Discontinuity in development: Kenya's middle-scale manufacturing industry

Ferrand, David Vaughan

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Discontinuity in Development:
Kenya's Middle-scale Manufacturing Industry

by David Ferrand

PhD thesis 1999

ABSTRACT

This thesis concerns middle-scale enterprise and economic development, focussing on the case of Kenya. The distribution of industry in Kenya is characterised by an apparent underdevelopment of middle-scale enterprise compared with micro- and large-scale, a feature frequently referred to as the 'missing middle'. A further distinctive feature of Kenya's middle is the relatively strong involvement by entrepreneurs of Asian origin. The immediate objective of this thesis is to produce a better understanding of these phenomena, argued to be highly relevant to Kenya's wider economic development.

To understand the position of the middle in Kenya, a new concept frame is put forward based on a broadly institutional approach drawing on both new and old institutional economics. This frame sees the potential for middle-scale enterprise in terms of the economic and social context, with formal and informal institutions playing a role. The notion of discontinuity is introduced to describe interactions between elements of structure which produce an adverse exchange environment for enterprise. It is argued that Kenya has a generally hostile environment for middle-scale enterprise, characterised by discontinuities and uncertainty. Entrepreneurs from Kenya's Asian communities are able to escape these generic problems by use of informal social institutions, accounting for their relative success.

Evidence from cases studies of middle-scale enterprises owned by Kenyans of both Asian and African origin, together with secondary data, broadly supports the argument. There are strong indications of discontinuities between large and middle-scale enterprise and within the formal institutional environment. Asian entrepreneurs are observed to rely heavily on informal social institutions to facilitate exchange. Such an option does not appear open to aspirant African entrepreneurs. Supporting the development of Kenya's middle-scale will necessitate addressing the discontinuities undermining its development. Simple deregulation and market liberalisation will not suffice.
Discontinuity in Development: 
Kenya's Middle-scale Manufacturing Industry

by

David Vaughan Ferrand

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Thesis submitted for the degree of Doctor of Philosophy

17 JAN 2000

University of Durham
1999
# Contents

1. INTRODUCTION ............................................................................................................. 1

1.1 OUTLINE OF THE THESIS ......................................................................................... 3

2. MIDDLE-SCALE ENTERPRISE AND ECONOMIC DEVELOPMENT .................................. 7

2.1 INTRODUCTION ......................................................................................................... 7

2.2 DEFINING 'MIDDLE-SCALE ENTERPRISE' .................................................................. 8

2.2.1 Existing definitions of enterprise scale ............................................................... 8

2.2.2 Conceptual problems of definition ........................................................................ 11

2.2.3 Towards a conceptual definition of terms .......................................................... 16

2.2.4 Operationalising the concepts of micro-, middle- and large-scale ......................... 18

2.3 THE STATIC ECONOMIC ROLE OF MIDDLE-SCALE ENTERPRISE ....................... 20

2.3.1 The view of scale from orthodox economic theory ............................................. 21

2.3.2 Changing views ..................................................................................................... 25

2.4 LINKING SCALE AND ECONOMIC DEVELOPMENT ..................................................... 31

2.4.1 Dynamics of enterprise development .................................................................... 32

2.4.2 The embeddedness of enterprise development..................................................... 38

2.5 CONCLUSION ............................................................................................................. 42

3. KENYA AND THE 'MISSING MIDDLE' ........................................................................... 49

3.1 INTRODUCTION ......................................................................................................... 49

3.2 SYNOPSIS OF KENYA'S ECONOMIC DEVELOPMENT ............................................. 50

3.2.1 Pre-colonial period ............................................................................................... 50

3.2.2 Colonial period ..................................................................................................... 51

3.2.3 Post-independence period ..................................................................................... 53

3.3 THE MANUFACTURING SECTOR IN KENYA ............................................................... 55

3.3.1 Growth of manufacturing ...................................................................................... 55

3.3.2 Structure and demand ........................................................................................... 58

3.3.3 Linkages ................................................................................................................ 60

3.3.4 Location ................................................................................................................ 63

3.3.5 Summary .............................................................................................................. 65

3.4 DEVELOPMENT PRIORITIES ..................................................................................... 65

3.4.1 The development context: poverty in Kenya ....................................................... 66

3.4.2 The employment imperative ................................................................................. 67

3.5 KENYA'S MIDDLE-SCALE: SIZE AND OWNERSHIP ................................................. 70

3.5.1 Review of statistical evidence .............................................................................. 71

3.5.2 Ownership of Kenyan manufacturing .................................................................. 73

3.5.3 The 'missing middle' ............................................................................................. 76

3.6 CONCLUSION ............................................................................................................. 78
4. EXPLAINING THE MIDDLE

4.1 INTRODUCTION

4.2 KENYA'S MIDDLE – THE KEY QUESTIONS

4.3 REVIEW OF KENYAN STUDIES

4.3.1 Micro-enterprise growth constraints

4.3.2 Constraints to middle-scale entry

4.3.3 Middle-scale enterprise task environment

4.3.4 The broader context: political economy

4.3.5 Summary

4.4 A SURVEY OF THEORETICAL FRAMEWORKS

4.4.1 Orthodox economic theory

4.4.2 Dynamic approaches

4.4.3 Capacities for enterprise

4.4.4 Understanding the task environment

4.4.5 Determining a frame of reference

4.5 CONCLUSION

5. EXPLORING INSTITUTIONAL ECONOMICS: THE SEARCH FOR THEORETICAL FOUNDATIONS

5.1 INTRODUCTION

5.2 FUNDAMENTAL PROBLEMS OF EXCHANGE

5.2.1 Co-ordination

5.2.2 Co-operation

5.2.3 Dimensions of the problem

5.3 STRUCTURE AND EXCHANGE

5.3.1 Institutions

5.3.2 Habits, routines and culture

5.3.3 Governance, organisation and relations

5.3.4 Trust and calculativeness

5.3.5 The structuring of exchange

5.4 DYNAMICS OF INSTITUTIONAL CHANGE

5.4.1 The efficiency perspective on institutional change

5.4.2 Institutional evolution

5.5 CONCLUSION

6. INSTITUTIONS AND DISCONTINUITY: A CONCEPT FRAME FOR EXPLAINING KENYA'S MISSING MIDDLE

6.1 INTRODUCTION

6.2 AN ANALYTICAL FRAMEWORK

6.2.1 Culture

6.2.2 Institutions

6.2.3 Governance mechanisms

6.2.4 Action and transition

6.3 DISCONTINUITY

6.4 MODES OF EXCHANGE
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.4.1 Traditional market</td>
<td>171</td>
</tr>
<tr>
<td>6.4.2 Exchange by contract</td>
<td>171</td>
</tr>
<tr>
<td>6.4.3 Relational exchange</td>
<td>173</td>
</tr>
<tr>
<td>6.4.4 Embedded exchange</td>
<td>175</td>
</tr>
<tr>
<td>6.4.5 Long-term contracting</td>
<td>177</td>
</tr>
<tr>
<td>6.4.6 Entrepreneurial firm</td>
<td>179</td>
</tr>
<tr>
<td>6.4.7 Bureaucratic firm</td>
<td>180</td>
</tr>
<tr>
<td>6.5 ANALYSIS OF THE EXCHANGE ENVIRONMENT IN KENYA</td>
<td>181</td>
</tr>
<tr>
<td>6.5.1 The Kenyan exchange environment</td>
<td>182</td>
</tr>
<tr>
<td>6.5.2 The middle scale enterprise exchange environment in Kenya</td>
<td>184</td>
</tr>
<tr>
<td>6.5.3 Micro scale enterprise</td>
<td>190</td>
</tr>
<tr>
<td>6.5.4 Large scale enterprise</td>
<td>191</td>
</tr>
<tr>
<td>6.5.5 Summarising the argument: comparative analysis</td>
<td>193</td>
</tr>
<tr>
<td>6.6 CONCLUSION</td>
<td>195</td>
</tr>
<tr>
<td>7. EMPIRICAL METHODOLOGY AND FIELD RESEARCH</td>
<td>199</td>
</tr>
<tr>
<td>7.1 INTRODUCTION</td>
<td>199</td>
</tr>
<tr>
<td>7.2 THE EMPIRICAL RESEARCH PROBLEM</td>
<td>200</td>
</tr>
<tr>
<td>7.3 APPROACHES TO RESEARCH</td>
<td>202</td>
</tr>
<tr>
<td>7.3.1 Qualitative and quantitative research</td>
<td>202</td>
</tr>
<tr>
<td>7.3.2 Use of primary and secondary data</td>
<td>205</td>
</tr>
<tr>
<td>7.3.3 Choice of primary research strategies</td>
<td>206</td>
</tr>
<tr>
<td>7.4 PRIMARY RESEARCH DESIGN</td>
<td>210</td>
</tr>
<tr>
<td>7.4.1 Data collection</td>
<td>211</td>
</tr>
<tr>
<td>7.4.2 Populations</td>
<td>212</td>
</tr>
<tr>
<td>7.4.3 Instruments</td>
<td>213</td>
</tr>
<tr>
<td>7.4.4 Quality</td>
<td>215</td>
</tr>
<tr>
<td>7.5 SOURCES OF SECONDARY DATA</td>
<td>217</td>
</tr>
<tr>
<td>7.6 APPROACH TO DATA ANALYSIS</td>
<td>218</td>
</tr>
<tr>
<td>7.7 FIELDWORK</td>
<td>222</td>
</tr>
<tr>
<td>7.7.1 Preliminary phase</td>
<td>222</td>
</tr>
<tr>
<td>7.7.2 Main phase</td>
<td>223</td>
</tr>
<tr>
<td>7.8 CONCLUSION</td>
<td>225</td>
</tr>
<tr>
<td>8. ANALYSIS OF EVIDENCE</td>
<td>228</td>
</tr>
<tr>
<td>8.1 INTRODUCTION</td>
<td>228</td>
</tr>
<tr>
<td>8.2 EVIDENCE FROM THE CASE STUDIES</td>
<td>229</td>
</tr>
<tr>
<td>8.2.1 Case one: Ancom</td>
<td>229</td>
</tr>
<tr>
<td>8.2.2 Case two: Zintex</td>
<td>236</td>
</tr>
<tr>
<td>8.2.3 Case three: Boncord</td>
<td>243</td>
</tr>
<tr>
<td>8.2.4 Case four: Tykor</td>
<td>250</td>
</tr>
<tr>
<td>8.2.5 Cross-case analysis</td>
<td>258</td>
</tr>
<tr>
<td>8.3 SECONDARY EVIDENCE</td>
<td>265</td>
</tr>
<tr>
<td>8.3.1 Middle-scale enterprise</td>
<td>266</td>
</tr>
<tr>
<td>8.3.2 Micro-scale enterprise</td>
<td>271</td>
</tr>
<tr>
<td>8.3.3 Large-scale enterprise</td>
<td>275</td>
</tr>
<tr>
<td>Table</td>
<td>Title</td>
</tr>
<tr>
<td>-------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>Table 2-1</td>
<td>Distinguishing the micro, middle and large-scale enterprise types</td>
</tr>
<tr>
<td>Table 2-2</td>
<td>Distribution of number of private-sector non-farm enterprises by number of employees, across selected economies</td>
</tr>
<tr>
<td>Table 2-3</td>
<td>Distribution of employment by number of employees in private sector non-farm enterprises, across selected economies</td>
</tr>
<tr>
<td>Table 2-4</td>
<td>Time series distribution of employment by number of employees in private sector non-farm enterprises, across selected economies</td>
</tr>
<tr>
<td>Table 2-5</td>
<td>Micro and small enterprise (MSE) contribution to employment and incomes across selected developing economies (early 1990s)</td>
</tr>
<tr>
<td>Table 3-1</td>
<td>Growth in Kenya's GDP</td>
</tr>
<tr>
<td>Table 3-2</td>
<td>Average annual growth rates in contribution to GDP by sector</td>
</tr>
<tr>
<td>Table 3-3</td>
<td>Structure of production – distribution of GDP by sector</td>
</tr>
<tr>
<td>Table 3-4</td>
<td>Structure of manufacturing, 1995</td>
</tr>
<tr>
<td>Table 3-5</td>
<td>Growth of population and labour force, 1970-2000</td>
</tr>
<tr>
<td>Table 3-6</td>
<td>Employment by sector</td>
</tr>
<tr>
<td>Table 3-7</td>
<td>Growth in employment in the formal sector, 1974-96</td>
</tr>
<tr>
<td>Table 3-8</td>
<td>Sectoral employment distribution by establishment scale in the formal sector, 1995</td>
</tr>
<tr>
<td>Table 3-9</td>
<td>Distribution of employment by establishment scale across sub-sectors of all manufacturing industry, 1993</td>
</tr>
<tr>
<td>Table 5-1</td>
<td>Prisoners' dilemma payoffs</td>
</tr>
<tr>
<td>Table 5-2</td>
<td>Distinguishing attributes of market, hybrid and hierarchy governance structures</td>
</tr>
<tr>
<td>Table 6-1</td>
<td>Modes of exchange</td>
</tr>
<tr>
<td>Table 6-2</td>
<td>Middle-scale: exchange by contract and long-term contracting</td>
</tr>
<tr>
<td>Table 6-3</td>
<td>Middle-scale enterprise: relational contracting</td>
</tr>
<tr>
<td>Table 6-4</td>
<td>Middle-scale: embedded exchange</td>
</tr>
<tr>
<td>Table 6-5</td>
<td>Micro-scale enterprise: growth prospects</td>
</tr>
<tr>
<td>Table 6-6</td>
<td>Large-scale enterprise: external exchange environment</td>
</tr>
<tr>
<td>Table 6-7</td>
<td>Large-scale enterprise: internal exchange environment</td>
</tr>
<tr>
<td>Table 6-8</td>
<td>Scale and modes of exchange</td>
</tr>
<tr>
<td>Table 7-1</td>
<td>Underlying logic for the interview schedules</td>
</tr>
<tr>
<td>Table 8-1</td>
<td>Ancom - evidence for hypotheses relating to exchange by contract, long-term contracting and bureaucratic firm</td>
</tr>
<tr>
<td>Table 8-2</td>
<td>Ancom - evidence for hypotheses relating to relational exchange</td>
</tr>
<tr>
<td>Table 8-3</td>
<td>Ancom - evidence for hypotheses relating to embedded exchange</td>
</tr>
<tr>
<td>Table 8-4</td>
<td>Zintex - evidence for hypotheses relating to exchange by contract and long-term contracting and bureaucratic firm</td>
</tr>
<tr>
<td>Table 8-5</td>
<td>Zintex - evidence for hypotheses relating to relational exchange</td>
</tr>
<tr>
<td>Table 8-6</td>
<td>Zintex - evidence for hypotheses relating to embedded exchange</td>
</tr>
</tbody>
</table>
Table 8-7: Boncord - evidence for hypotheses relating to exchange by contract and long-term contracting and bureaucratic firm .................. 244
Table 8-8: Boncord - evidence for hypotheses relating to relational exchange .................. 246
Table 8-9: Boncord - evidence for hypotheses relating to embedded exchange ................................................................. 248
Table 8-10: Tykor - evidence for hypotheses relating to exchange by contract, long-term contracting and bureaucratic firm 252
Table 8-11: Tykor - evidence for hypotheses relating to relational exchange .................. 254
Table 8-12: Tykor - evidence for hypotheses relating to embedded exchange .................. 256
Table 8-13: Cross case analysis - evidence for hypotheses relating to exchange by contract long-term contracting and bureaucratic firm 259
Table 8-14: Cross-case analysis - evidence for hypotheses relating to relational exchange ................................................................. 261
Table 8-15: Cross-case analysis - evidence for hypotheses relating to embedded exchange ................................................................. 264
Table 8-16: Secondary evidence for middle-scale enterprise - hypotheses relating to formal modes of exchange 267
Table 8-17: Secondary evidence for middle-scale enterprise - hypotheses relating to relational exchange 268
Table 8-18: Secondary evidence for middle-scale enterprise - hypotheses relating to embedded exchange 270
Table 8-19: Secondary evidence for specific hypotheses ................................................................. 272
Table 8-20: Secondary evidence for large-scale enterprise - hypotheses relating to external exchange 276
Table 8-21: Secondary evidence for large-scale enterprise - hypotheses relating to internal exchange ................................................................. 281

Table A-1: Middle-scale: exchange by contract and long-term contracting .................. 306
Table A-2: Middle-scale enterprise: relational contracting ................................................................. 307
Table A-3: Middle-scale: embedded exchange ................................................................. 308
Table A-4: Micro-scale: growth ........................................................................................................ 309
Table A-5: Large-scale: external exchange environment ................................................................. 310
Table A-6: Large-scale: bureaucratic firm mode ................................................................. 311
Table D-1: Ancom supply tasks ........................................................................................................ 335
Table D-2: Ancom demand tasks ........................................................................................................ 344
Table D-3: Ancom labour tasks ........................................................................................................ 352
Table D-4: Ancom technology tasks ........................................................................................................ 357
Table D-5: Ancom finance tasks ........................................................................................................ 359
Table D-6: Summary of evidence for specific hypotheses (Ancom) ................................................................. 364
Table D-7: Zintex supply tasks ........................................................................................................ 367
Table D-8: Zintex demand tasks ........................................................................................................ 371
Table D-9: Zintex labour tasks ........................................................................................................ 374
Table D-10: Zintex finance tasks ........................................................................................................ 379
Table D-11: Summary of evidence for specific hypotheses (Zintex).......................383
Table D-12: Boncord supply tasks........................................................................386
Table D-13: Boncord demand tasks.................................................................389
Table D-14: Boncord labour tasks.................................................................393
Table D-15: Boncord technology tasks..........................................................397
Table D-16: Boncord finance tasks...................................................................400
Table D-17: Summary of evidence for specific hypotheses (Boncord)..............402
Table D-18: Tykor supply tasks........................................................................406
Table D-19: Tykor demand tasks.......................................................................410
Table D-20: Tykor labour tasks.........................................................................414
Table D-21: Tykor finance tasks.......................................................................417
Table D-22: Summary of evidence for specific hypotheses (Tykor)......................421
Table D-23: Summary of cross-case analysis for specific hypotheses.................427
Figures

Figure 3-1: Manufacturing production, 1964-95 .................................................. 56
Figure 3-2: Growth rates in manufacturing production, 1964-95 .............................. 56
Figure 3-3: Capital formation in manufacturing, 1964-1995 ....................................... 58
Figure 3-4: Location of formal sector manufacturing employment, 1995 .................... 64
Figure 3-5: Growth in formal employment, 1974-96 .................................................. 68
Figure 3-6: Distribution of all manufacturing employment by establishment scale, 1993 ........................................................................................................... 72
Figure 3-7: Ownership of a sample of 100 large-scale manufacturers .......................... 74
Figure 6-1: Framework for the analysis of the exchange process .............................. 162
Figure D-1: Kenyan garment and textile sub-sector .................................................... 330
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1. INTRODUCTION

This thesis is concerned with the middle-scale enterprise and its role in economic development. It focuses on the particular position of the middle-scale in Kenya, and notably its claimed under-development which has given rise to the notion of a 'missing middle'. The purpose of the study is to investigate this claim further, develop a conceptual framework within which to address the middle-scale enterprise and apply this to the Kenyan context in order to improve our understanding of the phenomenon.

As intellectual tides have ebbed and flowed in the study of economic development, the question of the scale on which economic activity is organised has remained a constant, if sometimes shadowy, theme. The significance of this theme increased in the second half of the twentieth century with economic development emerging as an activity directed towards the newly independent states of the 'Third World'.

In the early decades of development the imperative was rapid catch-up. Large-scale projects were initiated aimed at catapulting developing economies\(^1\) to the frontiers of modern production. Much of the argument was based on the supposition that efficient, modern production could only be achieved with leading edge technology and economies of scale. Africa today is littered with the remnants of large-scale failures.

By the seventies, two apparently contradictory intellectual streams converged in emphasising the significance of smaller-scale activity. Neo-classical economics with its core construct of markets comprised of freely interacting rational economic actors took the small enterprise for its own - representing the means by which such markets could actually be created. Associated strands of neo-liberal thought championed the freedom apparently exemplified by the lone heroic entrepreneur (Reagan, 1985). Meanwhile the revolt against gigantism and top-down development found its voice in works from E.F. Schumacher (1973) and the anthropologist Keith Hart (1973). By 1972 the micro-scale enterprises of the informal sector had been firmly 'discovered' for development in a famous ILO report on Kenya. Since this
time small-scale enterprise has remained at the top of policy and research agendas. The major dissent has been heard from Marxist scholars drawing attention to the danger of economic oppression and subordination within increasingly less regulated economies as policymakers have sought to unleash the putative entrepreneurial energy of small-scale private enterprise.

Interestingly in the study of smaller scale enterprise one of the least researched areas has been scale itself. Having defined the research domain many observers have remained content to regard the sector as undifferentiated with respect to scale. This has been notable with respect to the study of smaller scale enterprise in Africa. Although considerable research activity has been focussed on the sector and numerous interventions designed to support its development relatively little has been said about the larger end of the small-scale enterprise sector. Among policymakers and practitioners in small enterprise development a relative under-development of such enterprises, usually referred to as the 'middle', has been suggested. In its long-term perspective Africa study in 1987, the World Bank referred to this phenomenon as the 'missing middle'. Despite this recognition relatively little is known about the question.

This study seeks to start to address the gap in the understanding of the middle by examining in depth the case of Kenya, focussing on the manufacturing sector. The motivation for this work is based on the contention that the middle has a particular significance in the process of economic development. Our understanding of Kenya's economy must be regarded as worryingly incomplete if we cannot account for the scale structure of industry. Furthermore if it is the case that the middle is significantly under-developed then there are held to be potentially serious implications for economic development policy, most especially that related to the small enterprise sector.

The objectives of the study are necessarily both ambitious and limited. Given the relatively scarcity of research into the middle-scale, it will not be especially difficult to increase the stock of empirical, descriptive knowledge. Making a positive contribution to our understanding of the middle and its relevance to economic development is a more challenging task. Significant theoretical work is likely to be
required in order to achieve any progress in explaining the situation of the middle in Kenya. At the outset it is worth noting that orthodox economic theory does not offer an explanatory framework for phenomena associated with scale. Some modesty is therefore appropriate in setting the objectives here. The aim is to start the groundwork for an explanation of the middle in Kenya and beyond. Much will remain tentative and exploratory. Nevertheless the final objective of any research in this area must be to inform policy and guide interventions in support of economic development. The study will therefore consider the practical implications of the findings for action.

1.1 Outline of the thesis

The study starts by attempting to unravel what role the middle-scale enterprise plays in economic development and therefore substantiate why the question which this thesis seeks to tackle is of such interest (§2). Before turning to the primary question, it is necessary to clarify just what is meant by the concept itself, and the associated ideas of micro- and large-scale enterprise. Identifying the key underlying concept at issue here – and indeed confirming that there is one – represents an important first step. Having clarified the basic terms, some of the reasons for the interest in smaller scale enterprise, across both industrialised and developing economies, are surveyed before turning to the central question of the specific role of middle-scale enterprise in development.

Having explored the reasons why middle-scale enterprise might be of particular interest in relation to economic development, the relevance to the specific case of Kenya is then raised (§3). This starts by elaborating the basic frame of reference: what are Kenya’s economic development priorities. Economies in various states of economic development will have differing short and medium term goals, even if there is a broad consensus on the long-term pursuit of sustainable economic growth. The poorest countries of the world inevitably have a particular focus on the elimination of poverty. Within the context of it economic goals, Kenya’s history and current state of economic development can be assessed. This forms the essential background for examining the position of the middle-scale enterprise sector in Kenya. A number of specific questions must be addressed. Crucially it is necessary
to examine the evidence for the hypothesis, frequently put forward, that the middle is “missing” in Kenya’s industrial scale structure. Both empirical observations and theoretical considerations give rise to the question of the ownership of industry in Kenya and in particular the ethnicity of owners of middle-scale capital. These features of Kenya’s industrial landscape form the essential research question which this thesis seeks to address.

The literature is examined in the next chapter (§4) for answers to this question. The literature on Kenya’s missing middle and the middle-scale more generally is known to be sparse. Consequently the emphasis in exploring the literature is to consider how at a more theoretical level, questions of the middle can be addressed. In approaching the literature, it is taken as a theoretical precept that there is a need to account for the diversity of social phenomena implicated by the research question. The concept and understanding of scale does not belong exclusively within the realm of any one particular discipline. Consequently although the search starts within the economic literature, it is necessary, as Albert Hirschmann (1981) puts it, to ‘trespass’ into other areas of the social sciences.

The failure to identify a satisfactory theory leads to the requirement for a fresh theoretical approach within which the broader economic and social context for enterprise can be described (§5). This theoretical approach is based on a broadly institutionalist approach, drawing on both the new institutional theory of Douglass North and Oliver Williamson, together with some elements from the older institutional economics associated with Thorstein Veblen and John Commons.

A new approach to Kenya’s middle is developed, based on these institutional foundations in the following chapter (§6). A framework for the analysis of exchange and the exchange environment is put forward, within which the prospects for middle-scale enterprise and entrepreneurs can be understood in terms of features of the institutional structure. Finally, within this theoretical apparatus an argument is outlined explaining the particular situation of the middle in Kenya and a number of specific hypotheses and exploratory questions advanced.
Introduction

We then turn to the problem of how this argument can be empirically tested and explored (§7). The chapter starts by considering some basic questions regarding the approach to research – qualitative and quantitative, uses of primary and secondary data and the basic primary research strategy. Detailed aspects of the primary research design are then considered. The way in which the data collected is to be analysed is considered before concluding the chapter with observations from the field regarding the experiences in implementing these research plans.

The empirical evidence collected from the field in the form of four case studies from the garment industry, together with a considerable body of secondary data, is presented and analysed in chapter §8. This analysis is constructed around the specific hypotheses identified in the earlier theory chapter, but the emphasis throughout is on discerning the processes by which enterprises achieve exchange by interpreting the various findings from the field.

In the final chapter (§9), the research is critically reviewed and its consequences analysed. Three questions are posed in reviewing the argument put forward and its subsequent investigation: how defensible is the theory in the face of empirical evidence, how successful are the theoretical constructs used and ultimately how much further forward are we now in understanding Kenya’s middle-scale? The thesis concludes by considering the implications of this work for further research, wider theoretical issues and, finally, its practical ramifications for policy makers and development practitioners.
The term 'developing economy' is used throughout this thesis to refer to economies which are either entirely pre-industrial in structure or in the process of transition to an industrialised form. It is used in juxtaposition to the term 'industrialised economy' which refers to those economies which are substantially industrialised on a market-capitalist basis. The notion of industrial structure is understood in a primarily institutionalist sense (North 1990, Williamson 1996), referring to the essential way in which exchange is organised in the economy. A third category of 'transition economies' applies to a number of the states of the former Soviet Union and eastern Europe which are substantially industrialised but are in the process of changing from a centrally planned to a market-capitalist structure. These concepts are understood as ideal-types (in the sense used by Weber, 1949).

It is presumed that all economies classified by the World Bank as 'low-income' would be regarded as developing economies, and those in the 'high-income' category will be industrialised. However the 'middle-income' economies are more difficult to classify, potentially belonging to any of the three categories identified. Most difficult to classify are those economies which have been subject to a substantially unbalanced development process, resulting in a mixture of pre-industrial and industrial forms. However for the argument pursued in this thesis, the focus is firmly on the two polar types of developing and industrialised. The idea of mixed or hybrid types is not pertinent to the central argument.
2. MIDDLE-SCALE ENTERPRISE AND ECONOMIC DEVELOPMENT

2.1 Introduction

The focus of this research is middle-scale enterprise in developing economies. More specifically the aim is to explain the form of the middle-scale enterprise sector in one particular developing economy - Kenya. In this chapter, two essential precursors to this study are considered: What is the meaning of the term 'middle-scale enterprise' and why is it of interest, especially in relation to economic development?

On an intuitive level, middle-scale enterprise is readily understood. It refers to enterprise of a scale intermediate between the large and (very) small-scale. In essence it reflects a recognition that the broad category of smaller-scale enterprise refers to a somewhat heterogeneous group of enterprises, and that a further distinction should often usefully be made. However once the term 'middle-scale' becomes the subject of explicit theoretical reasoning and empirical research, definitional problems quickly arise. Intuitive understandings of scale are frequently found to be based on a number of differing qualitative and quantitative dimensions which do not necessarily strongly correlate. Little can be achieved without a clear understanding of the terms used, both as an analytical category and as a usable definition. In the first part of this chapter (§2.2), the basic terms are defined theoretically and operationalised.

The role of smaller-scale enterprise in economic development generally has attracted strong and increasing attention amongst researchers, policy makers and others in the past thirty years. Part of this interest can be attributed to the simple numerical significance of the sector in most economies. Contrary to earlier expectations amongst some economists that smaller-scale enterprise would eventually be supplanted by larger-scale in many sub-sectors, evidence from a number of industrialised economies suggests that the smaller-scale shows no signs of disappearing. However it is the claim that smaller-scale enterprise makes a major contribution to employment generation across industrialised and developing economies alike, which has evoked the greatest interest. Specifically in developing economies it has also been argued that factor market conditions should favour
smaller-scale enterprise. This line of reasoning is taken to imply a virtuous coincidence of employment generation with economic efficiency. Related to the employment issue is the extent to which smaller-scale enterprise may be important in redressing regional economic imbalances. The second part of this chapter (§2.3) considers the specific position of the middle-scale in these major debates.

At a more fundamental level, it has been argued that smaller-scale enterprise generally, and the middle in particular, can play an important role in the process of economic development. The evolution of scale structure in the growth path of high performing economies offers some evidence to test this argument. Inevitably however such evidence can only be taken as suggestive rather than incontestable proof. Beyond any such broad empirical evidence we need to understand how middle-scale enterprise might play a role. The final part of the chapter (§2.4) is concerned with establishing this link between economic development and the middle. Determining the relevance or otherwise of the middle-scale inevitably depends on the theoretical understanding of the process of economic development. In the absence of a convincing, appropriate general theory, a somewhat eclectic approach is taken.

2.2 Defining 'middle-scale enterprise'

In spite of the attention the subject has received in recent years, there is surprisingly little discussion of the concept of 'scale' or 'size' implied by terms such as micro, small, medium, middle or large scale enterprise. That is not to say that there is any lack of definitions; these are found in abundance across academic research, policy statements and law. At issue is whether these definitions are referring to an essentially common concept.

2.2.1 Existing definitions of enterprise scale

In order to discover whether there is a common concept at issue it is essential to start by examining how the term is currently used. Many – perhaps most – definitions rely on equating enterprise scale with one or more dimensions. These dimensions can be classified as qualitative or quantitative. Reflecting a widespread interest in achieving an easily applied definition, simple quantitative measures predominate. Atkins and
Lowe (1997) in a survey of recent academic articles in the small enterprise literature found that at least 82% of the sample used purely quantitative measures, with 72% based on a single measure.

The most commonly used quantitative dimension is the number of employees in the business. In the Atkins and Lowe study, 68% of the articles sampled used an employment definition alone. Many official government and other statistical reports from around the world are similarly heavily reliant on this measure. Other quantitative measures frequently encountered are sales turnover, assets and capital.

There is however, as Roger Brooksbank has observed, rather less convergence on the thresholds or dividing lines for these dimensions to distinguish between the categories of small, medium and large. This is not unexpected since the dimensions are continuous – there is no obvious reason a priori for choosing one particular number rather than another. Given that ‘small enterprise’ is clearly a relative term – relative that is to ‘large enterprise’ – the distribution of firms by number of employees, for example, in a given population of firms will offer some guidance. The European Commission noted in its recent deliberations on the definition of small and medium-sized enterprise that a “threshold of 500 employees is not truly selective, since it encompasses almost all enterprises (99.9% of the 14 million enterprises) and almost three-quarters of the European economy in terms of employment and turnover …” (1996, p.5). A lower value of 250 employees was adopted as part of the final recommended definition. Threshold values found in common use vary from 50 workers to 500 workers, clearly a very wide range of values. Interestingly the US government definition uses one of two dimensions in which the threshold values vary according to industry sector (broken down as far as four digit standard industry classification). For number of employees, the small firm definition varies across a range of 100 to 1,500 employees between sectors (US Small Business Administration 1998).

Amongst qualitative dimensions, autonomy is one of the most frequently encountered. In the early 1970’s, the Bolton Committee inquiry into small firms in the UK regarded independence as fundamental to smallness (Bolton 1971). The European Commission definition of small and medium-sized enterprise explicitly
includes the independence of an enterprise from other enterprises and defines this in terms of capital or voting rights (1996, p.4). Such usage tends to obscure the complexity of the concept of independence. John Kimberley (1976) observes that autonomy is a continuous variable; a point reflected in Allan Gibb's (1997) discussion of the nature of smallness in business.

Closely allied to autonomy is ownership. For many observers there is a crucial link between scale and the involvement of the business owner in the operation and management of the business. Other qualitative dimensions cited in definitions are management style, formality, organisational complexity, production technology, product strategy and organisational objectives. The meaning ascribed to each of these terms is again not always clear and the cross-comparability of definitions open to doubt. Even where the same dimension appears to be used, determining qualitative values is inherently open to problems of measurement and the intrusion of subjective bias.

Many definitions make use of multiple dimensions. In the US government definitions, two dimensions are used alternately across industry sectors - number of employees and turnover. The European Commission definition referred to above, combines quantitative and qualitative - number of employees, turnover, asset value and independence. Brooksbank (1991) similarly proposes the quantitative dimensions of number of employees and turnover (though with different threshold values), and a qualitative dimension of product strategy. Similarly the final report of the Bolton Committee included number of employees and turnover together with three qualitative characteristics of the small firm: small market share, owner-management and independence.

Also rejecting any attempt to produce a simple definition, James Curran and Robert Blackburn (1994) propose a "'grounded definition' of the small enterprise" (p.56). The essence of this approach is to "shift the problem of defining the characteristics - qualitative and quantitative - from the researcher to those most involved in the kinds of economic activities selected for study." (p.56). The researcher uses various sources and methods, including direct enquiry, to determine how the key actors
involved in a particular area of economic activity see the scale of enterprise within that area.

Surveying the range of existing definitions strongly suggests that whatever definition is actually used will often reflect the particular interests or purposes of the definer.\textsuperscript{11} A statutory declaration will seek to minimise ambiguity, enabling the ready determination of what is, and is not, regarded as a ‘small enterprise’ for the purposes of legislation. Statisticians and academics engaged in highly quantitative work will tend to follow such an approach but emphasise the need for simplifying the measurement process. Those involved in policy making or designing interventions may have somewhat contradictory motivations. The need for demonstrable fairness and transparency in the public domain demands a simple, unambiguous definition.

Political agendas and ideological influences underpinning a policy or intervention can introduce a degree of complexity. At the least sophisticated level, if the goal is to deliver benefits to a specific target group then whatever definition is used will aim to ensure that this target group is addressed. More opaque is the extent to which the whole concept of small enterprise is to be rendered consistent with a particular ideology or political philosophy. A parallel issue arises in much academic research. Clearly it can be argued that ideology is strongly at work here too.

This brief survey of ways in which enterprise scale has been defined indicates that there is little consensus. It suggests that we now need to consider the conceptual questions which must underpin any useful definition.

2.2.2 Conceptual problems of definition

The understanding of what is a small enterprise is strongly conditioned by the theoretical apparatus into which the term is intended to fit. This evokes a basic question: what type of concept is ‘scale’ in the sense of middle-scale, large-scale or small-scale enterprise? The range of responses to this question is constrained by the stance taken towards social explanation. Some theorists assert that all social concepts are necessarily embedded within particular cultural contexts and therefore there are no generalizable social concepts.\textsuperscript{12} Putting aside this \textit{a priori} scepticism towards generalisation in the social sciences, we shall focus on the concept of scale.
The terms 'large' and 'small' are self-evidently relative – it would seem to make little sense to talk about small-scale enterprise if not in contrast, in principle, with large. However in using the term 'small-scale enterprise' there is no necessary explicit or implicit classification of an actual population of firms into large and small. The contrasting notion of a 'large-scale enterprise' need not be anything more than a hypothetical concept of the large-scale organisation of economic activity. Consider for example the recent discussion in the literature of contemporary Italian manufacturing. It has been argued that it is characterised by small firm production. There is no theoretical contradiction in supposing that this putative small firm dominance could be complete – in other words that there might be no large-scale manufacturers in Italy. The term 'small-scale enterprise' does not lose its meaning here.

A connection between scale and context is clear in many of the definitions reviewed above. Curran and Blackburn (1994) point to the significance of sector, Kimberley (1976, p.594) suggests variations according to organisational type while the difference in definition threshold values found in industrialised and developing economies indicates some dependency on the wider economic context. It is again important to note that this does not lead to the conclusion that scale is necessarily simply a localised description. The universal concept may remain unmodified while the particular referents are situationally determined.

The way is therefore open to argue that underlying the various definitions – seen simply as operationalisations of varying success – is a common idea. This seems implicit in arguments against or caveats on the use of simple quantitative dimensions and the search for qualitative measures. The US government's highly detailed list of threshold values for small business designation can be read as an attempt to capture an underlying concept in a way which is administratively effective. David Deakin's discussion of the definition of the small firm is highly revealing:

We might say that small firms are all those firms that employ less than 50 employees. However, there will be big differences in the size of firms with such a definition across different industrial sectors. For example, a clothing sector firm employing less than 50 will be much smaller than say a chemical
company employing less than 50 and there may well be little comparison between their respective turnovers.

Deakins (1996, p.34)

However Deakins does not explicitly state anywhere what is meant by 'size' here. It is this difficulty in specifying what is the conceptual issue which gives rise to the more convincing scepticism regarding a useful theoretical role for the concept of scale.

Kimberley (1976) examining organisation more generally, identifies four aspects of size found in the literature — capacity, personnel available, inputs or output and discretionary resources available — and argues that each is conceptually independent. “While they may be intercorrelated to some extent — and even to a large extent in some cases — the magnitude of the correlations is neither consistent enough nor high enough to justify their being considered interchangeable measures of the same concept.” (1976, p.588). This is not simply a criticism of the lack of conformity of use in the literature. Rather, Kimberley urges that a more differentiated understanding of scale is essential and that theory should be constructed in terms of these specific aspects of scale. The implication is that scale is merely a convenient term to classify a set of only loosely related organisational properties, and is itself of no theoretical interest.

This scepticism would seem to be reflected in the approach taken by a number of researchers. Pragmatically Malcolm Harper, for example, suggests that “the scale of a business needs only to be defined for a specific purpose, and there is no point in attempting to produce a universally or even nationally accepted standard” (1984, p.2). More strongly, John Page and William Steel assert that “the definition of [small-scale enterprise] must be functional, that is, related to the purpose at hand” (1984, p.10). The immediate implication is that the concept is highly localised in application. Findings regarding enterprise scale in one context would have little relevance to a different context. On this reading the current degree of interest in enterprise scale might seem somewhat surprising.

This line of argument logically threatens to efface the concept of enterprise scale from social and economic theory. Any defence of scale must be found not in
imperfect reductions to other terms but by establishing its own irreducible theoretical role. Allan Gibb's (1997) conception of smallness suggests a way forward in this direction.

Gibb sees the small business as an organisational form of economic activity which is fundamentally distinct from that represented by the large. This is illustrated by the stark contrast between the relative position of an owner-manager in a micro-scale business and an employee of a large-scale enterprise. The owner-manager "frequently exchanges a dependence upon a single limited source of income and employment for a large number of other dependencies particularly upon the customer but also upon suppliers, workers, distribution agents, bankers, accountants and indeed all who deal with the business." (1997, p.5).

As a consequence the owner-manager is personally exposed to uncertainty on a continual basis. Ownership is seen as critical, both in the obvious economic sense, but also in the social and psychological sense. Smallness leads to much greater control over the way in which the business and the owner-manager acts to achieve objectives.

Gibb's conception of the small business organisation is based on a contingency approach; the organisation and key actors within it, respond to the circumstances in which they are embedded. It is the nature of the business, within a given environment which determine the distinctive organisational form. Enterprising modes of behaviour, frequently associated with the small business are seen as a response by the manager of the business to the pressures presented by smallness within a particular type of environment.

Understood in this sense, enterprise scale is not simply reducible to any particular economic or other variables (number of employees, capital employed and so forth). Rather it concerns forms of economic organisation which are in turn fundamentally about problems of human co-operation and co-ordination. The appropriate mode of analysis is generally not in terms of particular dimensions - which are merely characteristics of scale, and thus necessarily are reductive of the broader concept. More relevant here is the notion of the "ideal type" associated with Max Weber. The ideal type is "formed by the one-side accentuation of one or more points of view and by the synthesis of a great many diffuse, discrete, more or less present and
Middle-scale enterprise and economic development

occasionally absent concrete individual phenomena: a conceptual pattern which brings together certain relationships and events of historical life into a complex, which is conceived of as an internally consistent system." (Weber 1949, p.90). This approach to concept formation reflects a distinctive strategy towards social explanation which recognises the particular importance of abstraction from the detail of social phenomena (Little 1989, pp.194-5). Applied to enterprise scale, it leads to the possibility of a theoretically richer and more useful term. It can be argued that this view resolves the apparent puzzle of a sustained wide-spread interest in the concept of smaller scale enterprise despite the obvious difficulties in deriving satisfactory simple definitions from empirical observation.

This understanding of scale leads to a more satisfactory answer to the sceptical question of why scale is of any importance in social explanation. Essentially as conceived it recognises a social phenomenon holistically, one which cuts across economic, sociological and political fields. An analysis of political economy which identifies a crucial role to an emergent industrial bourgeoisie is referring simultaneously to the organisation of production in independent units. The prospects for this industrial bourgeoisie are not determined solely by their political relationship to other political actors, though clearly vital, but also by the various conditions for successful small business. To take a more concrete example, the existence of a substantially small-scale based manufacturing economy in areas of Italy seems difficult to explain if small-scale is understood as simply referring to the number of workers per firm. Rather it is the recognition of the small-scale as an economic, technological, social and political entity which provides a convincing explanation.16

This review of the conceptual basis of scale has again indicated a considerable diversity of views. Understanding scale as an ideal type appears to offer the most promising route to a definition which will have conceptual value. It is consistent with the view of enterprise as a phenomenon which is embedded within a wider context. This seems important as we try to see how terms relate to a distinctive context, such as late twentieth century Kenya. There are however no theoretical short-cuts. We must now turn to the problem of identifying the scale types which
are to be the subject of this thesis and the causal mechanisms which give rise to their distinctive characteristics.

2.2.3 Towards a conceptual definition of terms

Much of the discussion so far has focused on the simple opposition between small and large-scale. Reference is frequently made in passing to an intermediate category of 'medium-scale' but rarely does it figure as a significant entity from a conceptual point of view. The term 'middle-scale' is used here to refer to a scale type which is distinctively intermediate between the smallest or 'micro-scale' enterprise and the large. Micro-scale and middle-scale are understood here as a sub-division of the broad type of small-scale enterprise. The aim in making such a distinction is to draw attention to the important scale related differences which are applicable to the broad type of small-scale enterprise.

The division of small-scale enterprise into a smaller and larger category has frequently appeared in the literature discussing scale in developing economies. Very large numbers of people are found throughout the developing world involved in small-scale enterprise. In many economies in sub-Saharan Africa the evidence suggests that the majority of non-farm employment is found in the sector. Much of this small-scale enterprise is distinctive by its extreme smallness in the sense suggested by Gibb. Following the seminal work of the anthropologist Keith Hart (1973) in Accra, significant attention has been drawn to the essential informality of much of the activity. Many enterprises operate on the margins of formal society, outside the realm of state and regulation. Distinct from these informal, micro-enterprises is a larger type of business which nevertheless is still essentially small-scale. Such enterprises, sometimes referred to as comprising the modern small-scale sector, notably operate in a more formal sense, both internally and externally. The application of the term 'middle-scale' to these types of enterprise reflects the sense in which they correspond to a form intermediate between the two polar forms represented by micro-scale and large-scale.

The notion of the middle-scale suggested by this literature is strongly associated with the notion of increasing formality of organisation as compared with the micro. This echoes work in the organisational development literature. Drawing on this approach
we can make an attempt to distinguish the three types of micro, middle and large-scale. There are a very large number of characteristics of enterprise organisation. In table 2-1, borrowing heavily from the approach taken by Gibb (1997), a number are presented together with how each might be distinguished according to type. Clearly such a list is highly conjectural and far from comprehensive. Much work remains to elaborate this definition and produce a clearer theoretical basis for the characteristics used. However it suffices for the purposes here in locating the basic concepts. It is important to emphasise that the purpose here is to describe ideal types, rather than a set of defining characteristics of actual middle-scale enterprises. No one characteristic is either necessary or sufficient for the definition of any types. It is argued that it is not possible to reduce the essential meaning of the terms to a simple definition.

Table 2-1: Distinguishing the micro, middle and large-scale enterprise types

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Micro-scale</th>
<th>Middle-scale</th>
<th>Large-scale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organisational culture</strong></td>
<td>Informal</td>
<td>Informal</td>
<td>Formal</td>
</tr>
<tr>
<td><strong>Vision</strong></td>
<td>Survivalist</td>
<td>Personalised</td>
<td>Synthesised</td>
</tr>
<tr>
<td><strong>Rules and processes</strong></td>
<td>Reactive</td>
<td>Rules of thumb</td>
<td>Systems</td>
</tr>
<tr>
<td></td>
<td>Ambiguity</td>
<td>Emergent</td>
<td>Clarity</td>
</tr>
<tr>
<td><strong>Problem solving</strong></td>
<td>Acceptance</td>
<td>Negotiation</td>
<td>Fiat</td>
</tr>
<tr>
<td></td>
<td>Reactive</td>
<td>Intuitive</td>
<td>Methodical</td>
</tr>
<tr>
<td><strong>Organisational structure</strong></td>
<td>Minimal</td>
<td>Patriarchal</td>
<td>Hierarchical</td>
</tr>
<tr>
<td><strong>Controls</strong></td>
<td>Negligible</td>
<td>Task oriented</td>
<td>Systematic</td>
</tr>
<tr>
<td><strong>Planning</strong></td>
<td>Implicit</td>
<td>Strategic</td>
<td>Explicit</td>
</tr>
<tr>
<td><strong>Task separation</strong></td>
<td>Minimal</td>
<td>Holistic</td>
<td>Functional</td>
</tr>
<tr>
<td><strong>Division of labour</strong></td>
<td>Minimal</td>
<td>Moderate</td>
<td>High</td>
</tr>
<tr>
<td><strong>Technology</strong></td>
<td>Simple</td>
<td>Appropriate</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>Found</td>
<td>Modern</td>
<td>State of the art</td>
</tr>
<tr>
<td><strong>Marketing</strong></td>
<td>Market following</td>
<td>Market driven</td>
<td>Market creating</td>
</tr>
<tr>
<td><strong>Alliances</strong></td>
<td>Expedient</td>
<td>Partnership</td>
<td>Strategic</td>
</tr>
</tbody>
</table>
2.2.4 Operationalising the concepts of micro-, middle- and large-scale

The definitions of middle-, micro- and large-scale developed here clearly do not lend themselves readily to the analysis of large populations of enterprises. Yet much understanding of scale phenomena within an economy will turn on being able to measure the distribution of firms by scale. It is thus not merely a question of practical convenience but methodological necessity to develop simple proxies for scale. We therefore return to consider the dimensions identified at the start of this discussion (§2.2.1) in order to determine which are the best candidates for use as proxies – simple operationalisations of the concepts developed. It is important to note that looking for such a proxy does not entail the abandonment of the more theoretically useful understandings of scale developed. However interpretation of evidence based on the use of such simple operationalisation must continuously take account of the potential distortions inherent in the measurement process.

As noted earlier a number of working definitions for scale attempt to overcome the limitations of a single dimension by using multiple dimensions. Although potentially useful in a number of contexts, there are potential problems. The most obvious is that practically, measuring more than one dimension consistently across a large population of firms will involve a considerable escalation in the difficulty of the research effort. The likelihood of finding compatible evidence from existing statistical data is very substantially reduced.

Amongst the existing dimensions in common use, the most widespread is clearly number of employees. In many ways this represents a good proxy for the concept of scale developed above. Increasing numbers of employees within a single enterprise necessarily involves changes in the nature of the organisation. It is also a direct measure of one dimension of the enterprise's resource base.

