access to capital; lack of enterprise culture; poor project planning, and implementation; and lack of managerial skills. Although the paper reported that the agenda for priority action within a time span of 12- 24 months after adoption of the paper was to be undertaken, the process remains incomplete and MSEs still experience the same constraints (Wegulo, 1997). The Sessional Paper No. 1 of 1994 on Recovery and Sustainable Development to the year 2010 (Kenya, 1994) reported that MSEs were to be given land near commercial centres.

Despite the land being made available, the issue of genuine title deeds showing the real owners remains controversial. This in essence has led to clashes between entrepreneurs and other people interested in this land. The Sessional Paper No. 2 of 1996 on Industrial and Transformation to the year 2020 noted that despite the efforts of the government, donors, and other private sector organizations to support and promote development of the MSE sector in Kenya, a number of policy constraints continue to inhibit the sector realization of its full potential (Kenya, 1996). In spite of these papers reporting the constraints and measures to be adopted to solve them, their frameworks are too general and cannot be implemented. In addition, these frameworks are hardly followed by budgetary allocations or the institutions to implement them thereby rendering them mere rhetoric (Maitha et al, 1997)

Assistance frameworks are support programs, which are put in place to overcome the constraints affecting the informal sector. Such programs include training, consultancy services, mentoring, marketing, technology, and credit schemes. In Kenya, many programs have been initiated to assist entrepreneurs overcome constraints they experience. Such programs include credit schemes by K-REP; training programs by K-MAP, World Bank, and United Nation Development Program; and association building in small enterprises by International Labour Organisation. A few of these programs have succeeded, but majority of them have failed due to lack of accountability and mismanagement.

Recognized needs of the entrepreneurs can be considered from the view point of the society as a whole and at the level of local community as well in terms of requirements of the group or individual wishing to start a new enterprise. Existing programs articulate these needs or institutions interested in informal sector work in order to overcome constraints affecting them.

Institutional frameworks include various dimensions of institutions activities with vested interests. These can be: Small enterprise specific dimensions that can further involve specific activities or general activities; national activities, regional or local level activities; and government sponsored or voluntary bodies' sponsored.

#### ➤ **Liberalised Market**

Liberalised market is a term used to refer to the lifting of restrictions on markets through allowing firms to compete freely in the economy (Sauve et al, 2000). Liberalisation of markets leads to fierce competition within the country by all types of enterprises whether private or public. The term-liberalised market is synonymously used with the term-liberalised economy. With the advent of economic reform programs and structural adjustment programs in the late 1980s in Africa, privatisation and liberalisation of trade at large emerged resulting to liberalisation of market. Though market liberalisation leads to enhanced domestic productivity, efficiency, improved quality, and lower prices which ultimately lead to improved consumer welfare, it also impose constraints that inhibit available domestic capacity to compete with the external sector (Ministry of Industry and Trade, 2003). Liberalisation of markets is a feature of a free market economy. In this system of economy, enterprises are allowed to operate freely without government intervention. This system has been favoured in the recent past by many African countries because it allows efficient allocation of country's resources through price mechanism (Jhingan, 1993).

#### ➤ **Constraint Model**

In this model, ten of the dependent variables used in this analysis- beneficiary's response to questions about whether access to credit, information, market, managerial skills, premises, employees,

team building (association), compliance costs, policies and taxation procedures represents constraints to enterprise operations and development- are limited dependant variables. These variables can take three discrete values in ascending order, corresponding to no constraint, minor constraint, and major constraint. Since the responses to the questions about perceptions are ordered, but are not actual count data, this model is estimated as an ordered response model (Greene, 2000). That is, assumption underlying the response model made by the beneficiary can be described by equation (1) below:

$$\text{Constr } ij = a + gXij + hCj + Uij.$$

Where *Constr ij*- refers to constraints or obstacles affecting the enterprise *i* in the region *j*, in which the beneficiary can rate as “no constraint”, “minor constraint”, or “major constraint.” *a*, *g* and *h* are constants. *Xij*- are various characteristics of enterprise *i* in region *j* that affect the entrepreneurs’ perceptions about constraints to development. *Cj*- are characteristics of region ‘*j*’ that affect the entrepreneurs’ perceptions. *Uij*- is a disturbance term. The entrepreneur classifies the constraint as being in class ‘*k*’ (e.g. a minor constraint). If  $a + (k-1)g < \text{constraint } ij < a + kg$ . Where the *g k*’s are a series of nuisance parameters that are estimated along with the coefficient vector (i.e. *g*). It is assumed that the disturbance term, which includes differences in individual entrepreneur’s perceptions about what constitutes a ‘major or minor’ problem, has a normal distribution. Positive coefficients on variables indicate that increases in that variable make entrepreneurs more likely to rate the constraint as a greater problem (i.e. it increases the likelihood that they rate the problem as ‘major’ problem).