Although only intended as an operationalisation of the theoretical terms, difficulties remain. Static thresholds used to distinguish between large, middle or micro very often do not take account of differences in the environmental context which will impact on scale as understood here. In order to be used accurately, the validity of such an operationalisation – as a basic proxy – should be evaluated continuously.
Failure to do this will introduce distortions in the cross-comparison between sectors and economies.

Actual measurement of the number of employees in an enterprise is subject to some degree of ambiguity — for example in the treatment of part-time and unpaid family workers. However these problems are well recognised and reasonably accurate counts are usually available. By contrast a measure such as capitalisation, although potentially useful, is often difficult to determine accurately especially when considering smaller-scale enterprise. It is also much more likely to be susceptible to systematic distortion. Business owners in developing economies, for example, are often reluctant to divulge the true value of their enterprises for fear of attracting the attention of the tax authorities.

Rather than attempting to establish and defend particular thresholds for micro, middle and large scale, distributions can be examined across convenient intervals. In the literature directed at developing economies, it is common to find a category threshold at 10 employees, and 50 or 100. Both field observations and a review of the literature suggest that these thresholds are likely to show a strong convergence with the underlying concepts developed.\textsuperscript{32} The definitions applied in this study will be: micro-scale: 0-9 employees (thus includes the single owner-operator), middle-scale: 10-99 employees and large-scale: 100+ employees. It is noteworthy that this threshold for large-scale is lower than that frequently used in industrialised economies. Given the variation in economic context a difference is consistent with the understanding of scale used here.

Using this operationalisation of scale, table 2-2 gives an indication of the relative populations of micro, middle and large scale firms across a number of economies. Although a simple census of establishments does not give much indication of the economic significance of each type, what is clear from this table is that the classification suggested does capture populations in each. Another feature of note is the variation in numbers of firms found in each interval which does not bear any obvious relation to economic development (taking GNP per capita as a very crude yardstick of economic development). Finally the sheer number of micro-scale and
middle-scale enterprises found in all economies helps to explain the sustained interest in the question.

Table 2-2: Distribution of number of private-sector non-farm enterprises by number of employees, across selected economies

<table>
<thead>
<tr>
<th>Country/region</th>
<th>Year</th>
<th>GNP(US)/capita</th>
<th>no employees</th>
<th>1-9 employees</th>
<th>10-49 employees</th>
<th>50-99 employees</th>
<th>100+ employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya 24</td>
<td>1995</td>
<td>270</td>
<td>55.7%</td>
<td>42.9%</td>
<td>0.9%</td>
<td>0.4%</td>
<td></td>
</tr>
<tr>
<td>United Kingdom 25</td>
<td>1996</td>
<td>18,060</td>
<td>67.6%</td>
<td>27.1%</td>
<td>4.4%</td>
<td>0.4%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Europe-19 26</td>
<td>1996</td>
<td>20,186</td>
<td>93.0%</td>
<td>5.9%</td>
<td>1.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States 27</td>
<td>1995</td>
<td>24,470</td>
<td>67.8%</td>
<td>25.4%</td>
<td>6.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan 28</td>
<td>1996</td>
<td>31,490</td>
<td>53.7%</td>
<td>28.0%</td>
<td>16.0%</td>
<td>1.4%</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

In conclusion, we now have a definition of the central concept of this thesis – the middle-scale enterprise – together with the related concepts of micro and large-scale. These concepts are based on an understanding of enterprise scale as essentially concerned with organisational form. Such an understanding does not give rise to readily applied terms. For practical purposes therefore a simple operationalisation has been put forward, based on number of employees, and using the thresholds suggested within the literature.

2.3 The static economic role of middle-scale enterprise

According to the definitions adopted here, middle-scale and micro-scale enterprise are the constituents of the wider concept of smaller scale enterprise. In starting an inquiry into the role of the middle, it is useful to start with the wider, and more heavily researched, subject of smaller scale enterprise. Much interest in smaller scale enterprise has derived from its relevance to employment. A significant proportion of employment is located in smaller scale enterprises in both developing and industrialised economies. Data in table 2-3 shows the proportion of employment in private sector non-farm enterprises classified according to number of employees. Even in the most concentrated economy covered, the United States, enterprises with fewer than 100 employees account for nearly half the total employment. These
distributions also suggest that both micro and middle-scale enterprises makes notable contributions to employment across all economies.

Table 2-3: Distribution of employment by number of employees in private sector non-farm enterprises, across selected economies

<table>
<thead>
<tr>
<th>Country/region</th>
<th>Year</th>
<th>GNP/capita</th>
<th>no employees</th>
<th>1-9 employees</th>
<th>10-49 employees</th>
<th>50-99 employees</th>
<th>100+ employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya 30</td>
<td>1993</td>
<td>270</td>
<td>13.4%</td>
<td>44.4%</td>
<td>5.3%</td>
<td>37.0%</td>
<td></td>
</tr>
<tr>
<td>United Kingdom 31</td>
<td>1996</td>
<td>18,060</td>
<td>13.6%</td>
<td>17.0%</td>
<td>15.3%</td>
<td>5.3%</td>
<td>48.0%</td>
</tr>
<tr>
<td>Europe-19</td>
<td>32</td>
<td>1996</td>
<td>20,186</td>
<td>33.0%</td>
<td>19.0%</td>
<td>48.0%</td>
<td></td>
</tr>
<tr>
<td>United States 33</td>
<td>1995</td>
<td>24,470</td>
<td>10.2%</td>
<td>13.2%</td>
<td>23.5%</td>
<td>53.1%</td>
<td></td>
</tr>
<tr>
<td>Norway 34</td>
<td>1985</td>
<td>25,970</td>
<td>47.2%</td>
<td>10.2%</td>
<td>42.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan 35</td>
<td>1996</td>
<td>31,490</td>
<td>6.2%</td>
<td>23.8%</td>
<td>34.8%</td>
<td>11.1%</td>
<td>24.6%</td>
</tr>
</tbody>
</table>

2.3.1 The view of scale from orthodox economic theory

Until the 1970's there appeared to be a broad consensus amongst economists and policy makers that in the industrialised world the small enterprise would eventually be supplanted by large. 36 Underpinning this view was the assumption that cost advantages derived from economies of scale and specialisation would favour larger-scale enterprises. Long term trends in the scale structure of many industrialised economies up to the 1970's tended to confirm the argument. A few examples illustrate the extent of this decline. In Germany, small enterprises (employing less than 200) accounted for 73% of employment in 1907. The figure declined steadily to reach 52% by 1970. In the US manufacturing sector, small-scale establishments accounted for 38% of employment in 1909; by 1967 the figure had shrunk to 23%. 37 This gradual shrinkage of the smaller-scale enterprise sector raised few concerns among orthodox economists who saw it as the necessary corollary of increasing economic efficiency. Interestingly, radical scholars were similarly unperturbed, seeing the unfolding of the capitalist mode of production predicted by Marx with ever increasing concentrations of capital. 38

The argument is more complex when applied to developing economies, accounting for the relatively greater early attention to scale in this context. At a macro level, the
evolution of scale structure was associated with the broader process of economic
development (Shinohara, 1968). Dennis Anderson (1982) suggested a three phase
model for the development of scale in manufacturing industry. In the first phase
micro-scale enterprise (described as 'household') predominate. During the next
phase the middle-scale develops rapidly and displaces the micro, before the final
phase in which the remaining household enterprises disappear and large-scale
eclipses the middle. This echoes the Walter Rostow (1960) stages of growth model
for economic development and leads to the same basic disputation: is it necessary for
later developing economies to pass through all the phases identified for early
developers in order to achieve sustainable industrial development. It has been
argued on one view that the development process can be accelerated by emphasising
the large-scale industries of the final phase, effectively leap-frogging the intermediate
stages. The opposing view is that all phases are an essential part of the
development process and cannot be bypassed. Smaller-scale enterprise has been
credited with developing the essential basis, particularly in terms of organisation and
human capital, on which later phases of industrialisation can be built. In many
developing economies, notably India, policies of small-scale industry promotion were
adopted based on this line of argument (Little 1987, p.225). Further exploration of
this broader role of scale in economic development will be deferred until later (§2.4).

More influential has been the assertion that smaller-scale enterprise has a special role
in generating employment. The essential basic claim is that smaller-scale enterprises
can create jobs at a relatively lower capital cost than large-scale. Underpinning this
argument is the assumption that developing economies are characterised by labour
surpluses and capital scarcity. Given efficient factor markets, labour should therefore
be relatively cheap and capital expensive by comparison with the industrialised
economies. Ceteris paribus, allocative (or price) efficiency favours more labour
intensive processes in developing economies. Smaller-scale enterprise, strongly
associated with greater labour intensity, is therefore seen as an economically efficient
source of job creation.

The argument however contains a number of critical assumptions which need to be
examined. Most obvious is the claim that smaller-scale enterprises use more labour
intensive processes. There is no theoretical connection between labour intensity and
enterprise scale in orthodox economic theory (unless of course it is taken as a part of the definition of scale). In principle a large-scale firm could simply replicate a labour intensive process. If a labour intensive process is more efficient then according to orthodox economic theory, the large-scale firm would necessarily adopt the more labour intensive process. Examples can certainly be found of larger-scale firms, operating in developing economies, deliberately adopting more labour-intensive production techniques on the grounds of efficiency. Equally, Schumacher (1973, p. 149) observed that smaller-scale firms do not necessarily utilise the most labour intensive technology available.

It is important to re-iterate that within orthodox economic reasoning it is not simply labour intensity which is at issue but also efficiency. Unless a more labour intensive process has higher capital productivity than a more capital intensive process, it will be less economically efficient. The essence of the conventional argument relies on the efficient substitution of labour for capital. Whether this is feasible or not depends entirely on the nature of actual available technologies. The existence of, or the possibility of, production using particular factor proportions is an open empirical question. Furthermore comparing production techniques is complicated by the extent to which products from differing processes are regarded as comparable. As Raphael Kaplinsky notes if a product is defined simply as "a writing implement", a relatively wide range of production technologies may be applicable. By contrast if the product is a "Parker pen" there is no choice at all (1990, p.35).

A number of empirical studies have been conducted into the relationship between scale, employment, efficiency and technology. There is strong evidence that labour intensive, economically efficient technologies do exist. Examining nine industries Howard Pack (1982) discovered such technologies in each case. These technologies were competitive on cost grounds with a more capital intensive technology, given prevailing factor prices. The relative differences in the capital intensity of alternate technologies varied very considerably across industries underlining the difficulty in making generalisations regarding technological choice.

Carl Liedholm and Donald Mead (1987) found in a cross-country study of seven industrial sub-sectors that there was both a strong positive correlation between
capital intensity and increasing scale (measured by employment) and a negative correlation with economic profitability. Such evidence is consistent with the claim that smaller-scale industry does derive a cost advantage from the use of more labour intensive technology. However it does not constitute proof that the source of increased profitability is the substitution of cheap labour for expensive capital.

The conclusions drawn from a major World Bank economic study into small enterprise were largely negative. Ian Little et al. concluded from examining data from India, Colombia, Japan and Taiwan that “capital intensity and productivity rarely rise and fall consistently in the expected manner as size increases” (1987, p.306). Rather it was found that both capital and total factor productivity frequently peaked in the medium scale enterprise intervals (employing 50-200), leading Little et al. to surmise that if anything it is the medium scale rather than small which is beautiful. However the over-riding conclusion was that “size as such, especially when measured by employment, is a poor indicator of any attribute of social importance” Little (1987, p.230).

Underlying this sceptical position is the extreme variability of efficiency found at the level of the firm within size classifications. For the India survey, which was the major focus of the study, these variations were such that only rarely was it possible to find statistically significant differences between size classes. These variances may however indicate not so much the irrelevance of scale as an interesting variable but the inadequacy of orthodox analysis. As Frances Stewart and Gustav Ranis emphasise (1990, p.10) all the studies reviewed tend to confirm that highly profitable, labour intensive smaller-scale enterprises do exist in many industry sectors. What is difficult to explain from a neo-classical perspective is why such a wide range of firm efficiencies should be found within industries. Only rarely, under conditions closely approximating those of perfectly competitive markets, can it be assumed that the selection of the scale of production or technology is reducible to a simple economising logic. Of particular significance in the developing economy context, as Raphael Kaplinsky (1990) argues, is the political economy of technological choice. Furthermore technology does not arise spontaneously, but as the outcome of considerable effort, both directed and accidental. The extent of the choice set is itself the result of political economic considerations. As writers advocating more
appropriate technologies have emphasised, often such appropriate technologies do not exist not because of a physical constraint but because relatively little effort has been focussed on their development.46

2.3.2 Changing views

From the 1970's the earlier somewhat deterministic view of enterprise scale was challenged from a number of directions. Throughout the industrialised world evidence began to appear of economic restructuring which reversed a long-term trend towards large-scale.47 David Birch (1979) produced a highly influential study of employment in the United States in which it was claimed that the majority of new jobs were being created in smaller-scale enterprises. In the UK, the official Bolton Committee inquiry into small firms similarly highlighted the contribution made by the sector to employment (Bolton, 1971). In the developing economy context a seminal report by the International Labour Organisation (1972) on Kenya highlighted the contribution of micro-scale enterprise (or the informal sector) to employment and incomes amongst the poor. Across the world, smaller-scale enterprise was seen as a mechanism for tackling chronic problems of regional economic imbalance created by restructuring in the industrialised countries and uneven patterns of growth in developing economies.48

A cross-country study of the leading industrialised economies by Loveman and Sengenberger (1991), found evidence confirming a number of reports that the widespread decline in employment within smaller-scale enterprise was reversed during the 1970s. Some of the basic data is shown in table 2-4, which includes more recent figures where available. The original data reviewed by Loveman and Sengenberger showed a remarkably consistent trend towards increasing employment in smaller scale enterprises across nine economies. This trend has broadly continued through the late eighties and early nineties across the industrialised economies with the notable exception of a slight resurgence in the larger-scale in Germany and Japan.49 The most recent data from Europe, Japan and the United States suggests a resurgence in the larger-scale in the mid-nineties, but not sufficient to reverse the gains made by the smaller-scale in the previous two decades.50
Table 2-4: Time series distribution of employment by number of employees in private sector non-farm enterprises, across selected economies

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Small (1-99)</td>
<td>41.3%</td>
<td>39.9%</td>
<td>39.9%</td>
<td>41.3%</td>
<td>40.1%</td>
<td>45.7%</td>
<td>46.9%</td>
</tr>
<tr>
<td>Medium (100-499)</td>
<td>13.8%</td>
<td>13.0%</td>
<td>13.3%</td>
<td>12.2%</td>
<td>12.4%</td>
<td>13.0%</td>
<td>14.1%</td>
</tr>
<tr>
<td>Large (500+)</td>
<td>44.9%</td>
<td>47.1%</td>
<td>46.8%</td>
<td>43.5%</td>
<td>47.5%</td>
<td>41.4%</td>
<td>39.0%</td>
</tr>
<tr>
<td>Small (1-99)</td>
<td>53.3%</td>
<td>56.9%</td>
<td>57.3%</td>
<td>56.6%</td>
<td>55.7%</td>
<td>55.6%</td>
<td>54.1%</td>
</tr>
<tr>
<td>Medium (100-299)</td>
<td>16.7%</td>
<td>15.8%</td>
<td>16.3%</td>
<td>16.5%</td>
<td>17.3%</td>
<td>17.7%</td>
<td>18.3%</td>
</tr>
<tr>
<td>Large (300+)</td>
<td>30.0%</td>
<td>27.3%</td>
<td>26.4%</td>
<td>26.9%</td>
<td>27.0%</td>
<td>26.7%</td>
<td>27.6%</td>
</tr>
<tr>
<td>Small (1-99)</td>
<td>39.0%</td>
<td>43.4%</td>
<td>46.2%</td>
<td>49.4%</td>
<td>50.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium (100-499)</td>
<td>18.4%</td>
<td>17.3%</td>
<td>18.3%</td>
<td>15.4%</td>
<td>16.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large (500+)</td>
<td>42.6%</td>
<td>39.3%</td>
<td>35.5%</td>
<td>35.3%</td>
<td>33.7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>1907</td>
<td>1925</td>
<td>1961</td>
<td>1970</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small (1-199)</td>
<td>72.7%</td>
<td>61.5%</td>
<td>54.9%</td>
<td>52.3%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium (199-999)</td>
<td>13.3%</td>
<td>14.5%</td>
<td>15.5%</td>
<td>16.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large (1000+)</td>
<td>13.8%</td>
<td>24.0%</td>
<td>29.6%</td>
<td>31.2%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1988</td>
<td>1991</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small (1-99)</td>
<td>47.1%</td>
<td>49.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium (100-499)</td>
<td>17.7%</td>
<td>17.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large (500+)</td>
<td>35.2%</td>
<td>33.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small (1-99)</td>
<td>60.2%</td>
<td>63.5%</td>
<td>61.6%</td>
<td>69.3%</td>
<td>71.4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium (100-499)</td>
<td>12.8%</td>
<td>13.6%</td>
<td>12.8%</td>
<td>12.2%</td>
<td>9.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large (500+)</td>
<td>27.0%</td>
<td>22.9%</td>
<td>25.6%</td>
<td>18.5%</td>
<td>18.7%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Various explanations have been posited for changes in scale composition. Two explanatory factors, sectoral (compositional) changes and cyclical effects, would suggest the phenomena to be rather less significant from an organisational perspective. A sectoral shift across the industrialised economies away from manufacturing towards services accounts for some increase in smaller scale enterprise given that the service sector has consistently shown significantly higher proportions of smaller-scale enterprise than manufacturing. However the trend towards smallness persists on both a sectoral and sub-sectoral analysis. Manufacturing in particular has been the subject of close scrutiny with many observers finding that smaller-scale enterprises have shown greater resilience than larger-scale in the face of a general decline in employment within the sector.

It has also been posited that the effects of the business cycle vary with enterprise scale. Although Loveman and Sengenberger (1991) found some evidence of a link between the cyclical downturn of the early seventies and the resurgence of smaller-scale enterprise, the effect is insufficiently strong to account for the whole change. Crucially however there is now evidence that the changes have persisted in many economies through the whole business cycle.

Michael Piore and Charles Sabel (1984) claim that there has been a more fundamental restructuring of industrial economies. Earlier conditions which favoured the mass production of homogeneous goods based on large-scale, indivisible production process are changing. Markets have started to fragment with an increasing demand for more heterogeneous and innovative products. The result is the need for shorter, specialised production runs and rapid adjustment to changing requirements. Technology, especially associated with micro-electronics, has both reduced the unit costs of capital equipment in many areas and rendered it far more flexible in the tasks it is able to undertake. Under these conditions Piore and Sabel argue that firms in some economies have responded with a strategy of "flexible specialisation", one of "permanent innovation: accommodation to ceaseless change, rather than an effort to control it". Given the appropriate institutional environment, it is the smaller-scale enterprise, as an organisational type, which is best able to adopt this strategy. The orthodox view of competition based on efficiency is replaced by a dynamic view in which long-run unit costs are frequently of relatively minor
Middle-scale enterprise and economic development

relevance. In this new world, the smaller-scale enterprise has a potential competitive advantage.

The claim that smaller-scale enterprise has a special role in the creation of jobs has attracted considerable debate. Birch (1979) asserted that in the United States for the period 1969-76, 82% of new jobs were created by small firms. In a subsequent study for the period 1981-85, Birch (1987) attributed 88% of net job creation to small firms. These figures are clearly influential in the policy arena. Recent research for the US Small Business Administration (SBA) declares that "from 1992-96 ... virtually all net new jobs were generated by small firms with fewer than 500 employees." (US Small Business Administration, 1997). Given that in 1996 small firms (employing less than 500) accounted for only 56.5% of employment this tends to support the claim for a special role for small firms in creating jobs (ibid.). Furthermore over 77% of net job creation is accorded to the smallest firms employing less than 20 employees, whilst such firms accounted for less than 25% of total employment.

Studies such as these have been subject to extensive criticism on methodological grounds.\textsuperscript{53} It is argued that the extent of the small enterprise contribution is overstated as a result of statistical features – notably the crossing and re-crossing of scale boundaries implied as a result of short-run fluctuations in firm size about the optimal scale (referred to as regression-to-the-mean bias). Factors already mentioned in relation to changes in scale structure - compositional shifts and cyclical effects are also relevant. A study of establishment size in manufacturing in the US from 1972-86 by Davis and Haltiwanger (1992) attempting to control for these effects found relatively little variation in job creation with scale. Taking a longer-term perspective SBA research produced a more modest result: from 1976 to 1990, small firms (employing less than 500 workers) contributed 65% of new jobs whilst accounting for an average of 53% of employment.

In the context of developing economies, the 1970's saw a shift in the dominant development paradigm from economic growth to basic needs. Where the informal, micro-enterprise sector had previously been largely ignored as representing a backward and marginal form of economic activity, it became recognised as one of the primary sources of income for the poor (ILO, 1972). The question of productive
efficiency and the putative economic desirability was somewhat overshadowed by the
realisation that it was this sector and not the modern, larger-scale which was
absorbing the rapidly expanding labour force in many developing economies. The
importance of the smaller-scale enterprise sector (measured here as enterprises
employing less than 50) for employment and incomes is illustrated in table 2-5.

Most notable is that in each of the five African countries for which data was
produced more than half of all households depended on micro or small enterprises
for at least half their income. Although reliable, consistent statistics are difficult to
find, the claim that the micro-enterprise sector is the primary source of new non-
subsistence income-generation opportunities in many developing economies has
remained largely unchallenged. Recent official figures from Kenya, for example,
indicate that, from 1993 to 1996, the micro-enterprise sector contributed 90% of the
net growth in employment (outside small-scale agriculture and pastoralist activities).

Table 2-5 : Micro and small enterprise (MSE) contribution to employment and
incomes across selected developing economies (early 1990s)

<table>
<thead>
<tr>
<th>Country</th>
<th>MSEs employment/ population age 15-64 (%)</th>
<th>MSEs employment per 1,000 persons in the population</th>
<th>Share of hired workers (%)</th>
<th>% of households depending on MSEs for at least half of income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>17%</td>
<td>71</td>
<td>39%</td>
<td>n/a</td>
</tr>
<tr>
<td>Kenya</td>
<td>18%</td>
<td>83</td>
<td>23%</td>
<td>69%</td>
</tr>
<tr>
<td>Lesotho</td>
<td>17%</td>
<td>84</td>
<td>10%</td>
<td>75%</td>
</tr>
<tr>
<td>Malawi</td>
<td>23%</td>
<td>92</td>
<td>18%</td>
<td>70%</td>
</tr>
<tr>
<td>Swaziland</td>
<td>26%</td>
<td>118</td>
<td>15%</td>
<td>64%</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>27%</td>
<td>127</td>
<td>16%</td>
<td>52%</td>
</tr>
<tr>
<td>South Africa</td>
<td>n/a</td>
<td>81</td>
<td>19%</td>
<td>n/a</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>19%</td>
<td>109</td>
<td>36%</td>
<td>n/a</td>
</tr>
</tbody>
</table>

The more problematic question of the longer-term economic role of micro-enterprise
remains. At issue is whether micro-enterprise, which makes up the greater part of
the smaller-scale sector in many developing economies, represents anything more
than a desperate response to the lack of alternatives. As Frances Stewart (1977) has
observed, in the absence of state welfare provision, unemployment is simply not an option.

It is widely acknowledged that the conditions of work in many micro-enterprises are often extremely poor, characterised by: "long working hours; exceedingly low remuneration and commensurately low labour productivities; poor health and safety standards; and generally a lack of purpose in work other than its being an exceedingly arduous means of subsistence." (Andersen, 1982, p.938). Daniels et al (1995) in their survey of Kenyan micro-scale enterprise in 1995 found that nearly two-thirds of enterprises generated a net income per person of less than the government minimum wage in both urban and rural areas. Fewer than half generated more than the equivalent of one US dollar a day and less than one in five produced an income comparable with the average reported in the formal sector. Although these figures don't take account of other contributions to livelihoods the evidence is clearly consonant with the notion that many micro-enterprises are purely survivalist activities.

The pessimistic view is that productivity in micro-enterprise is necessarily constrained. The International Labour Organisation, despite its long established support for micro-enterprise in Africa, concedes that they can act as a "labour sponge" and that the "the total value added by them can decline, in extremely adverse economic and regulatory conditions, despite increases in the total employment they provide." (ILO, 1994, p.7). At best minimal incomes can be maintained, at worst increasing supplies of labour increases the competition in an already saturated market depressing earnings yet further. On this view micro-enterprise is only accorded a limited role in economic development and the crucial objective of raising incomes amongst the poor.

Summarising the argument so far, it is clear that the simple magnitude of employment in smaller-scale enterprise in both developing and industrialised economies accounts for much of the attention received. However the increased interest has itself lead to changes in the theoretical perspective on the subject. The experience of the industrialised economies has shown that a simple, deterministic model of scale evolution does not offer a satisfactory explanation for scale
phenomena. The OECD concluded in a recent analysis that "to help ensure a growing and healthy economy, it would seem important to have a mix of large, small and medium enterprises with strong links between them" (1994, p.127). Analyses based on examining the relative productive efficiency of various scales appear somewhat over-reductive. Economically efficient firms can be found at all scales and regardless of their putative efficiency, micro-enterprises remain a highly significant feature of the economic landscape of many developing economies.

2.4 Linking scale and economic development

Although the recent evidence has undermined a simple model of scale and economic development, the contention that smaller-scale – and specifically middle-scale – enterprise plays a role in the process of economic development is still strongly supported by macro-level statistics. Examining time-series data across a number of disparate economies shows that regardless of the extent of concentration in latter stages, smaller-scale enterprise is found to be numerically highly significant during the early and middle stages. This applies to both early industrialising economies such as Germany and the United States, through the later, such as Japan, to the most recent newly industrialised such as South Korea and Taiwan. Interestingly while the role of the large-scale conglomerate in the rapid industrial development of both Korea (the chaeboli) and Japan (the zaibatsu) has received considerable attention, a considerable proportion of both economies was organised in smaller-scale enterprises both prior to and during the major periods of growth. It is notable that there are no cases reported in which a market economy has reached an advanced state of industrial development without passing through a period in which a large part of economic activity has been organised as first micro-scale then middle-scale enterprise.

The key theoretical task remains to determine the role played by scale in the process of economic development; the bare statistical facts will not show causality. In tackling this problem, the more recent approaches to scale discussed suggest that a broader theoretical basis for explanation is required than that offered by orthodox neo-classical theory. First, since economic development is itself a process the appropriate analytical stance is dynamic rather than static as implied by equilibrium
theory. Frances Stewart observes, “neo-classical economics ... is concerned with static equilibria. In practice economies are in continuous disequilibrium, and it is dynamic aspects (ie: factors contributing to fast or slow growth) which are of major concern to most countries, rich and poor. Hence the [neo-classical] theoretical apparatus is to this extent irrelevant to most economies” (1985, p.285). Second, the context in which enterprises operate in developing economies can only rarely be characterised as a nexus of competitive free markets. The general case is a complex structure of economic, social and political relations and institutions. These two analytical points are strongly connected.

2.4.1 Dynamics of enterprise development

Orthodox economic analysis says little about how an enterprise develops to reach a particular level of productive efficiency nor its prospects for future development. Yet these appear to be fundamental issues in economic development. Technologies do not effortlessly transfer from one economic context to another. Numerous examples of failed attempts to transplant advanced production techniques to developing economies have amply demonstrated this point. Determining which is the most desirable arrangement from a set of hypothetical forms ignores the question of what is actually possible given a particular starting point. The study of economic development necessarily concentrates on possible trajectories or paths of development rather than end states. Investigation of enterprise development logically has a similar focus. The major significance of the middle-scale to economic development may derive precisely from its position as an intermediate form, as it is conceived here (§2.2.2). Before turning to investigate this claim, some theoretical preliminaries are needed.

The essential path dependency of enterprise development can be seen most readily by examining production technology. Sanjaya Lall argues that much of the relative performance of manufacturing firms can be understood in terms of technological capabilities: “the skills – technical, managerial and institutional – that allow productive enterprises to utilize equipment and technical information efficiently. These capabilities are firm-specific, a form of institutional knowledge that is made up of the combined skills of its members accumulated over time.” (1993, p.720). The
development of capabilities is thus incremental in character; firms build on
capabilities already mastered, building organisational skills and knowledge. Key to
the development of the firm are those which Lall classifies as investment capabilities:
"the skills needed to identify, prepare, obtain technology for, design, construct,
equip, staff and commission a new facility" (1992, p.166). Such capabilities are
essentially second-order – determining the firms ability to develop new capabilities in
production.

Lall's conception derives from the evolutionary economics proposed by Richard
Nelson and Sidney Winter (1982). At the heart of this theory is the concept of
"routine" which describes all regular and predictable patterns of behaviour by the
firm. Routines embody the skills and knowledge of the organisation, determining its
capabilities. The concept of a routine relates strongly to Michael Polanyi's notion of tacit
knowledge. Performance of many tasks whether by an individual or organisation
depends on unarticulated knowledge either directly or as sub-tasks of a more
complex whole. A simple example of unarticulated knowledge is found in an activity
such as swimming (Polanyi, 1962). The ability to swim cannot be derived from a set
of explicit rules. Crucially it is only through the process of doing it that an individual
masters swimming. An explicit description of the process of swimming is rarely used
as a basis for learning how to swim, and probably never in exercising the skill once
acquired. Even where knowledge can be made explicit, the efficient exercise of that
knowledge may be tacit. Nelson and Winter quote the example of algebraic
manipulation in which the ability to perform aspects of the problem without
reflection are crucial to undertaking a highly complex task.

The development of an enterprise is understood in terms of change in the
enterprise's routines. (Such a development includes a possible progression from
micro- to middle- and large-scale as implied in the conceptual definition sketched in
table 2-1 earlier.) This is seen as the outcome of an evolutionary process based on
the interaction between enterprise and environment. A hierarchy of routines can be
conceived in which low level are modified according to middle which are in turn
subject to high level. Higher-order routines within the enterprise determine how the
enterprise reacts to various outcomes to modify those at a lower level. Selection or
adaptation occurs both passively and actively to all routines. Routines which are
successful will result in fewer failures and faster growth of the firms in which it is present leading to greater replication of the routine. The converse is also true — unsuccessful routines will have adverse impacts on the growth and survival prospects of firms. Actively, firms will monitor and emphasise what is successful and other firms and new entrants to the market will tend to imitate. Successful routines are therefore moulded by the particular environment in which they occur.

The evolutionary argument directly challenges the reductionism of orthodox theory which represents the firm purely in cost terms. One key aspect of the picture suggested by evolutionary theory and highlighted by Piore and Sabel (1984) is flexibility. The notion of flexibility relates to a wide range of problems — short term and long term, operational, tactical and strategic (Carlsson, 1989). Put simply it concerns the basic capability or readiness of the firm to change, most especially in the face of new conditions. Flexibility is in principle irreducible to a static cost calculus because it relates to future conditions which are fundamentally uncertain. Within Nelson and Winter's exposition, flexibility will be a function of an enterprise's routines. The nature of low level routines will strongly determine the operational flexibility of the firm whilst those at a higher level will relate to strategic flexibility. Emphasising the significance of flexibility, Burton Klein (1984) introduces the notion of dynamic efficiency, referring to the process by which new ideas are generated and implemented in response to opportunities or threats.

The question to which we can now return is how an evolutionary, dynamic theory might illuminate the question of the role of the middle. As noted earlier many developing economies are characterised by large numbers of micro-enterprise. Furthermore historical evidence shows that many, now industrialised economies were similarly characterised by large numbers of micro-enterprises at the start of the process of industrialisation. The emergence of these enterprises is theoretically comprehensible from an evolutionary perspective. In terms of organisational form, technology and linkages, or 'routines', micro-enterprises tend to be continuous with pre-industrial agrarian economies. That such enterprises often appear in spite of, rather than because of, state interventions is indicative of the extent to which they are a short evolutionary step from preceding economic arrangements. Entry barriers, in a very broad sense, are low.66
Large-scale enterprise by contrast involve major leaps in organisation and technology. The process of establishing large-scale enterprises in developing economies is usually strongly associated with the use of external support from the industrialised world. The capability to develop large-scale enterprise is necessarily absent in a developing economy – since such capability it is argued is a product of embedded, progressive, learning. Substitution is therefore inevitable. Although feasible, it is often found difficult to establish efficient large-scale enterprise in developing economies and usually involves an on-going dependence on external support.

Attempting to transplant approaches from industrialised economies risks imposing ill-adapted forms into a new environment. The micro-level selection and adaptation processes implied by an evolutionary development of enterprise capability is clearly bypassed by a move directly to large-scale enterprise. According to the evolutionary model these enterprises will necessarily lack the dynamic capacity which is essential to be adaptive to changing conditions.

The argument suggests a hypothesis that attempts to make discontinuous changes in technology or organisational form risks producing an etiolated form of industrialisation. Middle-scale enterprise can be seen as an essential stage in industrial development. Essentially it represents a crucial evolutionary step from micro-enterprise. However it is a key step in the process of industrial development since it represents a move towards a form in which the possibilities for more productive activity are enormously widened as the preceding analysis has shown. Attempts to determine which scale is or is not the most productive in highly generalised circumstances, as noted earlier, have proved somewhat inconclusive. It is however possible to conclude that middle-scale enterprise as a form includes far more possibilities for statically efficient production than micro-scale. The recent evidence from industrialised economies reviewed above shows that the locus of what can be competitively produced in smaller-scale enterprise is far greater than had previously been supposed. More important however is that middle-scale emerging from an evolutionarily continuous development path is far more likely to be broadly flexible and thus dynamically efficient.

Recalling the conception of scale types developed earlier, it was argued that the organisational form of smaller-scale enterprise is essentially adaptable. This applies
Middle-scale enterprise and economic development

to both the micro and middle-scale types – both represent forms in which resources are largely mobilised by negotiation rather than direct control. Middle-scale is distinguished from micro-scale by a greater degree of complexity necessitated by the extent to which there are significant resources within the direct locus of control of the organisation. Routines increase in complexity and a greater hierarchy is distinguishable. Given that productive capabilities are embodied in these routines, increasing complexity of routines must to an extent be a corollary of increasing productivity. In short, it is conjectured that the middle-scale represents a flexible organisation of relatively complex productive capabilities and resources.⁶⁹

Looking at the economy as a whole, it has been argued that flexibility is especially significant in relation to economic development. Tony Killick proposes that:

An economy with a flexible structure, which can readily adjust to the needs of the time, will achieve faster development than an economy with a rigid structure. Inflexible economies can expect retarded growth, with disjunctures between demand and supply creating bottlenecks, balance-of-payments strains, inflationary pressures and other economic dislocations.

Killick (1995, p. 1)

Organisation of industry in middle-scale enterprise, in theory, offers precisely such a flexible structure by comparison with one based on large-scale. This argument derives from recent work on the phenomena of industrial districts, in both industrialised and developing economies. Some of these industrial districts, which have proved competitive in global markets appear to be dominated by middle-scale enterprise. It is precisely the flexibility of the districts which is held to be responsible for their success.⁷⁰

The evolutionary view suggests another important facet of the role played by micro- and middle-scale enterprise. Interestingly this derives from a common criticism of smaller-scale enterprise. It is claimed that relatively high rates of closure among smaller enterprises compared with larger shows the essential weakness of the form. However, as Sidney Winter points out, the argument is simplistic: “Survival data for enterprises of a particular sort say nothing about the viability of that form of enterprise; newly formed businesses generally replace the failures.” (1995, p.9). Winter goes on to point out that on the contrary, “rapid advance via strong selection
at the level of routines could have turbulence at the firm level (high entry and exit) as its logical corollary, granting only the plausible premise that it is easier to establish new practices in new enterprises than it is to overthrow and replace established practices in old enterprises” (p. 15). This argument provides a theoretical basis for the common claim that smaller-scale enterprises are a source of vitality in an economy with relatively low entry barriers enabling entrants to introduce and test innovatory ideas.

The contribution of the smaller-scale sector to industry-wide or economy-wide capacity development is, however, contingent on a number of factors. Rapid evolutionary development depends on strong linkages between actors in the economy. What works and does not work needs to be readily recognised by competing firms. High exit rates may be an indication of systemic imbalances in the task environment; especially likely where state intervention is high. Selection cannot be presumed to produce a Panglossian outcome and firm exits do not come without cost. Much tacit knowledge generated within an organisation may be regarded as embodied not within the individuals comprising the organisation but across those individuals taken as a collective. When the particular organisation is dissolved then that knowledge is necessarily lost.

Further scepticism regarding the role of smaller scale enterprise is invited by the observation of relatively low average growth rates amongst micro-scale enterprise. Early support for smaller-scale enterprise in India and subsequently Kenya and elsewhere had been based on the argument that smaller-scale enterprise would provide an industrial seedbed. The relatively low rates of ‘graduation’ from micro-scale to middle-scale and from middle to large has been taken as evidence of an intrinsic limitation in the potential role of smaller-scale enterprise. It is clear from the foregoing that this argument largely misconstrues the role of smaller-scale enterprise. Furthermore average ‘graduation rates’ in industrialised economies have consistently been found to be similarly unspectacular. The extraordinary cases of companies which have grown from micro-scale to reach the Fortune 500 or FTSE-100 within a few decades are just that – extra ordinary. These success stories provide a powerful warning of the dangers to an economy of an excessive preoccupation with the existing large-scale. However attempts to spot and support such
'winners' has proved a largely futile exercise. The critical issue it is argued here is not graduation but the question of whether evolutionary development is occurring. The non-emergence of a middle-scale, given a very large micro-scale sector, suggests a stalling of the economic development process.

2.4.2 The embeddedness of enterprise development

The evolutionary argument just sketched strongly suggests that context is highly significant to enterprise development. It is also suggested by the definition of middle-, micro- and large scale developed earlier (§2.2.3) which are based on a contextual understanding. We need to consider both the implications of the context within which enterprises are embedded and how this context itself develops. Before turning to the specific question of the middle it is necessary to briefly consider how embeddedness broadly relates to theory.

Market failure is a common theme in the orthodox economic analysis of developing economies. Put simply market failure refers to the circumstances in which the conditions of exchange vary between economic actors, whether actual or potential. Identity matters and participants in the market are held to receive differing signals. At the heart of this conception is the notion that such variation is essentially anomalous and exogenous to the proper analysis of the role played by say scale in economic performance. Where for example differing scale types are found to face systematic differences in the costs of say capital or labour, such gains or losses are not regarded as theoretically attributable to the organisational forms involved, but to the simple failure of markets.

A profoundly divergent view is advanced within new institutional economics. According to transaction cost theory, which forms a major element of the new institutional economics, it is inherently costly to transact. Only under the most favourable conditions can all relevant information be signalled through the price mechanism and the cost of transacting approach zero. In general, exchange will involve problems of both co-ordination and co-operation between participants. Both the relationship between actors and the nature of the transaction itself matters in determining the cost of exchange. Transaction costs are the result of the organisational arrangements and institutional structure in which an enterprise is
Embedded. The costs of production are the sum of both transformation and transaction costs (North 1990).

Using transactions cost theory for comparative organisational analysis reveals the significance of scale. Consider some economic activity in which, arguendo, there are no significant indivisibilities or economies of scale to be found. We might therefore suppose that the activity could be organised in either a single large-scale, vertically integrated firm or a collection of smaller firms. According to transactions cost theory, the crucial economic difference between the organisational alternatives is found in the relative costs of transacting — within the hierarchy of the firm or externally. Both the internal establishment of formal bureaucratic controls and the external ordering of complex transactions using formal institutions of law are potentially costly. However informal economic and social institutions are also relevant to the ordering of transactions and particularly so for smaller-scale enterprise. Reiterating the point made earlier, middle-scale and micro-scale enterprise are quintessentially informal modes of organisation (table 2-1). This applies both inside and outside the boundaries of the firm. Problems of cooperation in exchange are often tackled not by reference to formal procedure or legal contract but on the basis of mutual understanding and relationships, which are directly supported by informal institutions.

It is argued therefore that the possibility for what could be described as a ‘small firm economy’ is dependent on the particular nature of the informal institutional environment. In the most favourable circumstances informal rules constrain opportunistic behaviour and encourage the formation of long-term co-operative relationships. Informal organisation of transactions necessarily involves lower direct transaction costs than formal — neither managers nor lawyers are required to order the transaction. Thus in an appropriate institutional context micro- and middle-scale firms could enjoy cost advantages over large-scale.

A small firm economy may also be more favourable in terms of co-operative adaptation than a large scale. Co-operation within the large-scale unitary organisation is imposed by fiat and bureaucratic procedure. The danger is that the arbiter in cases
of dispute, the chief executive or board, may be somewhat distant from the nature of an exchange problem within the same organisation, say between two divisions.

The argument for the transactional efficiency of smaller-scale enterprise is clearly highly contingent. Only where the total institutional environment is strongly aligned to the needs of smaller-scale enterprise can it be presumed that such gains will be available. Interestingly the reasoning provides a possible explanation for the long-term persistence of widely differing proportions of middle- and micro-scale firms within economies at similar stages of industrial development (table 2-3). Specific evidence from in-depth analyses of clusters involving large numbers of smaller-scale enterprise provide strong evidence of the significance of the institutional context and resultant exchange relations. It can be speculated that in the developing economy context, where the formal institutional environment may be poorly developed, the role of informal institutions might be greater. Organisation of some sectors of the economy on the basis of middle-scale enterprise may thus be a more viable option by comparison with integration into large-scale firms.

We now turn to consider the development of the environment itself. According to North in order for a society to realise the gains of industrialisation — the "second economic revolution" — a fundamental change in the institutional structure is required. Informal institutions are replaced by the formal and the state plays an increasing role. There is however no necessary path of development for institutional structure. It is suggested however that industrialisation based on the middle-scale enterprise form depends on institutions which are a relatively small-step from those associated with pre-industrial societies. The development of the middle can thus be seen as a stage in a continuous evolutionary path of institutional development. A move straight to large-scale enterprise for an industrialising society may thus miss an important intermediate developmental step.

As North argues, institutional changes actually occur at the margin, reflecting shifts in relative prices and the relative bargaining power of actors in a society. Thus "institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules." (North, 1995, p.20).
Here finally the notion of the long run significance of middle-scale enterprise as suggested by the stages of growth models of Shinohara (1968) and Andersen (1982) can be understood. Smaller scale enterprises, and middle-scale in particular, collectively have a major interest in the development of a productive institutional environment. The survival and growth of middle-scale enterprises is highly dependent on the task environment in which they are embedded. A lower cost, more efficient transactional environment is therefore highly significant to the interests of middle-scale enterprise.

There is a stark contrast with the largest scale firms in which many functions are internalised and considerable control can be exerted on the environment. In economies typified by small markets, monopoly or oligopoly and monopsony or oligopsony are common. Larger firms have a powerful interest in exerting pressure on the development of the institutional framework to protect such positions of dominance. The greatest returns, in the short-term at least, will not necessarily result from a lower cost transactional environment but one which preserves the concentration of economic power and the availability of rents. As Deborah Brautigam (1994, p.139) observes: “a small class of large-scale producers is likely to spend considerable energy trying to achieve or preserve its particularistic access to special state resources or protection”. An alliance of large-scale enterprise and the political elite of a developing economy thus risks precisely the type of economic stagnation predicted by dependency theorists.  

The institutional argument therefore reiterates the emphasis placed on the role of the industrial bourgeoisie in development by many political economists. It argues that the analysis must take account of the political and economic interest of a particular group or class. A *comprador* class is indeed possible in the periphery, but not a necessary outcome. The owners of middle-scale enterprise have a class interest in the development of an institutional environment which promotes economic development based on a competitive, exchange economy.
2.5 Conclusion

The link between smaller-scale enterprise, and particularly middle-scale, and economic development is clearly justified. Scepticism towards the relevance of the subject appears to derive largely from an excessively reductionist view of the meaning of scale itself. Where scale is understood simply as a quantitative measure of employment or capital concentration, the theoretical interest quickly dissipates. However seen as a distinctive description of economic and social organisation concepts of micro-, middle- and large-scale enterprise become considerably more valuable. As theoretical constructs the terms are most usefully understood as ideal types.

Much attention has been focused in both developing and industrialised economies on the job creation potential of smaller-scale enterprise - encompassing both the micro and middle type identified here. The result has been a somewhat polarised debate between advocates and detractors of smaller-scale enterprise. Inevitably with such debates, the evidence is never sufficiently clear to permit one side or the other to claim unequivocal victory. On the side of those in favour of smaller-scale enterprise, it is clear that stories of the inexorable demise of the small have been much exaggerated. Smaller-scale enterprise is highly significant in employment terms throughout the world. Long-term trends towards larger-scale have been reversed in many industrialised economies. In many developing economies micro-scale enterprise provides incomes for the poorest in society. Perhaps most significant is that some of the most dynamic, advanced industrialised economies are characterised by relatively large smaller-scale enterprise sectors. There is little doubt that the smaller-scale sector is responsible for a significant proportion of job creation.

There is however justification for some scepticism towards the stronger claims made for job creation in the smaller-scale sector. As much as smaller-scale enterprise now appears as a permanent feature of most economies, industrialised and developing, larger-scale will equally persist. A balanced economy seems likely to include both. The social-welfare consequences of smaller-scale enterprises are not universally positive. There is evidence from both developing and industrialised economies that employment conditions in the smaller-scale are often significantly poorer in many
material aspects than those found in larger-scale. Much micro-enterprise in developing economies offers little prospect for producing more than basic survival incomes.

Much of the argument regarding the economic significance of scale for development has focussed on the static analysis of productive efficiency based on orthodox theory of the firm. Neither the theoretical nor empirical work leads to convincing indisputable conclusions. Large, middle and micro can all be beautiful in the right light. Most significant is the refutation of a presumption that technological progress inevitably leads to greater scales of organisation. Proponents of appropriate technology and the flexible specialisation thesis have shown that the possibilities for economic organisation are not, in general, foreclosed by technology.

Understanding the relationship between scale and economic development requires a broader theoretical framework than offered by orthodoxy. Two emerging strands of economic thought – evolutionary and new institutional theory offer a more promising basis on which to understand the question. A dynamic perspective seems demanded by a question which is fundamentally about a process. Furthermore enterprise does not take place in vacuo but is embedded in economic and institutional structure. The role of scale it has been argued can only properly be understood within this broader context.

Examining the dynamics of enterprise and economic development from an evolutionary perspective highlights the significance of learning. Here it appears that the middle-scale organisational type has a distinctive role. Fundamentally, at the level of the firm it represents an intermediate step on a continuous evolutionary path between pre-capitalist, unspecialised, low technology production and the highly specialised, technologically intensive organisation of an industrialised economy. At the macro level, the relatively high turbulence of the sector may positively contribute to learning across the economy.

Analysis of the context for enterprise reiterates the importance of evolutionary continuity and flexibility. The organisational form of middle-scale enterprise is more coherent with the quintessentially informal institutional character of pre-industrial
Middle-scale enterprise and economic development.

society. Equally it represents a potentially more flexible arrangement which is more likely to adapt successfully to the uncertain conditions associated with rapid economic development. Finally and perhaps most crucially the middle has a highly significant political economic role. It is argued that the development of institutional structure appropriate to an industrial market economy depends on a polity which has a material interest in just such a development. It is the middle-scale which has the most to gain from such a project.
Notes

1 The term 'scale' and 'size' are used interchangeably here, reflecting the literature. Although it would be argued here that the term 'scale' conveys more of a sense of the qualitative differences, common usage has muddied the distinction to the extent that attempting to establish differential usage here would risk confusion.

2 Gibb (1997) observes this lacuna in knowledge in spite of the considerable recent attention given to smallness, not least in relation to the putative intended restructuring of large scale organisations in the industrialised economies to capture perceived gains from 'smallness'.

3 Auciello (1975), for example, found over fifty different formal definitions of small scale enterprise in a survey of seventy-five countries.

4 Both Brooksbank (1991) and Hailey (1991) make a similar distinction between qualitative and quantitative definitions of scale. Since many definitions combine more than one dimension, a third hybrid category is needed in their schema.

5 Numerous examples may be cited. The UK government uses a simple employment definition for statistical purposes (UK Department of Trade and Industry, 1997). The European Commission recommends a definition based on four criteria of which the employment element is clearly a major part (European Commission, 1996). Interestingly the annual European Union wide survey on small and medium enterprise (the European Observatory for SMEs) whilst primarily using the Commission recommendation occasionally falls back on the use of a single employment measure (EIM, 1997). The US Small Business Administration classifies on either employment or turnover according to industry classification (US Small Business Administration, 1998). In a review of World Bank lending to SMEs in developing countries it was observed that definitions varied across countries, but the general definition advanced was again on the employment scale (Webster et al 1996, p.3). The Kenyan Government uses the employment measure comprehensively – covering policy and statistical measurement (Republic of Kenya, 1992b).


7 Brooksbank (1991, pp.18-20), taking definitions of medium scale as an example found very substantial variations in the cut-offs across just ten academic articles. For number of employees, definitions ranged from an interval of 10-250 to an interval of 1,800-4,999. Similarly for sales turnover the range was an interval of £1.4-5.75 million to an interval of £16-666 million. The key point here is that the intervals do not even overlap. Without further dimensions, the referent of medium scale in these articles is clearly completely different.

8 Although number of employees is not strictly continuous (unless it is equated with labour input) this is clearly not relevant to the argument.

9 The US Small Business Administration definition of a small business for a large number of industry sub-sectors is employment of 500 workers or less (US Small Business Administration, 1998). Meanwhile the Kenyan government defines small scale enterprise as employing 50 or less (Republic of Kenya, 1992b). Webster et al (1996, p.3) in reviewing World Bank lending to SMEs, claims that "SMEs generally have from 10 to 200 workers". Micro-enterprises occupy the lower range of less than 10 employees. Numerous other examples of the variance could be cited.


11 A similar point is made by Neck (1977, p.10) and Page and Steel (1984, p.10)

12 For a discussion see Little (1989, pp.187-216) and Geertz (1984)

13 See for example Piore and Sabel (1984)

Middle-scale enterprise and economic development

13 See also Gibb (1993a)

16 See Piore and Sabel (1984), Weiss (1988)

17 A notable exception is in relation to discussion of Germany's industrial structure in which the role of the 'Mittelstand' has received considerable attention (see for example, Simon 1992)


19 See for example Liedholm and Mead (1987), Lubell (1991)

20 See for example De Soto (1989), King (1996) and Mead and Morrisson (1996)

21 See for example ILO (1994) and World Bank (1989)


23 Source: World Bank (1995), figures for 1993. Figures for Europe exclude Liechtenstein (data not available) – however given the relatively small population of Liechtenstein this will not significantly affect the figure.

24 Source: Daniels et al (1995), Republic of Kenya (1996). Note that for the category 1-9, the actual range used for 1-10 from the Daniels' study. Two sources were required since on methodological ground it is believed that the Daniels' survey of micro-enterprises under-counted the middle-scale, whilst the CBS data under-counted the micro. The figures are only used indicatively here.

25 Source: UK Department of Trade and Industry (1996.)


28 Source: Japan Bureau of Census (1996)

29 Source: World Bank (1995), figures for 1993. Figures for Europe exclude Liechtenstein (data not available) – however given the relatively small population of Liechtenstein this will not significantly affect the figure.

30 Source: Parker and Torres (1994), Republic of Kenya (1995). Note that for the category 1-9, the actual range used for 1-10 from the Parker and Torres study. Two sources were required since on methodological ground it is believed that the Parker and Torres survey of micro-enterprises under-counted the middle-scale, whilst the CBS data under-counted the micro. The figures are only used indicatively here.

31 Source: UK Department of Trade and Industry (1996.)


33 Source: US Small Business Administration (1997)

34 Source: Sengenberger and Loveman (1988)

35 Source: Japan Bureau of Census (1996)


37 Source: Loveman and Sengenberger (1991)
38 See Marx (1976)
39 This view can be taken as a crude corollary of the Mahalanobis models which justified investment in capital intensive industries for India (see Streeten, 1983, pp. 15-21)
40 For a discussion see Streeten (1983, pp.10-15)
41 This is obviously something of an over-simplification of the argument, but draws out the central ideas. See Bannock and Binks (1989), Schumacher (1973)
42 See for example, ILO (1994), Republic of Kenya (1992b)
43 For example, producers in the garment industry of varying scales in Kenya were found to be highly selective in their adoption of high-technology equipment. To take one instance, it was claimed that no firm, large or small, would use an automated fabric laying machine precisely because it was far cheaper to continue to do this by hand in Kenya. A particularly interesting case was found in the glass industry. A very large-scale producer of glass bottles, using a high technology integrated bottling plant, chose not to invest in the optional automated packing line, but rather to pack the final product entirely by hand. (Source. Interviews with managers, field-study 1997, 1994)
45 Mead (1991, p.415-6) suggests that one explanation for the existence of relatively inefficient small-scale enterprises in India is the strength of government intervention in support of the sector. In other countries the policy environment is generally more hostile to smaller-scale than larger-scale, resulting in the survival of only the most efficient smaller-scale firms, explaining the relatively greater efficiency of the smaller-scale in these environments. However from a strictly orthodox economising perspective there is no explanation as to why a substantial variation in efficiency should persist.
46 See for example, Schumacher (1973), Stewart and Ranis (1990), Kaplinsky (1990), Smillie (1991)
47 See for example, Loveman and Sengenberger (1991, p.2)
48 See for example, Uribe-Echevarria (1990, 1991), Storper (1990b), Sengenberger (1993)
53 Reviewed briefly in Loveman and Sengenberger (1991) and OECD (1994)
54 This is illustrated by survey work on Kenya in which studies conducted in 1993 and 1995 showed dramatically differing results despite very similar methodologies. Total employment in the micro and small enterprise sector was estimated at 2 million in 1993 and only 1.2 million in 1995. Such a contraction is regarded as highly improbable and growth estimates from the latter study of approximately 10% per annum in the sector were regarded as more reliable (Daniels et al, 1995; Parker and Torres, 1994).
55 See for example ILO (1994).
56 Republic of Kenya (1997b, p.63). The "informal sector" can be a somewhat problematic term (see Mead and Morrisson, 1996). Here the understanding corresponds closely to the notion of the micro-enterprise type discussed above: "The term informal sector, also referred to as 'Jua Kali', covers all small-scale activities that are normally semi-organised and unregulated, and use simple labour-intensive technology. Self employed persons or employers of a few workers largely undertake these activities. The informal activities are undertaken by artisans, traders and other operators in work-sites such as open yards, market stalls, undeveloped plots, residential houses and street pavements. Through not registered with the Registrar of Companies, they may or may not have licences from
local authorities for carrying out a variety of businesses.” (p.72) The extent to which this definition was rigorously applied in the statistical work is not clear.


This figure excludes the relatively small number of directly paid wage employees. Net enterprise income is attributed to owners and unpaid workers.

Source: Republic of Kenya (1997b, p.70)

A point confirmed by others – see for example Ghate et al (1996)

Andersen (1982), Bannock and Binks (1989)

See for example World Bank (1993)

Herbert-Copley (1990), Lall (1993)


The point here may appear somewhat laboured; the existence of micro-enterprise is not regarded as particularly mysterious to most observers and the notion of low entry barriers well established. However based on a purely neo-classical understanding of the firm, the co-existence of firms at differing levels of profitability and productive efficiency is somewhat mysterious.


As noted earlier, Piore and Sabel (1984) argue that this is partly a consequence of new technologies.

This argument parallels that put forward by Piore and Sabel (1984)


Low rates of micro-scale enterprise graduation across Africa have been reported by Mead and Liedholm (1998).

Computer and other high-technology industries provide many of the best known examples – Microsoft Corporation, Apple Computer, Compaq, Dell, Sun Microsystems and Hewlett Packard.

This is also strongly suggested by the business systems literature, see for example Whitley (1992).


There is a substantial literature relating to both industrialised and developing economies. See for example Couplet and Pecqueur (1991), Schmitz (1993), Nadvi and Schmitz (1994) and Kozul-Wright (1994).

See for example Leys (1975) and Kaplinsky (1982).

See for example the collection edited by Berman and Leys (1994).
3. KENYA AND THE 'MISSING MIDDLE'

3.1 Introduction

Middle-scale enterprise, it emerges from the argument in the last chapter, has a potentially highly significant role in economic development. We now turn to consider the position of the middle-scale manufacturing sector in one particular developing economy, Kenya. The purpose of this chapter is to consider what is known about the middle in the context of Kenya's economic development and therefore what research questions are raised as a result.

An outline of the path and current state of Kenya's economic development forms the essential background for our inquiry (§3.2). In attempting to understand the middle in Kenya we need to consider its basic context. A century ago, much of the economic activity within the area which constitutes present day Kenya could be characterised as traditional peasant subsistence agriculture or pastoralism. Within the following century Kenya experienced first colonisation and then the creation of the modern independent nation. The position of the Kenyan economy today and its state of industrial development has to be understood against this wider historical canvas.

In the next section (§3.3) attention is directed more specifically towards the position of Kenya's manufacturing sector. The argument in the last chapter emphasised the dynamic role of middle-scale enterprise. Therefore we need to go beyond the basic numerical indicators of output, employment and growth, and consider the underlying dynamic of the sector.

The framework for the question of the middle is completed by considering Kenya's development priorities (§3.4). Economic development is indissociable from issues of poverty, arguably universally, but certainly in relation to developing economies. We start therefore with a brief examination of poverty in Kenya. Given the population growth rates Kenya has experienced, poverty elimination will require not simply an increase in incomes from current economic activity but the generation of significant numbers of new income-generating opportunities.
Having established the necessary context, we can finally consider the middle-scale sector itself in Kenya (§3.5). The evidence regarding the scale structure of Kenya's economy, and manufacturing in particular is examined. A key question which will also further illuminate the question is the ownership of Kenyan industry and the middle-scale in particular. This leads finally to the crucial issue: Is Kenya's middle missing? In discussing this question within the context set by this chapter and the last, the essential research questions which this thesis will tackle can be located.

3.2 Synopsis of Kenya's economic development

Kenya's modern history is frequently considered as divisible into three major periods: pre-colonial, colonial and post-independence. However as Penelope Hetherington (1993) warns, this rigid tripartite division of Kenya's history tends to obscure processes which it can be argued are continuous through history albeit significantly modified by the political changes occurring at the onset and end of the colonial period. Kenya only attained full political independence from Britain in 1963. Much analysis of Kenya's industrialisation only starts from this date, giving rise to the unwarranted assumption that Kenya's industrialisation started at this time. The pre-colonial period has been subject to even greater neglect.

3.2.1 Pre-colonial period

In the nineteenth century, within the area which was to become Kenya, a majority of the communities practised settled agriculture, though a significant minority were pastoralist. Although much of the economic activity was directed at subsistence, it is important to note that many of these communities did generate surpluses in various commodities and engage in trade (Ochieng' 1992a). Furthermore craft production was also widespread, notably in iron and pottery (Wandiba 1992).

The coastal region had been involved in international trade for many centuries with other areas on the Indian ocean and Europe. A substantial settled Arabic and Indian population on the coast dominated this trading activity. Trade with the interior was conducted by coastal merchants who organised caravans to the interior.¹
Although exchange was clearly important to the pre-colonial economies of Kenya, it was also highly constrained by a number of factors. The technology used for producing goods was rudimentary, involving limited division of labour. Physical transportation was highly costly in the absence of a developed road system. Crucially the institutional environment was not appropriate to a high density of exchange and accumulation. Most obvious was the lack of a convenient store of value and means of exchange.

3.2.2 Colonial period

European explorers arrived towards the end of the nineteenth century. By 1898 Kenya had been declared a British protectorate, and a full colony established in 1902. The boundaries of what is now Kenya were set by the European powers somewhat arbitrarily. Significantly these boundaries took little account of the pre-existing African nations (Ochieng' 1992b). Originally British imperial interest in Kenya was limited to its significance as the land lying between the coast and Uganda. The huge cost over-run of building a railway from Mombassa through Kenya to Lake Victoria, finished in 1901, caused the British government to consider further ways of recouping the investment. This lead to the encouragement of colonial settlement and large-scale commodity farming - in coffee, sisal and tea.

Immigrants arrived from a number of origins, notably Britain and India. European settlers were able to alienate vast tracts of the most fertile regions of central Kenya for large-scale cash crop production. Some Indians originally arrived in Kenya as indentured labourers for the construction of the railway, and opted to stay following its completion. Many others travelled independently to East Africa perceiving greater economic opportunities. Indians were excluded by colonial policy from agriculture and established themselves in micro-scale enterprises across Kenya, notably in small shops or dukas. Those with formal education were able to occupy junior positions in the colonial administration.

During the early colonial period (prior to the second world war) the emphasis of the colonial state was on primary agricultural production with a limited degree of processing before export. Industrial development was limited (Vaitsos 1991, p.10).
The colonial state rapidly introduced a complex set of formal institutions, based primarily on those evolved in Britain and other parts of the British Empire.

Of critical importance during this period was the development of the cash economy. A unit of currency was established by the colonial economy (initially the Indian rupee). The opening of the railway resulted in a dramatic reduction in physical transactions costs. The imposition of a hut tax in 1902 effectively forced many of the indigenous people into the cash economy. Farmers were effectively forced to produce a commodity surplus for sale or sell their labour to the large-scale plantations to raise cash. The roots of the regional imbalances seen in contemporary Kenya were also sown during this period. Communities, such as the Kikuyu, in close proximity to colonial activity underwent major social and economic change whilst those inhabiting the outlying regions were far less affected (Maxon, 1992a).

The latter part of the colonial period, from the second world war onwards, saw more tangible industrial development. Early dependency theorists tended to underplay the extent of industrialisation in the imperial possessions in the periphery during the colonial period. Such theorists have tended to characterise the colonial economy as being purely concerned with the extraction of primary materials for processing at the centre. In fact significant manufacturing industry developed during the colonial period. The colonial state was active in encouraging the expansion of local industry. Initially this was a response to the difficulties of supplying the colony during the war. Subsequently British imperial policy was to dramatically increase the scale of production in the colonies. Substantial state investments were made through the Colonial Development Corporation in Kenya.

Manufacturing in the private sector was dominated by subsidiaries of multi-nationals and Kenyan based European and latterly Asian entrepreneurs (Swainson 1980). Himbara (1994b, pp.35-74) notes that significant local Asian manufacturing capital had been established by the 1950s. Indigenous Africans did not become significantly involved. Although there is evidence that some middle-scale firms appeared in this period, large-scale investment predominated (Swainson 1980, Himbara 1994b). Much of the activity could be characterised as import-substituting, there is evidence that Kenya benefited from making significant manufacturing exports to the other
countries in the region. The three British East African colonies, Kenya, Uganda and Tanzania were formed into an economic union, the East African Community (EAC), which not only eliminated all trade barriers within the area, but also had a unified transport system and a degree of industrial co-ordination. Manufacturing exports by the early 1960s accounted for 29% of all manufacturing value-added, of which 70% went to neighbouring countries. Trading links with UK weakened considerably during the colonial period itself, from a position in 1914 in which 46% of exports were made to UK to 26% in 1951 (Mosely 1982, pp. 213-4).

3.2.3 Post-independence period

In the period immediately following independence Kenya experienced strong economic growth. This slowed substantially in the seventies and further still in the early eighties. There were some signs of recovery in the late eighties, but the nineties shows the position worsening again (table 3-1). This decline appears set to continue with a provisional figure for 1997 of growth in GDP of only 2.3% and projections for 1998 of 1.6% (CBK, 1998a). As the figures for GDP per capita show, given Kenya's very high population growth rate, the result has been increasingly modest rises in wealth. The nineties has essentially been a period of stagnation, with indications now of a regression.

<table>
<thead>
<tr>
<th>Table 3-1: Growth in Kenya's GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Year</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>1965-72</td>
</tr>
<tr>
<td>1973-80</td>
</tr>
<tr>
<td>1981-85</td>
</tr>
<tr>
<td>1986-91</td>
</tr>
<tr>
<td>1992-96</td>
</tr>
</tbody>
</table>

In the period immediately following independence, there was an assumption that industrialisation would provide the engine of economic growth, following the dominant modernisation theories. The growth of industry and manufacturing in
particular in the early period seemed to support this argument as shown by table 3-2. However by the eighties, the rate of growth in manufacturing had slipped back considerably, leading Guihatd and Sekhar (1982) to suggest that industrialisation was faltering.

Table 3-2: Average annual growth rates in contribution to GDP by sector

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>All industry</th>
<th>Manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965-73</td>
<td>6.2%</td>
<td>12.4%</td>
<td>12.4%</td>
<td>1.6%</td>
</tr>
<tr>
<td>1973-80</td>
<td>3.7%</td>
<td>5.7%</td>
<td>6.9%</td>
<td>1.9%</td>
</tr>
<tr>
<td>1980-92</td>
<td>2.9%</td>
<td>3.9%</td>
<td>4.8%</td>
<td>4.8%</td>
</tr>
</tbody>
</table>

A major breakthrough in industrialisation has evidently failed to occur, with the proportion of output attributable to industry and particularly manufacturing rising only modestly in the post-colonial period as illustrated by table 3-3. These figures almost certainly over-estimate the real impact of Kenya's formal industrial sector. A majority of the population continue to engage in subsistence farming activities, the measurement of which is difficult for the purposes of estimating contribution to GDP, being outside the formal cash economy (World Bank 1993, p.308).

Table 3-3: Structure of production – distribution of GDP by sector

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>All industry</th>
<th>Manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>na</td>
<td>8%</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>1956</td>
<td>na</td>
<td>13%</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>1963</td>
<td>35%</td>
<td>18%</td>
<td>11%</td>
<td>47%</td>
</tr>
<tr>
<td>1965</td>
<td>33%</td>
<td>20%</td>
<td>12%</td>
<td>47%</td>
</tr>
<tr>
<td>1980</td>
<td>32%</td>
<td>22%</td>
<td>13%</td>
<td>45%</td>
</tr>
<tr>
<td>1987</td>
<td>31%</td>
<td>19%</td>
<td>11%</td>
<td>50%</td>
</tr>
<tr>
<td>1992</td>
<td>27%</td>
<td>19%</td>
<td>14%</td>
<td>54%</td>
</tr>
<tr>
<td>1996</td>
<td>27%</td>
<td>19%</td>
<td>13%</td>
<td>54%</td>
</tr>
</tbody>
</table>
Over the post-independence period, the state's involvement in the economy has changed significantly. Immediately following independence, the government followed an import-substituting industrialisation policy. In support of this policy, strong protection was provided to infant industries through tariff and regulatory barriers, foreign investment encouraged and state investment in industry made directly or via state owned development finance institutions. Intervention in agriculture was strengthened through increased direct control over marketing channels and prices (RPED 1993, p.5). Although there were some early efforts to support smaller scale industry, notably through the Kenya Industrial Estates middle-scale nursery project, much government intervention acted to protect large-scale enterprise. From the 1980's onwards there has been pressure, from the IMF and World Bank in particular, to liberalise the economy. After numerous false starts and heavy external pressure, a significant programme of adjustment was embarked on in the mid-1990s. The programme so far has included import, price and exchange liberalisation, reforms in the financial sector and the start of privatisation.

3.3 The manufacturing sector in Kenya

The development of manufacturing has consistently been seen as the cornerstone to the wider process of economic development and a move away from dependency on agriculture. As the figures in table 3-3 above suggest, after a strong start following independence, the sector has failed to significantly increase its share of national output in the last two decades. Combined with the overall slowdown in the growth of the whole economy, the strong implication is that Kenya's industrialisation project has lost its way.

3.3.1 Growth of manufacturing

Superficially figures for manufacturing production since independence show a relatively strong increase (figure 3-1). Looking more closely, growth rates have varied significantly and have shown a consistent decline in recent years (figure 3-2). Moderate real growth in value added has occurred since independence: an average of 8% per annum over the period 1964-84. However analysis by Sharpley and Lewis (1990, pp.211-9) of the period 1964-84 shows that this growth has predominantly,
(69%), emanated from the growth of domestic demand, rather than either import substitution (26%) or less still export growth (5%). Exports have consistently declined in relative importance over the period.

Figure 3-1: Manufacturing production, 1964-95

![Graph showing manufacturing production from 1964 to 1995.](image)

Figure 3-2: Growth rates in manufacturing production, 1964-95

![Graph showing growth rates in manufacturing production from 1964 to 1995.](image)
A highly significant trend has been the declining ratio of value-added to output across virtually all manufacturing sub-sectors. Aggregate results indicate that as a whole Kenya's industry is adding less value: in 1967 total manufacturing value-added was 28% of total output, in 1988, the proportion was only 13% and by 1995 the figure fell to 9%. Clearly there are a number of possible explanations for such a position. Improved efficiency resulting in reduced production costs, or increased competition leading to a squeeze on profit margins would reduce the ratio. However improved efficiency or lower prices would suggest greater competitiveness in international markets which should result in an increase in the proportion of output exported. Kenya has experienced precisely the opposite trend. Changes in tariff protection - with lower tariffs on output and higher on intermediate inputs would be another cause of reduction in the ratio. In fact the actual changes in tariff structure in Kenya have been consistently in the opposite direction. Protection for Kenya's manufacturing output has been consistently increasing whilst changes in import tariffs on intermediate inputs have resulted in relatively lower duties for these inputs (Sharpley and Lewis 1990, p.236). Disaggregating industries with increased specialisation by individual producers will tend to increase national output for a given level of value-added. However there is little evidence that this has occurred. A crude indicator suggesting a more negative interpretation is a decline in ratio of value-added to imported intermediate inputs. In 1967, aggregate manufacturing value-added was 79% of imported intermediate inputs. By 1988 the ratio had fallen to 69%. This leads to the final and most cogent explanation that the broadening of Kenya's industry has not been accompanied by a commensurate deepening. Rather the implication is that "manufacturing growth in Kenya has involved investment in a succession of industries dependent on imported inputs, and whose profitability necessitates increasing rates of effective protection, or subsidy from other sectors of the economy" (Sharpley and Lewis 1990, pp. 237-8).

The rate of capital formation is also broadly consistent with this analysis (figure 3-3). Following a sharp increase in the immediate post-independence period, there have been no indications of a sustained upward trend. Although the figure for 1995 shows a new high, this is only a provisional figure. More data is required before it
can be presumed that there has been a recovery in the underlying rate of investment in manufacturing.

**Figure 3-3 : Capital formation in manufacturing, 1964-1995**

![Graph showing capital formation in manufacturing, 1964-1995](image)

**3.3.2 Structure and demand**

The composition of Kenya's manufacturing output is indicated by table 3-4. Three measures are given owing to the difficulty in providing a clear indicator of the activity by a single measure. The measure of value added which might normally be used alone is rendered unreliable owing to market distortions caused by tariff barriers, import restrictions, price controls and monopolies. The most obvious feature is the low level of production of capital goods. Machinery constitutes only 5% of total value added with output and employment in the sub-sector lower still. A proportion of this will also include consumer goods. By contrast, a large proportion of manufacturing industry is involved in producing consumer goods.

Although, as Coughlin (1991b, p.364) notes Kenya has moved beyond “elemental types of import substitution”, the overall picture can be described as one of
domination by the production of consumer goods with a number of pockets of moderately deep industrialisation. Such pockets include textile and garments, steel and agro-processing.

Table 3-4: Structure of manufacturing, 1995

<table>
<thead>
<tr>
<th>Sub-sector</th>
<th>Output</th>
<th>Value-added</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foodstuffs processing</td>
<td>45%</td>
<td>33%</td>
<td>30%</td>
</tr>
<tr>
<td>Beverages &amp; tobacco</td>
<td>4%</td>
<td>11%</td>
<td>4%</td>
</tr>
<tr>
<td>Textiles</td>
<td>3%</td>
<td>7%</td>
<td>16%</td>
</tr>
<tr>
<td>Leatherwear</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Wood industries</td>
<td>1%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td>Paper &amp; publishing</td>
<td>3%</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>2%</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>Oil, plastics &amp; rubber</td>
<td>22%</td>
<td>13%</td>
<td>4%</td>
</tr>
<tr>
<td>Non-metallic minerals</td>
<td>3%</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>Metals and metal products</td>
<td>4%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>Machinery</td>
<td>7%</td>
<td>7%</td>
<td>2%</td>
</tr>
<tr>
<td>Transport</td>
<td>5%</td>
<td>4%</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

The market for Kenya’s manufacturing output is largely domestic. In 1988 exports accounted for only 6% of manufacturing output. This represented 38% of total exports by value, the bulk (59%) accounted for by unprocessed agricultural commodities. Of these manufacturing exports 35% were petroleum and coal products, for which the average value added for the sub-sector is only 4.7% of the output value. A further 23% related to food, beverages and tobacco. Overall
exports to the rest of Africa, predominantly neighbouring countries, account for 25% of total exports. The majority of exports made to Africa are manufactured goods. The figure for export to Africa is probably in reality somewhat higher than indicated by the official figures. Prior to the breakdown of the East Africa Community, exports to the other member states, Tanzania and Uganda, formed a very large proportion of total exports to Africa. Since the formal end of the community, anecdotal evidence suggests that there is significant smuggling activity between the former member states. Very little manufacturing output is exported to OECD countries, save a substantial quantity of refined petroleum to refuel ships and aircraft stopping in Kenya. (Republic of Kenya 1989). Kenya has clearly yet to develop a manufacturing capacity sufficient to penetrate global markets whilst it remains more industrially advanced than many of its African neighbours.

3.3.3 Linkages

The early emphasis in development models on large-scale industrialisation was based on the premise that benefits would 'trickle-down' to other parts of the economy. A crucial test of this argument in Kenya is to consider the extent of linkages in the manufacturing sector. Establishing clearly the state of integration of Kenya's manufacturing both internally and with other sectors of the economy is not easy without detailed data. Full input-output tables, which are not available, would be needed to establish the precise position. However a number of specific studies, together with some of the aggregate studies offer some indications of the current position. The state of predominantly large-scale, highly visible, producers is most accessible and is considered first. However, a few studies have suggested that a different pattern might exist for smaller-scale producers. Following this, we finally turn to the vital question of the inter-relation between large-, middle and micro-scale enterprise.

Unsurprisingly, the strongest links are probably forward linkages between the agricultural sector and food processing industry. The production of processed tea, refined sugar and canned pineapples is organised with a factory at the nucleus of a collection of independent large- and micro-scale growers (Coughlin et al 1991, pp.162-3). In the case of both sugar and pineapples, production is partially vertically integrated with a large-scale plantation at the nucleus which provides part of the raw
material input required. Both the sugar and tea industries source substantial quantities of input from small-scale farmers. The connections between growers and processors extend beyond simple market transactions with the processors procuring agrochemical inputs and providing some finance of crops for growers. A number of other industries, have similar links between primary and secondary sectors. Locally grown timber feeds the saw-mills and paper-mill, cotton is produced for ginning in local plants and much leather for the tanneries is derived from Kenyan herds.

The integration within manufacturing appears to be highly variable. In many subsectors, significant quantities of intermediate input are derived from foreign sources, reflected in the high aggregate ratio of value-added to imported intermediates discussed earlier. In the pharmaceutical industry for example, local firms only compound and package medicines (Owino 1991, pp.57-76). In many of these firms virtually all inputs are sourced from foreign suppliers, including the packaging material – some of which is already produced locally. By contrast there is substantial backward integration in the steel industry (Coughlin 1991d, pp.240-90). Final products cover a wide range - sheet-steel, nails, wire-wood, barrows, pipes, roofing sheets, various sections and channels. A significant number of intermediate inputs are manufactured - for example, wire, wire-rods, galvanised sheet. Other intermediates, a further step backward, are produced locally – steel ingots, continuous cast billets and even refractory bricks for furnaces. There are however many notable absences, including any local ore-smelting capacity. Furthermore there are many areas in which mid-level intermediates are not found locally. For example local wire-wood producers use imported steel-rods as feedstock. There are forward linkages, with many of the products used by other manufacturers especially by metal fabricators - for example, there are a number of firms involved in vehicle coach-work using local steel plate. Other industries reported to possess considerable backward and forward linkages are textiles and printing and packaging (Coughlin 1991b, p.364). Following liberalisation there is some anecdotal evidence that these linkages are weakening as producers look to import intermediary inputs.

It is in the area of capital equipment where Kenyan manufacturing seems weakest. Not only does Kenya manufacture and supply relatively few of the original capital goods for industrial investment, there appears to be relatively little activity in
manufacturing spare parts, servicing and developing or adapting existing plants. Although it is not possible to prove this contention quantitatively, the small size of the machinery manufacturing sub-sector and considerable anecdotal evidence does provide considerable support. Machinery accounted for only 5% of manufacturing value-added (table 3-4) in 1995. This figure is also partially constituted by the assembly of various consumer goods such as radios and television. In numerous firms, there is evidence of the almost overwhelming reliance on imported capital technology. Studies in Coughlin and Ikiara (1991) and field visits have indicated the use of imported capital equipment in a very wide range of industries. Even capital equipment which has simply been assembled locally appears to be relatively unusual. Many industries have strong linkages with foreign suppliers who provide a comprehensive package in which all elements of a production technology, including installation and maintenance, is provided. Very rarely is equipment locally designed and fabricated.

Although less is known about micro-scale enterprises in the informal sector, the pattern of linkages described in some studies suggests a more integrated form is sometimes found. Sverrisson (1993, pp.123-34) describes the production of furniture and other wood products in a middle-sized town by small scale enterprises. Linkages appear to be very strong. The basic raw material, wood, is sourced predominantly from local saw-mills cutting locally grown timber. Intermediate products, such as turned legs for tables, are produced by small-scale firms for use by other carpenters. Equipment, from hand tools to more sophisticated machines such as lathes and band saws, is fabricated by local metal working firms. The linkages extend beyond simple market transactions however. There is evidence of various forms of co-operation including sub-contracting of both production of parts or finished products and utilisation of machinery in one enterprise by another. Servicing and repair of machinery is also carried out by local firms. King (1996) provides evidence of similar strong linkages in the Nairobi informal wood and metal sectors.

It has been contended by some observers that there is a particular absence of linkages between the larger and smaller-scale producers (for example, Masai 1991). Masinde's (1994) study of the Kenyan motor vehicle assembly industry shows intrinsically weak links between the large-scale assemblers and middle-scale
component suppliers. While there are a number of middle-scale firms sub-contracted to the large-scale assemblers to supply various components, Masinde (1994, pp. 268-70) found that these linkages almost certainly only existed owing to government regulation. Vehicle assemblers have been required to source certain components locally, a requirement with which they complied reluctantly. Significantly there are no indications that the large-scale assemblers wish to increase the proportion of locally sourced components. The view of the large-scale in this industry was that local small-scale producers offered poor, inappropriate quality relative to their requirements. This example tends to confirm a pessimistic view of the relation between scales of industry.

3.3.4 Location

A major concern in Kenya is the problem of regional and rural-urban imbalances. It is government policy to tackle such imbalances. We consider briefly the extent to which Kenya's manufacturing is consistent with this policy objective. Although not the main thrust of the argument in this thesis, it is noted that smaller scale enterprise has been strongly associated with promoting more even patterns of rural and regional development.

Formal sector manufacturing is strongly localised in the major towns (defined as those with a population greater than 100,000) as shown in figure 3-5. Thika, one of the eleven towns in the mid-size category (defined as a population between 30,000 to 100,000) accounts for nearly 7% of total manufacturing employment, compared with 9.3% found in this category as a whole. However Thika is essentially a satellite town of Nairobi. It is less than 30 miles from the capital and linked to it by a good, fast road. Rural areas (defined here as all settlements with a population of less than 2,000) accounts for over 80% of the population and only roughly a quarter of manufacturing employment. Clearly and somewhat unsurprisingly, taken as a whole, formal manufacturing shows very significant urban bias. Regional bias is equally strong. Four of Kenya's eight provinces, North Eastern, Eastern, Nyanza and Western account for 45% of the country's population, yet contain only 12% of manufacturing employment. There are no separate studies regarding the location of middle-scale, therefore it is unknown whether the distribution indicated varies with scale within the formal sector.
The location of the informal manufacturing sector is more difficult to judge. The 1985 World Bank survey suggested that 504,000 people were employed in the urban informal sector as a whole and 213,000 in rural non-farm activities (Livingstone (1991, p.654)). However the latter figure does not include part-time non-farm, household, rural activity which is believed to be very substantial. The aggregate amount of part-time work in addition to the full-time is believed to be equivalent to around 1.5 million jobs (Wright 1989, p.11). Daniels et al (1995, p.8) estimate total informal employment in the urban areas of 341,754 (29% of the total) and 833,476 (71%) of the total. According to the definition of urban/rural used this compares more favourably with the population division of 25% urban, 75% rural. Such estimates can only be taken as a very rough guide since they are based on the relative contribution of various activities to household income for a limited sample of rural households. However it does suggest that rural informal enterprise is likely to be very considerable.

These figures only indicate total informal sector activity, and it is not known whether the proportion of manufacturing remains the same in urban and rural locations. According to government statistics for 1988, 18% of urban informal sector enterprise
were involved in manufacturing activity, with a further 10% in repair activity (Livingstone 1991, p.656). Surveys of activity according to town size suggest relatively little movement in the proportion of manufacturing to trade/service, with a range of 16% in Nairobi/Mombassa, to 20% in the smallest towns (less than 20,000 inhabitants). The smallest centres, classified as trading centres with a population of less than 2,000, show a slightly smaller proportion of manufacturing at 13%. However these figures are based on enterprise establishment surveys and ignore the crucial household-based activity. A survey of rural non-farm activity in 1977 showed that 41% of those involved in such activity were engaged in manufacturing (Livingstone 1991, p.659). There is a suggestion therefore that manufacturing in rural areas is concentrated in households rather than enterprises in rural centres. Such a distribution would be consistent with the part-time nature of much rural informal activity. In conclusion, whilst the evidence is sparse, manufacturing in the informal sector appears to be distributed far more evenly with population by comparison with the formal.

3.3.5 Summary
Kenya's formal manufacturing sector shows strong indications of reaching an impasse. Growth is slow and there is no evidence yet of a recovery in investment. Although there are some relatively deep pockets of industrial development in a few sub-sectors, overall the manufacturing economy is oriented towards the production of consumer goods for the domestic market. Perhaps most disturbing is the suggestion of fragmentation, especially between the formal and informal, urban and rural.

3.4 Development priorities
The essential significance of Kenya's industrial sector ultimately derives from the context of the country's priorities for development and government policy. We start by considering the fundamental problem of poverty faced by Kenya before turning to consider how employment generation can contribute to its solution. This provides the basic frame within which to consider the position of Kenya's middle-scale in the next section.
3.4.1 The development context: poverty in Kenya

Despite comparative political and economic stability over the last thirty years, Kenya remains amongst the poorest countries in the world. According to World Bank (1995) figures in 1993 at US$270 it had the 15\textsuperscript{th} lowest GNP per capita in the world. Taking the more useful comparison of purchasing power parity, Kenya remains amongst the twenty poorest nations. This low national average level of wealth is compounded by a highly inequitable income distribution, with the poorest 20\%, accounting for only 3.4\% of consumption and the richest 10\% consuming 48\%.

Poverty is a notoriously difficult concept to define both theoretically and practically.\textsuperscript{27} Most studies of poverty in Kenya have concentrated on measuring absolute rather than relative forms of poverty. A useful measure of very severe poverty used in a recent study is that of hard-core or food poor. The food poor are defined as “those who would not meet their minimum calorie requirements even if they concentrated all their spending on food” (Republic of Kenya 1997a, p.35). Consumption expenditure includes both actual monetary expenditure and an imputed value for non-monetary consumption (therefore including subsistence production). The study found that 47\% of adults in rural Kenya and 27\% in urban areas were hard-core or food poor. The incidence of poverty varies strongly with region. In the worst hit districts of the northern rural areas, rates of hard-core poverty exceeded 80\%.

Measuring trends in poverty are very difficult. Even where the same definition of poverty and study methodology is used, there are apt to be very strong variations. Some poverty is transitory, with households entering and leaving poverty readily. There is significant seasonal variation and dependence on weather conditions year to year. Often those just above the poverty line remain highly vulnerable. A participatory poverty assessment in 1996 offers a useful indication of the trend in poverty. The study covered seven districts, both urban and rural. It was found that 77\% of those questioned indicated that the poverty situation had worsened by comparison with the position five years previously. This assessment was broadly consistent with the first study, with 42\% of households classifying themselves as ‘very poor’ (Republic of Kenya 1997a).
3.4.2 The employment imperative

Given a low economic base, it is clear that tackling poverty depends on achieving strong, sustainable economic growth. Kenya has one of the highest population growth rates in the world, which presents a major threat to achieving any significant progress in increasing incomes. Although the growth rate is believed to have peaked (table 3-5), the labour force will continue growing into the next century. As Diane Hunt observed:

The problem which Kenya faces is not just to eliminate poverty among the 6.2 million people (labour force plus dependants) already living below the poverty line [in 1976], but to prevent the spread of poverty to a large proportion of these 8 million new labour force entrants and their dependants. Since these projected labour force entrants had almost all been born by 1980, and since it would be impossible to exert a significant influence on the birth rate in the very short term, these numbers must be accepted as already determined.

Hunt (1984, pp.100-1)

The immediate challenge for Kenya is to produce income-generating opportunities for these new entrants, simply to contain current levels of poverty. The greater challenge is to make substantial progress in reducing poverty.

<table>
<thead>
<tr>
<th>Table 3-5 : Growth of population and labour force, 1970-2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
</tr>
<tr>
<td>Labour force</td>
</tr>
</tbody>
</table>

Reliable figures for sources of income generation are not easy to obtain. Table 3-6 shows World Bank data. Drawing on more recent official Kenyan government data implies a somewhat different picture for 1993, with agriculture accounting for 75%, industry 6% and services 19%. These figures are probably not comparable. With the growing awareness of the informal, non-farm sector, the more recent figures include employment in the informal sector which was probably not counted in previous studies. The basic picture is clear enough however. Kenya remains highly dependent on agriculture as a means of generating livelihoods for the majority of its
population. Only 2% of the labour force is employed in the formal agricultural sector, highlighting the importance of small-scale agriculture and pastoralist activities.

Table 3-6: Employment by sector

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>86%</td>
<td>5%</td>
<td>9%</td>
</tr>
<tr>
<td>1980</td>
<td>81%</td>
<td>7%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Urging the case for major land reform in order to increase the absorptive capacity of the sector, Hunt (1984) has argued that the potential for increasing both formal and informal non-farm employment is also highly constrained. Scepticism regarding the prospects of significant growth in formal employment is clearly supported by recent slow growth in all sectors, illustrated in figure 3-5 and shown in table 3-7. It is important to note that over 70% of the high growth in services over 1974 to 1984 related to expansion of public sector services. Government policy is now to reduce public sector service employment which it is acknowledged grew to unsustainable levels (CBK 1998b).

Figure 3-5: Growth in formal employment, 1974-96
Recent figures suggest strong recent employment growth in the informal sector. From 1993 to 1995, Daniels et al. (1995) indicate an average annual growth rate of 10% while official figures, Republic of Kenya (1997b) suggest over 23%. There are question marks over the reliability of these figures (RPED 1996, p.1). The doubts Hunt expresses regarding the potential of the informal non-farm sector contrast somewhat with a growing interest within both the government and donor community in Kenya. As noted in the last chapter (§2.3.2), there are concerns that many enter the informal sector as a result of the lack of any alternative. The informal sector is highly heterogeneous. In one of the few studies of the informal sector in Kenya with a long-term perspective, King (1996) reported strong variations in performance across the sector. Even in the generally more dynamic manufacturing sector, there were areas where virtually no technological progress had been achieved in twenty years. In other areas of activity there were however signs of increasing technological confidence. Over 50% of informal sector activity is in commerce which has even lower prospects for real increases in productivity.

A serious question must also however arise over the capacity of the small-scale agricultural and pastoralist sector to continue absorbing new entrants to the labour force:

The high population growth rate continues to aggravate the problem of land shortage in the small farm areas holding greatest potential for farming. Inheritance patterns practiced by most Kenyan ethnic groups (division of land among surviving sons) seems certain to enhance land shortage in those areas. In addition, much of the great rise of production from small farms in the past three decades has come as a result of the intensification and expansion of
cultivation in the areas most suitable for agriculture. Some scholars have argued, therefore, that the so-called easy option utilized to expand agricultural production have been used up.

Maxon (1992b, p.294)

Although Maxon points out that there are may be grounds for greater optimism regarding further productivity growth, the problem of landlessness remains. The prospects for significant land reform depend heavily on the political economy. There have been few indications that the conditions will arise under which such radical reforms could occur.

The evidence suggests than no one sector can be relied on to solve Kenya’s employment crisis. Kenya is a fundamentally agricultural economy and will remain so for many years. Many industries and services depend directly on the state of agriculture. Recent data shows that over 30% of formal sector manufacturing and 45% in the informal sector is involved in agro-progressing. More generally there is evidence to suggest strong demand linkages. However it is also clear that to tackle problems of unemployment and poverty in the next century Kenya will need to develop alternative sources of jobs and wealth. Although the informal sector has so far acted as something of a safety net, it does not alone, constitute the basis for an industrialisation dynamic. The development of the formal sector has been increasingly disappointing while Kenya is clearly dependent on achieving a breakthrough here. Returning to the theme of the previous chapter, we now consider the position of the middle-scale enterprise sector and how this may relate to Kenya’s industrial development.

3.5 Kenya’s middle-scale: size and ownership

Two features of Kenya’s industrial landscape are often noted in both the scholarly and wider literature. First is the notion that middle-scale enterprise is under-represented – that there is a ‘missing middle’. Second is that Kenya’s private sector industry is predominantly owned by non-indigenous Africans. We need to consider both of these claims in order to draw a clearer picture of Kenya’s middle before turning to consider the implications following the argument in chapter 2.
3.5.1 Review of statistical evidence

There is no single authoritative source of information on the scale distribution of Kenyan industry. The Central Bureau of Statistics collects and publishes data regarding employment within formal sector establishments. Although the data is not disaggregated further above 50 employees, it nevertheless provides a preliminary indication of the distribution of employment (table 3-8). It is important to note also that the proportion of smaller-scale enterprises will be less than that for smaller-scale establishments. Across all sectors, these figures show the predominance of large-scale. Both middle-scale and micro-scale in all sectors are shown to be relatively small. However a very large number of micro-enterprises in the informal sector are not counted in this study, distorting these figures significantly.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Micro 1-9 workers</th>
<th>Middle 10-49 workers</th>
<th>Large 50+ workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>1.1%</td>
<td>6.5%</td>
<td>92.3%</td>
</tr>
<tr>
<td>Industry</td>
<td>2.4%</td>
<td>13.2%</td>
<td>84.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1.7%</td>
<td>12.5%</td>
<td>85.8%</td>
</tr>
<tr>
<td>Services</td>
<td>4.6%</td>
<td>17.4%</td>
<td>78.0%</td>
</tr>
<tr>
<td>Overall</td>
<td>3.5%</td>
<td>14.6%</td>
<td>81.9%</td>
</tr>
</tbody>
</table>

A fresh analysis was made of data from a number of sources for the manufacturing sector. This for the first time gives a comprehensive picture of the scale distribution of Kenyan manufacturing, illustrated in figure 3-6 below. The shape of this distribution is strongly suggestive of an under-representation of middle-scale enterprise. Interestingly, the indication is that the most significant contributors to employment are found at the poles of scale, with very small scale (2-4 employees) and the very large scale (500+ employees).

Examining the distribution on a sub-sectoral basis enables stronger conclusions to be drawn. In each of the four most important sectors from an employment perspective,
foodstuffs, textiles, wood and non-metallic minerals (mainly pottery, bricks and cement), less than 5% of employment is in middle-scale enterprise. Those sectors in which the middle shows the greater representation, machinery and transport, are the smallest and ones in which the micro-scale is likely to be faced with production process related barriers (economies of scale and indivisibilities).42

There are relatively few areas in which it is known that process barriers will also be faced by middle-scale enterprise. One such area is oil refining which has significant process indivisibilities. However Kenya's single integrated refinery only accounts for 7% of employment in the oil related sub-sector. In other industries in which large-scale is heavily involved, middle-scale technologies are known to exist. Raphael Kaplinsky (1990, pp.104-34) provides evidence of such technologies in sugar and bread production where large-scale dominates in Kenya. Other obvious examples include brewing, shoe making and dairies.

The data, albeit somewhat limited, would therefore seem to support the contention that the middle is missing in Kenya's manufacturing.
Table 3-9: Distribution of employment by establishment scale across sub-sectors of all manufacturing industry, 1993

<table>
<thead>
<tr>
<th>Sub-sector</th>
<th>Employment contribution</th>
<th>Micro 1-9 workers</th>
<th>Middle 10-99 workers</th>
<th>Large 100+ workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foodstuffs processing</td>
<td>20.8%</td>
<td>40.8%</td>
<td>4.9%</td>
<td>54.3%</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>2.3%</td>
<td>3.5%</td>
<td>1.6%</td>
<td>94.9%</td>
</tr>
<tr>
<td>Textiles and garments</td>
<td>26.9%</td>
<td>73.7%</td>
<td>3.2%</td>
<td>23.1%</td>
</tr>
<tr>
<td>Leatherwork</td>
<td>2.1%</td>
<td>52.6%</td>
<td>4.2%</td>
<td>43.0%</td>
</tr>
<tr>
<td>Wood industries</td>
<td>27.2%</td>
<td>91.8%</td>
<td>2.2%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Paper and publishing</td>
<td>1.9%</td>
<td>4.1%</td>
<td>24.4%</td>
<td>71.5%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>1.5%</td>
<td>28.4%</td>
<td>27.1%</td>
<td>44.5%</td>
</tr>
<tr>
<td>Oil, plastics and rubber</td>
<td>1.8%</td>
<td>6.7%</td>
<td>20.2%</td>
<td>73.1%</td>
</tr>
<tr>
<td>Non-metallic minerals</td>
<td>10.3%</td>
<td>92.4%</td>
<td>1.9%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Metals and metal products</td>
<td>3.5%</td>
<td>43.3%</td>
<td>17.0%</td>
<td>39.7%</td>
</tr>
<tr>
<td>Machinery</td>
<td>0.8%</td>
<td>9.5%</td>
<td>35.7%</td>
<td>54.8%</td>
</tr>
<tr>
<td>Transport</td>
<td>0.4%</td>
<td>0.0%</td>
<td>30.1%</td>
<td>69.9%</td>
</tr>
<tr>
<td>Other</td>
<td>0.5%</td>
<td>81.1%</td>
<td>2.0%</td>
<td>16.9%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>66.6%</td>
<td>5.0%</td>
<td>28.3%</td>
</tr>
</tbody>
</table>

3.5.2 Ownership of Kenyan manufacturing

It is a widely recognised, though surprisingly sparsely documented feature of Kenya’s economy that a relatively small proportion of formal industrial capital is privately owned and controlled by indigenous Africans. Significant investment by multinational corporations and, in earlier periods, the state offers some clue as to why much large-scale capital may not be held by ethnic African capitalists. Anecdotal evidence suggests that much middle and large-scale enterprise is owned by Kenyans of Asian descent, primarily from the Indian sub-continent. If this is the case then there is the suggestion of a more involved situation than earlier analysis has described.

Although the literature, both scholarly and general, contains frequent reference to the presence of local Asians in Kenyan industry, precise figures regarding ownership are difficult to find. Justifying further efforts to increase the involvement of Africans in enterprise, the Kenya government notes in its Sixth National Development Plan: “in
terms of turnover, the manufacturing and trading activities of non-indigenous Kenyans who make up less than 2% of the population now constitute more than 65% of the total” (Republic of Kenya 1989a, p.152). However no further detail is offered.