### 3. Research Methodology

#### ➤ Data Sources

The data used in this paper came from the field survey conducted in Kisumu town. Table I in Appendix 1 provides list of demographic characteristics of Kisumu town. Table II in Appendix 1 provides a summary statistics for the sub sectors and sample used in analysis. The main purpose of these demography and sub sectors was to determine the extent they affect enterprise performance.

**Table I: Demographic Characteristics of the Kisumu Town**

Study Area Characteristics/ Demography	
Population	322,734
No. of Entrepreneurs	26,100
Beneficiaries	1,800
No. of Respondents	180

Source: PATO, Nyanza Province and PCO, Nairobi 2002

#### ➤ Population and Sample

The target population was MSE entrepreneurs in Kisumu town, which is approximately 20,000 (Kenya, 2001). Accessible population for the study involved all entrepreneurs who attended voucher training programme in the town, whose number stood at 1800 (PCO, 2002). A sample of 100 entrepreneurs was interviewed. This sample was selected through sample random selection technique.

#### ➤ Research Design

A survey research was used because it enables generalisation and prediction of data to be made, and also it allows collection of data by use of interview schedules (Mugenda & Mugenda, 1999).

**Table II: Distributions in Terms of Sectors of Entrepreneurs**

<b>Sector</b>	<b>Frequency</b>	<b>Percentages</b>	<b>Cumulative Percentages</b>
Mechanics and Automotive	27	27.0	27.0
Wood work	24	24.0	51.0
Metal works	18	18.0	69.0
Food processing	8	8.0	77.0
Agro processing	6	6.0	83.0
Printing	4	4.0	87.0
Textiles	4	4.0	91.0
Building	3	3.0	94.0
Electrical and electronics	2	2.0	96.0
Leather works	2	2.0	98.0
Handicraft	2	2.0	100.0
<b>Total</b>	<b>100</b>	<b>100.0</b>	

Source: Field Survey data of entrepreneurs of MSEs in Kisumu

#### ➤ **Instrumentation**

A questionnaire and observation schedule was used to gather data from the entrepreneurs of MSE in Kisumu.

#### ➤ **Data Analysis**

Collected data was analysed using both inferential and descriptive statistics. Data was subjected to SPSS version 11.5 where cross tabulation coefficients that comprised chi square statistics and Pearson R statistics were obtained. The cross tabulation was done between Independent variable (MSEs performance) against Dependent variables (constraints affecting MSEs). Inferential data was presented in the table of cross tabulation. Quantitative data was presented in the descriptive statistics table.

## **4. Empirical Results**

This section presents the results on constraints affecting entrepreneurs gathered from 100 MSE entrepreneurs in Kisumu. In particular, respondents were asked/ required to respond to questions such as, “Using (a three- point scale) can you please tell in turn how problematic are these constraints (access to credit, information, market, managerial skills, premises, policies, taxation procedures, employees, team building and compliance cost) for the operation of your enterprise? The scores are as follows: 1. Indicates no constraint 2. Indicates minor constraint 3. Indicates major constraint. The descriptive and cross tabulation coefficient statistics shown in the Appendices 2 and 3 are presented and discussed below.

#### ➤ **Access to credit**

Access to credit amongst MSE entrepreneurs has been regarded as a major constraint (Kibas, 1995). This study discovered that the results of access to credit with a descriptive statistic of 95 respondents (see Table III) rating access to credit as a major constraint to enterprise operation. The coefficients of cross

tabulation between enterprise performance and access to credit are statistically significant at a ten percent significance level (see Table IV). These results signify a positively strong causal correlation between enterprise performance and access to credit. The results may signify that entrepreneurs who are not accessed to credit or loans are not more responsive to greater performance. The results explain the importance of credit to good performance of enterprises.