Nicola Swainson (1980, p.152) reported that in 1972, 63% of gross product for manufacturing was attributable to foreign owned producers. Raphael Kaplinsky (1982, p.209) confirmed the role of foreign capital, finding in 1976 that 44% of issued capital was foreign owned. Both studies concentrated on the role of multinational capital, influenced strongly by the on-going dependency debate. More recently, Constantine Vaitos (1991, p.16) asserted that despite the emergence of the Kenyan Asian industrial class, “on the whole foreign interests [transnational corporations] continued to dominate at least half of the large manufacturing firms in Kenya”. David Himbara (1994b), in one of the few studies to investigate ethnicity and ownership, found a far greater role for Asian capital in both the large and middle-scale than these earlier works had acknowledged. In his sample of predominantly large-scale enterprises (employing more than 50 workers), Himbara found 75% were Asian owned (figure 3-7 below). Even assuming that all the publicly quoted companies were ultimately owned by Africans, a mere 10% of these firms can be assumed to be African owned. These studies are not necessarily wholly inconsistent. On a methodological note, Himbara’s study was drawn from the members of the Kenya Association of Manufacturers which is known to be strongly

Figure 3-7: Ownership of a sample of 100 large-scale manufacturers
linked to the Asian business community. Furthermore some Asian capitalists in Kenya are not citizens and would therefore be classified as foreign. However Himbara also found evidence of a significant growth in Kenyan Asian investment in manufacturing in a period when multi-nationals were divesting and the government drastically reducing the scale of its direct involvement. A number of examples of Asian investors acquiring multi-national subsidiaries were discovered. Of 27 large-scale firms established between 1978 and 1993, 24 were owned by locally based Asians. Only one was indicated as African owned, with the other two owners being a local European and the Kenya government.

No specific statistics are available classified according to scale. An attempt was made in this study to classify ownership of manufacturing industry using secondary data. Ethnic origin was identified by examination of the owners' surnames. Names are believed to correlate very strongly with ethnicity, there being relatively little inter-marriage between Asian and other communities. Although such an approach is susceptible to error, it nevertheless offers a strong clue to the general pattern of ownership. Data for the 845 middle-scale enterprises registered were examined. 71% of those with identifiable ownership (51% of the total) and classifiable were wholly or partly owned by Asians. Africans meanwhile were involved in ownership of only 21% of those with identifiable ownership (15% of the total). Of 314 large scale firms, 69% of those with identifiable ownership (or 62% of the total) had Asian ownership. 21% of those with identifiable ownership (or 19% of the total) were wholly or partly owned by Africans. The latter figures are clearly consistent with Himbara's findings.

No data is available regarding ethnicity and the micro-scale. However in the vast literature on the subject there is every indication that it is wholly dominated by Africans. References to Asian owned micro-scale or informal enterprise universally relates to the pre-independence period. The supposition made that Asian owned micro-enterprise is relatively scarce is also strongly confirmed by a recent major study of Kenyan manufacturing enterprise (Biggs, Conning, Fafchamps and Srivastava 1994).
To put all these figures 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.

3.5.3 The 'missing middle'

The notion of a missing middle in Kenya's manufacturing sector is strongly supported by the data. Taking the simplest indication, the employment distribution of manufacturing enterprise by number of employees is U-shaped, reaching a minimum in the interval corresponding to the middle-scale. Only 5% of manufacturing employment falls in the middle-scale. In the most concentrated of industrialised countries, the United States, 24% of all private non-farm enterprise is found in this employment interval. In Japan, the figure rises to 46% (see table 2-2).

Examining the ownership of industry suggests that African middle-scale capital is even more attenuated; there is clearly a pronounced African missing middle. Given that Africans constitute the vast majority of the Kenyan population this is a very important finding. Kenya's overall U shaped scale distribution appears to arise from

Figure 3-8: Hypothesised form of Kenya's 'missing middle'
the conjunction of two more familiar ones (illustrated in figure 3-8): an African, essentially pre-industrial form, with large numbers of micro-enterprise, and an upward inclined more linear Asian one, more associated with a middle to late industrialisation. Both state and multi-nationals are believed to show a more large-scale oriented form, contributing to the strength of the large-scale.

It might also be speculated on the basis of the earlier discussion that the middle is also missing in a more logical or structural sense. Put crudely, there appears little connection in many sectors between the micro-enterprise based informal economy and the modern, large-scale dominated formal. This lack of connection extends beyond the absence of production and consumption linkages. The differences in the nature of production in the formal and informal are profound and crucially there are few examples of enterprises, entrepreneurs or methods which seem to fall between the extremes. If the informal economy is seen to be embedded in a traditional African socio-cultural context and the formal into the modern then there is the alarming suggestion of the presence of a dual society. The curious domination of modern private-sector manufacturing enterprise by a non-indigenous industrial bourgeoisie is suggestive of just such a dichotomous position.

Given the role ascribed to the middle-scale in economic development in the last chapter and the indications of a stalling in Kenya’s industrialisation project, this missing middle must be regarded as highly significant. The implication of the argument elaborated is that understanding the under-development of the middle may provide fundamental clues to the wider problems in Kenya’s industrialisation project.

The above analysis clearly shows the importance of explaining Kenya’s missing middle, the research question which this study will address. To address the question fully will require an explanation, in analytical detail, of why different types of entrepreneur apparently face somewhat different prospects. It is not sufficient to explain why many African entrepreneurs are unable to enter the middle-scale or perhaps why many middle-scale enterprises fail. We also need to know why other, predominantly Asian, entrepreneurs are successful and their enterprises apparently 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.

3.6 Conclusion

The most basic measures of performance indicate a continuing decline in Kenyan's economic growth since the early halcyon days of post-independence. There are strong indications that the development of manufacturing industry which has been seen as critical to the industrialisation process has slowed dramatically. Although Kenya has not experienced the dramatic reversals of some sub-Saharan economies, the indications are that the industrialisation programme has stalled.

A closer examination reveals worrying signs of the absence of any endogenous growth dynamic: declining export performance and increased dependency on foreign inputs, both in terms of intermediate and capital inputs and process technologies. There are few signs of a capital goods industry emerging. Linkages within the manufacturing sector appear to be weakening. A pessimistic hypothesis suggested by the evidence is that the industrial structure has reached a state of impasse from which further development does not appear easy.

The urgent need to generate new sources of wealth and income-generating opportunities has not diminished. Kenya remains one of the poorest countries in the world, saddled with one of the highest population growth rates. Still an essentially agricultural economy, there are strong doubts over whether the agriculture sector can continue to absorb new entrants to the labour market far into the next century. Rapid industrialisation would appear essential to containing and reducing poverty in Kenya.

A major feature of Kenya's manufacturing structure is the apparent under development of the middle-scale. There is a notable lack of ethnic African owned middle-scale enterprise, while Asians have fared rather better. Given the importance ascribed to the middle in the development process, discussed in the last chapter, we need to ask why it is that a broader based middle has yet to emerge in Kenya.
Progress with this question may perhaps shed a little more light on Kenya's development problems and future prospects.
Kenya and the 'missing middle'

Notes

3 Gregory (1993), Seidenberg (1995)
4 For example Rodney (1972) and Leys (1975)
6 Cowen (1982), Himbara (1994b)
7 Source: RPED (1993, p.4), Republic of Kenya (1997a, p.20). The Regional Program on Enterprise Development is a World Bank sponsored cross Africa research programme. It has been undertaken in Kenya by the Departments of Economics, Göteborg University and University of Nairobi. Citation from the various research reports is by kind permission of RPED.
13 This extends from early development plans (Republic of Kenya 1967) to a recent Sessional paper on the planned transformation of Kenya into an industrialised economy by the year 2020 (Republic of Kenya 1997c)
15 Source: see note 14 above
17 Where value added is calculated post-tariff.
18 Assuming that changes in value-added as a consequence of restructuring do not cause a very substantial shift in aggregate value-added.
19 Source: Republic of Kenya (1997, p.87, 135; 1989, p.82, 124)
22 Central Glass Industries for example produces bottles for pharmaceuticals.
23 Personal interview, Nairobi 1991
24 See for example, Republic of Kenya (1992a, 1992b)
27 See for example Sen (1987)
28 World Bank (1994)
30 The position is complicated by the fact that many small-scale/subsistence farmers also engage in non-farm activities. These, often seasonal, activities have been estimated to contribute between 35 to 50% of income (Hunt 1984, p.114).
Kenya and the 'missing middle'


35 Parker and Torres (1994, p.8)


38 This has consistently been recognised in government policy, most recently in the eighth National Development Plan (Republic of Kenya 1996)


40 Data was drawn primarily from the Register of Industry as at 1996 (courtesy of Ministry of Commerce and Industry) and GEMINI/K-Rep 1993 National Baseline Survey of Micro and Small Enterprise database (courtesy of K-Rep). The results were compared with those from the Central Bureau of Statistics published figures (Republic of Kenya, 1996) to ensure there were no major inconsistencies (beyond those implied by the scope of the different sources). There remains some concern over under-reporting of the middle-scale businesses from these data sources. The GEMINI/K-Rep study identified very few middle-scale enterprises, for methodological reasons. Registration of enterprises, though a statutory requirement, is not universal. Smaller formal enterprises are most likely (of the population addressed) to avoid registration; larger-scale by simple virtue of their prominence are less likely to attempt or succeed in avoiding official detection. King (1996) reported cases of middle-scale enterprises, graduating from the micro-scale, which still remained invisible to officialdom.

41 Source: see note 40 above

42 It should be noted that this does not provide an a priori reason for the lack of any particular scale of enterprise. Transaction cost reasoning can be used to explain why there is a strong association between process scale and enterprise scale (Williamson, 1975, 1985). This is discussed in chapter 4.

43 Source: see note 40 above

44 Source: Himbarab (1994b, p.49)

45 World Bank (1994, p.204) figures confirm the reduction in foreign direct investment. In 1992, total foreign direct investment was US$6 million as compared with US$79 million in 1980. The contribution of the government to investment in manufacturing has also now greatly reduced. In 1988, the public sector was responsible for only 3% of total capital formation in the manufacturing sector. In 1979, the proportion was 10%, whilst in 1973 it was 37% (Republic of Kenya 1989b, 1980, 1975).

46 Error may also arise from the sample set. As noted earlier, although middle-scale enterprises are required under law to register, it is likely that some do not. It is entirely feasible that there may be a systematic difference in the ethnicity of the owners of non-registering enterprises.
4. EXPLAINING THE MIDDLE

4.1 Introduction

The last chapter established that Kenya's manufacturing sector is characterised by the relative scarcity of middle-scale enterprises. This 'missing middle' appears to have a distinctly ethnic dimension. A large proportion of the meagre number of middle-scale enterprises are owned by entrepreneurs from the Asian ethnic minority in Kenya. By contrast indigenous Africans who comprise the vast majority of Kenya's population own a small fraction. In this chapter the literature is explored for possible explanations of this phenomenon.

Before turning to the literature some elaboration of the research question is required (§4.2). There is a large body of work on both Kenya and theoretical approaches to the firm and enterprise development. In order to judge the extent to which various explanations and theoretical approaches offer satisfactory answers, it is necessary to be clear as to what are the crucial issues.

The search for an explanation starts with existing work relating to Kenya (§4.3). Although relatively little research has been specifically directed at the particular question of the middle, much has been conducted into smaller-scale enterprise more generally, the manufacturing sector and the wider story of Kenya's recent economic development. If a convincing complete explanation of the Kenyan middle cannot be found, we may yet find some useful clues for the investigation.

The next section, §4.4, takes a broader perspective, examining the theoretical approaches which may be relevant to the research question. As the earlier discussion of definitions showed (§2.2), the concepts of smaller-scale and middle-scale enterprise do not clearly belong to any one academic discipline. These are terms which appear across a wide field of social inquiry. In looking for a theoretical framework the boundaries between various disciplines within the social sciences will be ignored and a focus made on the potential to explain the phenomena at issue.

The final section (§4.5) of the chapter attempts to draw together this review of some rather disparate arguments. At issue is whether the phenomena of the middle-scale
in Kenya identified in the previous chapter can satisfactorily be explained within the theories elaborated in the current literature. If such an explanation is not forthcoming then we need to consider what are the strengths and weaknesses in the existing arguments and theory as a basis for building a new approach.

4.2 Kenya's middle – the key questions

In the last chapter it was suggested that the manufacturing sector in Kenya may be thought of as resulting from the conjunction of two distributions. One, comprising African owned enterprise, is characterised by a vast number of micro-scale enterprises, few in the middle and somewhat more in the large. The other, Asian owned, shows significant presence in both the middle and large-scale, but relatively little at the micro-scale. Understanding this state of affairs which produces Kenya's missing middle is the essential explanatory task here.

Any explanation must be capable of accounting for the very clear differences between the two ethnic groups – African and Asian. It is clear from the data reviewed in the last chapter that understanding Kenya's middle is not simply a question about scale alone, but the differences between ethnic groups. No assumptions will be made at the outset regarding the basic aetiology. Explanations may be found in terms of social structure or the specific histories of ethnic groups in Kenya. The requirement is simply that the explanation presents a convincing story of this singular feature of Kenya's industrial landscape.

The absence of middle-scale enterprise suggests that either few enterprises are created at the middle-scale level or there is a very high mortality rate leading to a low population level at any given time. Detailed data on middle-scale firm entry and survival rates would enable the weight of these two factors to be judged. In the absence of such data, both will have to be considered giving rise to three questions:

1. What constraints, if any, are there to micro-scale enterprises from graduating into the middle?

2. Is there a reason why more entrepreneurs do not start-up at the middle-scale level?
3. Is the operating environment inimical to middle-scale enterprise, causing high firm mortality?

The first two questions, concerned with entry, may also relate to responses to the third. Entrepreneurs perceiving a hostile operating environment can be expected to seek alternative investment opportunities. Other forms of entry are possible— notably through externalisation of functions by large-scale enterprises. However such questions can be broadly subsumed within an inquiry into the nature of the middle-scale operating environment. Explanations for Kenya’s middle may be found in answers to the first two questions regarding entry, the third alone relating to survival, or all three questions. In each case such answers must account for the differences observed between African and Asian performance.

4.3 Review of Kenyan studies

Much of the literature on Kenyan smaller-scale enterprise has focussed on the micro-scale. Consequently it is primarily relevant to the question of constraints on micro-scale enterprises graduating into the middle. Rather less has been written directly concerning middle-scale enterprise. Such work is primarily concerned with various characteristics of the operating environment for middle-scale enterprise. A few studies have addressed the entrepreneurial constraint to middle-scale enterprise formation. Finally major, broad debates at the political economic level have relevance to the middle.

4.3.1 Micro-enterprise growth constraints

Investigations into the constraints to micro-enterprise growth and graduation into the middle-scale have been oriented around factors such as access to credit, scale of demand and access to markets, availability of raw materials, sources of capital equipment, availability of premises, infrastructure and regulatory constraints. Researchers have found all these factors cited by micro-scale enterprise owner-managers as creating problems. In one of the largest studies of the micro-scale sector to date, Daniels et al (1995, p.27) found that availability of capital and market demand were regarded as the two most significant problems faced. Another recent study (RPED 1996, p.252) discovered that access to credit was regarded as the most
Explaining the middle

serious business problem confronted by nearly half of the micro-scale manufacturing enterprises interviewed.

An interesting proposition put forward by Liedholm (1992) is that while micro-scale 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 costs associated with conforming to regulation – tax, registration, employment law, not to mention rent-seeking by public sector officials.

Although these studies have offered some useful primary indications of barriers to micro-scale enterprise growth, there are a number of shortcomings. Establishing causality is problematic. The perception by informal sector operators that access to credit would enable a sustainable expansion in business activity may be badly flawed. Methodologically there is some concern that survey methods tend to 'lead' the respondent to a set of pre-determined replies. More fundamentally, the question which is rarely addressed satisfactorily in this literature is why do these constraints arise. If, for example, an entrepreneur perceives that she is unable to access finance then the question which inevitably arises is why not? Such a question becomes more focussed when a comparative approach is taken: why can one entrepreneur not access credit, where another is able to do so, or at least is not constrained by it? Historical evidence raised in the last chapter (§3) suggests that many early Asian enterprises in Kenya started at the micro-scale. The apparent mass graduation of Asian business suggests that constraints have been overcome here at least.

Studies by Dorothy McCormick of micro-scale manufacturing in Nairobi offer a more interesting perspective on the graduation question. 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. 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.
4.3.2 Constraints to middle-scale entry

The importance of the entrepreneur as the central actor in enterprise development was emphasised in early post-colonial writing on the developing economies. 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 some traditional cultures as being inimical to the idea of change and innovation itself (Leff 1979). Hagen (1963), for example, argues 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) which had been presumed deficient in entrepreneurial supply. Marsden (1990, p.21) and the World Bank (1989, p.136) are unequivocal in arguing that there is no shortage of entrepreneurship throughout sub-Saharan Africa.

If entrepreneurial behaviour is taken within 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' which is entrepreneurship or Schumpeterian creativity, it is more useful to examine what barriers have to be overcome by the entrepreneur. 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. Among accumulating men there was a weaker, though still present, rural-urban link, whilst for 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.

In an early post-independence study of smaller scale enterprise, Peter Marris and Anthony Somerset (1971) 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. By contrast, it is argued that the Asian entrepreneur belongs to a society which has already evolved and absorbed many aspects of the social implications of production based on a capitalist enterprise economy (Marris and Somerset 1971, p.144).

Kilby (1971, 1988) takes a more prosaic approach to entrepreneurship and considered 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) concludes 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.

Marris and Somerset similarly point to a managerial bottleneck in African enterprise which constrains the emergence of middle-scale enterprises. An inability to delegate is held to arise both due to inadequate business experience and lack of trust among participants in the enterprise. It is posited that the latter derives from features of the African social-economic context.

There are a number of difficulties with these arguments. In the first instance much of the theory is speculative without sufficient in-depth empirical study, especially of Asian enterprises, to justify these conclusions. The evidence for systematic structural differences between African and Asian entrepreneurs needs to be justified. Taking a
broadly functionalist approach to culture or social structure encounters the explanatory problem that much of the Asian community in Kenya emerged from subsistence peasant societies in India not dissimilar to those in many pre-colonial African communities. The fundamental explanatory task becomes an account of how and why the paths of these communities have diverged. Regarding culture as a given framework or context independent of economic activity demand a much deeper comparative ethnography of both business communities. Simply assuming that cultural factors are responsible for differences begs the question.

4.3.3 Middle-scale enterprise task environment

Mohammed Kerre (1989) 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. Marris and Somerset (1971) speculate 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. 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-sale 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. Peter Coughlin (1988b) observes, for example, that smaller-scale enterprises were sometimes found to be discriminated against when sourcing inputs from large-scale producers. Catherine Masinde (1994, 1996) in her study of the motor vehicle assembly industry found generally weak linkages between the large-scale assembler and middle-scale enterprises. In comparison a study by Árni Sverrisson (1993) of indigenous smaller scale, predominantly micro-scale, wood-working enterprises in Nakuru shows that
linkages between firms both horizontally and vertically are important, though still not characterisable as strong. Although 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 emphasises 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 and Pecqueur who contend that concepts such as the industrial district must not be seen as a simple arithmetic-economic sum of enterprises. 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 and Pecqueur 1991, p.308). Interestingly however, among 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 based networks of Asian enterprises, but presents no firm evidence to support the contention. Although this study of the enterprise environment provides some useful signposts, it does not explain Kenya’s middle. Although the importance of social networks in many economies is well established, it has not been shown that access to such networks is a sine qua non for successful middle-scale enterprise. The lack of instrumentally useful networks for African entrepreneurs does not alone imply that the environment faced by these entrepreneurs is inimical to middle-scale enterprise. Empirically there were no studies of Asian enterprises to confirm the impact of social networks or indeed their conformance with the hypothesised form. The increased relevance of networks to middle-scale as compared with micro must also be shown.

A recent comparative study by Biggs, Conning, Fafchamps and Srivastava (1994) into the finance of enterprises in Kenya, covering both scale and ownership questions, shows an interesting increase in theoretical depth. Taking a new institutionalist approach, Biggs et al provide an important illustration of why social networks can matter instrumentally to entrepreneurs. Asian entrepreneurs are able to access both trade and informal credit based on trust derived from social relations. Clearly this study only addresses finance which though highly relevant cannot be assumed
Explaining the middle without further investigation to account for the form of Kenya's middle. A broadening of this study to include enterprise tasks beyond finance would seem to offer a promising direction.

4.3.4 The broader context: political economy

The correct reading of Kenya's post-colonial history in particular has been the subject of very considerable debate in the literature. This debate has ended somewhat inconclusively with a widespread retreat from the general (or 'grand') theories which underpinned it, in the face of both empirical evidence and meta-theoretical problems. However the detailed argument offers valuable insights into understanding the scale and ownership of industry in Kenya.

Colin Leys (1996) re-examining the Kenya debate, argues that despite an excessive focus on explicating Kenya's internal capitalist class in the original debate, the existence of a politically effective class with a sufficiently strong interest in productive growth is the most likely source of the political (rather than purely economic) conditions for such productive growth. Taking this argument a stage further it can be supposed that the prospects for various scales of enterprise can be linked to the political strength of the fraction of capital involved. Here, Deborah Brautigam (1994) suggests, smaller enterprise by its very nature faces a disadvantage compared with larger. A small class of large-scale producers will be better able to organise and exert political influence compared with a large class of small-scale producers. This applies as much to either direct capture of state power, or the formation of coalitions with the politically strong. The logic applies as far as the level of the individual enterprise. In addition to production economies of scale, it might be supposed that there are political economies of scale.

The Kenya debate also revealed difficulties in the application of Marxist concepts of class, originally formulated in relation to a particular stage of European history. David Himbara (1993, 1994b), for example, points out that through much of the Kenya debate the question of indigenous Asian capital had been largely ignored. It would appear to a large extent that this reflected the conceptual difficulty in dealing with the fragmentation of the indigenous bourgeoisie implied by the co-existence of Asian and African capital in Kenya. Yet even within African capital, ethnicity is
manifestly a more significant source of collective identity and basis for political action than class. Michael Cowen and Scott MacWilliam (1996) attempt to capture this with the concept of co-existent 'layers' of capital drawing their identity from ethnicity. Although the concept of class does not deny the possibility of competition between members of that class, the layering of capital gives rise to conflict between collective elements of capital.

The corollary of this argument for the behaviour of the state is identified by Gavin Kitching, again commenting on the Kenya debate:

(1) the State is not the agency of any single force in Kenya (i.e. it is not the agency of multinational capital or indigenous capital, or of any 'fraction' of either form of capital), it is rather a continual site of struggle among all these forces, a struggle whose outcome is not foreclosed, and which continually results in contradictory policy outcomes; and (2) the state is not an 'it', it is not a unity, for the struggle outlined above has, as one its effects the fracturing of the State, and indeed of particular state institutions, into contending forces which themselves enter into conjectural alliances and oppositions. ... The State in Kenya is a mess, in short, and it is so because it is embedded in a society and economy undergoing continual conflicts between nascent forms of national capital, different factions of transnational capital, and (in particular overlap with the above) between different social strata, ethnic and regional groupings, and so forth, within the indigenous population.

Kitching (1985, p.132)

A further complicating aspect of state agency is the extent to which the state can be used as a site for direct accumulation by the controlling forces at any point. The use of the state apparatus to build private wealth from various types of rent-seeking activity through to outright alienation of state assets has been well documented.

Returning to the question at issue here, given the centrality accorded to the state in these arguments, we need to consider just how the actions of the state affect industrial development. Most obvious is the substitution of public for private enterprise in particular sectors. The state is able to totally displace private activity either by legislative fiat or through monopolistic activity. Sectors covered range from basic infrastructure (roads, electricity, water) and services (education and training) through to direct activity in agriculture and manufacturing. The state intervenes in markets of various kind, again by legislative fiat or through market activity. Financial markets, for example, are usually subject to varying degrees of regulation and direct
state involvement in the provision of credit and savings. At another level, fiscal and trade policy will effect both the immediate environment for enterprise and shape the broader macro-economy. Finally, fundamentally the state also determines the formal institutional environment within which capitalist enterprise takes place. Notably this includes definitions and enforcement of property rights.

With such a wide range of state activity, there is some difficulty in linking the outcome of action with the putative intent of the agent - the state. Both unintended and intended outcomes of state action must be admitted, not least because of the fundamental uncertainty of the link between action and outcome. Understanding impact on particular scales of industry is rendered even more difficult where it is infeasible to identify class with ownership of various scales of industrial capital.

Himbara, focussing particularly on the effect of corruption and patrimonialism argues that “the leading obstacle to further accumulation is the postcolonial Kenyan state” (1994b, p.160). Meanwhile Cowen and MacWilliam contend that: “the [Kenyatta] regime’s exercise of state power secured general conditions which facilitated the accumulation of capital. From cementing conditions of private property to extending the basis of an industrial labour force and securing the provision of social infrastructure for private investment, the post-colonial regime acted to renew the hegemony of capital ... Moi’s regime replicated that which the Kenyatta regime originated.” (1996, pp.136-7)

The difficulty is that both analyses seem correct to some degree. That independent Kenya has pursued a general policy of extending the capitalist mode of production seems unobjectionable, especially when compared with, say neighbouring Tanzania. However the evidence Himbara presents of the destructive impact of the state’s action on Kenya’s industrial development is compelling. Understanding the impact of state action on a specific area of the private economy, such as the middle-scale seems difficult using the theoretical apparatus of class and modes of production. As Himbara (1997, p.1) observes: “[state] policy has tended to hinder the role of East African capitalists of Indian descent, the most able domestic fraction of accumulators”. The relative success of Asian entrepreneurs in the middle-scale, in the face of strong negative state intervention, demands a more complex argument.
4.3.5 Summary

The Kenya literature contains no complete, convincing explanation for the middle-scale. Two major difficulties can be identified. First, is the apparent lack of a theoretical framework which is able to draw together the diverse strands of evidence into a cohesive explanation. A number of interesting hypotheses regarding enterprise behaviour or constraints have been encountered which could contribute to this explanation, but which taken individually do not produce a complete picture. A second problem lies in the paucity of in-depth empirical studies into middle-scale enterprises, both African and Asian. We now turn to the search for a theoretical framework as the precursor to an empirical investigation.

4.4 A survey of theoretical frameworks

There is much theory within the social sciences addressed directly or indirectly to the economic and social organisation of production, of which our research question forms a small element. Although the difficulties noted in some of the Kenyan literature may derive precisely from the adoption of a narrow economic perspective, an obvious place to start the search for theory is within orthodox economic theory. The identification of short-comings in this theory will be valuable in seeking a more appropriate framework.

4.4.1 Orthodox economic theory

The orthodox neo-classical theory of the firm is purposively highly reductionist. The firm is represented as a production function which describes the quantity of a specific output which will be produced by a firm with a given quantity of inputs. Firms are held to act solely to maximise profit. Under conditions of competitive equilibrium, the scale at which firms actually operate is that which maximises profit. The question of scale can arise within the theory from both supply side and demand side considerations. A third way in which the theory can be applied is to consider the circumstances in which the rigid abstractions no longer hold — market failure. The theory thus relates to the research question primarily in terms of the environment for middle-scale enterprise.
Supply-side

Within the theory the direct role of firm scale, if any, is represented by the production function. In line with the profit maximisation postulate, firms will choose to operate at the most efficient scale – that which corresponds to the minimum long-run average unit cost. This minimum point on the cost function will depend on the production function and the factor input price. Although the factor input prices, together with all other market prices, are usually held to be invariant with scale, they can (and do) vary substantially between economies. In order to understand the scale at which firms operate we therefore need to examine both the production function and the factor prices faced.

Actual production technologies found in industry tend to support the existence of significant economies of scale in many sectors. Looking at the purely technological aspects of these scale economies, an L-shape is suggested for the average cost curve. This is most clearly seen where the technology is capital intensive, involving indivisible machinery and a high volume of output. Unit costs will only be minimised once the plant is operating at or near full capacity. Beyond this point however the question of scale becomes indeterminate. The theory therefore only offers a lower bound – indicating the minimum scale of operation.

In order to proceed any further it is necessary to take a broader view of the production function and to suppose that it is composed of both a physical technology and an organisational technology (You 1995, p.443). The organisational technology is commonly supposed to exhibit diseconomies of scale.

The combination of economies and diseconomies of scale produces a 'U-shaped' cost curve. This curve predicts the boundaries of efficient operation and thus the boundaries of scale at which firms will be found in a particular industry, assuming perfect market conditions. In general the theory does not predict the distribution of firms by scale within the boundaries of efficient operation. (Only in the limiting case, where the curve has a minimum point, does the theory predict that all firms should converge on this single scale of operation.) The prediction is an inverted U-shaped distribution of enterprise scale; the converse of the one we are trying to explain.
An aggregate distribution may be explicable in terms of scale economies by decomposition into the underlying sectoral distributions. Consider an industrial structure characterised by a number of sectors in which minimum economies of scale produce a large firm distribution and a number in which such economies are negligible and diseconomies of organisation eliminate all but the smallest. This could produce a U-shaped distribution of firms of the type observed at the aggregate level in Kenya. However examining the disaggregated sub-sectoral data (§3.5.1) does not support the argument; the missing middle persists at the sub-sectoral level in Kenya. It is of course possible that a greater level of disaggregation is necessary.

A more fundamental problem remains with this line of argument. Within the neoclassical 'black-box' view of the firm, nothing is said as to why organisational diseconomies should arise. The postulation of organisational diseconomy appears to perform the role of 'theory-saving' – ensuring that the theory is not contradicted by evidence. Understanding why costs might systematically change with scale is an essential part of the explanatory task at hand.

**Demand-side**

The efficiency argument just sketched takes no account of the demand for output. Firms will only be efficient at the scale predicted by the theory provided that there is adequate market for the output. Where markets are relatively small, the unit costs associated with a poorly utilised large-scale production technology may be significantly higher than those of a small-scale. Aggregate levels of demand in developing economies are necessarily lower than that found in the industrialised economies, leading to the supposition that enterprises in developing economies face relatively small markets. However this does raise the question as to what determines the theoretical limits of the market.

Transportation costs represent one potential economic barrier which can restrict the effective size of a market (Fafchamps 1994, pp.4-6). These costs are dependent on factors such as physical geography and infrastructure as well as the nature of the commodities themselves. Infrastructure in many developing economies is notoriously poor. It is clear the market for say, a bread producer in a small, isolated rural community will not be large.
Regulation in various forms, sometimes deliberately, can limit market size. This is most obvious in relation to import barriers—varying from full prohibition to varying levels of duty. Less obviously, restrictions on say the movement of livestock for health reasons, will also act to restrict and localise market size.

Market fragmentation can occur as a consequence of consumer taste, whether specifically manipulated by producers or otherwise. Piore and Sabel (1984) have argued that in industrialised countries, consumer taste is shifting towards increased variety and effectively smaller markets. Niches can also be created for products in which it is the very labour intensity (and by extension limited potential economies of scale) which is sought by consumers. The demand for handmade or finished goods has increased significantly. African micro-enterprises, for example, have thrived in selling handmade articles to tourists. Although many of the articles could be produced more cheaply using mass production technologies, the market is insulated from competition by the consumer preference for the traditional production method. Related to this theme is the potential differentiation which firms can achieve in the market through customer service. Fitting such an empirical feature of markets into neo-classical theory is problematic since it inexorably leads to questions regarding the nature of exchange. The orthodox framework does not directly address such questions.

**Market failure**

Neo-classical economics uses abstract, idealisations as the basis of its theoretical toolkit. That reality does not precisely match such idealisations does not constitute a falsification of theory. The points of departure between model and reality point precisely to the areas in which auxiliary hypotheses are required in order to enrich the applied model. The subject of market failure represents an important area of such work. A number of the studies relating to constraints on micro-scale enterprise growth considered above (§4.3.1) are implicitly or explicitly based on market failure.

The notion of market failure in factor markets introduces a theoretical space which directly admits important empirical observations and potentially enhances the ability of orthodox economic theory to explain scale. If factor prices vary with firm-scale then it is feasible that combined with the economies and diseconomies of scale
Explaining the middle multiple equilibria could be generated in some sectors. The theory would therefore be able to account for the existence of more complex distributions of firm-scale within particular sectors. In particular a 'missing middle' type distribution becomes broadly comprehensible, although there remains no explanation for the relative proportions of firms found at each point or range of 'efficient' operation predicted.

Labour markets within both industrialised and developing economies are widely reported to behave in ways which diverge significantly from the simple neo-classical market model. In particular it is often claimed that wage rates in smaller-scale enterprises are lower than those in larger-scale. A variety of explanations are put forward to explain such variances. The ability of smaller-scale enterprises to escape costs associated with labour related regulation and unionisation is often cited as a major factor. The relationship between ownership and management, discussed earlier (§2), is closely linked with enterprise scale. The productivity of labour may therefore vary as a consequence of the direct involvement of owners in the management and labour of a small enterprise. Family labour is often more significant in smaller scale enterprises and may modify labour costs. However understanding such markets requires a broad framework which includes social variables.

Finance is similarly held to display complexities not captured by the simple market view. It is common to find that larger scale firms face significantly lower costs of credit than smaller. This is readily explicable in terms of the problem of risk faced by the lender. Here neo-classical theory again stands in need of augmentation if it is to give a satisfactory theoretical account, as the work by Biggs, Conning, Fafchamps and Srivastava (1994) on Kenya has shown. In other ways smaller enterprises might face cost advantages. Investors in small firms are frequently either directly involved in its management and operation or have important social relationships with the manager (family, kinship, friendship etc). The identity of the supplier and user of capital matters and implies a very significant modification to the abstract picture of a capital market. Finally, government and other agencies have frequently attempted to support smaller-scale enterprises with interventions designed to reduce the cost of capital to qualifying firms.
Forms of regulation, other than those already discussed, will also give rise to deviations from the market ideal. The direct impact on costs is clear in some instances. For example, in the United Kingdom, larger and smaller enterprises face differentials in company taxation rates. Other forms are more difficult to trace: compliance with various forms of company legislation — for example relating to health and safety — may give rise to a fixed (or only semi-variable) level costs which larger companies can absorb with a smaller impact on unit costs. However the smallest companies may escape from the need to comply completely, either due to their relative invisibility (hence ‘informality’) or formal exemption. Finally the whole area of regulation can be complicated by rent-seeking behaviour amongst officials charged with implementation. These again may have a differential effect according to scale. Small companies may have some advantage in their lack of visibility but simultaneously lack the power to resist the attention of corrupt bureaucrats.

Combining these forms of imperfect market behaviour and economies of scale, Marcel Fafchamps (1994) postulates that the cost curve against firm scale in some industries in Africa is bell-shaped. Such a curve would predict the existence of firms at the micro-scale and larger-scale, and the non-existence of the middle-scale.

However the major theoretical difficulty with the notion of market failure is the limitation in its explanatory force. We might attribute a scale feature to various aspects of market failure, but all this indicates theoretically is that markets are not behaving in the way modelled by the neo-classical theory. Although useful as an analytical tool in this respect – drawing attention to what may be pertinent features in the economic landscape – the basic theory does not offer a systematic way with which to account for market failure. The point, made by many critics of the neo-classical theory, is that the conditions under which perfect markets exist are exceptional; the main case in both developing and industrialised economies is non-market behaviour. If the phenomenon of scale is linked closely to the question of market behaviour then we must move beyond the neo-classical framework if we are to explain it satisfactorily.
Problems with orthodox theory

Beyond the difficulties raised in relation to the particular arguments relating to scale there are more basic difficulties with the orthodox approach. A fundamental problem within neo-classical theory is explaining why firms, of any scale, exist at all. In a seminal paper, Ronald Coase (1937) pointed out that if all market transacting is costless there is no reason why all production cannot be organised through the market. All inputs could be sub-divided without limit since there is no cost implication of such sub-division. The physical indivisibility of technical processes or productive assets does not present any theoretical constraint on sub-division of ownership of these assets. Vertical integration of production within firms would similarly be incomprehensible if intermediate goods could be traded effortlessly. That there should be no cost advantages to the organisation of at least some activities within a single administrative structure seems highly counter intuitive. Coase argued that contrary to the neo-classical view, transacting through the market is never without cost (summarised succinctly in a later article):

In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.

Coase (1960, p.15)

The costs of contracting through a firm offers a mechanism for economising on such transaction costs and an explanation, with a cost framework, for the existence of the firm. We will return to this theme later (section 4.4.3).

The maximisation postulate which lies at the heart of the cost based approach is also problematic. Most obvious is the problem of the realism of this postulate. Observation of micro-scale and middle-scale enterprise behaviour tends to strongly challenge the validity of this assumption. On a more theoretical level, the maximisation postulate creates specific difficulties with respect to explaining a non-trivial distribution of firms within industry sectors. Firms are shown to either only exist at a single scale of efficiency or indifferently within a range of scales. The former appears to be an over-constrained explanation, the latter under-constrained.
Explaining the middle

The static equilibrium approach on which neo-classical theory is based supposes that a useful analysis can be made without consideration of the process by which firms move from one state to another. Within the determinism implied by the maximisation postulate, from a theoretical perspective at least, the process of firm development can be seen as largely epiphenomenal. Scepticism regarding the maximisation postulate undermines the logic of this reduction. In the next section (§4.4.2) dynamic approaches relevant to firm scale are considered.

Orthodox economic theory points to important features in understanding firm scale. However its seems that a convincing theory of industrial scale cannot be constructed within an unmodified neo-classical framework. On the supply-side the suggestion of diseconomies of scale is clearly an important idea and in relation to demand, market size was identified as potentially significant. Understanding the fragmentation of markets leads to more micro-level questions regarding the nature of exchange and how markets are formed. A broader theoretical framework is needed.

4.4.2 Dynamic approaches

A dynamic perspective has relevance in a number of ways to the questions with which we are faced. Moving beyond the static in orthodox economic theory produces a more complex picture of the environment in which enterprise operates and significantly enriches the understanding of scale. Dynamic analysis is most obviously relevant to issues of enterprise development and the question of how micro-scale enterprises might graduate into the middle. A number of theories have attempted to account for scale distributions based on assumptions regarding the growth process. Finally evolutionary economics represents a more radical attempt to replace static equilibrium analysis with a wholly dynamic theory. It will be recalled that evolutionary theory was found to shed light on the role of the middle in economic development (§2). We now examine the implications for explaining the development of the middle.

Change and flexibility

Starting from an orthodox equilibrium argument, firms are assumed to adapt their scale of operation to optimise profitability with a given market demand. Where the market demand fluctuates, the flexibility of a particular production technology
becomes relevant. There is a potential trade-off between static efficiency and the ability to vary output. A mass production technology may exhibit very strong returns to scale which under static conditions could result in the lowest average unit cost of production, at a particular level of output. However this efficiency can fall off dramatically, in the short-run at least, as production levels move away from the optimum. Intuitively this would seem reasonable in relation to a capital intensive technology. The capital employed in a large-scale process cannot be readily changed in the short-term and there is likely to be a relatively low potential for variation in the labour input to either boost production or save costs. By contrast a technology which exhibits lower returns to scale in the static, may be far more flexible. The marginal costs of a change in production from the optimum could be far lower than those of the mass-production technique. A labour intensive technology may be able to increase or decrease production rapidly by variation of the labour input.

The result is a competitive dynamic equilibrium in which firms using different production technologies can co-exist. David Mills and Laurence Schumann, following the orthodox approach, suggest that this explains the existence of small firms which are able to "compete successfully with large, more static-efficient producers by absorbing a disproportionate share of industry-wide output fluctuations. This is possible because small firms use production technologies that are more flexible than those chosen by large firms" (1985, p.766).

Examining the concept in more depth, Bo Carlsson (1989) reveals that flexibility depends not just on process technology but also heavily on organisation. Furthermore it can be understood as existing at a number of levels. Short-term or operational flexibility relates to the ability to make variations on a day-to-day basis, and is strongly driven by the basic organisation of the firm. Medium-term or tactical flexibility derives primarily from process technology and includes the cost considerations identified by Mills and Schumann. Finally long-run or strategic flexibility describes the ability to "introduce the new products quickly and cheaply, to accommodate the new products quickly and cheaply, to accommodate basic design changes, and most importantly, the nature of the organization of the firm and the people in it, their attitudes and expectations, particularly with respect to risk taking and change." (p.201).
The recognition of the importance of flexibility undermines further the use of a purely cost based analysis to understanding scale. It provides another reason why the orthodox theory of the firm is unable to explain the presence or absence of firms at a particular scale. The link between flexibility and organisation is highly significant. As we have argued earlier smaller scale enterprise represent distinctive forms of organisation. Michael Piore and Charles Sabel (1984) contend that it is precisely flexibility which accounts for the competitiveness of smaller firms even in the face of long-run cost advantages from large-scale operation. Unfortunately it offers little prospect of explaining why middle-scale firms should not emerge.

_Growth theories of the firm_

Alfred Marshall (1948) emphasised the notion of firms having a life-cycle. This view of the firm produces a shift to the dynamic frame of analysis. Although not necessarily contradicting the economising stance of neo-classical thought, conceptualising the firm as an entity which itself develops through time leads to very different outcomes. Theories vary in complexity from those based on highly simplified assumptions regarding growth rates, such as Gibrat's Law, to those concerned with a more fundamental understanding of growth processes, typified by Edith Penrose's (1959) theory of the firm.

Gibrat's Law is used as the basis for a number of stochastic models, stating that the growth rate experienced by individual firms is independent of current size and history (You 1995). If all firms in a given population experience the same growth rate with some random variation the size distribution will tend towards a log-normal distribution – similar to the empirical findings across a number of industry sectors in some industrialised economies (Simon and Bonini, 1958).

Such models can be rendered more sophisticated in a number of ways (You 1995, p.454). As identified in our simple breakdown of the research question (§4.2) above, firm entrance and exit into the population is a vital aspect of the reality of firm population dynamics. Inclusion of these factors, unsurprisingly, improves the fit between the model's projections and empirical findings. A negative correlation of growth rate with firm age again reflects a common observation. The relatively greater
Explaining the middle

stability of larger firms can be reflected by reducing the variation in growth rate with size.

These models can be criticised in a number of ways. Although the scale distributions derived are closer to those found in some economies than those predicted by orthodox neo-classical theory, the empirical confirmation does not appear strong in the literature. In particular the aptness of the assumptions for smaller firms has been questioned.\(^{27}\) A more fundamental question is what such models actually explain. Presuming *arguendo*, that a model based on Gibrat’s law showed a good match with the empirical data, there would be good reason to suppose that firm growth patterns captured by the assumption were responsible for firm scale distributions. The key explanatory issue however is what drives the growth rate. Mathematically it will always be possible to determine a growth function of greater or lesser simplicity, combined with various exit and entrance parameters, which will model any conceivable distribution. A stochastic theory is of limited interest unless it explains why a variable takes a random distribution and how the boundaries values for such a variable are determined. The latter will presumably be critical in explaining the variation between different scale distributions found across economies and industry sectors. Furthermore postulation of a random effect must be justified by appeal to either the complexity of the growth process or its true indeterminacy.

A more sophisticated approach to growth is advanced by Jovanovic (1982) who posits that cumulative learning by firms is the key determinant of the life-cycle. A highly simplified conception of learning is utilised: at the outset firms face a high degree of uncertainty regarding their own costs and production efficiency. By observation of their performance in the market firms are able to determine more accurately their actual efficiency. According to this more accurate information, firms determine their future. If the firm finds itself to be highly efficient and profitable, it seeks to increase that profitability by growing rapidly and increasing output. By contrast firms which find that their performance is poor are less inclined to grow and will ultimately exit where they determine that returns are too low.

Jovanovic’s model and its derivatives, while apparently augmenting the neo-classical theory in ways which address weaknesses in its application to the problem of scale,
Explaining the middle

104

actually undermine it further. Once questions of imperfect information, inefficiency and learning are admitted, an altogether more sophisticated theoretical apparatus seems to be demanded. The highly stylised assumptions here obviously do not, and are presumably not intended to, garner much support from even the most superficial observations of actual firm behaviour. At best the "broad" agreement between the model and empirical evidence reported by Jovanovic justifies a theoretically deeper level of inquiry in this direction.

At the heart of Edith Penrose's (1959) growth theory is the broad notion of the firm's 'internal resources'. Amongst these resources it is management capacity at any given time which is the primary constraint to the expansion of a firm. Although additional managerial services are presumed to be available in the market, growth depends on the capacity of the existing management team. Increasing this capacity in an effective way takes time as new individuals are brought into the existing team and gain experience in working with the other members of the team. The theory does not deny the potential relevance of external product or factor markets but argues that in general these are not the constraining elements: "size is but a by-product of the process of growth, that there is no 'optimum' or even most profitable, size of firm" (1959, p.201). We will defer further discussion of the notion of capacities (§4.4.3) and now turn to the evolutionary argument, to which Penrose's theory can be seen as the precursor.

Evolutionary economics

Recent work in evolutionary economics represents an attempt to shift the perspective of economic analysis firmly from the static to the dynamic. Its conclusions for firm-scale at the outset seem largely negative, sustaining the scepticism regarding the maximisation postulate discussed earlier (§4.4.1).

Richard Nelson and Sidney Winter (1974, 1982) propose that firm behaviour at any point is not determined by maximisation but largely according to a set of routines. These routines determine how the firm responds to a given environmental stimuli. They can also be seen as representing part of the firm's capacity - the tacit or unteachable knowledge gained by working in teams and learning-by-doing referred to by Penrose (1959). In an evolutionary sense they act as 'genes', passing on
behavioural traits over the firm's life and potentially between firms through imitation. Therefore in the short-term, at least, stability is assumed in these rules – providing continuity in firm behaviour from one period to the next.

Modification to firm behaviour occurs as a response to actual performance within a given environment. This can occur through both unconscious or blind selection (Darwinian) and conscious, active selection (Lamarckian). Firms that have successful routines are more profitable, have greater resources for investment and are therefore better able to grow. Conversely, unsuccessful routines are less profitable, either leading to lower profitability and stagnation or contraction, and ultimately perhaps extinction. However firms are also able to observe their performance in an environment and can respond to negative outcomes by searching for new routines. The search process conducted by the firm can itself be represented by higher order routines. Increased behavioural sophistication is afforded by the notion of a hierarchy of routines. Innovation in an industry sector is represented by an increase in the set of potential routines available over which the firm may search.

The evolutionary approach fundamentally undermines the static determinism of neo-classical theory. Firm state is not predictable, even hypothetically, simply from a knowledge of current environmental conditions.

In the evolutionary view ... the size of a large firm at a particular time is not to be understood as the solution to some organizational problem. General Motors does not sit atop the Fortune 500 (at over $100 billion in 1986 sales) because some set of contemporary cost minimization imperatives (technological or organizational) requires a certain chunk of the U.S. economy to be organized in this way. Its position at the top reflects the cumulative effect of a long string of happenings stretching back into the past, among which were the achievement of relatively good solutions to various technological and organizational problems, the success of its ancestral companies in establishing strong positions in a young market that turned out to be a good one, and of course the creation by merger of the company itself. In short, a position atop the league standings is not a "great play". It may express the cumulative effect of many great plays; it does not exclude the possibility that there were also several not-so-great plays.

Winter (1993, p.192)
Applying the evolutionary perspective to our research question gives rise to an interesting view. Returning to the history of Kenya's industrial development (§3.2), Asian privately owned manufacturing enterprise, appears to have evolved from the micro, through to the middle and large-scale. Meanwhile African enterprise would seems to be still at the start of the evolutionary process, in the micro-scale. There is some historical evidence to support the claim of an earlier entry of the Asian community first into trading and subsequently manufacturing. Both the colonial and post-independence governments acted to exclude Asians from the agricultural sector, forcing them into other sectors. However the notion of a 'head-start' should not be overstated. As noted earlier, many Asian entrepreneurs also originated from subsistence peasant societies. African accumulation pre-dates independence and all state restrictions on African enterprise were eliminated more than thirty years ago. A further, crucial, question is why successful routines should not transfer from Asian to African enterprise.

The evolutionary approach provides a useful framework within which to view the research question faced here. However it raises issues which demand further explanation. Finally, it simply does not yet provide us with a clear basis from which to address the three simple questions raised earlier regarding entry and survival in the middle-scale (§4.2).

4.4.3 Capacities for enterprise

The discussion of Penrose's growth theory and evolutionary economics draws attention to enterprise capacities while leaving open the question of the nature and function of those capacities. Possible deficiencies in relevant capacities has already been raised in our earlier discussion of the Kenyan literature (§4.3.2). We now explore in more depth the two themes already established – entrepreneurship, and management and organisation.

Entrepreneurship

Within the broad orthodox economic paradigm it has been argued that entrepreneurship should be regarded as the fourth factor of production, after land, labour and capital. Entrepreneurship is here conceived as the essential catalyst which combines the three factors into a productive form. The entrepreneur appears to be
needed more especially in relation to growth and the somewhat opaque neo-classical concept of technical change to which most growth is attributed. Deficiencies in the supply of entrepreneurship have long been posited as a key constraint on enterprise. Frank Knight claimed that “the supply of entrepreneurial qualities in society is one of the chief factors in determining the number and size of its production units” (1921, p.283). Early economic development theorists were concerned with just such a supply deficit (Leff 1979). The middle-scale would seem particularly susceptible to the supply of entrepreneurship. It represents a step forward in organisational and technical complexity as compared with the micro-scale but remains heavily dependent on the central character of the entrepreneur.

In order to understand the relevance, or otherwise, of entrepreneurship to economic analysis generally and the middle-scale specifically, the concept needs to be clarified. However as William Baumol observed: “the entrepreneur is at the same time one of the most intriguing and one of the most elusive characters in the cast that constitutes the subject of economic analysis.” Similarly Peter Kilby has suggested that the entrepreneur can be likened to A. A. Milne’s storybook ‘heffalump’:

The Heffalump is a rather large and very important animal. He has been hunted by many individuals using various ingenious trapping devices, but no one so far has succeeded in capturing him. All who claim to have caught sight of him report that he is enormous, but they disagree on his particularities. Not having explored his current habitat with sufficient care, some hunters have used as bait their own favorite dishes and have then tried to persuade people that what they caught was a Heffalump. However, very few are convinced, and the search goes on.

Kilby (1971, p.1)

Much of the discussion regarding the special role of the entrepreneur has been dominated by two themes: uncertainty and innovation. The counter-claim that there is no special entrepreneurial role distinct from management will be considered in the following section.

Richard Cantillon writing in the mid-eighteenth century is credited with originating the term ‘entrepreneur’, associating it with the taking of risk and bearing of uncertainty. Following this line of thought Knight (1921) conceived of the entrepreneur as responsible for making decisions under conditions of uncertainty.
Many of the key decisions taken by firms, for example whether to invest in a particular plant or not, are based on assumptions regarding future economic conditions. Any economic action which is extended through time is *a priori* subject to uncertainty. Knight distinguished uncertainty from risk. Uncertainty is taken to refer to a lack of information regarding the form or basis of a problem and therefore what outcomes are feasible.\(^{31}\) Risk meanwhile can be regarded as a quantifiable unknown, in which the form of the problem is apprehended and what remains to be determined is which of a finite set of outcomes will actually occur.\(^{32}\) In principle risk can be expressed in terms of probabilities of various outcomes. Presuming, *arguendo*, perfect capital markets, the problem of risk is in principle dissolved. Suppliers of capital simply weight the cost of capital to account for the probability of various unfavourable outcomes – foremost obviously being business failure and loss of capital. Uncertainty meanwhile remains a problem which is wholly intractable within neo-classical theory; uncertainty *ex definiens* is not reducible to a value. We have already noted, uncertainty appears highly relevant to the question of whether middle-scale enterprises emerge from the micro-scale in Kenya (§4.3.2). At issue here is whether the notion of the *entrepreneur* as the bearer of uncertainty actually enriches theory significantly.

The association of entrepreneurship with the bearing of uncertainty directs analysis in three possible directions. First and perhaps most obviously it might be supposed that individuals possess varying innate psychological propensities to bear uncertainty or take risks. This might seem reasonable based on the casual observation of marked differences in gambling habits among individuals in any given society. However it is less clear that variations in the incidence of risk taking found *between* populations should be explained by reference to innate psychological traits in the first instance rather than systematic social or economic factors.\(^{33}\)

This points to a second direction of analysis. A given social and economic context may significantly modify the risk faced by individuals. Political and macro-economic instability characterise many developing economies increasing the background level of uncertainty. All markets, especially risk markets, are likely to be poorly developed and radically incomplete in the neo-classical sense.\(^{34}\) The consequences of failure in business may be markedly different between industrialised and developing
explaining the middle economies. A business failure in the latter context could deprive an individual of the means of subsistence.\textsuperscript{35} Such an analysis directs attention away from the notion of entrepreneurship towards the social and economic environment.

A third form of analysis considers the extent to which the activities of the entrepreneur might modify uncertainty. In part this relates to the way in which the entrepreneur organises the activities of the firm, and therefore is to some degree part of the wider discussion of organisation. However it is also fundamentally conditioned by the way in which the entrepreneur makes sense of the economic and social world in which she acts. Ultimately this points to an analysis of the cognitive environment of the entrepreneur determined by culture.\textsuperscript{36}

Joseph Schumpeter's conception of the entrepreneur as innovator has been the most enduring in the literature. In Schumpeter's theory, the entrepreneur is placed at the heart of economic development. It is the entrepreneur who breaks the cycle of routine economic activity, "swimming against the stream" to produce a "new combination of means of production". Schumpeter is careful to distinguish this function from risk bearing (the function of the capitalist), management and the inventor. Enterprise is solely about the carrying of new combinations. Five cases of "new combinations: are identified:

(1) The introduction of a new good — that is, one with which consumers are not yet familiar — or of a new quality of a good. (2) The introduction of a new method of production, that is, one not yet tested by experience in the branch of manufacture concerned. Which need by no means be founded upon a discovery scientifically new, and can also exist in a new way of handling a combination commercially. (3) The opening of a new market, that is, a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before. (4) The conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created. (5) The carrying out of the new organisation of any industry, like the creation of a monopoly position (for example, through trustification) or the breaking up of a monopoly position.

Schumpeter (1934, p.66)

The entrepreneur is thus an irreducible element in capitalist economic development. It is equally relevant to the development of late industrialising economies as the earliest in which technological discovery was a part of economic advancement.
Again it seems particularly pertinent to the middle as distinct from the micro-scale. We have argued that middle-scale enterprise in developing economies involves a crucial step forward in economic organisation towards that of an industrial exchange economy from the traditional pre-industrial form. This would appear to necessarily involve innovation. The question of entrepreneurial supply is thus raised again.

Among early development economists, W. Arthur Lewis (1955) emphasised the potential constraints from socio-cultural structure on innovatory entrepreneurship within developing economies. The view, described by Leff, of “relatively lethargic, ‘tradition-bound’ societies whose cultures seem inimical to innovation and vigorous economic expansion” (1979, p.60) suggests a supply constraint in entrepreneurs. Considerable theoretical and empirical work has been directed at understanding entrepreneurial supply, positing either broadly psychological or sociological causes.

Typifying the psychological approaches, David McClelland constructed a theory based on the motivation for achievement – which he termed n Achievement. It is proposed that “entrepreneurial behaviour is exhibited by people who are high in n Achievement in (1) their desire to take personal responsibility for decisions, (2) their preference for decisions involving a moderate degree of risks and (3) their interest in concrete knowledge of the results of decisions” (1971, p.109). McClelland argued that this crucial n Achievement characteristic is formed during an individual’s childhood, with the major determinant being the parents’ religious world view or ideology. A culture which does not possess an achievement oriented ideology will thus produce few entrepreneurs. The argument at this stage echoes Max Weber’s sociological theory, which emphasises the impact of the beliefs, especially religious, of a society. Weber traced the development of capitalism in Europe to the Protestant ethic. Both entrepreneurship and the environment in which it flourishes are held to be supported by the societal world view or geist provided by Protestantism (MacDonald 1971, pp.76-7).

Interestingly Schumpeter’s psychological explanation for entrepreneurial behaviour suggests that social and psychological conditioning are largely irrelevant. Three elements explain entrepreneurship: “the dream and will to found a private kingdom ... the will to conquer ... to succeed for the sake of success itself ... [and] finally there is the joy of creating” (1934, p.93). The source of this entrepreneurial
Explaining the middle psychology is atavistic: “activity urges springing from capacities and inclinations that had once been crucial to survival, though have now outlived their usefulness” (1955, p.33).

As noted earlier specifically in relation to Kenya, many observers have vigorously denied that there is any lack of innovative behaviour in developing economies. Hubert Schmitz argues that there can be no question of a deficit in entrepreneurial supply of this kind, quoting studies which “reveal great initiative, inventiveness, responsiveness and readiness to jump at opportunities” (1982, p.431). Serge Latouche (1993) refers to the creativity and dynamism found in the ubiquitous informal sector of the developing world. Leff concludes more cautiously that “economic development in most current LDC's can proceed without these countries having to wait for a psycho-cultural transformation that would increase the supply of entrepreneurs” (1979, p.60).

The representation of entrepreneurship as a simple variable is highly problematic. Kilby (1971) has noted that many of these approaches depict entrepreneurship as being either entirely present or entirely absent. In relation to understanding the growth of small enterprises, Allan Gibb and Les Davies (1990) contend that the emphasis needs to move away from the various social, psychological or economic characteristics of entrepreneurs to the actual behaviours in enterprises. It is argued that “different types of entrepreneurial behaviour are required in different marketplaces to achieve growth and different traits, skills and competencies will be needed depending upon levels of uncertainty and complexity in the market” (pp.19-20).

Turning to the question of the relationship between enterprise scale and entrepreneurship, the usefulness of the concept as a primary explanatory variable becomes yet more doubtful. Although the association between smaller scale enterprise and entrepreneurship is enduring in the literature, it is not clear how entrepreneurial supply of the irreducible 'innovative' kind might affect enterprise scale. Under conditions of entrepreneurial scarcity, will larger or smaller scale enterprise be favoured? The presumption that small enterprise is always necessarily innovative in the Schumpeterian sense needs to be questioned. If merely establishing a small enterprise were evidence of such innovatory enterprise then the notion of a
shortfall in supply would clearly not apply to those developing economies such as Kenya with very large populations of micro-enterprises. Some notion of the quality or magnitude of the entrepreneurial input seems inescapable if it is to be useful in explaining industrial scale. However there are no grounds for supposing a simple relation between the degree of innovation needed and enterprise scale. Cases of apparently highly innovative companies have been found at all scales.

Explanation of scale distributions in terms of the supply of innovatory entrepreneurship cannot be immediately refuted. However such an explanation will necessarily involve a greater degree of complexity than the simple under-supply of an undifferentiated entrepreneurial input. Furthermore there are no a priori reasons for not seeking a clearer understanding of the role of the entrepreneur in the firm. Certainly it seems theoretically premature to look for the causes of enterprise in social or psychological structures before understanding more clearly how entrepreneurship or more generically, enterprising behaviours, affect the behaviour and performance of firms.

**Management and organisation**

We now consider this more direct link between enterprise performance and organisation, and entrepreneurship in terms of the actual role of the entrepreneur in the firm. Such a link, as we have already seen (§4.3.2), has been made by Peter Kilby and examined in the context of developing economies. He identified thirteen roles performed by the entrepreneur in a firm, which are broadly classified into four groups relating to exchange relationships, political administration, management control and technology. Kilby claims the empirical evidence shows that whilst the first two roles are generally performed “vigorously and effectively” in developing economies, it is deficiencies in the last two which represent “operational bottlenecks to indigenous industrial development” (1971, p.40). This approach explicitly focuses on the “mere-managerial” aspects of entrepreneurial function.³⁸ Kilby goes on to state that, pace Schumpeter, “the characterization of the entrepreneurial function as one of innovation and the attendant activities simply does not fit late-developing countries” (1988, p.224).
Once again the basic question here is how managerial ability relates to enterprise scale. Robert Lucas suggests a simple model in which firm output is a function of managerial technology in addition to the familiar production technology. Managerial technology is dependent on the innate and variable talent of individuals. Firm size distribution in any economy is thus related to this distribution of managerial ability. The effectiveness of management is also held to diminish with scale – reflecting the limited span of control of any manager. Lucas shows that the model can lead to the prediction of an increase in average firm size with economic development and rising capital per capita and wage rates, which shows strong agreement with empirical evidence from the US.\textsuperscript{39}

The usefulness of this model, as stated, to the problem at hand is questionable. Once more there is the generic difficulty of applying equilibrium reasoning in economic contexts where markets diverge so strongly from the neo-classical abstract ideal. More specifically the simplifying assumptions of homogeneity in entrepreneurial and labour markets are troubling. As Gibb (1997) observes, the task environment of the small scale enterprise owner-manager can be conceptualised in a radically different fashion from that of the manager-entrepreneur of a large corporation. Finally the notion of managerial talent is not developed. Differences in scale distributions could be explained by appeal to the notion of variances in managerial talent.\textsuperscript{40} However the problem remains to explain precisely these differences. Following Gibb’s argument, the supply of entrepreneurs should be considered in relation to enterprise scale and perhaps according to sub-sectors. The arguments put forward by Marris and Somerset (1971) and Kilby (1971, 1988) are more consistent with this approach.

This line of argument regarding the specific role of the entrepreneur appears more promising than the idea of an irreducible entrepreneurial capacity. It is consonant with the evolutionary framework outlined earlier. In the analysis of both Kilby and Marris and Somerset the concern is how the African middle-scale entrepreneur is created and what barriers might be placed in the way of the development of such an entrepreneur. The argument inexorably draws us, again, to consider how the task environment in which the entrepreneur operates, facilitates or prevents enterprise of various types and the formation of essential capacities.
4.4.4 Understanding the task environment

The theory reviewed so far has drawn attention to the importance of the context from which enterprise emerges. However we have yet to find a theoretically cogent basis from which to describe this context. Clearly a useful description of the task environment must show how features of that environment impinge on enterprise. The industrial districts, clustering and sub-contracting literatures have notably emphasised the significance of the enterprise context for its performance. It has been claimed that within an appropriate environment clusters of middle-scale enterprises have been able to compete in international markets. A key theme in the literature is how the embeddedness of enterprise in a broad economic and socio-cultural context may contribute significantly to this competitiveness. Clearly this connection between the socio-cultural context and enterprise performance is highly relevant to our research question here which seeks to explain differences between entrepreneurs from ethnic groups operating in the same economic circumstances.

We start by considering how the recent literature on industrial districts and sub-contracting may inform the question before turning to the underlying theoretical issues. As we have already seen (§2.4.2), transaction cost economics offers a potential theoretical starting point for understanding how exchange is organised between and within firms. Transaction cost theory is however only a part of the wider new institutional economics. In the final part of this brief review we consider how the concepts of economic and social institutions might provide a more complete theoretical picture of the context for enterprise.

Beyond the firm: industrial districts and sub-contracting

Recent studies of smaller scale enterprise, both in industrialised and developing economies, have increasingly focussed on the position of the firm as part of a wider system of production. It is argued that the efficiency or competitiveness of the firm is not based simply on its own capacities, but also on those of other firms to which it is related in a number of ways.

Alfred Marshall observed that economies “could often be secured by the concentration of many small businesses of a similar character in particular localities”. These external economies are “dependent on the general development of the
industry”, and are distinguished from *internal* economies which are “dependent on the resources of the individual houses or businesses engaged in it, on their organization and the efficiency of their management” (1948, pp.221-231). Marshall suggested that external economies in industrial districts could arise from the possibility of a high degree of specialisation in terms of both technology and labour skills and the strength of information flows within the district. The focus of economic analysis thus moves logically from the level of the firm to that of the collective. Deep division of labour can occur within the district; small individual firms becoming very highly specialised on one aspect of the total production process taking place across the district.

Within the market oriented view of contemporary economics, externalities are regarded as those costs and benefits arising from a transaction which are not fully captured within the market determined price. Hubert Schmitz (1995, 1997) argues that this notion of external economies implies a passive origin and thus represents only one component of the potential gains available to firms within the industrial district. A second arises from purposeful joint action by firms. Such joint action might range from simple co-operation between two firms (such as sharing of equipment or joint product development) through to collaboration by groups of firms in the common interest (examples include local infrastructure projects, training institutes, marketing organisations and lobbying associations). Schmitz uses the broader concept of collective efficiency to capture the competitive advantage derived from a combination of both external economies and joint action within the industrial district.

There is a wealth of contemporary empirical evidence from both industrialised and developing economies regarding industrial districts. Setting aside the more detailed on-going debates, the evidence is strong in further undermining the suggestion of a simple relationship between scale and efficiency (or better, competitiveness). Taking the firm as the unit of analysis over-reduces the phenomena, losing sight of important features of reality which directly affect scale. The questions which now need to be addressed are: under what circumstances does collective efficiency arise and how might these relate to firm scale? A key point made by Schmitz (1995, p.533) is that not all geographical collections or clusters of firms in the same sector
will form an industrial district, in the sense of generating significant gains from collective efficiency.

Recent studies of sub-contracting relationships have drawn attention to the more general significance of inter-firm linkages. In particular geographical proximity does not appear to be a necessary feature. Evidence from a number of economies shows how production processes are spread across large numbers of firms. Yoshio Sato (1983) observes that industrial organisation in Japan in particular is strongly characterised by the extensive disaggregation of production. The depth of this disaggregation is illustrated by the case of a large motor vehicle manufacturer which has 168 primary suppliers, which themselves have 5,500 secondary sub-contractors, which in turn use a further 36,000 tertiary subcontractors. A significant proportion of Japanese manufacturing industry appears to be organised in the form of subcontracting production systems – referred to as shitauke.

A number of features of the shitauke system are of interest here. First, there is strong involvement of all scales of firm in the system. Second, the strength of Japan’s small and medium enterprise sector is closely associated with the system. Finally the nature of the relationship between firms seems highly significant. By contrast with a pure market exchange in which short-term outcomes are primary, Sato argues that “Japanese industrial society trade is usually based on long-term profitability with both sides trying to maintain the relationship” (1983, p.22). Similarly, Naoki Kuriyama notes “long-term continuity of transactions has been, and continues to be, a pervasive practice of Japanese subcontracting” (1990, p.3).

Comparative studies tend to emphasise further the bearing of inter-firm relationships on the nature of the production system. In an investigation of Japanese and Western (US and Western European) motor vehicle industries, the ratio of valued added to total sales was found to be between 30-40% in the Western final assembler as compared with only 20% in the Japanese. This appears to be strongly correlated with the differences in relationship observed between contracting firms (Kuriyama 1990, p.7). Mark Lazerson (1990) emphasises the heterogeneity of sub-contracting and contends that forms of sub-contracting based on a strong degree of mutual cooperation represent an intermediate organisational form between complete vertical
integration within the hierarchy of a firm and arms length exchange through the market.

The difference in sub-contracting arrangements across economies has clear relevance to the questions of scale. Extensive use of sub-contracting would appear to offer greater opportunities for small-scale enterprise. More fundamentally the simple dichotomy of market and hierarchy, assumed in the earlier discussions, has been undermined. The level of analysis inexorably moves to that of systems of firms.

**Transactions costs: the enterprise as governance structure**

The primary focus for transaction cost economics is understanding how and why exchange is organised within and between firms. It therefore provides a basis for analysing firms conceived as part of a wider system of production. The starting point is Ronald Coase's insight that the neo-classical assumption of costless market transactions obscures the fundamental reason for the existence of firms. As noted earlier (§4.4.1), Coase argued that the firm can be understood theoretically as a mechanism for reducing transaction costs. In the subsequent development and elaboration of transaction cost economics, notably by Oliver Williamson, transactional analysis also deals with organisational forms which are neither firm nor market. It is argued that both industrial districts and sub-contracting relationships can be understood theoretically as forms existing between market and hierarchy.

According to Williamson, transaction costs arise as a result of two behavioural assumptions which challenge the neo-classical view of *homo economicus* or rational economic man. The first is of bounded rationality, which follows Herbert Simon's contention that economic actors are "intendedly rational, but only limitedly so". Hence prior to undertaking any transaction, economic actors cannot know all possible outcomes — information is incomplete. Comprehensive contracting, in which all possible outcomes are dealt with *ex ante* is rendered impossible with incomplete information. The second assumption is that agents are opportunistic — "self-interest seeking with guile". It is a strong form of self-interest in which crucially any imbalances in the strength of the position of two transacting parties may be exploited. This forecloses transacting according to promise without support, in which unknown circumstances arising *ex post* can be dealt with by a general *ex ante* agreement.
According to Williamson the attributes of transactions are critically distinguished according to three dimensions: the frequency with which they recur, the uncertainty to which they are subject and the type and degree of asset specificity involved by those involved in the exchange. The last is a central theme in transaction cost economics and refers to "the degree to which an asset can be redeployed to alternative uses and by alternative users without sacrifice of productive value" (1996, p.105). Such assets may be physical – plant and equipment, human – skills and knowledge or intangible – brand names. One of the most common cases of asset specificity arises where a firm provides an employee with specialised, firm specific training. The employee invests in developing skills which are only useful within that particular firm; meanwhile the firm has invested in the provision of training in a specific individual.

Firms and markets, together with intermediate or ‘hybrid’ arrangement between these two polar forms, describe the different governance structures within which transactions are organised. Underpinning transaction cost economics is the postulate: “transactions, which differ in their attributes, are aligned with governance structures, which differ in their costs and competencies, in a discriminating (mainly, transactions-cost-economizing) way” (1996, p.101). Williamson argues that the central problem of economic organisation is adaptability. The primary instrumental difference between governance structures is found in their performance with respect to kinds of adaptation as a result of the instruments deployed.

Characterised by high-powered incentives combined with the information conveyed by price signalling, perfect markets result in strong autonomous adaptability. This is precisely the type of market allocative efficiency highlighted by Friedrich Hayek (1945) and others. In circumstances where transactions involve no asset specificity, little uncertainty and low frequency, the market produces the lowest transaction cost. A price is offered and taken in the market. By contrast the firm possesses strong administrative controls which permit strong co-operative adaptability. Where transactions imply high asset specificity, uncertainty or frequency, co-operative adaptability is necessary. Thus, for example, the labour of an individual with skills specific to a firm is almost invariably brought within the governance structure of the firm.
It is the necessary tension or contradiction between the instruments of incentive and administrative control which Williamson contends explains the limits of the firm and market. Hybrid forms of governance represent an inescapable compromise between the two poles – with only moderate incentives and administrative controls. The loss of high power incentives gives rise to the costs of bureaucracy – the tendency of managers within an organisation to pursue goals other than pure efficiency. By contrast the lack of administrative control gives rise to the costs of the market – the inability to reap the benefits of co-operation.\(^47\)

Transaction cost theory provides an enriched theoretical basis for the comparative analysis of large, middle and micro-scale enterprise. Crucially it provides a theoretical understanding of why, from an economising perspective, functions may be internalised to a firm or externalised – the so-called ‘make or buy’ decision. Industrial districts and sub-contracting networks can be conceived of as ‘meta-enterprise’ organisational forms, intermediate between market and hierarchy. The opportunity or ‘economic space’ for various scales of enterprise is seen to depend on the transactional environment. However transaction cost theory does not explain how \textit{real} markets convey information or a hierarchy exerts administrative control.\(^48\) Crucially it does not explain how transaction costs are shaped by the environment – which is the key question we need to explain. The broader new institutional economics, of which transactions cost theory is one part, offers such an explanation.

\textbf{New institutional theory}

Institutions, according to Douglass North, are the “humanly devised constraints that shape human interaction”; more simply they are the “rules of the game in society” (1990, p.1). These rules, both formal and informal, cover the political and the economic. Formal political rules “broadly define the hierarchical structure of the polity, its basic decision structure, and the explicit characteristics of agenda control”. Meanwhile the formal economic rules “define property rights, that is the bundle of rights over the use and the income to be derived from property and the ability to alienate an asset or a resource” (p.47). Explicit, highly specific agreements can be reached through the use of contract.
Informal institutions cover a multitude of rules which guide behaviour. Many of these are strongly internalised by a social group – within the norms, customs and traditions of society. North sees these rules as part of culture which provides the conceptual framework through which information is understood. Consequently many such rules may be largely self-enforced. However they might also depend on the threat of retaliation from the second party or by a third party through societal sanction or authority. The distinction between formal and informal is not a clear one. As societies develop, especially economically, there is an increasing degree of formalisation. Rules which once implicitly guided society become explicit. The formalisation of rules, North argues, may reflect the need to handle more complex situations arising from the more complex organisation of an industrial society. However it is important to be clear that informal rules are never displaced by formal. The effective application of formal rules depends to a significant extent on becoming embedded in the informal rules act to guide much routine behaviour.

Economic and political performance is linked to institutional structure formally through transactions cost theory. North argues that the cost of economic or political exchange is determined by institutions. Broadly consistent with Williamson's approach, transactions costs arise theoretically from fundamental assumptions regarding human behaviour, in which self-interest looms large, together with the general nature of exchange in which information is necessarily both incomplete and costly. Institutions can act to solve the problem of co-operation implied by the existence of transaction costs by the way in which they structure exchange.

At a fundamental level, exchange involves the transfer of the rights to valuable attributes embodied in goods, services or labour. In a world of limited information, in the general case, these attributes are not immediately known. Furthermore, in general again, information regarding attributes will be held asymmetrically between transacting parties, giving rise to the possibility of gain by one party. Assuming wholly unconstrained wealth maximising agents, co-operation could only occur in the simplest types of exchange where information problems are negligible and a positive outcome is consistent with self-interested behaviour. This represents the theoretical limiting case in which exchange will be minimal, constrained by high transaction costs. Where agency is structured by institutions, transaction costs may be reduced
and more complex forms of exchange become possible. North posits that the performance of economies can be related to the effectiveness of the institutional structure in reducing transaction costs.

The impact of institutions on the cost of transacting can be understood in terms of both measurement and enforcement costs. Property rights are highly relevant to the measurement costs of transacting – determining what is the potential content for a transaction. More obviously, measurement entails quantifying the attributes which are sought in an exchange. These, for example, may be supported by the legal definition of standard weights and measures, for example. Enforcement meanwhile concerns the cost of monitoring and ensuring compliance with agreements. As noted earlier the enforcement may be first, second or third party. The bedrock of a formal legal system is the existence of a third party, the state, to enforce the rules. Transaction costs are directly determined by the extent to which agreements bound by law are supported by credible state action. The effectiveness of the court system is critical to the efficiency of the key formal institutions in an economy characterised by a high density of exchange.

New institutional economics sees the economic actor as located within an institutional matrix. The condition of perfect markets in which exchange can be accomplished costlessly is a limiting case which is only rarely approximated under specific ideal institutional conditions. Economic opportunities are a function of both transformation (neo-classical production) and transaction costs. In order to understand scale and ownership in an economy, the specific position of actors needs to be considered. North again broadly agrees with Williamson in seeing the firm as a structure for modifying transaction costs. However North emphasises the institutional context within which the firm operates.

New institutional economics represents a very broad framework within which to describe the instrumentally relevant context of economic activity. It shows how social structural factors can impinge on economic outcomes. This is crucial in relation to our explanatory task. However some theoretical difficulties remain. In particular Williamson's principle of transaction cost minimisation is uncomfortably redolent of the maximisation postulate in orthodox economic theory which we were forced to abandon. In terms of building an explanation for Kenya's middle, much
theoretical work remains. The link between organisation forms, such as micro, middle and large-scale enterprise and a broadly conceived institutional structure needs to be laid out in some detail in order to tackle the question before us.

4.4.5 Determining a frame of reference

The foregoing exploration of the literature has covered a considerable range of theoretical approaches. On the basis of this review we now turn to the choice of an overall conceptual frame of reference for the study. In determining a frame of reference it is essential that the insights of other theoretical approaches and existing empirical investigations are not lost. The examination of both the specific Kenyan and wider literature revealed a number of interesting perspectives on questions of the middle. A highly inclusive frame of reference is needed within which an explanation can be constructed which builds on earlier work.

Orthodox micro-economic theory (§4.4.1), placing the enterprise centre stage, provided a useful starting place for the review of the literature. However a number of fundamental questions were raised regarding the applicability of neo-classical theory to the problem of explanation at hand. Many of these problems can be seen to derive from the essential theoretical economy of the orthodox theory of the firm, the corollary of which is an excessive reductionism, at least in relation to the phenomena with which we are concerned here.

The static nature of orthodox theory has been tackled by various more dynamic analyses (§4.4.2). Among these, the recent literature on flexible specialisation and industrial clustering has been especially pertinent to explaining the competitiveness of smaller firms in industrialised and developing economies. These approaches direct attention towards the significance of the context in which enterprises are found, including socio-cultural factors. This has clear relevance to the ethnic dimension of the explanatory problem at issue. However the obvious shortcoming of the work here is that it is concerned with the success of smaller firms and is not immediately applicable to explaining why smaller firms (and the middle) do not emerge.

Studies of the 'alien entrepreneur' have clear relevance to the question of the relative success of the Asians in Kenya. This work reveals that the Kenyan Asian case is
certainly not unique – Granovetter (1995) for example shows that there are strong parallels with the entrepreneurial communities of overseas Chinese found in Southeast Asia. From a theoretical perspective the difficulty once more is that work on the alien entrepreneur is focussed on explaining success, and cannot, unelaborated, explain the relative failure of indigenous communities which is so pertinent to the Kenyan case. However this literature makes a key contribution to the question here in pointing to the vital role played by socio-cultural structure in shaping the task environment of entrepreneurs and conditions for success.

Looking inside the 'black box' neo-classical view of the firm leads to a focus on the key figure of the entrepreneur (§4.4.3). Various theories have been propounded suggesting explanations for the emergence (or non-emergence) of the entrepreneur conceived of as a risk bearer or innovator essential to the development of enterprise. The history of many late developing economies, including Kenya, offers a possible basis for systematic differences from the industrialised economies in the supply of entrepreneurship conceived in this way. Beyond the potential incompatibility between socio-cultural norms of pre-industrial societies and entrepreneurship, the experience of colonisation and discrimination itself may have introduced a debilitating effect on the emergence of African entrepreneurs. 50 From a theoretical perspective however it is argued that the conception of entrepreneurship as an irreducible 'fourth factor' input to the firm is unsatisfactory. Crucially it fails to address the diversity of roles and behaviours required of entrepreneurs in differing contexts. Taking a more prosaic approach to entrepreneurship – focusing on the traits, skills and competencies needed to succeed in enterprise – leads to the question of the conditions under which these capacities are formed. Once more the emphasis is on understanding the context for enterprise.

At the macro-level of explanation, tracing the specific history of Kenya's economic development (§3.2) points to numerous factors which are pertinent to the contemporary form of the middle-scale. Pre-independence colonial policy, for example, clearly had an inhibitory effect on the development of non-European business. However without theoretical elaboration, a direct reading of the history of Kenya does not of itself suggest why the African middle should remain undeveloped while an Asian middle has emerged. Marxist frames of reference have been widely
applied to this problem of interpretation of Kenya's post-colonial history. Both the Marxist thesis of marginalisation of the informal sector (or petty commodity production) and neo-Marxist dependency theory (§4.3.4) offer useful perspectives on the questions of the middle, emphasising the role of the state and political economic context. However theoretical difficulties arise from a Marxist frame of reference due to the lack of adequate micro-foundations and its inherent determinism. Recent attempts by the informalization school to resolve these difficulties (Meagher, 1995) have failed, as yet, to produce a convincing theoretical apparatus.

New institutional theory, based on transaction cost micro-analytic foundations, offers a frame within which to analyse the task environment faced by enterprises (§4.4.4). It provides the theoretical basis from which analyses at the micro and macro level can be linked. Analysis of the institutional context is able to show how, taking an economising perspective, the various factors already discussed as potentially relevant, impinge on the enterprise task environment. Enterprises, conceived as governance structures, can be instrumentally distinguished according to organisation forms such as micro-, middle- and large-scale. The theory provides a rich conceptual frame of reference within which to explore each of the three questions posed earlier regarding constraints to the development and survival of middle-scale enterprises (§4.2). Although clearly requiring considerable theoretical elaboration new institutional theory offers precisely the frame of reference sought here – within which the phenomena with which we are concerned can be conceptualised satisfactorily and which builds on existing work.

4.5 Conclusion

In this chapter an attempt was made to find an explanation for the current state of Kenya's middle-scale manufacturing: its general under-development and the pre-eminence of Asian enterprise. Three areas were identified for investigation: constraints to growth of micro-scale enterprise into the middle, constraints to direct entry and threats from the task environment to middle-scale survival.

The Kenyan literature was reviewed for evidence or theories regarding these issues. Although there is a substantial literature on smaller scale enterprise in Kenya, much is focused on the micro-scale rather than the middle. Furthermore there is relatively
little which deals directly with the ethnic dimension. In conclusion it was found that this existing literature, although offering some valuable clues, does not offer a convincing explanation of Kenya’s middle-scale.

Having failed to find an explanation for the specific phenomena, we then turned to the literature for a theoretical approach within which an explanation might be constructed. Reviewing some of the more influential theories which have been applied to questions of smaller-scale enterprise failed to uncover a wholly satisfactory framework. Orthodox economic theory proved inapplicable to the problem. Consideration of the dynamics of enterprise growth and evolutionary economics together with the enterprise context shows that the cost minimisation premise cannot be sustained. Arguments regarding innate capacities for enterprise inevitably raise the question of how such capacities are developed. This brings us back to the notion of context. New institutional theory offers a basic, broad frame within which to construct a theory. The task now is to build such a theory which explains how the exchange environment varies with both scale and ethnicity.
Notes


3 Or Peter Kilby’s (1971) ‘heffalump’


5 The reduction of culture to a small number of dimensions has become common in the organisational literature, notably in work following Geert Hofstede (1980, 1991). Hofstede’s approach has recently been applied to African enterprise by Dia (1991, 1996) and Tayki-Asiedu (1993). The difficulty of such positivist approaches to culture, as Case (1994, p.10) noted “resides in the mistaken logic of inquiry; a logic which implicitly or explicitly asserts a performatively workable and accurate definition of ‘culture’ is, in principle, attainable.”

6 See also Masai (1991)


9 Kitching (1985) noted the specific methodological difficulties inherent in the Kenya debate. Later many development theorists adhering to dependency theory in one form or another have acknowledged that the successful development of economies in East Asia represents a severe challenge to the theory. The collapse of communism in the former Soviet Union and Eastern Europe, together with the emergence of an increasingly pro-market ideology in the People’s Republic of China is not readily understood within the ‘grand’ Marxist theory of economic history and the necessary supplanting of the capitalist mode of production by the communist mode. (Although, as Little 1989, pp.21-2, observed the abandonment of Marxist grand theory does not undermine the value of historical materialism as a tool for the analysis of political economic development). Finally as Leys (1996, p.3-44) has noted the emergence of the global economy and the abandonment of the Bretton Woods system for regulating capital movements and international trade has undercut the raison d’être of development theory - the possible pursuit of independent national strategies for economic development. At the meta-theoretical level, Booth (1985, 1993) pointed to the “system-teleology or functionalism” (Booth, 1993, p.51) of Marxist theory which is subject to increasing attack by those concerned with understanding the “real-world problems of development policy and practice” (ibid.)

10 Cowen and MacWilliam (1996)

11 See for example, Himbara (1994a, 1994b, 1994c). Numerous examples have been reported in weekly news magazines published in Nairobi, such as The Economic Review and Finance (various issues). Evidence of corruption has been reported in successive reports of the Public Accounts Committee and reports of the Auditor-General.

12 Parastatals involved in a number of key agricultural and agro-processing sectors (such as cereals, coffee, tea, sugar and forestry) have statutory monopolies or monopsonies. Government investment in a number of sectors (such as sugar processing, vehicle assembly, oil refining, finance and textiles) has been substantial.

13 Tanzania pursued an explicit programme of radical socialism immediately following independence. This has only relatively recently been abandoned.
14 In the elementary formulation, the question of firm-scale is purposively ignored through the law of constant returns to scale for wider theoretical reasons (Hausman 1992, p.43).

15 This is illustrated by the graph below. Line a represents the production function for a small-scale technology, line b for a large-scale. For production quantities greater than the equilibrium point p (to the right), the unit costs are lower for the production function represented by line b than that represented by line b. For quantities lower than p (to the left) the unit costs are lower for the function represented by line a.

16 Pratten (1991), Fafchamps (1994, p.5)


19 In the strictly neo-classical world such regulation and union powers are held to be causally responsible for the market failure.


21 See for example Granovetter (1985), Hodgson (1988), North (1990)

22 Interestingly however Alchian and Demsetz have argued that there is no important distinction between the allocation of resources within the market and the firm. They claim that "to speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties." (Alchian and Demsetz, 1972, p. 777). The difference between the firm and market only arises from the importance of co-operation in teams amongst workers, with the firm representing an efficient structure to monitor individual contributions to a collective effort. Such an argument appears to disregard the fundamental origins of transactions costs in uncertainty. See also Hodgson (1988, pp.196-9)

23 For an extensive critique see Hodgson (1988)

24 Friedman (1953) put forward what has become the standard orthodox defence to this problem. It is argued that maximisation does not appear as a direct result of intentional maximising behaviour by agents but as the result of an evolutionary selection process which eliminates non-maximisers such that firms behave 'as if' they maximised. Winter (1964) showed that this argument is deeply flawed. See also Nelson and Winter (1982), Langlois (1986), Hodgson (1993a, 1993b).

25 Mills and Schumann (1985), following Stigler (1939)

26 The argument can be represented in terms of short-run cost curves (illustrated below). The capital intensive technology, indicated by short-run cost curve C1 offers the greater potential efficiency, at an output level of q. However outside output levels in the region defined by p, the less capital intensive technology, denoted by short-run cost curve C2 is more efficient. In the long-run, as suggested by the long-run cost curve LC, there are alternative production methods which would be more efficient than C2 at levels of output greater than r. However moving to such a technology will only be efficient in the long term if demand is maintained at the higher level. Where demand is fluctuating the firm with the cost-curve C2 is able to meet the fluctuating demand more efficiently than a firm with cost curve C1.
Caveats must be made here. It is entirely feasible that a capital intensive technology is flexible – most obviously that it can be rapidly re-deployed to produce alternative products. Labour intensive processes by contrast may not be so flexible. It may take a considerable time to locate and train skilled workers to become effective in the production process. Furthermore ethical employment practice, often backed up by state regulation, places strong restrictions on the ability to shrink a workforce rapidly and at low cost.

27 Dunne and Hughes (1990), Evans (1987)
29 Robert Solow found that for the period 1990-49, 87.5% of the increase in US output was attributable to 'technical change' and only 12.5% to the increased use of capital (Solow, 1957).
30 Baumol (1968, p.64). This elusiveness is demonstrated by a survey of the use of the term by Hébert and Link (1989) who were able to identify twelve different conceptualisations in economic history.
32 Referred to as parametric uncertainty by Langlois (1986).
33 As considerable discussion in the literature makes manifest, such posited psychological traits as the propensity to accept risk may themselves be socially conditioned.
34 A similar point is made by Leff (1979, p.48).
36 This follows the view of culture espoused by Clifford Geertz (1973).
37 Kilby (1971, p.6) makes the distinction between psychological theories, typified by those of Joseph Schumpeter (1934), David McClelland (1961), John Kunkel (1971), and sociological advanced by Max Weber (1930), Thomas Cochran (1971) and Frank Young (1971).
38 Such a stance continues to be criticised for leaving out the ‘special’ abilities of entrepreneurship. See for example Sethna (1992, p.5)
39 Specifically the elasticity of substitution between capital and labour must be less than unity. Acs (1996, p.xvi) points out that where the elasticity of substitution is greater than unity then Lucas’s model predicts the reverse – smaller firms scales will result.
40 The differences observed by Levy (1991) between the scale distributions of the Taiwanese and Korean footwear industries would be one such case.
41 See Stewart and Ghani (1991). Another way to put the concept is that “private costs or benefits do not equal social costs or benefits” (Schmitz, 1997, p.15).
Explaining the middle

42 In the industrialised context, see for example Piore and Sabel (1984), Goodman and Bamford (1989), and Pyke and Sengenberger (1992) and in the developing economy context Nadvi and Schmitz (1994), and Pedersen et al (1994).

43 Hudson and Sadler (1987) quoted in Lazerson (1990, p.4)

44 See for example, Sato (1983), Piore and Sabel (1984, pp.223-5), Kuriyama (1990)

45 Williamson has developed the theory over three key works, Markets and Hierarchies, (1975), The Economic Institutions of Capitalism (1985) and The Mechanisms of Governance (1996). In the earlier work, his analysis was confined to the notion of just two discrete modes of governance – markets and hierarchy (the firm). This has been strongly criticised for its reductionism (for example, Lazerson, 1990; Johanson and Mattson, 1987; Powell, 1990). Later work has given increasing significance to the notion of the hybrid form of governance structure which stands between market and hierarchy (see especially Williamson 1996, pp. 89-92). The discussion here focuses on Williamson's later position and its continuing criticism (for example, Bradach and Eccles, 1989).


47 Williamson (1985, pp.131-162). The economic significance of the loss of incentive within the firm has been discussed at length by Harvey Leibenstein (1989), introducing the concept of X-efficiency to describe the reduction in efficiency.

48 Such criticisms have been made by Granovetter (1985)

49 Interestingly it is the breadth of the new institutional framework which has resulted in its criticism by some scholars as essentially lacking in content (Toye 1995, Leys 1996, pp.80-103). It is argued here that such criticism ignores the conceptual value of the new institutionalist programme.

50 However given that the Asian community in Kenya was subject to a similar (though not identical) level of discrimination under the colonial regime as the African, (Ghai, 1953; Gregory, 1993; Manji, 1995) a more complex argument is clearly required.
5. EXPLORING INSTITUTIONAL ECONOMICS:  
The search for theoretical foundations

5.1 Introduction

In this chapter an institutional framework is elaborated as the basis for a concept frame within which to explore Kenya's missing middle in the next. The search for an explanation of Kenya's middle-scale in the last chapter revealed not simply the lack of a convincing account of Kenya's particular situation but also a gap in theory. A theoretical framework is needed which is able to explain why middle-scale enterprise may face constraints in Kenya, and why such constraints could vary with the ethnicity of entrepreneurs. New institutional economics was found to offer a broad basis within which the context for enterprise could be described. However much theoretical work remains before an institutional theory of Kenya's middle can be put forward. Institutional economics is itself in a state of considerable flux. There have been signs of convergence between strands of the new institutional theory and a re-emerging school based on the old. Much interest has arisen in other disciplines, notably economic sociology, organisation and economic anthropology. However many controversies remain unsettled. The concepts and principles to be adopted here must therefore be made explicit, including the core ideas such as institutions and culture. This is the task here by way of a prolegomenon for the next chapter and the detailed argument relating to Kenya and the research question.

The institutional approach starts with the analysis of exchange (§5.2). Two fundamental inter-linked problems arise – co-ordination and co-operation. Understanding how these problems arise and vary in exchange lays the foundations for considering the way in which context is instrumentally significant.

In the next section we move to the central question of how exchange is structured (§5.3). The crucial concept of the institution is discussed. This leads to an inquiry into the underlying structure of social and economic behaviour and the role of habits, routines and culture. In order to address the issue of ethnic differences which lies at the heart of the research question, a framework is needed which takes account of social and cultural features. Returning to the instrumental structure relevant to
economic transactions we then consider governance mechanisms, organisations and relations. The part played by trust in facilitating exchange and its relation to the notion of calculativeness precedes a discussion of the balance between rationality and structure in exchange. A crucial question is the extent to which an economising logic can be applied to institutional arguments.

In the final section the dynamics of institutional change is considered (§5.4). This is fundamental to the question of explaining what possible structures can and do arise. It is necessary to take a stance in relation to the somewhat divergent approaches in the literature. These centre around the extent to which it can be assumed that competition will necessarily result in the development of more efficient institutional structures. The question of the efficiency and coherence of the institutional structure in Kenya with middle-scale enterprise will be a central question to be addressed in the next chapter.

5.2 Fundamental problems of exchange

At the heart of exchange are two inter-linked problems — co-ordination and co-operation. In a given economy numerous potential exchanges are feasible. Whether a transaction actually occurs depends on finding a solution to the problems of co-ordination and co-operation entailed by the particular circumstances of the exchange.

5.2.1 Co-ordination

The need for at least the most elementary degree of co-ordination between participants in an exchange is scarcely controversial. A transaction can only occur if a buyer and seller can be brought together. According to the orthodox neo-classical model, co-ordination can be achieved through the invisible hand of the market. Underpinning co-ordination is information. In the neo-classical picture, price effortlessly conveys all the information that is required for exchange. The core insight of both transactions cost economics and information economics is that only in the limiting case will price convey all the information.

Douglass North posits that the "the value of an exchange to the parties ... is the value of the different attributes lumped into the good or service" (1990, p.29). In
order for an exchange to occur information needs to be conveyed from seller to buyer regarding the attributes of the good or service on offer. In the limiting case of homogeneous commodities, the attributes are well known and the information problem is simply one of co-ordinating those possessing the commodity with those wishing to buy. However as North observes, for even a simple commodity such as an orange, utility generally derives from such attributes as flavour, vitamin C, juice content and so forth. The assumption of homogeneity breaks down. A buyer needs to know something about the particular oranges on sale. Where the transaction is more complex, for example in the hiring of labour, a serious information question arises. The attributes sought will be various skills, aptitudes and working characteristics of employees.

5.2.2 Co-operation

The problem of co-operation arises from the same fundamental difficulty of incomplete information which underpins co-ordination. However it relates to specifically behavioural attributes of agents. Although an exchange might offer clear benefits to both participants in the exchange, the availability of such benefits depends on the behaviour of the other party. The difficulty arises in that unconstrained behaviour is generally unpredictable and influenced at least to some degree by self-interest. Oliver Williamson characterises human behaviour as opportunistic, meaning “self-interest seeking with guile” (1985, p.47). It is important to note however that the argument does not rest on a wholly pejorative view of human motivation. The possibility of altruism is certainly not denied. As Williamson points out “I do not insist that every individual is continuously or even largely given to opportunism. To the contrary, I merely assume that some individuals are opportunistic some of the time and that differential trustworthiness is rarely transparent ex ante” (1985, p.64). The key point here is the unpredictability of human

Table 5-1: Prisoners’ dilemma payoffs

<table>
<thead>
<tr>
<th>A’s decision</th>
<th>Confess</th>
<th>Don’t confess</th>
</tr>
</thead>
<tbody>
<tr>
<td>A: 10 years</td>
<td>A: 0 years</td>
<td></td>
</tr>
<tr>
<td>B: 10 years</td>
<td>B: 15 years</td>
<td></td>
</tr>
<tr>
<td>A + B: 20 years</td>
<td>A + B: 15 years</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B’s decision</th>
<th>Confess</th>
<th>Don’t confess</th>
</tr>
</thead>
<tbody>
<tr>
<td>A: 15 years</td>
<td>A: 2 years</td>
<td></td>
</tr>
<tr>
<td>B: 0 years</td>
<td>B: 2 years</td>
<td></td>
</tr>
<tr>
<td>A + B: 15 years</td>
<td>A + B: 4 years</td>
<td></td>
</tr>
</tbody>
</table>
Game theory can be used to illustrate the problem, using the often cited prisoner's dilemma. Two prisoners stand accused of a crime and are interrogated individually. Each is offered the same deal by the prosecutor. If the prisoner confesses, implicating the other, the confessor will receive a pardon, whilst the other will receive a very heavy sentence. However if the other prisoner also confesses, both will receive moderately heavy sentences. In the situation where both refuse to co-operate, the evidence will be sufficiently thin that both will receive relatively minor sentences. These payoffs are summarised in table 5-1. The problem of co-operation is clear. The optimal strategy is for both to refuse to confess. Both would receive relatively light sentences and the combined outcome, taking into account the utilities of both prisoners, is optimal – only 4 years would be served in the example. It would also be an equitable arrangement. However co-operation is essential – both must refuse to confess, in the knowledge that the other will similarly refuse. A unilateral refusal by one prisoner could risk a very adverse outcome for that prisoner if the other confessed. Based on the uncertainty of the other's behaviour and the pervasive possibility of self-interest, both will confess. The combined outcome is the worst for the two taken together, but avoids the risk of the worst *individual* outcome if one confessed and the other did not.

### 5.2.3 Dimensions of the problem

Although problems of co-ordination and to a lesser degree co-operation can be regarded as universal in exchange, it is also clear that different transactions will present varying levels of difficulty. As we noted in the last chapter (4.4.4), Williamson (1985, 1996) proposes that transactions can be distinguished according to three dimensions: asset specificity, uncertainty and frequency. We now consider these in more detail.