➤ **Access to Information**

The cross tabulation of the access to information against enterprise performance reports a strong and positive association. The coefficients are significant at ten percent significance level (see Table IV). These results support those of descriptive statistics, which indicate that access to information is a major constraint with actual rating of 91 of respondents (see Table III). The above findings indicate a very strong association between enterprise performance and access to information. The results may signify that entrepreneurs in Kisumu do not have better means of accessing information.

➤ **Access to Managerial Skills**

Managerial skill is very important for the success of an enterprise. This survey discovered that access to managerial skills against enterprise operation had a positive coefficient that is significant at five percent significance level (see Table IV). Entrepreneurs rated this constraint as a minor constraint, with actual descriptive statistic rating of 88 of respondents (see Table III). The findings denote a fairly strong correlation between entrepreneur performance and access to managerial skills. The results may indicate that entrepreneurs in Kisumu town do not consider access to managerial skills as a major constraint affecting enterprises performance. These findings contradict the results of Kinyanjui, (1996) who discovered that lack of managerial skills is an impediment to enterprise performance.

➤ **Access to Market**

The influence of access to market on enterprise performance has strong and positive coefficients that are significant at ten percent significance level (see Table IV). These findings denote that access to market is a major constraint with the actual rating of 95 of the respondents (see Table III). The results may suggest that entrepreneurs in Kisumu town experience a very big problem in marketing their commodities. Lack of market for the products manufactured by entrepreneurs has been regarded as a major problem in Kenya (CBS et al, 1999). Entrepreneurs in Kisumu have attributed this constraint to lack of marketing strategies.

➤ **Access to Premises**

Access to premises by entrepreneurs is rated as a lesser constraint with the actual descriptive statistic rating of 87 respondents (see Table III). This finding is supported by the cross tabulation statistics results of the access to premises against enterprise performance that has positive coefficients, which are statistically significant at five percent significance level (see Table IV). The positive values of coefficients denote a fairly strong association between access to the premises and enterprise performance in Kisumu town. The findings may suggest that access to premises in Kisumu town does not pose a major problem. These results contradict with the studies conducted by CBS et al, (1999) on the National MSE Baseline Survey 1999.

➤ **Access to Policies**

Policies are normally expressed in government documents such as sessional papers and development plans. Access to policies is a major problem in Kisumu with actual descriptive statistics rating of 92 respondents (see Table III). Positive coefficient values of the variables access to policies against enterprise performance at ten percent significance level backs up these findings (see Table IV). The findings may suggest that entrepreneurs in Kisumu town are not responsive to policies relating to MSE sector. The problem can also be attributed to lack of knowledge and skills on the policies related to MSE sector.

➤ **Taxation Procedures**

Taxation procedures in Kisumu pose major constraint to the entrepreneurs' performance, with the actual descriptive statistics rating of 90 respondents (see Table III). These findings concur with those of cross tabulation between taxation procedures and enterprise performance, which yields positive coefficients (see Table IV). These positive coefficients are statistically significant at ten percent significance level indicating a strong and statistically significant correlation between taxation procedures and the performance of enterprises. These findings may suggest that taxation procedures are a limiting factor to enterprise performance in Kisumu town. These results match well with those ones of Morris (1998) and Beck et al, (2002).

➤ **Access to Employees**

Access to employees is not a constraint to Kisumu entrepreneurs, with the actual descriptive statistics rating of 94 respondents (see Table III). These findings agree with cross tabulation coefficients of association between access to employees and an enterprise performance variable, which is negative (see Table IV). The negative coefficients signify a negative and insignificant relationship between access to employees and entrepreneurs' performance, at one percent significance level. These findings may indicate that access to employees do not pose any constraint to entrepreneurs. The results compares well with those of Rono, (1997).

➤ **Team Building**

Team building is reported to cause no constraint to entrepreneurs in Kisumu town, with the actual descriptive statistic rating of 91 respondents (see Table III). The results match with those of cross tabulation coefficients of the relationship between team building and enterprise performance variables that are negative (see Table IV). The negative coefficients are insignificant at one percent significance level. The findings indicate a negative and insignificant correlation between team building and enterprise performance. The results may suggest that entrepreneurs in Kisumu town have a good inter relationship, which has lead to good team building.