Asset specificity is defined as a “specialized investment that cannot be redeployed to alternative uses or by alternative users except as a loss of productive value. Asset specificity can take several forms, of which human, physical, site and dedicated assets are the most common. Specific assets give rise to bilateral dependency, which complicates contractual relations.” (1996, p.377). In asserting that asset specificity complicates contractual relations, Williamson is referring to the
problem of co-operation which inevitably arise under conditions of bilateral dependency. The greater the degree of asset specificity the more significant it becomes that co-operation is achieved in exchange.

Uncertainty arises fundamentally from the impossibility of producing accurate predictions of the future. Although all transactions are subject to some uncertainty – the future is never foreclosed – it is again possible to distinguish degrees of uncertainty. The risk that an orange is found to contain less juice than expected is considerably less than the risk that a highly skilled employee recruited to a work team does not have the personal attributes to work effectively with other members of the team. According to Williamson, uncertainty in exchange is strongly linked to human agency. The actions of other agents are never completely predictable and always carry the risk of opportunism.

The question of the frequency with which a particular type of transaction occurs arises in relation to understanding the viability of various ways in which problems of co-operation and co-ordination can be tackled, which is a major theme of this chapter. Where a transaction is unique or infrequent, costly mechanisms for ensuring precise co-operation are unlikely to be justified. Little effort is expended in monitoring the performance of temporary staff in an organisation. By contrast, long term employees will be subject to much closer scrutiny and care, albeit of very different types according to the nature of the job.

5.3 Structure and exchange

Having sketched the basis of the problems arising in exchange, we now consider how structure mitigates these problems. Exchange does not occur in vacuo; rather it occurs within economic, social and political structures. Structure stretches from simple dyadic relationships through organisational structures such as the firm, local networks and communities to the level of nation states and beyond. This structure profoundly affects the problems of exchange. Under favourable circumstances, actively or passively, co-ordination and co-operation is facilitated by structure enabling exchange to occur. According to transaction cost economics, the characteristics of exchange in particular circumstances should be measured in terms
of cost – the transaction cost. This implies the reduction of uncertainty in exchange to a cost. Now whilst this is justified in the case of a quantifiable risk, it is argued that in the circumstances of true uncertainty, such a reduction cannot occur. This is a key point which rests on the important distinction between risk and uncertainty, famously made by Frank Knight (1921). As Geoffrey Hodgson observes, uncertainty occurs where there is a “lack of information about the fundamental nature of the problem and the type of outcomes that are possible” (1988, p.204). Risk meanwhile concerns situations where the basic parameters of the problem are known and probabilities can therefore be assigned to each of the possible outcomes. It is possible therefore to reduce risk to a cost by weighting the various outcomes probabilistically. The same is not true of uncertainty, which must be regarded as a second irreducible dimension for characterising transactional outcomes.

In surveying the various types of structure relevant to exchange, we start with the central concept of institutional theory, the institution. We then turn to consider what structures underpin institutions and examine the closely linked subjects of habits, routines and culture. Moving from institutions in the opposite direction brings us to the more or less purposeful ways in which transactions are organised by agents in formal or informal structures, notable among these being the firm. Consideration of the relevance of social structure leads to the role of trust. We conclude by tackling the formidable question of how, in theory, agents use structure in exchange.

5.3.1 Institutions

Institutions, according to North’s (1990) definition noted earlier, are the rules, formal and informal, which structure human interaction. Both problems of co-ordination and co-operation can be mitigated by the structuring of action. Formal institutions cover a wide range from the political rules through economic to specific contracts. A hierarchy can be identified. Those at the highest level such as the political rules of a constitution provide the framework within which those at a lower level are constructed. Contracts are constructed within the terms of statute law which in term are ultimately dependent on constitutional arrangements. Scope varies widely from the rules imposed across a state through to those which apply to a single exchange situation.
Informal institutions include customs, traditions, norms, taboos, conventions and routines. There is no clear boundary between formal and informal institutions. North refers to the difference as "one of degree"; there is a "continuum from taboos, customs, and traditions at one end to written constitutions at the other." (1990, p.46). Formality is strongly associated with, though not defined by, representation in a written form and the explicit implementation or enforcement of rules. In pre-literate, pre-industrial societies all institutions are informal. However the formalisation of institutions does not lead to the elimination of the informal. To a very significant extent the interpretation and application of formal rules depends on a web of informal institutions. No formal rule can fully specify the circumstances to which it applies. This appeal to informality is sometimes explicit. Reference within English law, for example, to the judgement of a "reasonable person" reflects the impossibility of prescribing for all possible, relevant situations. The structuring of action implied by the formalisation of law is therefore explicitly embedded in the wider informal institutional context.

Fundamentally in relation to exchange, institutional structure improves information flow between agents, increasing predictability. This has implications for both co-ordination and co-operation. Simple examples are readily found. The use of standard weights and measures vastly simplifies the problem of measuring the characteristics of many goods. Many such standards are highly formalised – the definition of a kilogram is subject to international agreement. Others are rather more informal – produce sellers in Africa have been observed to rely on simple, arbitrary but common means for measuring produce without the use of relatively expensive weighing-scales. Within particular industry sectors large numbers of specific rules, some formal, some informal, arise which vastly enhance communication and hence co-ordination between participants in the sector. Often complex sets of standards in engineering industries permit components or sub-systems produced by different manufacturers to be easily brought together to function within a single system. Again some standards can arise informally. A particular producer’s standard is adopted by others and eventually forms the de facto industry standard. Alternatively standards may be developed formally by state-run or international standards organisations.
The impact of institutions on co-operation is considered by North (1989, 1990) largely in terms of (bounded) rational choice. Achieving co-operation in exchange is broken down functionally in terms of problems of measurement, monitoring and enforcement. Measurement relates not simply to the determination of the attributes which are to be exchanged, but also the definition of the property rights to be exchanged. North defines property rights as “the rights individuals appropriate over their own labor and the goods and services they possess” (1990, p.3). Institutions underpin the establishment and transferability of property rights. Again property rights are dependent on both formal and informal institutions.

Monitoring and enforcement are an essential part of the exchange process where opportunistic behaviour may obtain. The efficacy of institutional rules depends on their enforceability. The third party agency of the state underpins the effectiveness of many formal solutions to exchange problems. Compliance with the terms of a contract can be imposed by reference to courts. Frequently it is the simple availability of the mechanism to enforce an agreement which ensures co-operation. Compliance is the consequence of the credible threat of enforcement. This is of some significance since the (transaction) costs associated with actually taking court action in order to enforce the terms of a contract might well exceed the potential gains from an exchange.

The emphasis on enforcement derives from the rational choice perspective which characterises North’s position. Institutional rules are followed because it is in the interests of rational actors to do so. Enforcement is thus crucial in modifying the choice set faced by actors. Non co-operative outcomes are rendered unattractive to a rational agent by the enforcement of an institution. Suppose in the case of the prisoners’ dilemma, both prisoners belong to a society in which there is a very strong taboo against collaboration with the authorities and that the taboo is likely to be enforced murderously by the family of the aggrieved prisoner. In this case the dilemma dissolves – both prisoners can be rationally expected to effectively co-operate with one another and refuse to confess, thus producing the optimal outcome. The credibility of the threat is crucial to the efficacy of the institutional rule here which ensures the co-operative outcome. Equally however as Williamson emphasises credible commitments can also be used to support exchange. In this case
a "promisee is reliably compensated should the promisor prematurely terminate or otherwise alter ... [an] agreement" (1996, p.377)

It is important to observe that adherence to some social norms and values may be no different from any other institution: the pay-off is positive and there is effective social enforcement. There are probably few societies in which there is not some sense of a general taboo against dishonesty and breaking agreements; but the effectiveness of such a taboo is known to be highly variable. This can be understood to a degree by the extent to which it will be enforced. Such enforcement may be only dissimilar from formal arrangements of courts and states by the degree of informality. In pre-literate societies complex, informal arrangements for arbitration and enforcement in cases of dispute are well documented.\(^6\)

Alternatively, breaking agreements may result in a loss of reputation across a social group, leading to a refusal by group members to deal with an offender in the future. Any gain from opportunism on a single occasion is outweighed by the loss of combined gains from future exchange. Granovetter (1995) observes that within immigrant ethnic Chinese communities in Southeast Asia deviance from norms of behaviour amongst traders are swiftly detected. Malefactors are punished by exclusion from future participation in the co-operative networks. This penalty could be especially high since alternative economic opportunities for an immigrant may be scarce. The norm here is still enforced and conformance is predictable from the basis of individual rational choice to conform. What is interesting in this situation is that enforcement does not depend on a third party. Simplistically the situation can be regarded as equivalent to an indefinitely repeated prisoners' dilemma game. Robert Axelrod (1984) showed that the optimal strategy in a repeated prisoners' dilemma is to initially co-operate but immediately retaliate to any opportunism — 'tit-for-tat'. The transition from a simple collection of one-shot games (in which non-cooperative outcomes are assured) to a sequence of repeated games, depends on the transmission of the results of each 'game' to all other 'players'. Information flows are therefore critical here.

The impact of non-economic, social goals such as sociability, approval, status and power, must also be considered (Granovetter 1992a, p.4). Orthodox economists
have never denied the existence of such goals, merely the relevance to economic decision making. However the above analysis strongly suggests that a link is often present. Loss of business reputation may be accompanied by loss of social standing; the latter being potentially as important, or even more so, to an individual as the consequent loss of income. There is nothing incompatible here with a rational choice perspective. What is interesting is how the potential (and known) threat to a social goal from non co-operative behaviour can be relied on to ensure cooperation.  

Despite an emphasis on rational choice, North acknowledges that much observed behaviour is simply not explicable in utility-maximising. A “very large residual” of human behaviour is explicable only by the apparent internalisation of ideology or social norms and values. Examples of action which appear to be conclusively irrational from the perspective of the individual agent are not difficult to find. Involvement in any dangerous war situation seem rarely comprehensible in terms of individual rational choice. More prosaic examples include the oft-quoted example of the leaving of a discretionary tip in a restaurant to which the diner does not expect to return. Structural sociology, based on the tradition established by Talcott Parsons, shifts the focus of analysis from the individual to the social group, stressing the role of social norms and values. However Mark Granovetter (1985) raises the danger here of swinging from the “under-socialised” position of orthodox economic theory to an “over-socialised” one: “Actors do not behave or decide as atoms outside a social context nor do they adhere slavishly to a script written for them by the particular intersection of social categories that they happen to occupy.” (p.487). The difficulty raised is that both methodological individualism and social determinism are strongly imperialistic; assertion of one appears to deny the possibility of the other. The paradox is that whilst both are persuasive in given contexts neither can convincingly displace the other. Following Anthony Giddens (1984), the putative antinomy of action and structure needs to be replaced by a duality.

5.3.2 Habits, routines and culture

Geoffrey Hodgson suggests a resolution to these problems deriving from the original institutional economics of Thorstein Veblen and John Commons. At the
heart of the original or 'old' institutionalism is the concept of habit: "Habits can be defined as a largely non-deliberative and self-actuating propensity to engage in a previously adopted pattern of behaviour." (Hodgson 1998, p.178). Action is therefore significantly shaped by the habits of the individual. The shaping of action at this stage is at the level of the individual. Rather than representing an inescapable script, habits actually underpin extensive rationality. Functionally, it is argued that the capacity to interpret, generally complex or uncertain, circumstances as the basis for decision making depends on the ability to use decision making rules. The processing capacity of the human mind, as emphasised by Herbert Simon, is intrinsically limited. Habits represent unconscious elemental decision making rules which economise on scarce cognitive capacity. The notion of tacit skills — non-codifiable procedures — and the learning of such skills can be understood in terms of habits and their acquisition.

The connection between habit and institution is neatly summed up in the definition of institution put forward by Walton Hamilton "a way of thought of some prevalence and permanence, which is embedded in the habits of a group or the customs of a people" (quoted in Hodgson 1998, p.179). Institutions are thus embodied in the particular habits of individuals within a social group, but are crucially held in common across that group. It is the notion of habits which enables the reconciliation of structure and action: "The imitation and emulation of behaviour leads to the spread of habits, and to the emergence or reinforcement of institutions" (1998, p.180). Individual agency and the performance of socially embedded actions produces and reproduces structure. However such agency is itself conditioned and produced by the institutional structure in which it occurs. There is a close connection here with Gidden's theory of structuration: "the rules and resources drawn upon in the production and reproduction of social action are at the same time the means of system reproduction (the duality of structure)" (1984, p.19).

Hodgson regards institutions as encompassing all significant structuring of human interaction. Conceived in this way, exchange is dependent on institutional structure at the most fundamental level. Institutions represent the basic conceptual apparatus which underpins communication or any form of social action, involving "the creation and promulgation of conceptual schemata and learned signs and meanings."
Institutions are seen as a crucial part of the cognitive processes through which sense-data are perceived and made meaningful by agents. Indeed ... rationality itself is regarded as reliant upon institutional props.” (1998, p.180). According to Hodgson, language itself is therefore a “social institution par excellence” (1997, p.677).

This view of institutions is in contrast with that of the new institutionalists who emphasise the extent to which institutions shape rational or intendedly rational behaviour. However it is important to note that North, representing one of the most influential writers in the “new” school,¹ accords to the concept of culture a very similar role to that attributed by Hodgson to institutions manifested in habits: “Culture provides a language-based conceptual framework for encoding and interpreting the information that the senses are presenting to the brain.” (North 1990, p.37). Conceived in this way, culture is seen to underpin the production and reproduction of informal institutions.

As with the classification of formal and informal institutions, a distinction between the culture and institutions of a social group cannot be easily drawn. However it is suggested that it remains useful to distinguish the terms for analytical purposes. Culture (and language) form the socially constructed backdrop to all social action, whereas institutions involve the rules, sometimes explicitly, otherwise implicitly, which form the basis on which exchange is constructed. Clifford Geertz’s understanding of the concept of culture is useful here: “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.” (1973, p.14). The crucial point made by Geertz in advancing this semiotic view is that culture cannot be codified as atomistic rules internalised by individuals within a particular cultural system. Rather it comprises “webs of significance”, inseparable from the actors and significantly, “it is through the flow of social action that cultural forms find articulation”.¹⁰

Culture is clearly a crucial element of social structure with respect to problems of exchange. The basis of co-ordination is in communication, whether language based or otherwise. This is most obvious in relation to trading across language barriers – for all but the simplest transactions some translation is necessary. More subtle is the
extent to which groups in particular industry sectors or organisations develop specialised languages which facilitate closer co-ordination between agents. As noted earlier co-operation is itself underpinned by co-ordination. However it has also been argued that co-operation itself may be deeply embedded within culture.

The relationship between culture and co-operation is strongly illustrated in the concept of a "moral economy" imputed by James Scott (1976) to a number of peasant cultures in Southeast Asia. Scott argues that patterns of co-operative behaviour observed in the societies studied derived from two key moral principles: the norm of reciprocity and the right to subsistence. The crucial point in the argument is that the way in which actors perceive exchange is shaped by this common perspective. Material co-operation or non-co-operation is not the result of a simple utilitarian calculus in which the utility of following some moral precept is balanced against a potential gain from opportunism. Culture precedes such a calculus. However this does not entail that culture is immutable and entirely insulated from the material circumstances of social arrangements. It is precisely where culture, material circumstances and power lose coherence that pressure arises for change in one element or another. Thus Robert Bates (1989) argues that the moral economy of Kikuyu peasants in pre-independence Kenya itself largely disintegrated with the transformation of material circumstances brought about by economic opportunities created by the colonial economy. Further consideration of change in institutional and cultural structure will be deferred while we now turn to the remaining major way in which exchange is structured.

5.3.3 Governance, organisation and relations

Much structure which is relevant to the organisation of transactions occurs at a highly localised level, in the form of specific relationships and organisations such as the firm. The meso-level structures introduced earlier (§4.4.4) – industrial clusters and sub-contracting networks – are also highly germane here. Lance Davis and Douglass North distinguish the institutional environment from the institutional arrangement: "The institutional environment is the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution. .... An institutional arrangement is an arrangement between economic
units that governs the ways in which the unit can co-operate and/or compete." (1971, p.5). Williamson (1996) refers to this latter as the governance structure, identifying three generic modes of governance in capitalism – market, hybrid and hierarchy (corresponding to the firm). He argues that the analysis of governance arrangements is vital to the understanding of how exchange actually takes place. An excessive preoccupation with court ordering (associated with the formal institutions) can ignore the significance of private ordering put in place by the parties to a particular transaction. Similarly for the case of de jure versus de facto legal rights: “The conceptual hazard in both cases is to assign too much weight to the formal features (court ordering and de jure legal rights) at the expense of the unremarked and more subtle real features (private ordering and de facto economic rights)” (Williamson 1996, pp.333-4).

It should be noted that Williamson’s conception of governance structure is effectively continuous with the broader structure referred to by institutions (Khalil, 1995). This appears inconsistent with North’s later sharp distinction between institutions and organisations:

> Like institutions, organizations provide a structure to human interaction. Indeed when we examine the costs that arise as a consequence of the institutional framework we see that they are a result not only of that framework, but also of the organizations that have developed as a consequence of that framework. Conceptually, what must be clearly differentiated are the rules from the players. The purpose of the rules is to define the way the game is played. But the objective of the team within that set of rules is to win the game – by a combination of skills, strategy, and co-ordination; by fair means and sometimes by foul means. Modeling the strategies and skills of the team as it develops is a separate process from modeling the creation, evolution and consequences of the rules. (1990, p.4).

The difficulty here is that organisations, such as the firm, can be regarded as both structures for organising transactions and unitary economic actors. Neither view is logically excludable; it is a question of analytical focus. Williamson is concerned with questions such as why transactions might be organised through the firm rather than the market. North meanwhile regards organisations as actors: “purposive entities designed by their creators to maximise wealth, income, or other objectives defined by the opportunities afforded by the institutional structure of society” (1990, p.73).
Williamson (1996) dimensionalises governance structures according to the instruments through which transactions are organised in each structure. These instruments are incentive intensity and administrative controls. According to Williamson adaptation is the central problem of economic organisation. There are, however, two distinct types of adaptation: autonomous (mainly concerned with simple co-ordination) and co-operative. The key performance attributes of the three modes of governance identified by Williamson are therefore in terms of adaptability. These are summarised in table 5-2 below.

Markets, representing one pole of a spectrum of possible governance structures, are characterised by strong incentives associated with the price signalling mechanism: "[Each party] appropriating ... individual streams of net receipts, ... has a strong incentive to reduce costs and adapt efficiently. ...[H]igh-powered incentives result when consequences are strongly linked to actions in this way" (1996, p.103). Within an unfettered market there are clearly no administrative controls. The consequence is that this form of governance structure is strong in relation to solving simple problems of co-ordination in exchange autonomously. However such incentives are antithetical to co-operation as illustrated by the prisoners' dilemma problem.

By contrast the hierarchy of the firm, representing the opposite pole, has strong administrative controls. The presence of such controls enables problems of co-

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<th>Table 5-2 : Distinguishing attributes of market, hybrid and hierarchy governance structures</th>
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++ = strong, + = semi-strong, 0 = weak

operation to be solved more readily. If both prisoners in the prisoners’ dilemma were subject to administrative control, the optimal outcome (both refusing to confess) could be assured by simple direction. However according to Williamson the presence of strong controls necessarily diminishes the incentives which work powerfully in the market to co-ordinate agents.

The hybrid form sits between the two poles and represents in all senses an intermediate position. The instruments of the hybrid form are semi-strong in terms of both incentives and administrative controls. As a consequence, the performance attributes are semi-strong with respect to both types of adaptation. Examples of the hybrid notably include long-term sub-contracting relationships.

Granovetter (1985) criticises Williamson's conception of organisational structure as abstracting too far from the specific socially embedded circumstances of agents. The efficacy of administrative control is held to be vastly overestimated. Rather, it is urged that the real structure of an organisation is strongly dependent on the specific relations between actors within that organisation. Similarly the nature of the relationships between firms (and agents representing firms) operating in a market are also argued to be critical to understanding how exchange actually occurs between firms. In Kenya, the connections between Asian enterprise, whether middle- or large-scale are widely believed to transcend a simple business relationship and include a socio-cultural component. Many other commentators have similarly criticised the apparent reductionism implied by Williamson's market-hierarchy continuum. Much of this criticism has focussed on the construction of an intermediate 'hybrid' form on this putative continuum. Emphasising the general economic significance of organisational forms which are "neither market nor hierarchy" (Powell 1990), it is contended that such forms are not fully captured by Williamson's two dimensional picture of governance structures. Intermediate forms suggested include networks, joint ventures, franchises, corporate clans and cross ownership structures. Granovetter's critique has the greatest theoretical generality and can be interpreted as a call for greater attention to be paid to the social instruments of organisation which give rise to informal governance structures. As with institutions, the final structural context for exchange is found in a combination of both the formal and informal.
Exploring institutional economics

It is ironic that despite Williamson’s call to pay more attention to *de facto* (rather than *de jure*) structures which govern exchange, one of the major difficulties presented by his conception is the focus on *formal* structures of governance. Administrative control essentially refers to a form of long-term contracting facilitated by a given institutional environment.\(^12\) Williamson’s understanding of the employment relation is strongly influenced by Chester Barnard; essentially it is regarded as involving an implicit or explicit agreement to “accede to authority within a ‘zone of acceptance’.” (Williamson 1996, p.33). The specific agreement defines the zone, the scope of which must be balanced against appropriate inducements. Interestingly Barnard (and Williamson) recognise that “formal and informal organization always and everywhere coexist and that informal organization contributes to the viability of formal organization.” (p.34).

One difficulty in attempting to produce a richer descriptive framework for governance, which takes into account the informal and social dimensions, is that the mechanisms available are a function of the institutional environment. This point has been highlighted by Gary Hamilton and Nicole Biggart (1988) in relation to the problem of applying transaction cost economics (based largely on the institutional framework found in the United States) to East Asian economies. Williamson concedes the point: “the institutional environment matters and … transaction cost economics, in its preoccupation with governance, has been neglectful of that.” (1996, p.230).

In relation to non-market governance structures, Williamson’s broader focus is on how alternative structures can solve problems of co-operation within a rational choice (or “calculative”) perspective. An important facet of the theory is that it does not deny the significance of social institutions or other structures in constructing solutions to such problems. Social or business reputations, both between and within firms, can be used as a mechanism for supporting co-operation in exchange. In the example of the ethnic business community, the availability of social sanctions are held to be a function of the community’s institutional structure. The threat of social ostracism in the small Asian communities in Kenya is reported informally as a counter to avoiding the payment of debts.\(^13\) These offer “contextual features with respect to which transaction-specific governance is crafted”. A taxonomy of six

Granovetter (1985, 1992a, 1992b) urges that analysis of the structuring of exchange must encompass the specific relations in which agents are embedded. Information about exchange partners, actual or potential, is the basis from which the problems of co-ordination and co-operation can start to be solved. Relationships involve the conscious and unconscious acquisition of knowledge about the other party: "our information about ... partners is cheap, richly detailed, and probably accurate." (1992a, p.42). Specific, idiosyncratic structuring of exchange between agents helps explain the strong variation in the nature of exchange observed where formal governance structures are identical.

Examples can be readily found to illustrate the point. The notion of employment covers a very wide range of effective structuring of exchange. At the formal level, wide variations in contractual terms are common. However the informal variation is often far more significant – the degree of real co-operation is determined by the nature of the relation between employer and employee. This is strongly illustrated by the disruptive effective of workers 'working-to-rule' in disputes with employers.

5.3.4 Trust and calculativeness

Trust is frequently regarded as at the root of co-operation and has been the subject of much discussion in relation to exchange. A prisoners' dilemma could readily be solved if both prisoners were able to trust the other not to confess. Jeffrey Bradach and Robert Eccles (1989) propose that the mechanisms of governance, authority and price, should be supplemented with that of trust. Williamson (1993) however vigorously opposes this argument, claiming that the concept of trust in virtually all economic situation can be dissolved in terms of 'calculativeness' or rational choice. That members of an ethnic business community are able to trade on the basis of verbal contracts is not a case of blind, unreflecting trust in one another, but rather rational expectation. The confidence that business partners will generally not default on deals is frequently underpinned by known social sanctions which would apply in such cases. According to Williamson, conceptual clarity and theoretical economy
demand, that the notion of trust should be expunged from the analysis of economic exchange.\textsuperscript{14}

Many significant exchange problems represent the indefinitely repeated prisoners' dilemma games introduced earlier (§5.3.2), for which guarded individual co-operation is the optimal strategy. Williamson shows how many cases apparently dependent on trust can be readily re-interpreted in terms of rational calculation. That this should be so is not surprising given the interpretation of trust by a number of theorists. Diego Gambetta suggests that "when we say we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of co-operation with him." (1988, p.217).\textsuperscript{15} As Richard Craswell (1993) observes, the idea of calculativeness seems to be embedded within this formulation.

John Humphrey and Hubert Schmitz (1996) highlight the extent to which trust arises as a generalisation about the likely future behaviour of agents based on past performance. This seems consistent with a straight-forward notion of individual rationality. Most rational predictions about the future are founded, at some point, on induction.\textsuperscript{16} The prediction by a scientist that a particle will follow a particular trajectory through space-time would not appear to represent a case of the scientist 'trusting' the particle to display this behaviour. Rather the prediction is derived from a conceptual picture of what causes particle motion, which though distilled into a highly abstract theoretical form, is ultimately based on a series of inductive generalisations. The behaviour of human agents may similarly be regarded as predictable to some extent. A weak analogy can be drawn between informal institutions as laws governing human behaviour and say, quantum mechanics as laws governing particle behaviour. In attempting to start trade with an unfamiliar society, a cautious trader will make efforts to understand the institutional structure of that society.\textsuperscript{17}

The analogy with particle physics is obviously weak insofar as human agents are regarded as highly individual in behaviour (and ultimately possessed of free-will). Predictability is thus enhanced by attempting to learn about the behavioural traits of
specific agents. Both relations and habits are relevant here. The structuring of an agent's behaviour in habit and routine underpins predictability. A long-term relation enables the gathering of information about such habits. Finally once a pattern of co-operative behaviour is established it may be internalised by actors to form the basis of regular behaviour. Hodgson summaries the argument usefully:

[A]pparent acts of trust are not only a blending of knowledge and ignorance, but also of thought processes at different levels of consciousness, of both conscious deliberation and unconscious habit and routine. We learn from experience in what sort of situation we can normally place our trust, and by becoming familiar with them we begin to act habitually once trust is established. (1988, p.166)

The derivation of trust from predictive rationality is consistent with the strategy taken by confidence tricksters. The essence of the confidence trick is to mimic behaviour which strongly suggests to the victim that the fraudster adheres to relevant institutional rules and norms.

It is perhaps the notion of free-will which gives rise to the essential idea of trust. Although prediction of future co-operation may rely on conformance with norms of behaviour much social rule following can never be wholly assured. Trust reflects the subjective assessment of an agent that another will follow such rules, but with the caveat that as a free agent she could choose to do otherwise. In the case of dyadic relations, Granovetter argues that a strongly normative element is generated to the question of co-operation simply on the basis of familiarity:

Economic relations become overlaid with social content... I may deal fairly with you not only because it is in my interest, or because I have assimilated your interest to my own (the approach of interdependent utility functions), but because we have been close for so long that we expect this of one another, and I would be mortified and distressed to have cheated you even if you did not find out (though all the more so if you did).” (1992a, p.42, emphasis in original)

Although the action of determining whether a partner is 'trustworthy' as a basis for engaging in exchange can often be shown to be consistent with calculative rationality, such an analysis does not, of itself, necessarily explain economic action. It is important to note, pace Craswell (1993), that the argument that agents behave 'as if' they were calculative depends on an evolutionary selection argument which simply
cannot be sustained. Unless behaviour can be shown to be guided by a mechanism other than embedded agency there is no justification for simply assuming an effective calculative position. Ultimately the extent to which economic actions are non-calculative is illustrated very plainly by the success of confidence tricks mentioned earlier and other common cases of misplaced co-operation.

It needs to be emphasised however that conformance with norms which produce trust cannot be taken as a given. The impact of frauds and other abuses of unenforced normative rules is to undermine the efficacy of such rules. Institutions are subject to change. The supposition that adverse outcomes will be consistently ignored by those with a capacity to act risks a swing towards an "over-socialised" form of explanation. Similarly the claim that a society is characterised by a collectively greater propensity to trust (in this sense) can only be regarded as an intermediate step in understanding that society. Determining why there should be such a greater propensity constitutes the greater part of the explanatory task.

5.3.5 The structuring of exchange

The concepts discussed relate the way in which a transaction is structured to outcomes. From an economic perspective outcomes could be dimensionalised in terms of cost and residual uncertainty. The question now is how such outcomes relate to the way in which exchange is enacted. Williamson's approach, as outlined earlier, is to appeal to a simple economising perspective, consistent with an orthodox equilibrium approach. Presumed far-sighted contracting by agents results in the choice of arrangements which minimise transactions costs. Furthermore he argues that uncertainty is reducible to cost.

An unmodified equilibrium argument relies on a modified form of the neo-classical maximisation postulate. Many of the criticisms applied to the maximisation postulate in orthodox economic theory remain valid (§4.4.1). There is also some danger of logical inconsistency. Global maximisation – or very far sighted contracting is no longer feasible in principle – once the notion of bounded rationality is introduced. However the question of economic efficiency is still highly pertinent. A combination of weak selection pressures and intended rationality must, ceteris paribus, be presumed to result in a degree of discrimination, at the margin, against less efficient ways of
organising exchange, in favour of the more efficient. In cases where a projected exchange involves a high asset specificity, uncertainty or frequency, it is likely that there will be many situations where the choice of one governance mechanism over another has a clear advantage in reducing cost or uncertainty. In this situation it is anticipated, and largely supported by empirical application of transaction cost economics (Williamson 1996), that the cost minimising choice will be chosen.

A simple illustration of this argument can be found in the comparison of large and middle-scale enterprise where there are highly significant transformational economies of scale and process indivisibilities implied by the production technology. An obvious example is presented by crude oil refining. The existence of significant economies of scale determines that ceteris paribus a large-scale production technology will be chosen. However as noted earlier (§4), the indivisibility of process alone does not entail that the optimal organisational form for a refinery is large-scale. Process indivisibility does however imply that transacting of product within the overall process requires very significant co-ordination and co-operation. The asset specificity of stages in the process are ex hypothesis very high. The degree of asset specificity suggests that mitigation of uncertainty in exchange will predominate in the rational choice of how production is organised. Regardless of the institutional environment the use of a formal governance structure, by integrating stages of a continuous flow production process into a single organisational entity, will minimise uncertainty.

The example illustrates how a first-order comparative argument based on economising on transactions cost and uncertainty can be used to explain choices of organisational arrangement. However important caveats need to be made. Rational agency is only overtly exercised at the margins of structure. Culture and institutional structure cannot be simply changed according to the exigencies of a particular choice to be made. Firms themselves encompass some deeply embedded means of structuring relationships. As Hodgson puts it: "the function of the firm is ... not simply to minimize transactions costs, but to provide an institutional framework within which, to some extent, the very calculus of costs is superseded." (1988, p.207).
Exploring institutional economics

Related to this point is the question of rationality. 'Rational choice' is exercised within the cultural, including linguistic and ideological, framework of agents. The extent to which objectively more or less efficient arrangements can be perceived by agents is thus dependent on *Weltanschauung* — the way in which agents actually see and make sense of the world. The notion of residual uncertainty itself is very strongly conditioned by the cognitive framework of actors. An evolutionary selection argument can only be relied on to eliminate deeply flawed conceptions of what arrangements result in greater or lesser cost under relatively stringent conditions.\(^{20}\) It is also important to note, following Granovetter (1985), the problem of agency — especially in a large organisation. If there is a conflict between the interests of an employee exercising managerial discretion on the part of a firm and the maximisation of profit to the firm, the outcome will itself depend on the structuring of the relationship between employee and firm.

The conclusion to be drawn from these points is that many marginal decisions cannot be understood on the presumption of optimisation. Where a firm is faced with the 'make or buy' choice for a particular transaction, understanding whether it actually does buy or make will depend heavily on the detailed structuring of the exchange environment surrounding that decision. In general the way in which the decision is structured derives from the subjective perspective of the decision maker. The first-order approximation that a decision will be made on the basis that it objectively minimises transaction costs and residual uncertainty can only be made cautiously according to the wider context.

Examples from Kenya illustrate these points. A large-scale brewer finding its glass bottle supplier unwilling to improve its production to the required level of quality, made the investment itself, entering glass production.\(^{21}\) The essential problem was that variations in bottle quality wreaked havoc on the brewer’s automatic line with frequent stoppages arising due to bottle breakages. The brewer had made considerable efforts over a number of years to persuade its supplier to upgrade production. When the bottle manufacturer’s only competitor in Kenya collapsed, owing to import controls existing at the time, it was left with an effective monopoly in the Kenyan market. The brewer’s subsequent decision to ‘make’ rather than ‘buy’
is here consistent with a minimisation of transaction costs and especially uncertainty in exchange. The first-order approximation is appropriate.

By contrast Owino (1991) reported that the subsidiaries of multi-national corporations operating in Kenya consistently procured many inputs from the parent company although such inputs were available locally at lower cost. No transactional problems were immediately presented by procuring locally. In comparison import regulations and exchange controls at the time actually imposed an additional transaction cost and degree of uncertainty (especially given periodic shortages in foreign exchange) in ensuring a reliable supply of inputs. Understanding the procurement decision here does not appear amenable to an obvious first-order approximation of transaction cost and uncertainty. Rather we may need to look to the way in which the managers of the Kenyan company or perhaps those of the remote holding company see the situation. The use of relatively small-scale suppliers in a developing economy may present significant uncertainty within the understanding of the relevant decision maker.

A 'first cut' in accounting for differences in scale distribution can thus tentatively be provided by considering the comparative features of institutional environments. Where the institutional environment appears to offer a greater space for the organisation of exchange at a large-, middle- or micro-scale, then *ceteris paribus* we expect to find a greater proportion of the economic activity to be organised on that scale. The impact of both social and cultural factors at various levels in the structuring of exchange can lead to greater separations in the economy than a simple economising logic would immediately suggest. This point is highly pertinent to the notion of a dual economy involving on the one side modern, large-scale enterprise and on the other informal, micro-scale. The presence of significant numbers of large-scale, technologically advanced multi-nationals may create relatively little space for smaller organisations.

### 5.4 Dynamics of institutional change

How the structuring of exchange evolves is a critical element of institutional theory, but also somewhat controversial. New institutionalists retaining a strongly neo-
classical flavour such as Andrew Schotter (1981) take an efficiency perspective. Structure arises because it increases economic efficiency. This view has been strongly countered both from within the broad ‘new’ institutionalist school (notably North 1990), by those such whose intellectual antecedents lie with the ‘old’ institutional theory of Veblen and Commons (such as Hodgson 1988, 1998) and beyond (notably Granovetter 1985). The issue is vital to developing institutional arguments. Since we have argued that the institutional structure is critical to the structuring of exchange and the possibilities for large-, middle- or micro-scale enterprise, it is necessary to consider how that structure arises.

5.4.1 The efficiency perspective on institutional change

Schotter (1981) claims that: “every evolutionary economic problem requires a social institution to solve it”. This strongly functionalist approach to institutional change is difficult to sustain, both theoretically and empirically. The argument is continuous with the earlier discussion regarding efficiency and the structuring of exchange (§5.3.5). If the structuring of a particular transaction cannot always be presumed to be efficient at the margin the construction of an argument demonstrating how efficient institutions arise is threatened.

As we have seen many important economic institutions are overt – defined explicitly in law and actively enforced by the state. Support for an efficiency argument can be seen to arise from the presumption that in general there will be pressure from intendedly rational agents for highly inefficient laws and regulations to be eliminated and replaced with more efficient ones. It might be conceded that some peripheral inefficiency may persist but the general tendency will be towards an increasingly economically efficient institutional arrangement. However this efficiency argument founders when the variety and depth of structure needed to construct a sophisticated institutional theory is considered. Much of the structuring of exchange occurs at a level where there can be no active choice between structural alternatives. Notably culture provides the cognitive lens through which decisions are formed. Many informal institutions are followed unreflectingly and only change slowly through time.
5.4.2 Institutional evolution

Douglass North notably abandoned the functionalist position taken in his earlier work (North and Thomas 1973), driven by the realisation that examples of economically efficient institutional arrangements are actually comparatively rare in history (North 1981, 1990). North’s more recent theory derives from a closer examination of the processes by which institutional change occurs.

Institutions, together with the standard constraints of economic theory, determine the opportunities in a society. Organizations are created to take advantage of those opportunities, and, as the organizations evolve, they alter the institutions. The resultant path of institutional change is shaped by (1) the lock-in that comes from the symbiotic relationship between institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions and (2) the feedback process by which human beings perceive and react to changes in the opportunity set.

North (1990, p.7)

As a result institutional change is path dependent and there can be no presumption that a particular path leads towards greater efficiency: “if the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities then organizations – firms – will come into existence to engage in productive activities.” (North 1994, p.361). Once a major investment has been made in piracy, there is an incentive to protect the institutional framework which rewards the activity. A similar argument can be applied to the political elites who benefit from rentier states in developing economies.

This argument is profoundly important for understanding economic performance in terms of institutional structure. North contends that history is replete with examples of economies which are locked into highly inefficient institutional arrangements which will not simply resolve through the pressure of competition. At the heart of this theory is the connection between the political and economic. Now as the most casual observation of even putatively ‘politically efficient’ democratic systems reveals, transaction costs and uncertainty in political exchange are generally far higher than those in economic exchange. Stringent conditions are necessary for the subsequent evolution of formal institutions which support a highly developed exchange
economy. As North observes these conditions have only arisen infrequently in history.

Understanding an institutional structure at any given time may require an examination of the history through which it evolved. There are no guarantees that the elements of an institutional structure will be coherent. Specific facets of (especially formal) institutional structure may be interposed into an economy according to a particular set of political or economic interests at some point in history. That such an intrusion is incoherent with other aspects of the economic and social system neither necessarily weighs against its occurrence nor indeed the persistence of its effect. The subsequent path of institutional evolution may only be comprehensible by continuing to account for all such historical perturbations.

5.5 Conclusion

In this chapter an institutionalist theory of exchange has been explored. At the heart of this theory is the claim that social, and more specifically economic, phenomena arises from structured or more precisely, structurated social or economic action. The institutionalist perspective asserts that action and specifically economic exchange can be conceived primarily in terms of institutional structure. The structuring of exchange is analysed from a functional perspective in terms of two fundamental generic problems — co-ordination and co-operation between agents.

The way in which the exchange process is structured has been examined here, based on an institutionalist stance. Three aspects of the structuring of exchange have been emphasised: culture, institutions and mechanisms of governance. The outcomes of exchange, measured in terms of cost and residual uncertainty, depend on how it is structured. Only a highly cautious behavioural assumption can be made in relation to the organisation of transactions — that agents will generally intend to minimise cost and residual uncertainty in exchange and that competition will sometimes exert a pressure to do so. It is concluded that there is no basis for a general behavioural postulate. Institutions similarly cannot be presumed to necessarily increase efficiency and nor will institutional change follow a deterministic path towards more optimal solution to exchange problems. Economies may be characterised by institutional
structures which are highly ineffective at resolving problems of exchange either
generally or in relation to specific types.

The institutionalist approach offers a theoretical basis for describing the context for
enterprise in terms of the exchange environment. Crucially it admits features of
social structure and culture which would appear to be essential in attempting to build
an explanation for Kenya's middle which takes account of ethnic features. In the
next chapter we turn to the task of building such an explanation on an institutional
base.
Notes

1 It is, for example, strongly emphasised in the industrial districts literature.

2 See Smith (1776, p.400)

3 Institutions can also apply to group of states in the case of supranational agreements, such as the European Treaty which defines the constitution of the European Union.

4 For example, in the main Kisumu market in Kenya, a large number if traders were observed using three particular sizes of empty container for measuring tea. The specific weight and volume of tea thus measured was not known; however with all traders using the same types of container it was possible for consumers to readily compare prices amongst competitors. (Source: Field study, 1997)

5 There are numerous examples of standards which arose informally – being associated initially with a single manufacturer. For example - VHS video recorder format, Centronics parallel interface port, the IBM PC architecture, the QWERTY typewriter keyboard layout

6 There are numerous ethnographies which document the enforcement of such informal arrangements. Examples from economies within Kenya are described in Kenyatta (1978), Bates (1989), Ensminger (1992), Ochieng' (1992), from Java in Geertz (1963) and Morocco in Geertz (1973).

7 This could also be understood in terms of the concept of social capital. According to Coleman (1988), social capital parallels financial, physical and human capital but is “embodied in relations among persons” (p.S118). This capital can be regarded as at threat by non co-operation or other forms of behaviour deemed inappropriate.

8 Hodgson’s position which he describes as a 'modern institutionalism' is elaborated in a number of works, especially Hodgson (1988, 1993a, 1997, 1998).

9 North was awarded the 1993 Nobel prize for economics, and is widely cited in writing on institutional economics.

10 Geertz’s position has a strongly relativist flavour and is therefore frequently held to stand in straight contradiction to rational choice approaches with a presumed positivist basis. It is argued here that neither strong relativism or positivism results in a satisfactory epistemological or ontological position. Rather the position taken here is pragmatist following the recent work of Hilary Putnam (1990, 1995) which draws heavily on the American pragmatist school associated with William James, Charles Sanders Peirce and John Dewey. Without attempting to elaborate the argument here, it is simply noted that pragmatism steers between the naive realism of positivism which is rightly strongly criticised by Geertz and the “loss of the world” entailed by strong relativism which undermines any form of materialist analysis.


12 It should perhaps be re-iterated that the informal and cultural background are at least as important as the formal laws which permit the construction of a modern employment relationship or a corporate entity.

13 Source: Field observation, 1993

14 Williamson does not suggest that trust has no referent in social relations. He concedes that there is trust and at least a near non-calculative stance in special personal relationships (between family members for example). However he argues that once a commercial aspect appears so does calculation.

15 A very similar formulation is proposed by the economic sociologist, James Coleman (1990).

16 It is precisely those predictions which appear to have no empirical inductive basis which are most likely to be described as irrational. Thus apocalyptic predictions based on the exegesis of biblical texts or divine private communications are often treated with very considerable scepticism.
17 Geertz (1973) offers a perfect example, describing how a Jewish trader in central Morocco identified and made use of the highly specific socio-economic institutions of the Berber with whom he was trading.

18 Geert Hofstede (1980, 1991) has been strongly associated with such an approach.

19 It is conceivable that an institutional environment could undermine this choice. If a law restricted the size of companies in terms of capital to a particular low level then provided it was enforced, the supposed integration suggested in this example clearly would not occur. However such a regulation is obviously somewhat far-fetched. This argument is however illustrated by rather less dramatic arguments. Little et al (1987, §3) found that regulation in India intending to favour enterprises below a defined threshold gave rise to a tendency to restrict the growth of enterprise into the larger category.


21 Source: Field observation, 1993

22 For an overview see Smelser and Swedberg (1994). It is important to note that some sociological work continues to regard social structure as exogenous to the economic (Coleman 1988)

6. INSTITUTIONS AND DISCONTINUITY: A concept frame for explaining Kenya's missing middle

6.1 Introduction

The objective of this chapter is to develop a concept frame to explain Kenya's missing middle using the institutional theory outlined in the last chapter (§5). The task, established earlier (§4), is to produce an argument which shows how the social and economic context of enterprises and entrepreneurs constrains the development of middle-scale enterprise. The institutional approach elaborated in the preceding chapter showed how context can be described in terms of various structures which relate directly to the performance of exchange. A concept frame using this approach can be used to interpret the particular contexts of African and Asian entrepreneurs in Kenya and offer an explanation for the strikingly different patterns of middle-scale enterprise and hence the aggregate form of the 'missing middle'.

In the first section of the chapter (§6.2), a framework is elaborated within which enterprises exchange can be understood, based on the theoretical apparatus of institutional economics discussed in the last chapter. Each of the major elements in the structuring of exchange are placed into this framework. This then forms the basic institutional model on which the subsequent argument can be based.

The next section (§6.3) introduces and develops the concept of discontinuity in institutional structure as a tool for the analysis of the structuring of enterprise exchange. This concept addresses the dysfunction of the institutional environment with respect to the problem of exchange, as a result of the incoherence in the institutional structure.

Using the analytical framework developed seven key modes of exchange are then identified and described (§6.4). These modes represent generic ways in which problems of exchange are addressed based on the institutional environment faced. Five modes external to the firm are posited - traditional market, exchange-by-
contract, relational exchange, embedded exchange and long-term contract and two modes representing organisation within the firm – entrepreneurial and bureaucratic.

Finally the crucial argument is made linking the exchange environment faced by middle-, micro- and large-scale enterprise in Kenya to institutional structure (§6.5). This argument is based on the establishment of a generic association between the organisational forms represented by each scale type and reliance on particular modes of exchange. Since each mode is dependent on different aspects of the institutional structure, the connection is established between the exchange environments faced by middle-, micro- and large-scale enterprise and this institutional structure. Using this framework an explanation is proposed for the distinctive form of Kenya's middle-scale manufacturing. Hypotheses are made regarding the differing institutional environments faced by African and Asian entrepreneurs in the middle-scale. The explanation draws strongly on the existing literature reviewed, but is also necessarily reliant on a number of conjectures which require empirical investigation.

6.2 An analytical framework

The task now is to produce a framework based on the institutional theory developed in the last chapter within which an explanation for the middle in Kenya can be built and specific hypotheses put forward. The last chapter showed that exchange is subject to a complex set of structures across a number of levels and with differing bases. This theory of the structuring of exchange can be described in terms of a simple framework, illustrated by the diagram below (figure 6-1).

The basic premise is that the way in which exchange is structured (illustrated on the diagram in the box on the left) determines the particular enactment of exchange (the box on the right). A transaction arises from the actions of the two (or more) agents involved. Thus the structuring and enactment must be considered in relation to both (or all) the actors involved. This is represented in the diagram by the long boxes, labelled 'agent a' and 'agent b' which cut across various strata of structuring finishing with the (structured) action which gives rise to a transaction. Crucially, the pertinent structure for each agent is not necessarily identical, as suggested by the separation of the boxes.
Figure 6-1: Framework for analysis of the exchange process
Structures as suggested in the last chapter (§5.3.2-3) can be regarded as arranged hierarchically in two directions. Three types of structure are shown in a hierarchy (from left to right on the diagram): culture, institutions and governance mechanisms. In relation to both culture and institutions, we can think of structures existing at a hierarchy of levels. The broadest, represented by the outer boxes, working inwards, with the most specific or localised at the centre. The hierarchy of these structures derives from the extent to which successive elements are embedded in the previous.

Culture provides the essential cognitive frame or *Weltanschauung* within which the world is understood. The culture of an organisation represents one facet of the cultural position of an agent, which will be embedded within the wider culture of an ethnic group or nation state. The rules of the game – institutions – are drawn within this world view. The formal and informal institutions of a society are drawn against the culture of that society (§5.3.2). Laws most obviously are expected to reflect the cultural values of a nation. Similarly the rules and norms of an organisation reflect its highly specific culture. The degree of authoritarianism in an organisation will be reflected in how strongly its policies and procedures directly control the actions of employees. The institutional rules determine the possible mechanisms of governance – which finally structure the actions which produce the transaction. The nature of a legal contract clearly depends on the applicable laws. The possibility of particular employment relations will be a function of the personnel policies of an organisation. Among the Boulou and Fang ethnic groups of Central Africa, a borrower's social capital can be pledged as collateral for a loan using a token of minimal value (as trivial as a ballpoint pen) based on the informal institutions of these groups (Dia 1996, p.50).

Having described the basic inter-relations of the various elements within the framework, we now turn to consider each of these elements in more detail.

6.2.1 Culture

The term culture encompasses both ideology and language (§5.3.2). Ideology refers to the more normative aspects of culture. It includes a sense of not just 'how the world is' but also how it 'should be'. Crucially it is impossible to dissociate fact and
value.\textsuperscript{1} Put simply, the way in which things are described is inevitably coloured by the notion of what is important and not important to the interpreter.

As already noted culture can be identified at levels from the highly specific, within a particular organisation, through local communities and ethnic groups to the more generic at the level of the nation state and beyond. The idea of 'the West' and 'Eurocentrism' is associated with aspects of culture common to much of western Europe, North America and Australasia.

Analysis of culture in practice is problematic. It is not susceptible to direct measurement in terms of specific cognitive attributes of individual agents. Culture is constructed across agents and does not exist independently of their interactions. Determination of the particular expressed values and beliefs of agents only measures what may be the consequences of culture. Inference of a cultural framework from such measures is dangerous since the meaning of expressed terms depends on the relationship to other terms. Crudely, culture is a system of meaning. Echoing Max Weber, we are concerned here with \textit{webs} of significance. The appropriate stance, as Geertz (1973) shows, is interpretative.

\textbf{6.2.2 Institutions}

Institutions are the basic rules of interaction (§5.3.1). These are both formal and informal and as we have noted can exist across a number of levels. At the most localised level there are rules and norms specific to a particular organisation. Within communities or regions, both formal and informal rules are found. Many formal rules are strongly associated with the nation state which defines, polices and enforces the structure of the legal system. Again however informal rules, especially those related to the actual implementation of the formal rules of the legal system, are associated with this level. Finally institutions do exist at a supra-national level. Groups such as the European Union, NAFTA and PTA produce institutions which apply to member states. Finally conventions on international law have near global status.

It is within the framework of institutions that governance mechanisms are constructed. Most obviously, the possibility of the \textit{firm} as a governance structure
Institutions and discontinuity

depends on property rights and employment laws which permit the type of long-term asset ownership and incomplete employment contracting which is at the heart of the structure. Informal institutions are clearly also highly significant here. The legitimacy of work practices derives to a considerable extent from a socially constructed sense of what are the outer boundaries of a 'zone of acceptance' in the employment relation.

The notion of the rules and norms of an organisation should be distinguished from the organisation as a governance structure. Transactions organised within an organisation are structured according to the possibilities afforded by the rules of that organisation. This can be illustrated using a simple example. In a large bureaucratic organisation it is not uncommon to find complex sets of internal, organisation specific rules which define employment terms, grades and structures. A particular employment transaction is structured, drawing on these rules, to construct a particular contractual form which is the governance mechanism.

6.2.3 Governance mechanisms

The mechanisms used for the governance of transactions again include both the formal and informal (§5.3.3). Informally the elemental mechanism of governance is the relationship between agents. Among the most common formal mechanisms found within a capitalist market economy are those associated with the firm. Formally, a firm can be regarded as a nexus of contracts. The effective governance mechanism will be a result of both the formal and informal mechanisms. In the case of the firm, the overlaying of informal relationships within the formal structure of the firm gives rise to the distinctive features of the organisation.

It is important to distinguish the organisation from the governance mechanism. Although formal governance mechanisms lie at the heart of the formal organisation, they do not define the organisation. In relation to the problem of structuring exchange, organisation itself encompasses its own rules and norms, effectively highly localised institutions, and organisational culture. The formal governance mechanism itself provides in some degree the framework within which this localised structuring occurs. It should be recognised therefore that the model presented in figure 5-1
clearly represents a convenient simplification of a highly complex social environment.

Structures of individual governance mechanisms may interact such that the effective mechanism must be understood as the wider context. A common example is where relationships interact such that the effective mechanism of governance must be regarded as the network. Thus the unit of analysis moves from the simple dyadic relationship to that of a network.

In the model shown in figure 5-1, the governance mechanisms are shown separately for the agents involved in the transactions. A transaction occurs across a mechanism and therefore the real context of the transaction is the joint effective mechanism. The separation shown schematically represents the extent to which agents may bring different governance mechanisms to bear on the same transaction. This separation it will be argued later can give rise to problems in exchange.

6.2.4 Action and transaction
The problems of co-ordination and co-operation, in general, give rise to costs and uncertainty associated with a transaction. In circumstances where the transaction involves intrinsic uncertainty, frequency or asset specificity the potential scale of resultant costs and uncertainty are likely to be significant. The transaction cost and uncertainty are determined by the way in which a particular type of transaction is structured. Clearly other consequences will arise from a social action, but from an economic perspective, a first-order reduction to dimensions of cost and uncertainty captures outcomes of primary causal significance.

6.3 Discontinuity
The framework as presented might suggest a necessary continuity or coherence in the various features that structure exchange. However, based on the argument advanced in the last chapter regarding the dynamics of institutional change (§5.4), there is no necessity that elements of structure are coherent. Rather it is proposed here that discontinuity in the structuring of exchange is a very common feature of many economies and is important in understanding the exchange environment. We start
this discussion of discontinuity by recalling the connection between structure and outcome developed in the last chapter.

Differing structures of exchange will result in different outcomes in terms of both transaction cost and residual uncertainty (§5.3). The functionalist or teleological approach argues that transactions will be structured in order to minimise cost (and uncertainty). Williamson proclaims that "the organizational imperative that emerges ... is this: Organize transactions so as to economize on bounded rationality while simultaneously safeguarding them against the hazards of opportunism." (1985, p.32, emphasis omitted). Now as argued in the last chapter (§5.3.5), the presumption of economising cannot be sustained. Rather the agent faces an exchange environment which will offer various opportunities and constraints. Although individual agents have strong influence over the particular governance mechanism employed in a transaction, control exerted over the institutional structure will be very much weaker. The governance structure and thus economic activity observed will be significantly shaped by the institutional structure. However, ultimately the most immediate influence on a transaction relates to the mechanisms employed by transacting agents. From the analytical perspective, the crucial question is how the structure impedes or facilitates exchange. Does a particular environment result in high cost and uncertainty for all but the simplest transactions and does it result in a favouring of particular mechanisms of governance? As described in the last chapter, structure emerges in a number of strata and cannot be assumed to arise subject to a consistent set of influences. There can be no Panglossian assumption that structures emerge which produce an optimal exchange environment.

The term discontinuity is introduced to describe, in a functional sense, features of the exchange structure in relation to the exchange process. A discontinuity is defined as a feature of the structuring of exchange where the result is systematically dysfunctional with respect to the problem of exchange, as a result of the incoherence in structure. 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, resulting in higher transaction costs or greater residual uncertainty, than would otherwise be the case.
A discontinuity can arise between the sets of structure in which each agent is embedded. Most commonly we expect to see it arise between 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. 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 governance mechanisms may be seen manifested in particular types of instrument. A common illustration is the requirement in large tenders for performance guarantees backed by formal-sector banks. 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.

Where the institutional structure does not support the construction of governance mechanisms which could enable particular types of transaction a further case of discontinuity is found. 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.
Finally a severe case of discontinuity can be located between the whole institutional structure and classes of exchange action. 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.\footnote{It has been argued that the 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.} If such an argument can be substantiated then it represents a profound case of a functional discontinuity between capitalist enterprise and institutional structure.

In the last two sections we have elaborated a basic framework for the analysis of the structuring of exchange using the institutional theory developed in the last chapter. An important concept of discontinuity in structure has been introduced. We now need to consider how this framework can be applied to the analysis of enterprise context. In the next section we examine ways of typifying how exchange is structured by enterprises.

### 6.4 Modes of exchange

Exchange can be characterised in a number of ways using the framework. Analytically, it is useful to identify what are the dominant types of exchange resulting from structure. Weber's notion of ideal types, introduced earlier (§3), is again a helpful device for expository purposes. A preliminary identification of types can be achieved by considering their primary reliance on elements of structure. A simple classification is produced from determining whether the underpinning institutional structure is formal or informal and whether the governance structure places a transaction inside or outside the boundaries of the organisation. Such a taxonomy is necessarily somewhat crude, implying dichotomies which are false. As discussed in the last chapter, the interaction between formal and informal institutions is of great significance in understanding institutional structure. The boundaries between what is internal and external to the firm is often less clear than immediately apparent. Drawing the boundary according to legal definition, though clearly important, risks over-emphasising the impact of formal institutions compared with the informal.
External governance mechanisms can be further divided between the situation in which there is only a minimal structuring (referred to as spot) and where the exchange is explicitly structured for transacting over time (referred to as term).

This classification gives rise to a number of characteristic ways of organising exchange, which we term ‘modes of exchange’. In total, seven modes of exchange are identified. These are shown in table 5-3, ranging from the least formally structured – in the traditional market, through to the most heavily – in the bureaucratic firm. Informally structured exchanges cover a wide range and thus two categories are introduced – relational and embedded – reflecting the varying weight on institutional or governance mechanisms.

![Table 6-1: Modes of exchange](image)

<table>
<thead>
<tr>
<th>Governance mechanism</th>
<th>External</th>
<th>Internal</th>
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<tbody>
<tr>
<td></td>
<td>Spot</td>
<td>Term</td>
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<tr>
<td>Informal</td>
<td>Traditional market</td>
<td>Relational</td>
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<td></td>
<td>Embedded</td>
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<tr>
<td>Formal</td>
<td>Exchange by contract</td>
<td>Long-term contracting</td>
</tr>
</tbody>
</table>

It will be noted that there is no pure market mode in this schema. Following Hodgson (1988) it is argued that the Hobbesian ‘state of nature’ or the Rawlsian ‘original position’ is a fiction; even the simplest market transactions occur within an institutional context. The nearest mode to the neo-classical notion of a market exchange, is that identified as the traditional market. We now consider each of the seven modes in more detail.
6.4.1 Traditional market

In the traditional market mode of exchange only informal rules are available to guide participants in exchange. Examples of traditional market exchange are often found in the circumstances of what is ordinarily referred to as a market — situations in which buyers and sellers meet to trade in a particular geographical location. Identity of participants in a traditional market is \textit{a priori} unimportant. However the relevance of informal rules should not be under-estimated. As noted earlier, informal standards for product measurement often emerge and are an important support mechanism for determining market price. Furthermore within the context of a real, physical market the mode of exchange does not always exemplify this traditional market. Informal governance mechanisms often arise in the form of relationships between buyers and sellers deriving from deliberate repeated transacting.

The traditional market mode of exchange involves relatively low transaction costs in absolute terms. However the scope of such a mode is highly constrained by the lack of mechanisms to mitigate problems of co-ordination and co-operation. Many types of transactions are not viable using a market form of exchange due to the uncertainty implied. Where there is significant asset specificity, transaction specific uncertainty or frequency in the transaction, this mode results in high residual uncertainty and will be avoided.

6.4.2 Exchange by contract

Exchange by contract is based explicitly or implicitly on state-maintained, formal institutional rules. Such rules have an impact on both the problems of co-ordination and co-operation. Very many transactions in industrialised economies are covered automatically by a complex array of formal institutions. Standards relating to weights and measures, for example, are often state enforced. This clearly facilitates co-ordination insofar as it becomes possible to readily determine what is actually on offer from a collection of sellers in a market.

A classic example of the explicit application of this mode is found in the use of a supply contract in which the precise terms of the exchange are explicitly laid out in a legally enforceable document. Such terms might include what is to be supplied,
perhaps its quality specification, when payment is due and so forth. Various contingencies are often dealt with. Co-operation is thus enforced by the terms of the contract. 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.

A crucial set of implied terms of exchange enforced by formal institutions relate to quality. Various laws and regulations may require that a vendor undertakes to meet various minimum obligations. Some of these are highly specific to the area of business – given products must conform with specific technical criteria. A purchaser does not need to contract with the vendor for the fulfilment of such standards. Other regulations may be far less specific. Consumer protection legislation in the UK for example demands that goods “correspond with their description, are fit for their purpose and are of satisfactory ... quality” (Howells and Weatherill 1995, p.123). Such a regulation represents a strong prohibition against malfeasance by a vendor. In all cases where the implicit or automatic terms are not met there is recourse to state enforcement through various agencies and ultimately the courts.

Exchange by contract offers the potential for more complex forms of exchange to be undertaken than possible within a traditional market. This mode of exchange represents a potentially very low cost means of measuring and enforcing many types of transaction. Central to the efficiency of this mode are the economies of scale which can be reaped by the state in undertaking the measurement and enforcement of generic types of transaction. Impersonal, mass markets are facilitated by the existence of a known, effective third party to enforce contracts on both sides. However where strong forms of co-operation are important, this mode has limitations. This is especially so in cases where there is a high degree of uncertainty and it is impossible or very costly to fully specify the terms of an agreement. Implicit contracting is more limited in scope and does not support more specialised forms of transacting.

Efficacy depends heavily on the extent to which the formal institutions which underpin this mode are efficiently policed and enforced by the state. Successful
construction of a formal institutional framework can be undermined by discontinuity between culturally based values and beliefs and the rules. The effectiveness of the framework depends on achieving legitimacy through the internalisation of values which support it. This will itself be manifested in the continuity or discontinuity between the formal and informal institutions.

Where the institutional framework is itself subject to any uncertainty then clearly transactions reliant on this framework will similarly be uncertain. Obvious examples occur where the legal system is subject to effective political intervention, whether formally or informally. In developing economies it is common to find situations in which contracts are unenforceable in practice though putatively carrying legal force. A related problem occurs where substantial changes to the formal institutional system are enacted frequently. The costs and timeliness of conflict resolution under law are also relevant.

Furthermore there is a question of the continuity between organisational form and the institutional environment. It is hypothesised that a firm which is organised on the basis of informal mechanisms of governance, underpins these with informal rules and norms and ultimately can be expected to possess an informal organisational culture. Such an essentially informal organisational structure is discontinuous in form with the formal institutional environment.

6.4.3 Relational exchange

Relational-exchange refers to forms of exchange which are reliant on the specific relationship between transacting parties. A governance structure is created which directly addresses co-ordination and co-operation on a personalised or agent specific basis. As discussed earlier, the basis on which co-operation may be accomplished can be seen in terms of either a purely rational choice based on pursuit of mutual advantage or by the extent to which a normative behavioural element enters the picture. The former is essentially equivalent to the case of indefinitely repeated games of the prisoners' dilemma. Underpinning any relationship is the question of the basic compatibility (beyond the simple material requirements of the exchange) between transacting partners. Co-ordination precedes co-operation. Both agents
must be able to discern enough about the opposite party to be assured that it is worth looking to develop a relationship.

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 can be ignored by the injured party in the interests of the on-going relationship. Providing that both parties see an advantage in continuing to trade with one another and see that there is a similar incentive for the other, then rational self-interest can be relied on to ensure co-operation. However the effectiveness of informal institutions underpinned by ideology particularly in facilitating the initial formation of relationships cannot be ignored.

Where the relation is to some degree substituting for the clear assurances which can be obtained from explicit contract (and hence potential third party 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. It is clear that 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.

Relational exchange offers a potentially very low cost mode of exchange. Direct transaction costs associated with formal modes, such as lawyers fees, are avoided. In notable contrast to exchange by contract, relational exchange is a more flexible mode. Where conditions change, parties are able to re-align the terms of exchange readily. However necessarily there is some degree of cost in terms of uncertainty. The point at which one party is over-exposed to opportunism in a relationship is not always clear. As noted before, the basis of many successful frauds is found in simulating a co-operative relationship.

The relational mode of exchange will be hampered by discontinuities between agents or organisations. Differences between organisations at the level of the rules and norms they employ and more profoundly in terms of culture give rise to mechanisms
Institutions and discontinuity

which fail to satisfactorily solve the problem of co-operation. The results of this form of discontinuity may be manifested in either the direct incompatibility of the resultant governance mechanisms with the problem presented, or the difficulty of co-ordination which then undermines the evolution of relational structures which could facilitate co-operation. Taking a simple example if a small company relies on the experience of its owner-manager to determine the adequate quality of its product, it may have difficulties in supplying another more formal enterprise which requires explicit measures of established quality tests. It is precisely this type of discontinuity which is held to exist between large and smaller scale enterprises, often hampering stronger linkages.

Where there is a generally high perceived level of background uncertainty in the task environment the relational mode may be rendered simultaneously more important but also more difficult. In an uncertain environment, there is a greater need to find strategic support in the form of strong relationship. However forming such relationships in the first place will be rendered more difficult.

A form of dispersed, asymmetrical relational contracting is represented by the building of reputations in a market. This fulfils both a co-ordination and co-operation function. The status of a strongly defended high quality brand informs potential exchange partners about a product or service. Furthermore the knowledge of investment in a reputation provides some assurance that the quality will be maintained in order to protect that investment.

6.4.4 Embedded exchange

The construction of informal mechanisms for exchange based on informal institutions gives rise to the embedded mode of exchange. It is hypothesised that the problem of exchange may be addressed by grafting economic relations onto existing social structures. The simplest impact on exchange is through better co-ordination which is facilitated by strong communication. Social informal institutions and a common cultural, ideological and linguistic frame of reference enhance the flow of information within a community embedded in these structures. Greater co-ordination in turn permits the construction of safeguards on transactions. Where
information flows readily, cases of malfeasance are reported rapidly to other members of the community. A single shot prisoners' dilemma game is effectively transformed into a repeated game, if a defaulter is unable to find future exchange partners outside the community. This is precisely the situation which Granovetter (1995) suggests exists amongst some Chinese immigrant communities in South-east Asia.

Social structure may also enhance the opportunities for constructing safeguards by the extent to which malfeasance can be met with social penalties. Loss of face or social standing in a community may be regarded as a serious loss in itself. Clearly the distinction between economic and social is often blurred – social and economic standing are often found to be conjoined. However the key idea is that the embedded mode of exchange offers access to possible intangible social 'hostages' which can support co-operation. Ostracism from a social network may be regarded by a participant in the network as a very significant penalty.

Finally informal institutional rules within a social group which supports co-operation may to a significant degree be internalised. Within the group, co-operative behaviour may be regarded as largely unreflecting. Institutions blur with culture and ideology. The way in which members of a group see their social and economic relations with other members of the group might barely admit the possibility of breaking implied agreements.

As an informal mode of exchange, the embedded mode again represents a potentially low transactions cost solution to problems of exchange and it can support highly flexible agreements. As Williamson notes, a credible agreement to deal fairly between parties in the future is a powerful mechanism for governance of exchange – presuming that it is possible. Information is cheap and generally reliable. Agreements can be constructed on the basis of a common frame of reference. The expectations and effective terms of a promise expressed against a common cultural background are clear. Use of social hostages carries no economic cost. In comparison with the use of the relational mode, there is less requirement to build a co-operative relationship over time. Many informal rules are presumed to pre-exist within a
Institutions and discontinuity

community. Finally the institutions which govern exchange in this way may to a significant degree be used unreflectingly. The notion of potential problems in exchange may simply not be present in the perception of members of a community.

Embedded exchange is however highly susceptible to discontinuities. The institutional structure must be continuous with the problem of exchange confronted. Structures which are appropriate for one set of economic circumstances may not be appropriate for another. Bates (1989) argues that the informal institutions of pre-colonial Kikuyu society, which can be interpreted as giving rise to a moral economy, were subject to enormous pressure with the economic changes arising from the creation of the Kenyan colony. Economic opportunities created by the colonial economy could not be exploited within the pre-existing institutional structure. Informal institutions might also result in effectively relatively high transaction costs. Participants in a moral economy, while potentially transacting at low cost and uncertainty with one another, may also be subject to costly obligations.

Discontinuity may readily arise between formal and informal institutions, again potentially undermining the effectiveness of the structuring of exchange. Such a discontinuity readily arises, as noted earlier, due to the differing dynamics of formal and informal institutional change. Geertz (1973) cites an interesting case from early colonial Morocco. Here an attempt by the French colonial authorities to impose a formal institutional structure simultaneously failed to prove efficacious in practice – being strongly resisted by the indigenous people – and also prevented the operation of informal institutions which had successfully governed trade in earlier periods.

6.4.5 Long-term contracting

Formal long-term contracting, closely resembles exchange-by-contract in its reliance on the formal institutional structure, but includes an element of informal governance to widen the scope of transacting. Returning to the supply example, it is clear that a long-term supply arrangement is unlikely to be achievable under a simple exchange-by-contract. Neither party will wish to formally commit to terms over a long period where conditions in the future may change substantially. The alternative is to produce a contract which includes a degree of latitude, enabling say supply prices to
be adjusted according to given criteria or a process of negotiation or arbitration triggered. In essence the necessary incompleteness of *ex ante* formal contracting is tackled by supplementing it with bounded relational contracting. Karl Llewellyn argues that in general, contract can be regarded as a framework: “a framework which almost never accurately indicates real working relations, but which affords a rough indication around which such relations vary, an occasional guide in cases of doubt, and a norm of ultimate appeal when the relations cease in fact to work.” (1931, pp.736-37, quoted in Williamson 1996, p.255).

This mode of exchange may potentially present an optimal solution to exchange problems commonly encountered. The use of the state-maintained institutional framework offers a potentially low cost means of transacting, but includes a degree of flexibility thereby widening the scope of this mode. It is essentially a form of constrained incomplete contracting. Compared with the informal modes reviewed above, it has both distinct advantages and disadvantages. The use of a formal contractual framework offers greater certainty of outcome under given conditions. A well constructed agreement can provide considerable support for many key contingencies. There is inevitably a residual degree of uncertainty in the efficacy of informal mechanisms where there is no ultimate appeal for enforcement to the power of the state. However the production of such agreements often comes at a heavy cost. Attempting to determine *ex ante* how to deal with a wide range of possible circumstances can result in protracted negotiation and technical drafting effort. Furthermore the contract as framework itself may still prove inflexible in the face of radical changes in conditions. The problem of bounded rationality remains.

Many of the threats from discontinuities raised earlier are pertinent here. As before, discontinuities which impede the efficacy of the formal institutional structure will be relevant. The consonance of the agents raised in connection with relational contracting (§6.3.3) is clearly relevant. Discontinuity between governance mechanism and the use of formal institutions discussed under exchange by contract (§6.3.2) presents a potential barrier.
6.4.6 Entrepreneurial firm

Internalisation of transactions to an organisation firm does not of necessity rely primarily on formal institutions – employment contracts, regulations, assignments of property rights.\textsuperscript{11} In the entrepreneurial firm, problems of co-ordination and co-operation are addressed using informal approaches and understandings. There are many points of similarity with the relational and embedded modes described earlier.

According to the understanding of scale developed earlier (§2.2), the smaller-scale enterprise types are characterised by the entrepreneurial firm mode of exchange. Smallness to a significant extent underpins the informality. Crucially the task of management (or control) in a small enterprise involves either limited or no division of labour. In such circumstances direct, informal control is feasible. The manager of a business employing five people in a small workshop does not need a formal clocking system to determine when employees are at work; she can see whether they are or not. It is the co-ordination of various dispersed aspects of control within a formal governance structure which leads to the formalisation of the control itself. The separation between ownership and management is another key area. Where the owner is the manager, the exchange problem between owner and manager is dissolved.

As noted earlier, the major advantage imputed to the formal governance mechanism is the control of uncertainty. Within the realm of the firm, all internal transactions are subject to direct control, which in principle solves the problem of co-ordination and co-operation. A relatively high cost is incurred from the administrative overhead of organising activities. According to Williamson, the loss of incentive necessarily incurred by bringing a transaction within a formal governance structure as compared with spot or informal structuring, may lead to a further effective cost. The entrepreneurial mode, with a less structured approach to producing a formal mechanism of governance, may be supposed to incur a relatively lower direct cost than the bureaucratic mode discussed below. The effective control mechanism, may also be assumed to be less attenuated where the span of control is narrow. Set against this, some management and planning techniques may be subject to effective indivisibilities which confine efficient use to larger organisations. Few smaller
organisations will have the expertise to carry out sophisticated financial forecasting. Potentially avoidable sub-optimal investment decisions may result.

The efficacy of the entrepreneurial firm as a mode of organising exchange clearly depends *ex definiens* on the informal institutions in which it is embedded. This leads to a vulnerability to discontinuity between the exchange problem and these institutions raised earlier. Attitudes to the employment relation and property are clearly important here. Much of this derives from the cultural framework. The perceived legitimacy of property rights and labour relations are of significance. A problem cited by Marris and Somerset (1971) in relation to small African firms in Kenya was the perception by family employees that they had a claim over the firm's assets.

The entrepreneurial firm mode is also susceptible to a discontinuity between the organisational rules and norms of the firm, which are held to be largely informal and the wider formal institutions of the economy in which the firm is embedded. Heavy employment regulation is often cited as being inimical to smaller, quintessentially entrepreneurial firms.

### 6.4.7 Bureaucratic firm

The bureaucratic firm mode of exchange is distinguished from the entrepreneurial mode by its reliance on the formal institutional framework. Explicit contracts of employment, allied with a host of regulation and agreements, formally delimit the zone of acceptance referred to by Williamson. The extent to which an employee must submit to the authority of the firm's management is clearly spelt out. Assertion of control and ownership over assets is defined in terms of formal property rights. Ownership and management control of the firm are commonly separated in the bureaucratic firm. There are a mass of institutions which support that separation. The larger-scale enterprise, *ex definiens* (§2), is dominated by the bureaucratic mode.

The relative costs and benefits of the mode have already been discussed comparatively with the entrepreneurial mode. In terms of susceptibility to discontinuity, the bureaucratic mode has a greater emphasis on the formal
institutions than the entrepreneurial. However in concluding it is posited that formal governance mechanisms can be regarded as to an extent superseding the institutional framework – creating an internal structure of governance. Vulnerability to discontinuity in the external institutional environment is therefore reduced by comparison with other modes.

6.5 Analysis of the exchange environment in Kenya

We now consider how Kenya’s manufacturing scale structure can be explained using the theoretical framework put forward. The prospects for enterprise and entrepreneurs, we have argued earlier (§4), depends fundamentally on the context in which they are located. Functionally context can be understood in terms of the exchange environment. The exchange environment is determined by the general economic conditions, the actors in an economy, and institutional structure. It is institutional structure which is held primarily responsible for systematic differences in the environment faced by middle-, micro- and large-scale enterprise, although economic conditions and existing composition play an important role. The framework outlined over the last three sections provides the basis for a comparative analysis of these types of enterprise.

This analysis starts by noting that middle-, micro- and large-scale enterprise each represents a distinct organisational form which it is argued results in a differing reliance on particular modes of exchange. Now since each mode of exchange is dependent on varying features of institutional structure, the exchange environments faced by middle, micro and large-scale enterprise will be shaped in different ways by the same basic institutional context. Where there is a strong reliance on the modes of exchange associated with informal institutions, the exchange environment will be conditioned by the particular informal institutions in which the enterprise or entrepreneur is embedded. Ethnicity will be a strong determinant of the informal institutional structure faced and there is therefore a link found between ethnic identity and the exchange environment faced. This is clearly highly relevant to the research problem we are tackling here.
The basis for aligning modes of exchange with the organisational types of middle, micro and large-scale is the notion of generic discontinuities arising between organisational and institutional structure. A crucial idea here is that an organisational structure characterised by an informal culture and *ad hoc* methods of operation will be discontinuous with formal institutional structures. It is important to note however that this is not a definitive characterisation; it only refers to the relative emphasis placed on particular modes of exchange by types of organisation. A micro-scale enterprise might, for example, still depend on the terms of a contract they have with an equipment supplier to service a machine. The analysis is essentially comparative, making a first-order approximation, referred to in the last chapter, in which it is assumed that more efficient arrangements will be chosen over less.

Differences will become more or less significant according to background factors which will impinge on all transactions, regardless of the structural position of agents. A high level of general economic uncertainty will tend to increase the uncertainty associated with all exchanges in an economy. Where uncertainty is high, the relative effectiveness of the various modes in mitigating uncertainty is highlighted.

The significance of the composition of an economy also needs to be emphasised. It will be argued that there is a discontinuity between large- and smaller (middle or micro) scale enterprise which undermines strong linkages between the two. Such problems will again be exacerbated by general economic conditions of uncertainty. The notion of discontinuity separating large and smaller scale sectors suggests a path dependency: where an economy is already dominated by large-scale enterprise, the smaller scale faces a difficult exchange environment, and vice-versa.

In considering the detailed argument, we start by examining the background which applies to all enterprises before considering the comparative position of the middle, micro and large in turn in Kenya.

### 6.5.1 The Kenyan exchange environment

It is hypothesised that the exchange environment in Kenya for all forms of enterprise is permeated by uncertainty. This uncertainty applies to both general economic
Institutions and discontinuity

conditions and specifically to the general institutional context. Two claims are implied here. First, that economically significant features of the exchange environment are actually subject to strong and chaotic or complex fluctuation, which renders them difficult to predict in principle. Amongst the features which can be regarded as especially significant are macro variables (exchange rate, interest rate, government spending, commodity prices etc), the formal institutional framework (law, regulation etc) and actions of major players in the economy (the state, parastatals, monopolists etc). Some indications of instability have already been considered (§3). Possible explanations for this instability is deferred until later (§8). The second claim is that uncertainty is perceived by entrepreneurs, managers and potential investors in enterprise and is a factor in decision making.

It was argued earlier (§5.3.2) that the establishment of formal institutions derives in large part from the host of informal rules and norms by which everyday action is guided. This gives rise to potential discontinuities between formal and informal institutions. Such discontinuities help to explain the suggestion of uncertainty and instability in the institutional framework. There is a clear historical basis for such discontinuity. Informal institutions evolved across a large number of pre-industrial societies contained within the geographical boundaries of Kenya. By contrast much of the formal institutional framework of the modern state of Kenya was constructed during the British colonial period and derives directly from a British model. Ultimately therefore at the base of such a discontinuity may be a more profound incoherence between culture and the formal institutional structure. The formal laws of Kenya thus lack a sense of legitimacy which as Hodgson (1988, pp.134-7) has argued is crucial to their effectiveness.

Differences between the informal institutional environment and cultural framework of African and Asian entrepreneurs have been suggested in the work of a number of writers on Kenya. It is suggested here that the structures of the Asian community (strictly communities) in Kenya may permit the widespread use of embedded exchange by entrepreneurs from these communities. By contrast such structures may not be present or usable in the African communities resulting in a different
exchange environment for Africans. Exploratory hypotheses as to why this should be the case are considered in relation to the middle-scale.

6.5.2 The middle scale enterprise exchange environment in Kenya

Intrinsic to the organisational form of middle-scale enterprise is a high dependency on external exchange. The high level of uncertainty noted in the exchange environment increases the difficulty of problems in exchange. We now consider in turn how the various external modes of exchange relate to the problem. The traditional market is ignored. Only relatively simple (and therefore uninteresting) exchange problems can be handled using a traditional market mode, since it implies a minimal level of structuring. Under conditions of high uncertainty, fewer still exchanges can be accomplished satisfactorily using the mode.

Formal modes: exchange by contract and long-term contracting

The middle-scale enterprise organisational type, as has been indicated earlier, is characterised by an informal organisational culture, use of rules of thumb and informal governance mechanisms. This type of structuring, driven by an essentially entrepreneurial internal mode of exchange, is discontinuous with formal mechanisms, institutions and cultures. Consequently it is argued that middle-scale enterprise tends to rely on external modes of exchange based on informal institutions – embedded and relational, rather than those based on formal institutions – long-term contracting or exchange by contract. The middle-scale enterprise will simply not see the use of formal mechanisms as an efficient or appropriate way of solving problems of co-operation in exchange. This contrasts with large-scale enterprise which is associated with external modes of exchange based on formal institutions – long-term and exchange by contract – again based on a discontinuity argument. The large-scale enterprise organisational type is characterised by a strongly formalised organisational culture, systematic rules and procedures and ultimately formalised governance mechanisms. This type of structuring, again driven by the mode of internal exchange, is discontinuous with informal cultures, institutions and mechanisms.
It is hypothesised therefore that middle-scale enterprises or entrepreneurs will tend to regard the formal institutional framework as either incompatible with their needs or inaccessible to them. In Kenya, the instability of formal institutions will further reduce reliance by enterprise on these modes. This argument is summarised schematically in terms of specific hypotheses in table 6-2. The hypotheses in the table (and the succeeding ones) are split into two, *explanandum* and *explanans*. The former relate to the assertions made regarding the actual behaviours and decisions of enterprises and entrepreneurs. Meanwhile the latter encompass the argument posited to explain these behaviours and decisions.

Table 6-2: Middle-scale: exchange by contract and long-term contracting

<table>
<thead>
<tr>
<th>Explanandum</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance, either implicitly or explicitly by the use of formal contract on the state-maintained economic institutional framework for solving the problem of co-operation in exchange.</td>
</tr>
<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism (in terms of impact on transaction costs and residual uncertainty) for solving the problems of co-operation.</td>
</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the state-maintained economic institutional framework for solving the problem of co-operation in exchange than large-scale enterprises.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
</tr>
<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs</td>
</tr>
</tbody>
</table>

**Relational exchange**

By contrast relational modes of exchange, based on informal institutions, it is suggested will be more strongly relied on by middle-scale enterprise. However the effectiveness of this mode will again depend on both the degree of instability in the economy generally and the potential exchange partners. It is posited that there is a discontinuity between the middle and large-scale which will give rise to problems for the middle in forming effective exchange relations with large-scale. In circumstances where large-scale organisations constitute a significant part of the economy, the
middle-scale or potential middle-scale entrepreneur may be faced with a strong
degree of isolation. This problem will be compounded by the high degree of
uncertainty in the Kenyan operating environment. The argument is summarised
schematically in table 6-3 below.

Table 6-3: Middle-scale enterprise: relational contracting

<table>
<thead>
<tr>
<th>Explanandum</th>
</tr>
</thead>
</table>
| 2.1 Middle-scale enterprises regard the formation of relations as an important means of
  informally solving problems of exchange. |
| 2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale
  organisations difficult. |

<table>
<thead>
<tr>
<th>Explanans</th>
</tr>
</thead>
</table>
| 2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as
  characterised by significant instability |
| 2.4 The governance instruments deployed by middle-scale enterprises and large-scale
  organisations appear to be different in kind and undermine the formation of exchange
  relations. |
| 2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale
  organisations are significantly, systematically different. |
| 2.6 The organisational culture of middle-scale enterprises and large organisations are
  systematically different. |

The argument regarding generic differences in the nature of external exchange
adopted by large and middle-scale firms is best illustrated by considering an example
in a little depth. It is well documented that large scale formal banks in many
countries find considerable difficulties in lending to middle scale enterprises. This
can be explained directly in terms of the discontinuities which separate large and
middle-scale enterprises.

Explanations cited in the literature explaining the problem, which is essentially one of
co-operation, revolve around the twin problems of screening out bad risks and
enforcing agreements following lending. Large banks commonly use highly formal
approaches to these problems, essentially exchange by contract. Highly structured,
formalised information is typically sought regarding the status of the business as a
means to assess the credit risk. Commercial contracts are drawn up between the borrower and lender, stipulating the precise terms of the transaction. Finally formal legal charges are often placed over the borrower's assets for use as collateral. The emphasis is firmly on reducing uncertainty using a formal governance mechanism. Middle-scale enterprises meanwhile frequently find it difficult to meet the transactional requirements of banks. Providing information in the form required is problematic – middle-scale enterprises do not produce highly formalised financial plans or monitor their performance in a highly systematic and quantified way. There is commonly little understanding of the terms of lending agreements. Ultimately the exchange by contract mode results in relatively high transactions costs, given the size of borrowing sought by middle-scale enterprises. Furthermore uncertainty is frequently not actually reduced by the mechanisms applied. Information produced in the formal manner required can be unreliable, not being a product of the process of managing the business, but as a direct response to the bank's requirement. Sometimes it will be produced by an intermediary (such as an outside accountant) who is at a distance from the business the information seeks to describe. The result is that the formal banks often find the business of lending to the middle unattractive, involving both too much residual uncertainty and cost. Essentially there is a discontinuity between the organisational form (in terms of cultures, rules and norms) of a middle-scale enterprise and this mode of exchange.

The obvious question is therefore whether a relational mode of contracting could not be used. Here the difficulty lies with the bank's inability to use such a mode. Relational exchange depends on strong information exchange using less formalised mechanisms. It is argued that it is precisely the discontinuity between the large-scale organisational form (culture, rules and norms) which prevents the level of understanding and communication necessary to build a strong relationship. Occasionally the internal rules of formal banks are constructed precisely to prevent the building of strong relationships between lending staff and clients. In Kenya it was found that as an attempt to reduce fraud, a number of larger banks rotate lending managers regularly in order to avoid too close a relationship with customers.
Embedded exchange

Embedded exchange offers an alternative mode of contracting for middle-scale business. However it depends on the existence of appropriate institutional structures. Broadly it is hypothesised that the Asian communities in Kenya possess such structures and these are utilised by successful middle-scale entrepreneurs to escape the generic problems of the Kenyan middle in exchange. It is suggested by contrast that the potential indigenous African middle-scale entrepreneur does not have recourse to institutions which permit the solution of exchange problems (table 6-4).

How do we explain this? The African entrepreneur is predicted to be excluded from Asian networks insofar as such networks are based on social, cultural and ethnic identity. Membership of the specific social group is held to be an a priori condition for access and participation in the network. However the question remains as to why effective networks do not form within African communities? Aspects of traditional African informal institutions and cultural frameworks bear at least superficial similarity to those of Asian communities in Kenya. Most obviously some form of 'moral economy' is discernible in both communities.

A number of tentative, exploratory hypotheses which singly or combined offer an explanation as to the inefficacy of African social structures in solving exchange problems. First, there may be important instrumental differences between the Asian and African social institutions and cultural frameworks. The African situation is not readily utilisable in the way described above - there is a fundamental 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.

Second, the scale of the network can be 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. 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.\textsuperscript{20}

Table 6-4 : Middle-scale : embedded exchange

<table>
<thead>
<tr>
<th>Explanandum</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate co-operation in exchange</td>
</tr>
<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
</tr>
<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate co-operation in exchange</td>
</tr>
<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate co-operation</td>
</tr>
<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of co-operation in exchange with member of other ethnic groups.</td>
</tr>
<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of co-operation in exchange with member of other ethnic groups.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.5 If entrepreneurs rely on ethnic based socio-cultural structure, how is the effectiveness of this structure best understood?</td>
</tr>
<tr>
<td>a) Rational action - backed by incentive/sanction</td>
</tr>
<tr>
<td>b) Internalised informal rules and moral values</td>
</tr>
<tr>
<td>c) Other</td>
</tr>
<tr>
<td>3.6 If entrepreneurs make no use of ethnic based socio-cultural structure, why?</td>
</tr>
<tr>
<td>a) Social networks in which they are involved are generally resource poor</td>
</tr>
<tr>
<td>b) Social networks in which they are involved are insufficiently large</td>
</tr>
<tr>
<td>c) Relationships within the networks are insufficiently strong and therefore offer little contribution to solving the problem of co-operation or co-ordination</td>
</tr>
<tr>
<td>d) Competition for scarce resources amongst members of the same ethnic group is too strong to permit co-operation</td>
</tr>
<tr>
<td>e) Significant elements of socio-cultural structure are repudiated in the process of entering the modern exchange economy</td>
</tr>
<tr>
<td>f) Other</td>
</tr>
<tr>
<td>3.6.1 If relationships appear to offer little contribution to solving the problem of co-operation and co-ordination, how is this best understood?</td>
</tr>
<tr>
<td>a) Simple absence of supporting or mutable structures</td>
</tr>
<tr>
<td>b) Structures are inimical to the required forms of exchange</td>
</tr>
<tr>
<td>c) The relationships, on balance, imply a greater liability or risk than asset or potential reward leading to their repudiation as a whole</td>
</tr>
</tbody>
</table>
Finally, we consider the content of the networks. African networks can be supposed to have a generally 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.

6.5.3 Micro scale enterprise

The micro-scale in common with the middle-scale is also characterised by the entrepreneurial mode of exchange. However the very smallness of this enterprise type entails that relatively little exchange occurs within the boundaries of the organisation. In the limiting case of a single owner-manager-operator, there are effectively no transactions organised within the firm.

As with the middle-scale, it is suggested that the dominant external modes of exchange are relational and embedded. The isolation from formal modes is even greater than that for the middle-scale. Returning to the example of credit, the discontinuities are deepened by the very informality of many micro-scale enterprises. Formal sector bankers in developing economies where micro-scale enterprises are often highly informal, find it very hard to actually see such activity as a business in the conventional sense. This is illustrative of a discontinuity at the level of organisational culture.

<table>
<thead>
<tr>
<th>Table 6-5 : Micro-scale enterprise: growth prospects</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
</tr>
<tr>
<td>4.1 Micro-scale enterprises find significant barriers to growth into the middle-scale</td>
</tr>
<tr>
<td>4.2 Micro-scale entrepreneurs refrain from investing in the growth of their existing businesses</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
</tr>
<tr>
<td>4.3 Micro-scale entrepreneurs see the exchange environment as resulting in a high degree of cost and uncertainty</td>
</tr>
</tbody>
</table>
The micro-scale enterprise faces an exchange environment which is conditioned by many of the factors which apply to the middle-scale. This renders the micro-scale type yet more isolated from other elements in the economy. The extent of this isolation leads to the creation of an effective dual economy.\textsuperscript{22} It is hypothesised that micro-enterprises thus fall back on a simple traditional market mode of exchange, which necessarily limits the potential for the growth of such enterprises.

6.5.4 Large scale enterprise

The large-scale enterprise type \textit{ex definiens} is an organisational form in which much exchange is internalised. Again simply following from our definition of the large-scale type, this internalisation is characterised as the bureaucratic firm mode of exchange.\textsuperscript{23} External exchange for large-scale enterprise is likely to be problematic in the face of both background uncertainties and discontinuities in the institutional environment which underpins exchange by contract and long-term contracting.

These circumstances it is argued leads to the favouring of a number of strategies on the part of large-scale organisation, which provide a viable means of organising exchange. Most significant is that there will be a strong pressure on the internalisation of exchange, bringing transactions out of the uncertainty of markets in which the modes of exchange favoured by large-scale are undermined by discontinuity. There will be an emphasis on ‘make’ in the classic ‘make’ or ‘buy’ decision. Related to this point, subsidiaries of multi-national corporations will use their parents or associated foreign companies as bulwarks against problems of exchange in the Kenyan environment. The internationalised basis of such organisations will permit effective access to exchange environments which are more conducive to exchange, especially on the basis of long-term contracting or exchange-by-contract.

Large-scale companies will seek to emphasise the minimisation of uncertainty in exchange. This will be achieved by restricting external exchange across discontinuities. Long-term contracting in particular with micro or middle-scale enterprise will be avoided due to the generic discontinuities between the
organisations. There will be a greater emphasis on forming exchange relations where structure is most likely to be continuous; that is with other large-scale organisations.

Finally strong use will be made of asymmetrical relations. The building of a brand image, or indeed the use of existing international brands in the case of subsidiaries of multi-national corporations, enables consumers to derive some assurance of product quality. Such building of brands has significant indivisibilities and economies of scale and tend to be unavailable to smaller enterprises.

**Table 6-6 : Large-scale enterprise: external exchange environment**

<table>
<thead>
<tr>
<th>Explanandum</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1 Large-scale 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 co-operation in exchange.</td>
</tr>
<tr>
<td>5.2 Large-scale enterprises regard exchange based on the state-maintained economic institutional framework as an efficient mechanism for solving problems of co-operation.</td>
</tr>
<tr>
<td>5.3 Large-scale enterprises are more likely to rely on the state-maintained economic institutional framework for solving the problem of co-operation in exchange than middle or micro-scale enterprises.</td>
</tr>
<tr>
<td>5.4 Large-scale enterprises do not regard the formation of relations with exchange partners as significant to their businesses.</td>
</tr>
<tr>
<td>5.5 Large-scale enterprises find engaging in all but the simplest exchange with middle-scale and micro-scale enterprises difficult.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.6 Large-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
</tr>
<tr>
<td>5.7 Large-scale enterprises do not perceive the institutional framework as inaccessible to them or incompatible with their needs.</td>
</tr>
<tr>
<td>5.8 The governance mechanisms deployed by large-scale enterprises and middle-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
</tr>
<tr>
<td>5.9 The organisational rules and norms adopted by large-scale enterprises, middle-scale organisations are significantly, systematically different.</td>
</tr>
<tr>
<td>5.10 The organisational culture of large-scale enterprises and middle organisations are systematically different.</td>
</tr>
</tbody>
</table>
**Table 6-7: Large-scale enterprise: internal exchange environment**

<table>
<thead>
<tr>
<th>Explanandum</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.1 Large-scale enterprises are more likely to internalise functions in Kenya than in environments characterised by greater stability</td>
</tr>
<tr>
<td>6.2 Large-scale enterprises are more likely to internalise functions rather than outsource to middle-scale enterprises.</td>
</tr>
<tr>
<td>6.3 Subsidiaries of multi-national corporations are more likely to source from parents or related companies than locally.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.4 Large-scale enterprises do perceive internalisation as a means of controlling uncertainty in exchange</td>
</tr>
<tr>
<td>6.5 Subsidiaries of multi-national corporations do regard use of internal sourcing as a means of controlling uncertainty in exchange</td>
</tr>
</tbody>
</table>

6.5.5 **Summarying the argument: comparative analysis**

The differences in exchange environment faced by middle, micro and large scale enterprises derive fundamentally from the dependence on differing modes of exchange, summarised in table 6-8 below.

**Table 6-8: Scale and modes of exchange**

<table>
<thead>
<tr>
<th>Scale type</th>
<th>Large-scale</th>
<th>Middle-scale</th>
<th>Micro-scale</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dominate modes of exchange</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Large-scale</th>
<th>Middle-scale</th>
<th>Micro-scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bureaucratic firm mode</td>
<td>Entrepreneurial firm mode</td>
<td>Relational exchange mode</td>
</tr>
<tr>
<td>Long-term contracting mode</td>
<td>Relational exchange mode</td>
<td>Embedded exchange mode</td>
</tr>
<tr>
<td>Exchange by contract mode</td>
<td>Embedded exchange mode</td>
<td>Entrepreneurial firm (limited)</td>
</tr>
</tbody>
</table>

According to this argument, both middle- and micro-scale enterprise are heavily dependent on informal modes of exchange. The implication is that the prospects for survival and growth of smaller scale enterprise depends on the ability of the enterprise or entrepreneur to use informal institutional structures to solve problems
Institutions and discontinuity

in exchange. Where there is a high degree of uncertainty in the economy, as we have argued is the case in Kenya, the importance of such structures increases.

By contrast large-scale is more reliant on formal institutional structures. A poor formal institutional structure threatens the ability of large-scale enterprise to engage in significant exchange activity. It is important to note however that large-scale, ex definiens, represents a form of organisation which may be the rational result of internalisation of functions rather than outsourcing. Increasing scale may be associated with an attempt to resolve problems of external exchange.

The essence of the argument is that the formal institutional environment in Kenya affords little space for middle-scale manufacturing or indeed the evolution of the micro into the middle. Problems in exchange are generally exacerbated by a high level of background uncertainty directly in terms of macro-economic performance and the institutional environment. Large scale enterprise as an organisational type enjoys a comparative advantage. By implication internalisation of functions is favoured wherever external exchange is rendered problematic.

Part of this argument relies on the historical circumstances of the initiation of Kenya's industrialisation. Early organisation of production in relatively large-scale enterprises contributes to the creation of a future exchange environment which is more favourable to large-scale and inimical to the development of the middle-scale. Essentially then it is argued that there is a path dependency in the evolution of the exchange environment which has to an extent locked-in to favour a large-scale organisational structure. There is clearly also a political-economic dimension to this lock-in argument, which encompasses the development of the formal institutional environment.

The relative success of middle-scale enterprises which are owner-managed by entrepreneurs of Asian origin is explained by the reliance on an embedded mode of exchange. Asian entrepreneurs have been able to exploit informal institutions which are specific to the ethnic communities to which they belong, in order to support this mode of exchange. By contrast it is hypothesised that the position of the ethnic
African entrepreneur has not resulted in a similar solution to the problem of exchange. The relative lack of development of the African middle-scale enterprise is therefore understood in the lack of real opportunity afforded by the exchange environment.

In chapter 4, three basic questions were raised by the question of Kenya's missing middle. It is useful to restate these now:

i) What constraints, if any, are there to micro-scale enterprises from graduating into the middle?

ii) Is there a reason why more entrepreneurs do not start-up at the middle-scale level?

iii) Is the operating environment inimical to middle-scale enterprise, causing a high rate of firm exit?

Fundamentally it has been argued that the operating environment is inimical to middle-scale enterprise in Kenya as a result of difficulties in the exchange environment caused by discontinuities. Asian enterprises and entrepreneurs are able to overcome these problems by the use of social institutions to support an embedded mode of exchange. The difficulty of actually operating a middle-scale business in Kenya will deter many African entrepreneurs from ever starting up in the middle-scale. Furthermore it can be speculated that the formation of capacities relevant to the operation of middle-scale enterprises is constrained by the poor exchange environment. African micro-scale enterprises are unable to capture the basic resources needed to grow or develop the managerial and technical capacities required for the growth process itself. Finally, remaining 'small and flexible' represents a rational strategy in the face of a hostile environment.