➤ **Compliance Cost**

**Table III: Entrepreneurs Response to the Nature of the Constraints**

Constraints	No Constraint		Minor Constraint		Major Constraint	
	f	%	f	%	f	%
Credit	2	( 2.0)	3	( 3.0)	95	(95.0)
Information	4	( 4.0)	5	( 5.0)	91	(91.0)
Managerial skills	8	( 8.0)	88	(88.0)	4	( 4.0)
Market	2	( 2.0)	3	( 3.0)	95	(95.0)
Premises	9	( 9.0)	87	(87.0)	4	( 4.0)
Policies	0	( 0.0)	8	( 8.0)	92	(92.0)
Taxation	3	( 3.0)	7	( 7.0)	90	(90.0)
Employees	94	(94.0)	2	( 2.0)	4	( 4.0)
Team building	91	(91.0)	5	( 5.0)	4	( 4.0)
Compliance cost	5	( 5.0)	6	( 6.0)	89	(89.0)

**Number of observations = 100**

Note: f indicates frequency and % indicates percentage.

Source: Field Survey of MSEs entrepreneurs



**Table IV: Cross Tabulation Statistics of the Coefficients of Constraints against Enterprise Performance**

<b>Variables</b>	<b>Pearson R</b>	<b>Sign R</b>	<b>Chi square</b>	<b>d.f.</b>	<b>Sign</b>
<b>Dependent Variable</b>					
Enterprise Performance					
<b>Independent Variables</b>					
Credit	0.109*	0.191	2.745	6	0.840
Information	0.126*	0.128	5.923	9	0.748
Market	0.140*	0.091	21.609	9	0.010
Managerial skills	0.025**	0.766	14.943	9	0.093
Premises	0.037**	0.656	15.523	9	0.078
Policies	0.135*	0.102	9.599	6	0.143
Taxation	0.133*	0.107	17.754	9	0.038
Employees	-0.003***	0.969	9.442	6	0.150
Team building	-0.016***	0.847	6.852	9	0.652
Compliance cost	0.122*	0.142	14.701	9	0.099

**Number of Observations = 100**

Note: Cross tabulation statistics coefficient values of Constraints variables against Enterprise Performance variable of MSEs entrepreneurs in Kisumu.

The asterisks \*\*\* Indicate a 1 % significance level, \*\* indicate a 5 % significance level and \* indicate a 10 % significance level.

Compliance cost involves the expenses incurred by a businessperson in order to register the business. Kisumu town entrepreneurs' rate compliance cost as a major constraint, with the actual descriptive statistic rating of 89 respondents (see Table III). These findings agree with those of cross tabulation coefficients between compliance cost and enterprise performance that are positive (see Table IV). The positive coefficients are statistically significant at ten percent significance level. The results signify strongly positive causal relationship between compliance cost and enterprise performance. The findings may indicate that compliance costs are limiting factors to enterprise performance in Kisumu town. Many scholars have pinpointed the problems posed by compliance costs (Beck et al, 2002)

The above results make us fail to reject the null hypotheses postulated viz: 1. Constraints which affect MSEs result from lack of skills. 2. MSEs require institutional support programmes to overcome the constraints affecting them. 3. Many constraints facing MSEs result from poor implementation and lack of coordination of policies. In sum, all of these hypotheses comprise elements that in one way or another do contribute to the constraints affecting MSEs.

**5. Conclusion**

This paper explored the constraints faced by MSEs in liberalised markets. We use responses from a survey of 100 entrepreneurs of MSEs in Kisumu town to analyse constraints affecting MSEs rather than relying upon information from documents and literature on informal sector. Although there is a strong

positive association between enterprise performance and many of the constraints, this relationship is not robust to controlling for simultaneity bias. Moreover, further survey do not indicate that access to managerial skills, premises, employees, and team building do not pose major constraints or not constraints to enterprise performance. Thus the results do not support the pro- SME prescription of directly supporting MSEs to avert these constraints. In sum, although enterprise is constrained by constraints such as access to credit, information, market, policies, taxation procedures, and compliance costs, other remaining constraints such as access to managerial skills, premises, employees and team building do pose either lesser constraints or no constraint at all.

Secondly, we find qualified evidence that constraints affecting enterprise performance in Kisumu town are caused by lack of skills on how to access financial institutions that offer credits with low interest rates, taxation procedures, policies, and compliance costs. Institutional support programmes are required by enterprises in order to overcome the above constraints. Finally, while poor implementation and lack of coordination of policies set by the government lead to many constraints affecting MSEs entrepreneurs, the findings discover MSEs environment should be enhanced by introducing support programmes such as training, consultancy services and counselling to enable MSEs grow and develop.

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