6.6 Conclusion

This chapter has provided a broad theoretical account of the particular feature of Kenya's manufacturing scale structure identified earlier (§3). Crucially it offers a
coherent explanation for both the general absence of the middle-scale and the relative strength of the Asian owned middle-scale in Kenya.

The theoretical framework used here represents a novel application of the emerging new institutional economics. A broad-based model of exchange enables the wider insights of institutional theory to be applied to the question. This broader framework encompasses social and cultural phenomena which were thought to be relevant to the question of scale.

The concept of discontinuity was introduced to refer to features in the structuring of the exchange environment. A discontinuity occurs where the structuring of exchange is dysfunctional with respect to tackling the problems of a particular exchange. It can occur between distinct elements of the structure or between structure and the exchange task itself. The essence of discontinuity analysis aims to relate economic outcomes to flaws in the exchange environment. The analysis of the exchange environment based on the model of the exchange process developed is simplified by the identification of modes of exchange. These modes of exchange describe the generic ways in which exchange problems are tackled within a market-capitalist economy.

The central question of scale structure it is argued can be understood in terms of the exchange environment. On a first order analysis the distribution of enterprise scale in an economy is held to depend on the opportunity or space for each scale type found in the exchange environment. The impact on enterprise scale of the exchange environment in Kenya is described in terms of the modes of exchange identified on the basis of the model developed.

The explanation rests on a number of testable assertions about the nature of the Kenyan environment and gives rise to further assertions and exploratory hypotheses regarding the relationships between entities. In the next chapter we look to see how the this new theory of Kenya's missing middle can be explored empirically.
Notes

1 The indissociability of fact and value is strongly argued by Putnam (1990).
2 This term is elaborated in a collection edited by Aoki et al (1990).
4 Changes in relative prices alter incentives in interaction. Relative price shifts include: factor prices, information costs and technology change (see North, 1990, p.84).
5 See for example Marris and Somerset (1971) and Bates (1989) for arguments in this vein concerning Kenya.
6 Traders interviewed in markets across East Africa frequently emphasised the important of regular customers. Where a customer visited a particular trader regularly, loyalty bonuses were forthcoming in the form of either discounts, free additional product or better quality of product. (Source: Field study, 1997). Geertz (1978) shows in his study of Moroccan bazaars the complexity of a situation which at first sight appears to typify simple market exchange.
7 For example European Community law requires that goods are generally reasonably safe. The means by which goods can be shown to fulfil this general requirement is by compliance with standards set by various designated bodies for various product types which provide the detailed specifications of what is regarded as safe. The British Standards Institute issues BS standards covering a very wide variety of such safety quality standards (Howells and Weatherill, 1995).
8 Bates (1989) argues that the outbreak of the Mau Mau conflict in the 1950s is strongly associated with this pressure. Much of Bates' thesis can be understood in terms of discontinuities in the political, social and economic institutional structure. The result was an attempt to change the 'rules of the game' by violent means.
9 Williamson (1996, p.96) offers an example of precisely this sort of contracting. The Northwest Trading Company and Nevada Power Company entered into a thirty-two year supply contract for coal which allowed adjustment of the terms of supply according to procedures defined in the contract.
10 The researcher's own experience in banking with the negotiation of large debt facilities for multinational companies illustrates the point. Broadly the interests of bank and client could be said to be convergent. The bank provided a loan which would be invested in the business of the borrower and repaid from the success of the client's business activities. Much of the difficulty in negotiation arises from determining what would happen in the event of an adverse result for the business producing a lower income stream than anticipated, delaying or threatening debt servicing. The framework which the loan agreement sought to delimit was when the bank would be entitled to act in order to protect its position – at the possible expense of the future viability of the business. Both negotiating and drafting such agreements is highly time consuming and requires the use of specialist lawyers. Much of the difficulty in producing such agreements is that they revolve around remote contingencies thought by both sides to be highly unlikely, but which would result in a situation where co-operation through relationship could no longer be relied on since the potential adverse outcomes for both sides were so severe.
11 This is clear enough from the experience of societies in which strong organisations emerge without the existence of formal institutions. To take an extreme example, members of criminal organisations such as the Mafia will be in little doubt that they belong to a hierarchy and are subject to the authority of the crime bosses. However it is unlikely that employment contracts or labour regulations will play much of a role in defining the employment relationship.
12 In the UK, the Companies Act provides the basic structure by which a company can be created as a legal entity and the basic functional relationship between owners and managers (directors) defined. Reporting requirements are laid down, both by the legislation and implicitly in the accountancy profession's statements of accounting practice. The greatest separation between ownership and control is facilitated by the stock exchange which again is subject to a complex set of institutions guiding its operation.
13 This is obviously consistent with the frequently suggested link between general uncertainty and a slowdown in economic activity.
The point here is that any underlying regularities in variables are not readily discernible from the phenomena themselves. See Kellert (1993) for a discussion of this topic.


The literature is vast. For a recent study of the Kenyan situation see Kariuki (1993). See also Webster et al (1996) for a summary of World Bank experience in developing economies.

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Hulme and Mosley (1996). These problems are sometimes expressed using the terminology from insurance markets in terms of "adverse selection" and "moral hazard". See also Von Pischke (1991).

Based on the researcher's own experience as a lending banker with a large-scale bank in Kenya dealing with middle-scale enterprise clients and further observations during field work (1996-7).


Granovetter (1992b, 1995) attributes the success of smaller-scale enterprises owned by the ethnic Chinese minority communities in SE Asia to just such an argument. At the heart of this success, according to Granovetter is the balance between coupling and de-coupling amongst members of a community in order to achieve economic advantage.


The idea of "dual economies" has been put forward by a number of commentators. Notable in respect to Kenya is ILO (1972).

An interesting feature of recent large company strategy and management literature (notably for example Peters, 1979) has been the emphasis on attempting to re-organise large companies to capture some of the advantages of the entrepreneurial mode of exchange (see Gibb, 1997). The extent to which this is feasible is clearly challenged by the argument here. Williamson (1985, §6) discussion of why all transactions are not organised in a single firm (the obverse of Coase's famous question) is relevant here. He argues that the key characteristics of the market mode of exchange cannot a priori be replicated in the since they are founded on incentives which are replaced within the firm by authority.
7. EMPIRICAL METHODOLOGY  
AND FIELD RESEARCH

7.1 Introduction

The theoretical explanation developed in the previous chapter represents a wide-ranging argument covering theoretical processes of economic development and facts about middle-scale enterprises in Kenya. If this argument is to be of any value in the real world then it needs to be tested and explored using empirical evidence. Two immediate questions are posed: to what extent is the theory consistent with the reality it seeks to explain and how can the theory be enriched and extended by consideration of empirical data.

Before looking to collect data either directly from the field or from the existing literature and sources, it is necessary to clarify exactly what is to be sought from this empirical work (§7.2). In the argument put forward in the last chapter a number of assertions were made at varying levels of generality. The first part of this chapter considers broadly how this argument is to be explored empirically.

Having defined the nature of the empirical research problem faced, we then turn to the question of broadly how this problem can be addressed (§7.3). The qualitative versus quantitative research debate is considered, both in relation to the more philosophical elements and those more directly relevant to the empirical method. A major methodological issue is whether to rely on primary or secondary research. It is argued that both can be usefully employed here. The choice of primary research strategy is then considered.

In the next section (§7.4), the detailed design of the primary research is described, covering the methods of data collection, choice of populations and instruments used. A key issue here is how quality is to be assured and the validity of the work established. Cross-cutting all aspects of the primary research design is the question of access which, in the particular context faced, presents a major challenge.
Turing to secondary sources (§7.5), there is a considerable body of somewhat disparate research which is applicable to the empirical testing and exploration of the theory. These sources are discussed briefly together with an indication of the areas to which they are applicable.

The final element of the empirical methodology which needs to be elaborated is how the evidence garnered is to be analysed (§7.6). Although much of this will be made evident from the presentation of findings in the next chapter, it is important to clarify from the outset the basic approach to analysis. In social science research there is again a lack of consensus on how data, and qualitative data in particular, should be analysed.

The fieldwork was conducted in Kenya over two phases: a preliminary stage and a main stage. The experience from the field over the two phases is described in the final section of the chapter (§7.7). In the actual implementation of the fieldwork there is inevitably significant variation from the intent of the overall research strategy and design. It was partly to control some of this variance that a preliminary phase was conducted. Whilst the major concern is to minimise the negative impact, there is also room for making use of unanticipated evidence and insight.

### 7.2 The empirical research problem

The theory advanced in the last chapter to explain Kenya's scale structure makes assertions at a number of levels of generality. At the highest level of generality there are implicit claims regarding social theory. The validity of the institutionalist approach outlined directly depends on a theory of the structuring of human action. Within this institutionalist framework, a model of the structuring of the exchange process was put forward. Other ways of describing the structure are conceivable within a broadly institutionalist approach. In describing the modes of exchange more concrete assertions are being made about the dominant forms of exchange within a broadly market economy. Crucially at this point, claims are made about comparative transaction costs and residual uncertainty. Based on both assertions made regarding specific circumstances in Kenya, and the understanding of the terms middle-, micro- and large-scale, an argument is finally put forward explaining the
scale structure of Kenya's manufacturing sector. This argument was summarised in specific hypotheses and exploratory questions regarding the behaviour of middle, micro and large-scale enterprises according to the exchange environment faced. (These are summarised in Annex A, as alternate hypotheses together with an appropriate null).

The argument as presented resembles a familiar model of science: a theory and auxiliary assumptions from which are deduced observable statements. The initial focus of the empirical task is to investigate whether the predicted regularities are supported by the available evidence. However the conclusions which can be drawn from such evidence is limited. It might be the case that a middle-scale enterprise is found not to have strong linkages with any large-scale organisations. However the explanation for this avoidance may not be for the reasons suggested in the last chapter. For example, rather than perceiving such entities as difficult to deal with due to fundamental discontinuities in the structuring of exchange with large-scale entities, it might be that there are no large-scale players in the sector in which that enterprise is involved. Furthermore it is important to note that the argument put forward in the last chapter does not predict quantifiable regularities at the level of observable social facts. The observation of a middle-scale enterprise engaged in a close exchange relationship with a large-scale enterprise does not necessarily falsify any part of the theory. Finally contrary observations cast doubt on the auxiliary assumptions in the first instance rather than the theory itself. The conditions in Kenya may be somewhat different from those assumed.

The line of causality which runs through the argument can be traced more directly. Thus the explanation itself can be investigated empirically; we can look to see whether the reason that entrepreneurs avoid exchange in a particular mode is a result of problems in structuring that type of exchange. Furthermore the assumptions regarding the nature of the Kenyan environment can also be directly measured independently of the rest of the argument.

The essence of the empirical task can be summarised as describing the exchange environment faced by various entrepreneurs and scales of organisation, and determining how this supports, refutes or extends the argument put forward. It is
useful to consider the argument in two parts: the *explanandum* and the *explanans*. Although the whole argument comprises the explanation of Kenya's middle (and thus comprises the *explanans* which is the thesis defended here) this distinction draws attention to the two steps involved. The *explanandum* refers to the expectations or predictions from the theory. Meanwhile the *explanans* provides an account, within the theoretical framework, of why the features of the *explanandum* are found. The specific hypotheses and questions of the last chapter were organised to follow this schema.

### 7.3 Approaches to research

We now turn to the question of how the hypotheses and exploratory questions generated from the theoretical argument of the last chapter are to be explored. Before examining the potential sources of data and methods of primary collection, some basic philosophical issues need to be considered.

#### 7.3.1 Qualitative and quantitative research

A major debate in social science research revolves around the uses and validity of quantitative and qualitative approaches. Much of this actually relates to meta-theoretical, epistemological and ontological questions rather than distinctively methodological issues. The question is not so much about 'how do we get at the facts?' as 'what do we mean by facts in the first place?'. In this latter sense, the use of the terms 'quantitative' and 'qualitative' are apt to be misleading. The association between two different debates – one methodological and the other essentially philosophical – arises from the implications for the former from the latter.

It was the positivist insistence on verification in science, Glaser and Strauss (1967) observe, which led to the emphasis on quantitative methods in social investigation. The supposition was that the newer social sciences could only hope to emulate the theoretical and especially predictive successes of the older natural sciences such as physics and chemistry by adopting the same methods. As Guba and Lincoln (1994, p.106) put it: "Scientific maturity is commonly believed to emerge as the degree of quantification found within a given field increases." Amongst the social sciences,
economics has remained most strongly wedded to the positivist notion of verification.

There has been a strong philosophical reaction to positivism, especially in relation to the philosophy of social science. This reaction has lead to many social theorists (outside economics) adopting a position which is essentially relativist. Although the revolt against positivism has been important for social science, there is some danger that relativism undermines the possibility of much useful social scientific enquiry. This problem is best illustrated by returning to the theoretical argument we are looking to explore here.

Underpinning the explanation for differences between Asian and African success in the middle-scale in Kenya, put forward in the last chapter, is the role of culture and social institutions. The distinct cultural and social backdrops against which entrepreneurs in communities in Kenya act gives rise to a variance in the exchange environments faced. However there is an important commonality of purpose assumed amongst entrepreneurs; put simply – to succeed in business. The shared experience of operating a business within the same economy essentially drives such a convergence. It echoes the point made by Daniel Little (1989, pp.230-8) against radical relativism that the basis of many – but by no means all – human needs, can be found in broadly common biological and environmental circumstances. Returning to the particular case of managing an enterprise, independent of cultural context, success (or at least survival) will entail, consciously or unconsciously, effective performance of a range of business activities. It can therefore be supposed that there is a valid and useful description of at least some aspects of enterprise which is cross-cultural. Such a position does not entail a retreat to naïve positivism and the notion that there may be an objective description somehow independent of the observer.

Turning now to the methodological question, we consider how to investigate the central feature of our theoretical explanation for Kenya's middle: the exchange environment. Understanding the entrepreneur's exchange environment necessitates attempting to see the entrepreneur's environment through her eyes and actions. A significant element of the empirical work must involve a study of the processes by which enterprises relate to the exchange environment. Such process investigations
Empirical methodology and field research

are necessarily qualitative in nature. The question of whether entrepreneurs do or do not rely on informal institutions in exchange is not one which can be codified into a simple question. The answer to a direct question will not necessarily relate to how exchange problems are overcome, but the respondents view of the question. What is needed are the detailed stories from the entrepreneurs regarding how exchanges are handled in practice. From this detail it is possible to interpret the process by which exchange is accomplished within the theoretical framework. Such investigations could be used in principle to generate quantitative data. A large scale survey of enterprises based on the 'qualitative approach' could be used to generate statistically significant results. This sort of research would obviously require very significant resources to undertake and for this reason alone, such studies are rare.

Both qualitative and quantitative data appear in social science and differing methods are more or less appropriate to each. Understanding the reasons for which entrepreneurs trade with certain organisations and not others is best treated ethnographically since the aim is to understand decisions and behaviours within the entrepreneur's own frame of reference. Bringing a structured theory to bear on such a problem risks distorting the evidence. The theoretical framework used here posits that we can understand the decision processes of entrepreneurs in terms of the extent to which they mitigate problems of co-ordination and co-operation in exchange. However we can only test a hypothesis about how entrepreneurs actually make decisions about things by examining how this occurs. Methodologically, the stance must be hermeneutic.

By contrast, the argument being investigated also gives rise to the prediction that \textit{ceteris paribus} middle-scale enterprise will trade with other middle-scale enterprises in preference to large-scale. This can legitimately and appropriately be investigated quantitatively, by means of say a structured survey.\footnote{Finding that a statistically significant proportion of middle-scale enterprise do indeed trade with other middle-scale enterprises in preferences to large-scale would be useful and compelling evidence in favour of the argument.} Much of the empirical task faced here is exploratory in nature. A number of exploratory questions rather than specific hypotheses have been generated. The
initial work aims to clarify these questions, potentially resulting in some more clearly definable research hypotheses. Similarly the qualitative hypotheses will also be subject to considerable refinement. A potential output from a qualitative research exercise could be a more readily quantitatively testable theory. Although it is argued that the investigation of exchange processes necessarily involves a qualitative approach, the derivation of quantitatively testable hypotheses would enable a second stage of research to be undertaken which might provide greater confirmation of the generalizability of conclusions.

7.3.2 Use of primary and secondary data

The theory we are seeking to test, defines terms within its own framework. To this extent therefore there is a need to conduct new original research based on this conceptual understanding. Reliance on existing data risks applying terms which though homonyms have a different referent. Process investigations of the type envisaged here clearly require new work based on the understanding of terms contained within the conceptual framework. Practically, relatively little empirical work has been conducted into the middle-scale enterprise in Kenya; there is rather more concerned with larger scale and the micro-scale. This results in both the necessity and justification for further investigations into the middle-scale sector particularly.

The scope of the theory advanced here is very wide and within the constraints of this particular study, a comprehensive primary investigation is impossible. Theoretical considerations dictate that the focus of research should be on the middle-scale. The argument put forward in the last chapter draws much of its force from a consideration of the exchange environment for middle-scale enterprise. It has been argued that the lack of start-ups or graduates from the micro-scale into the middle can be explained in large part by the hostility of the middle-scale exchange environment. Thus although primary studies of micro-scale enterprises would be valuable in determining the constraints to growth of this scale of enterprise, it is not the theoretical focus of this work. Similarly although according to the argument large-scale enterprise is also important in shaping the exchange environment of the
middle, again it is not the primary focus. The imperative at this stage is to increase the in-depth understanding of the middle-scale exchange environment.

There is some valuable work directly and indirectly relevant to the middle-scale in addition to a more substantial amount relating to the micro- and large-scale. This secondary data offers a very valuable resource for the investigation of the theory here. At one level, the extensive use of secondary data is purely pragmatic. Use of secondary data enables greater scope and depth in the empirical investigation (Frankfort-Nachmias and Nachmias, 1992). More fundamental is the need to build on existing research efforts. This research represents a modest contribution to a growing corpus of knowledge regarding enterprise and development in Kenya. The progress of this longer-term project dictates that the maximum possible use should be made of existing data.

There is perhaps also an ethical dimension. Signs of over-research in the Kenyan micro-enterprise sector particularly are starting to appear. Over-research is damaging to the reputation of researchers generally in the field, leading to access problems for future research and potentially exacerbating the measurement problem as respondents start to react to research. Furthermore research not only consumes the resources of the researcher but also the time of the respondent. There is something of an imperative therefore to use data collected as effectively as possible. The studies which can be used as a source of evidence in this study are summarised in Appendix C. The approach adopted therefore combines both primary and secondary data. Primary data collection is essential for the middle-scale enterprise aspect of the study and forms the basic focus for the fieldwork.

7.3.3 Choice of primary research strategies

In determining the appropriate strategy to apply to a particular research question it is useful to briefly review the strengths and weaknesses of the various possible approaches. As Robert Yin (1994) argues, the choice of research strategy should be determined by the nature of the particular research question posed. Amongst the most commonly used research strategies in the social sciences are survey, archival analysis, experimental, case-study, and history (Yin 1994, p.3).
Survey methods are very widely used in social science and especially economics. The primary motivation for adopting a survey approach is to establish generalisations across a population. The survey approach usually involves selecting a limited but statistically significant sample from a given target population for study. Results from the sample are used to generalise across the wider population. Census studies involve enquiries across all members of a population and therefore differ insofar as the middle-step of statistical inference is omitted. Obviously the research resources demanded for a census will generally be significantly greater than for a survey. Archival analysis can be regarded as closely related to the survey, seeking to establish generalisations based on examination of secondary data.

According to Yin (1994, pp.5-6) the survey is most appropriate for asking research questions of the type "who, what, where, how many, how much". Hence the goal of such research is either descriptive or predictive of particular phenomena. The survey and associated strategies are constrained in addressing explanatory questions. Much of what is measured by survey research is necessarily phenomenal and whatever regularities discovered are consequently also phenomenal. Where survey is used to support explanation, it is on the basis of the confirmation or otherwise of a pre-existing theory.

The point can be illustrated by a simple example. A survey might reveal that 45% of small businesses in a particular population have never approached a formal bank for a loan. What such a survey does not reveal is why these businesses have not sought loans. The obvious riposte here is that surveys can and are in fact commonly used to explain this type of phenomenon. Respondents might be asked to indicate reasons for not seeking loans, most often from a set of prepared answers in order to simplify the survey process. However offering a choice from a set of pre-prepared answers can only indicate a degree of support for a causal relationship which has already been proposed as explanatory. Even if the question is left open and responses are coded subsequently, there is the theoretical presumption that the explanation for such phenomena can be truly explained in terms of the expressed beliefs or desires of a respondent.
Experiment is often regarded as highly attractive insofar as it most closely resembles the approach associated within the natural sciences. It attempts to find causal links between entities (Dane 1990, p.76), answering what Yin (1994, pp.4-9) refers to as 'how' and 'why' type questions – problems of explanation. The difficulty of drawing inferences from real situations, where the crucial condition of *ceteris paribus* very often does not apply, is tackled by attempting to directly control circumstances. However actually setting up a controlled social experiment is difficult. Clearly the possibility of establishing anything approaching a social laboratory is very highly constrained. The focus of empirical social science is the social system, not the individual. In this study the concern is with the behaviour of entrepreneurs and enterprises situated within highly complex social systems. The phenomena are not separable, in principle, from the system. Replicating even the most basic conditions of such a system is infeasible. An alternative approach is to conduct experimentation within the field setting. Careful monitoring of conditions can be used to mitigate against the interference of extraneous variables in the experiment. Such experiments are again highly constrained in their application. At the outset the research problem must be based on a small number of controllable variables and there needs to be some confidence that other factors will not influence the outcome. These conditions are clearly not met in the research problem faced here.

The major remaining research option is the case study. Yin defines the case study research strategy in two parts:

1. *A case study is an empirical inquiry that*
   
   - investigates a contemporary phenomenon within its real-life context, especially when
   - the boundaries between phenomenon and context are not clearly evident.

2. *The case study inquiry*
   
   - copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result
   - relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result
   - benefits from the prior development of theoretical propositions to guide data collection and analysis.

Yin (1994, p.13)
The case study is also held to be most applicable to explanatory type questions of the “how” and “why” form. Cases can be used to trace the causal links between elements, most especially where causality can be presumed to be complex. The method is thus strongly suited therefore to the in-depth study of process. Finally, as Sylvie Chetty (1996) observes from her application of the case study method to research in small- and medium-sized firms, the case study allows new insights to be obtained which would not emerge from a survey approach. The method is also therefore highly relevant to exploratory types of work.

It is important to clarify the basis on which conclusions can be drawn from the use of case studies. The principle is not to make inductive generalisations as is the case with surveys. Frequently single cases are studied, clearly a poor basis on which to form an inductive inference. This is often taken to imply that case studies are only useful for exploratory or pre-experimental work, highlighted in the comment by David Nachmias and Chava Nachmias in a standard text on research methods that “since case studies analyze unsampled systems, they are weak on generalizations” (1976, p.42). This misinterprets the role of the case study research strategy. Cases relate to theory and as Yin puts it, “the case study, like the experiment, does not represent a “sample” and the investigator’s goal is to expand and generalize theories (analytic generalisation) and not to enumerate frequencies (statistical generalization).” (1994, p.10).

The argument advanced here to explain Kenya’s middle rests on understanding the exchange environment of the enterprise by considering how problems of exchange are tackled. At issue is the process of exchange. As noted above, the empirical research problem consists in not simply determining the extent to which observed features of exchange accord with theoretical prediction but also in attempting to trace the causes of such outcomes. Finally, a significant part of the empirical task at this stage is exploratory. The theory put forward is at an early stage of development. In relation to the use of informal institutions in exchange, a number of tentative exploratory questions have been advanced. The case study approach is clearly the appropriate strategy in this context.
7.4 Primary research design

The object of the primary research in the study is to test the argument by understanding the way in which enterprises carry out exchange tasks within the particular exchange environment in which they are found. This essentially addresses the arguments relating to middle-scale enterprise (elaborated in the specific hypotheses and questions in tables A-1 to A3, Appendix A). The clear unit of analysis is the enterprise. However within each enterprise, there is a sub-unit of analysis – the exchange task. Enterprises are involved in a range of different exchange tasks; it is by studying how these individual exchange tasks are achieved that the broader question of how the enterprise achieves exchange can be tackled. The case-study design thus corresponds to Yin's category of "embedded" – in the sense that the sub-units (the exchange tasks) are embedded in the fundamental unit (the enterprise).

Enterprises are typically involved in a wide range of exchange tasks. Examining the basic economic inputs and outputs enables a simple classification of the exchange tasks to be made. Five groups of exchange task can be readily identified: supply, demand, finance, labour and technology. The obvious objection to such an analysis is that it is highly simplistic and susceptible to the criticisms of being excessively reductionist. That firms are involved in other types of exchange tasks is not doubted here. Taking a dynamic perspective it is clear that there needs to be consideration of how the firm acquires the capability for growth. However the basic argument, as outlined earlier starts with a simple static analysis. More fundamentally however, while it is not contended that these types of exchange tasks are sufficient for all enterprise activity they are necessary. Problems in accomplishing these basic tasks will certainly have implications for the viability of even the simplest enterprise.

Fundamental to the argument to be explored is the positing of differences in the exchange environment between entrepreneurs from different ethnic communities, specifically African and Asian owned. Two types of case are therefore required to explore the differences: African owned and Asian owned enterprises. More than one case is sought for each type. This literal replication, as Yin (1994, p.46) refers to it, in no sense resembles population sampling associated with the survey type
Empirical methodology and field research

methodology. The logic here is more that of a repeated experiment, where replication of the same results increases confidence in the theoretical argument under test. The objective here therefore is to produce a total of four cases, two African and two Asian owned.

A pilot phase is an essential part of the design process. Experiences from this phase are described more fully below (§6.6.1). The purpose of this phase is to determine the viability of the proposed research process and a test of the instruments, together with collection of data.

7.4.1 Data collection

The essence of the cases involves investigating the process by which enterprises engage in various exchange tasks. There are a number of potential means of collecting evidence including interview, group discussions, direct observation, participant-observation and documentation (Yin 1994, p.80; Ghauri et al 1995, p.87). Each of these has particular advantages and disadvantages and no one source can be judged necessarily superior to another (Bulmer, 1993).

However before considering any choice of method, the practicalities of research need to be considered. Decisions regarding the approach taken to research must always take into account what is actually viable within the context. In developing economies many assumptions formed in the industrialised economy context are not tenable (Bulmer and Warwick, 1993a). Secrecy and a suspicion of questions are common in Kenyan business, a point also noted by Catherine Masinge (1994) in her study of large-scale enterprise linkages in Kenya. Entrepreneurs are very reluctant to disclose any written material. Furthermore it was made clear during the pilot stage that the recording of interviews would be regarded as intrusive. The idea of a group discussion was suggested to entrepreneurs interviewed. The response was that the subjects of discussion were too confidential to be shared with actual or potential competitors.

Access represents a related problem. Participating in research offers no immediate benefit to the respondent. There is however a cost in time, inconvenience and the risk that sensitive information may end up in the wrong hands. Ruth Holliday (1995)
in her study of small firms in the UK was able to gain access readily by offering to work unpaid for the companies, and therefore providing a tangible benefit. In this way she was able to acquire rich ethnographic data through participant-observation. This approach is less viable in a context where unskilled labour has a relatively low value.\textsuperscript{9} It also raises the problem of secrecy again.

The interview presents the least threat given to access. It offers a situation which the wary entrepreneur is able to control readily and therefore feel most comfortable with. It does not provide the richness of data and potential for triangulation by using multiple sources offered by methods such as participant-observation. The problem of access is so overwhelming that the interview technique is the clear choice in relation to this research.

7.4.2 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 of scale and ethnicity are not likely to be swamped by other factors. In particular it is important to avoid enterprise sub-sectors in which the process technology is known to be subject to significant indivisibilities or there are other major entry barriers. Oil refining is an obvious such activity. Although the association of large-scale processes with large-scale organisational types is explicable within the framework, it will also dominate the other factors which are the subject of this study. Other sub-sectors for which middle-scale processes exist, such as sugar processing, but where there has been very strong, direct government involvement will also be avoided. To avoid the possibility of other unknown extraneous factors "swamping" the data, enterprises can 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).

As noted earlier, 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. 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 should be chosen in which there are known to be a reasonable number, say at least ten, middle-scale enterprises. A number of manufacturing sub-sectors in Kenya fulfil all these criteria. Ideally two or three cases of African and Asian owned enterprises would be sought from at least two sub-sectors, in order to control for the impact of sectoral variances. However time and resource constraints dictates the use of only a single sub-sector. There is nevertheless considerable advantage in concentrating on a single sector. A considerable amount of data can be captured regarding that sub-sector, enabling an improvement in data quality by the use of triangulation from multiple sources of evidence.

The garment sub-sector (ISIC code 3220, manufacture of wearing apparel) meets all the above criteria and has the advantage of having been the subject of research work in the past, primarily at the Institute for Development Studies in Nairobi by Dorothy McCormick and others. The work thus benefits from the existing understanding of the sector and contacts with entrepreneurs. Furthermore it is hoped to be broadly complementary in widening further the understanding of this sub-sector.

7.4.3 Instruments

The instruments were developed using successive pilots. As described later (§7.7.1) the first instrument was found to be unsuccessful, leading to a significant revision. The new instruments were then piloted again before a final instrument was produced.

A preliminary structured questionnaire is used to establish basic background data on the enterprise (§B.2) and to enable the determination of its scale. The main part of the study is based on five semi-structured interview schedules, each relating to a particular type of exchange activity: supply, demand, labour, process technology acquisition and finance (an example, for supply, is given in Appendix B.3). There is a common underlying structure for each of these five interview schedules, although each is tailored to the particular area under scrutiny. The basic logic for these
Empirical methodology and field research

schedules is summarised in Table 7-1 below. In order to generate a simpler narrative flow in the interview, the topics and questions are re-organised in the schedules.

The schedules aim 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

Table 7-1: Underlying logic for the interview schedules

<table>
<thead>
<tr>
<th>Subject</th>
<th>Question</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composition</td>
<td>Who are the major actors in this area of the exchange environment?</td>
<td>Establish nature of all actual and potential exchange partners</td>
</tr>
<tr>
<td></td>
<td>How are they characterised?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Who does the enterprise work with primarily?</td>
<td>Establish key and other actual exchange partners</td>
</tr>
<tr>
<td></td>
<td>Who else does the enterprise work with?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Who does the enterprise not work with?</td>
<td>Establish potential sites of discontinuity</td>
</tr>
<tr>
<td>Nature of normal</td>
<td>What is the content of transactions in which the enterprise is involved?</td>
<td>Establish relevant characteristics of the transactions</td>
</tr>
<tr>
<td>exchange process</td>
<td>What are the significant requirements?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How significant is the particular partner to the enterprise (and vice-versa)?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How was the initial connection made with actual partners?</td>
<td>Identification of problems of co-ordination</td>
</tr>
<tr>
<td>Development of exchange interaction</td>
<td>Identification of problems of co-operation and approaches to solving</td>
<td></td>
</tr>
<tr>
<td>with specific actual partners?</td>
<td>What is the process of normal exchange Problems perceived</td>
<td>Further establish characteristics of transactions; establish strategies for solving problems of exchange</td>
</tr>
<tr>
<td>Means of solution</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Establish what changes can routinely</td>
<td>Further establish characteristics of transactions; establish strategies for solving problems of exchange, significance of flexibility and uncertainty</td>
<td></td>
</tr>
<tr>
<td>occur in the normal exchange process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dealing with major exchange problems</td>
<td>Identify and describe the major problems actually encountered in exchange.</td>
<td>Identification of major exchange problems and especially co-operation problems, notably susceptibility to uncertainty</td>
</tr>
</tbody>
</table>
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 schedules produced represent an attempt to resolve the conflict between openness and productivity.

Each interview schedule is administered in a separate meeting to avoid problems of interviewee fatigue and access problems again. Consequently each case ranges over at least five meetings. Beyond the interview, observations are sought in 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 is the difficulty in capturing all the data which emerges in the course of an interview. Where the instrument is most successful, 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. As noted earlier, the use of a tape recorder would constitute a barrier to free expression by respondents.

7.4.4 Quality

Maintaining quality is a key part of the research design. Yin describes four common tests for quality:

- **Construct validity**: establishing correct operational measures for the concepts being studied
- **Internal validity**: ... establishing a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships
Empirical methodology and field research

- **External validity**: establishing the domain to which a study's findings which can be generalized

- **Reliability**: demonstrating that the operations of a study – such as the data collection procedures can be repeated, with the same results

Yin (1994, p.33)

Measuring qualitative data often leads to questions of how the application of constructs can avoid subjective biases in measurement. The approach taken here has been to avoid directly operationalising the constructs on which the theory is reliant. Rather the instruments and mode of data collection emphasises capturing more basic, unstructured data from respondents.\(^\text{12}\) It is the task of the analysis process to codify this data in terms of the theoretical framework. This analytical process establishes a chain of evidence (Yin 1994, pp.98-9) from responses prompted by interview questions, through interpretations in terms of the framework and then to the specific and broad hypotheses. The nature of the studies, with an embedded unit of analysis – the exchange task – enables a convergence analysis to be made within the case itself. This represents a limited form of triangulation. Finally by concentrating on a single sub-sector some degree of triangulation between respondents is possible, although inevitably limited owing to the subjective nature of much of the data sought.

Establishing the validity of the causal relations posited in cases is not easy. It is argued that the decisions regarding exchange which are to be studied derive from the subjective views of the respondent. Although it is presumed that in general agents make at least *intendedly* rational decisions and hold largely consistent views, this is by no means assured. Although it is possible to triangulate using a number of responses to ensure that meaning is recovered consistently, there is clearly a potential for error. Perhaps the most obvious problem is that of *ex post* rationalisation. Respondents will often attempt to find explanations for their actions which most closely match what is thought to be a socially acceptable basis for action, either on the grounds of what is ethical or 'rational'. Most pertinent to our research problem here is that of discrimination between exchange partners on the basis of ethnicity. Respondents may be reluctant to admit making a distinction for fear of appearing to be racist. A desire to be seen as a 'rational business person' may lead to an emphasis on the logic
of cost minimisation or profit maximisation over intuitions or habits in decision making. The design of the instruments attempts to minimise this problem by carefully avoiding leading respondents in their answers.

The generalisation of findings is based here not on the notion of induction, but deduction. The cases represent tests of the validity of the theory. As such it exposes the theory to a test of falsification. Replication of case types provides a greater degree of confirmation than a single case. However the validity of the generalisation depends on the absence of relevant differences between those enterprises studied and the population of enterprises to which the theory is to be generalised. Case selection could not explicitly conform to standards of random selection, largely for practical reasons (discussed later §7.7).

The reliability of the research procedure according to Yin (1994, p.36) depends on the extent to which the same case could be repeated by a later investigator to produce the same results. In terms of design, fully documenting the process of research is an essential contribution to that reliability. There is however a measurement interaction problem which should be noted. The very process of research could make replication impossible. Put simply, enterprises studied once might be unwilling to submit to a further round of interviews. Again there is little that can be done to mitigate such a problem. Nevertheless designing for reliability remains an important canon of good research practice.

7.5 Sources of secondary data

There have been a number of studies of enterprise development and behaviour in Kenya which can be applied to the theory. These vary widely in their usefulness to the study here and the nature of the data which includes survey responses and case studies. Studies such as Masinde (1994) are very pertinent, examining in detail the linkages between large and small (corresponding to middle-scale) within the motor vehicle assembly sub-sector. The autobiography of Madatally Manji (1995), a highly successful Asian entrepreneur, provides a valuable history of the longer-term process of enterprise development, from a (lower) middle-scale firm to a leading large-scale firm today. The World Bank has recently undertaken a very substantial research
Empirical methodology and field research

project in Africa – the Regional Programme on Enterprise Development. This has produced some useful general survey results (Departments of Economics, Göteborg University and University of Nairobi) together with more specific studies by Biggs and collaborators and Teitel. The sources consulted are summarised in Appendix C, together with an indication of the area of the study for which evidence has been adduced.

Another useful source of data derives from the researcher’s own previous experiences as a lending manager in Kenya for a multi-national bank dealing with middle-scale and large-scale enterprises. Though clearly there are many caveats to be placed on the use of recollections from such experiences, it nevertheless offers some valuable insights based on participation, into the culture of a large-scale organisation and its exchange behaviour.

7.6 Approach to data analysis

Analysis of data which is significantly qualitative in character in many ways presents greater difficulties than the purely quantitative for which sophisticated techniques of statistical analysis are available (Yin 1994, Bryman and Burgess 1994). The approach adopted here has been to make substantial use of the theoretical framework by the derivation of specific research hypotheses and questions (§6) from the argument which is to be tested and explored empirically. This has two advantages. First, it guides the initial design of the fieldwork to ensure that crucial questions are addressed by the proposed work. Second, there is an elementary structure on which the analysis of data can be based. This analytical strategy Yin (1994, p.102) regards as preferable to the descriptive for case studies, since it relates more clearly to the theory which lead to the study in the first place.

There are however some dangers in making use of these hypotheses. One of the principal reasons for adopting a case study approach rather than a simple structured survey was that the phenomena to be studied are essentially processes which cannot be readily measured by simple questions. The hypotheses derived are regarded as signposts indicating key implications of the theoretical argument advanced.
Empirical methodology and field research

Refutation of the hypotheses and additional data gathered may point the way to a better argument within the general theoretical framework.

A number of the concepts used in the theoretical argument – discontinuity, institutions, governance mechanism and culture – cannot readily be operationalised. There is a significant danger of over-reducing the data by attempting a simplistic operationalisation. It has been hypothesised for example that large and middle-scale enterprises find difficulties in engaging in exchange because of a discontinuity in the governance mechanisms, organisational institutions and culture. Suppose that it is found that a middle-scale enterprise avoids taking a loan from a large-scale bank, preferring to find another source of finance. In looking to explain why this should be the case, according to the framework, a detailed examination and subsequent interpretation of the circumstances surrounding the two actors is required. What mode of exchange does the middle-scale enterprise actually use for finance and how does the bank approach the question? According to the analytical framework developed, we can understand this in terms of the governance mechanisms actually used – formal or informal.

In each of the major exchange activities examined, the first analytical task is to identify the key exchange partner or type of exchange partner with whom the enterprise is involved. The research instruments ask a series of questions which aim to identify these key partners. Also identified are the potential exchange partners with whom the enterprise might be involved are considered. Clearly the enterprise is potentially involved in a large number of transactions with many entities. Those potential transactions considered are ones which might be anticipated to have a considerable positive significance for the enterprise giving rise to the question of why they do not occur. Among the most obvious is where an enterprise apparently avoids a particular market for its products. The theoretical approach put forward here suggests that explanations will often be found to relate to transactional rather than transformational problems.

Having identified the significant actual and potential players in the exchange environment, the next task is to understand the relevant characteristics of the actual (or potential) transactions involved. Characteristics which are relevant, according to
the theory are those which will ultimately have an impact on transaction costs and residual uncertainty.

Focussing on the governance of transactions, it will be recalled that Williamson proposes three dimensions for transactions: asset specificity, frequency and uncertainty. The last can arise in a number of ways. Williamson distinguishes three types: primary — relating to the background conditions of the transaction deriving from "random acts of nature and unpredictable changes in consumer's preferences", secondary — deriving from communication whereby parties are not aware of the decisions and plans of others and tertiary — where incomplete and asymmetrical information may be used for advantage by an opportunistic party.

It is useful therefore to consider the characteristics of transactions which are relevant to information. Here the relevant characteristics are the valued properties of a transaction and how these can be measured and transferred. As discussed at length earlier, even the most basic information regarding price cannot be assumed to flow unimpeded between parties. Determining prevailing market prices for relatively simple products involves time and effort. More significant is the question of information asymmetry where there is a necessary differential in access to relevant information between parties.

Having determined which are the relevant characteristics of a transaction (or type of transaction), the potential problems, co-ordinative and co-operative, in exchange can be considered. The instruments seek to identify these by exploring the simple day-to-day process of exchange, how the critical aspects (say quality) can be assured, the problems which are perceived, how changes are made to the terms and so forth. These are the problems which potentially give rise to transaction costs and residual uncertainty.

The significance of the exchange is determined by considering how the transaction impacts on the operation of the business. This is the crucial context to which the approach taken to exchange should be related. Where the transaction is considered to be of critical or high significance to the enterprise then a greater transaction cost and residual uncertainty may be accepted. The exchange partner involved is
identified. Crucial categories required to test the hypotheses are whether it is a middle-, micro- or large- scale enterprise and whether African, Asian or otherwise owned. These are both areas specifically targeted in the interview schedules.

Finally then the mode of exchange must be determined. Understanding the mode of exchange involved entails elaborating how the exchange problems identified are solved (or not) by the structuring of the exchange. There are a number of questions (table 7-1 and appendix B) which directly tackle how the entrepreneur sees the problems as being overcome. However as implied earlier, this is the area in which a considerable element of interpretation of the evidence from respondents is needed. The basis of this interpretation is the basic model or analytical framework for exchange described in chapter 6. The analysis thus looks to identify the governance mechanisms, rules and procedures and institutions (formal and informal) which apply to the exchange problem. A useful start on this analysis is to consider any actual instruments used: legal documents, written technical specifications, verbal promises, unspoken undertakings and so forth. Ultimately such structuring must be understood from within the cultural framework in which the entrepreneur acts – underlining the need for an interpretative stance.

Having produced this basic analysis for each exchange task for each case, it becomes possible to consider the extent to which the task supports either the alternate hypotheses (and the argument put forward) or the null. Analysis across the case increases the scale of evidence deployed since each hypothesis is thus considered in relation to five distinct tasks for each case. A cross-case analysis is crucial both because a number of the specific hypotheses are explicitly comparative, but fundamentally because the argument to be tested and explored is comparative in nature. Clearly the crucial question is whether there are relevant differences to be found in the exchange environments faced by African and Asian entrepreneurs and what underpins such differences.
7.7 Fieldwork

The fieldwork was conducted in two phases. An initial stage was undertaken between November and December 1995, and the main stage between February 1996 and August 1997. Prior to discussing the findings in the next chapter, it is useful to summarise the experiences of the research process itself. These experiences will have a bearing on the conclusions which can be drawn from the evidence collected.

7.7.1 Preliminary phase

The preliminary phase of fieldwork involved both the interviewing of various key respondents in the field in order to establish the potential for the main stage and a pilot of the first draft of the case-study instrument. Although the preliminary phase generated valuable data in its own right its most useful function was to show clearly the need to drastically alter the case-study instrument. It also demonstrated more clearly the practical difficulties of conducting research in this area.

The initial case-study instrument took the form of a relatively highly structured questionnaire. In producing such an instrument the aim had been to permit a survey to be undertaken of a representative sample of middle-scale enterprises. However it quickly became apparent in practice that there was a tension between obtaining the rich data which was needed to properly investigate the theoretical argument and producing a readily administered instrument. Many of the answers to the more important questions concerned with the 'how' and 'why' an entrepreneur adopts a particular approach in exchange cannot be readily captured by a multiple-choice questionnaire. Most obviously offering a choice from a set of pre-prepared answers, even where one is nominally open (i.e. the "none of the above, specify other ..." option) inevitably leads the respondent to a particular set of answers, undermining the validity of the response. This was particularly important in relation to areas of the research question more concerned with exploration of the phenomena and theory building than confirmation of the theory. Furthermore it was found, even with the reductionism inherent in the structured questionnaire, that several hours were required to complete the questionnaire satisfactorily. A survey on this basis would have been impossible within the resource constraints and would have involved access problems.
An important outcome of the preliminary phase was therefore the adoption of a case study research strategy for the main phase. It was clear that a structured questionnaire would fail to capture evidence in the depth required. A major redesign of the instrument was undertaken to produce interview schedules for in-depth case studies.

7.7.2 Main phase

The main phase of the fieldwork was necessarily spread over a relatively long period. Access proved to be a very major problem in the fieldwork. One of the most difficult problems was actually identifying candidate enterprises for study. There is no public domain data on enterprise scale in Kenya. Various options were explored including using contacts, tracing networks and contacting government departments. Eventually data was availed by the Registrar of Industries in the Ministry of Industry and Commerce. From this raw data, the problem of making contact with enterprises was tackled. Numerous enterprises were contacted by telephone (although many contact numbers could not be found) and a preliminary identification of the enterprise type made together, where appropriate, with an attempt to secure a meeting for a first interview. An undertaking to maintain absolute confidentiality of data was found to be very important in overcoming some reservations. The production of a formal confidentiality undertaking helped back this up (§B.1).

Once agreement had been reached for participation by the enterprise in a study, the greatest difficulty was arranging the long series of contacts required to produce the case studies. In-depth case work necessarily requires a considerable amount of contact time with the organisation. Successful middle-scale entrepreneurs are usually very busy and have little spare time for the long meetings entailed by the interview schedules. Long gaps between interview meetings were common. Often considerable efforts were needed to persuade the entrepreneurs to arrange a meeting. One promising case ground to a halt when the entrepreneur felt unable to give any more time, being tied up in a new venture. Numerous calls were needed and a strong degree of persistence. A large number of journeys to enterprises proved fruitless when the entrepreneur failed to appear having been diverted to address a business
problem. Clearly the first priority for the entrepreneur is actually conducting business rather than talking about it.

An initial idea of bringing participants in the case studies together for a group discussion at the conclusion of the individual cases was raised during the interviews. This would have offered another slant on the discussions and a contribution to triangulation of data. The most positive response was lukewarm, while others were highly resistant to the idea. One respondent indicated that the ways of going about business we were discussing were crucial to the enterprise’s competitiveness and there was no way he wanted to share that with other competing entrepreneurs. The idea was therefore abandoned.

Studying relationships would clearly have benefited from being able to interview both sides involved in a particular relation. However the problem of confidentiality severely limited this possibility. The entrepreneurs were only able to talk frankly on the basis that the views expressed would go no further. It was clear that making contacts with the exchange partners who had been discussed would undermine the confidence of respondents that participation in the research exercise would have no negative impact. One enterprise dropped out of the study, clearly concerned about discussing sensitive matters with an outsider. There is an essential practical, methodological, measurement problem raised here. A necessary gap must be acknowledged between the data which is ideally sought in such a social research exercise and what can actually be obtained.

The fieldwork experience confirmed some of the difficulties inherent in undertaking research in a developing economy context such as Kenya. In-depth work appears to generate particular problems and suggests a caveat on the use of the case-study method (by comparison with say survey work) not commonly acknowledged in the literature. However it is also clear that it permits insights into the phenomena which could not be captured by less intensive work.
7.8 Conclusion

In this chapter the approach to an empirical investigation of the theory developed in the last chapter has been elaborated. Empirical work is needed to both test the validity of the theoretical direction taken and to elaborate a number of aspects of the theory. It has been argued that the extent of empirical work needed to examine an argument of this scope demands that the greatest use is made of existing material. For this reason, the empirical work has been divided into primary fieldwork investigation and an analysis of secondary data.

The primary research strategy regarded as most appropriate to the empirical research question is the case study. This enables a detailed investigation to be made of the processes by which middle-scale enterprises undertake exchange, the study of which in central to the theoretical argument elaborated in the last chapter. It also permits a more exploratory approach to be taken, allowing further development of the argument under review.

A number of middle-scale enterprises were studied in a single sub-sector — garment manufacturing. Cases were selected to include both African owned and Asian owned to permit a comparative analysis to be made. Four cases were conducted to satisfactory completion — two each of African and Asian ownership. This allows the extent of replication in findings to be tested both across all four cases and between the two ownership types.

The combination of primary research and a detailed search of the literature has produced a considerable body of evidence relevant to the research question. In the next chapter this evidence is examined in detail against the argument elaborated over the last two chapters (§5, §6).
Notes

1 This is the 'received view' of scientific method (Hempel 1968, Nagel 1979), based on the hypothetico-deductive (H-D) model:

\[
\begin{align*}
&H \text{ (theoretical hypothesis)} \\
&\mathcal{A} \text{ (auxiliary assumptions)} \\
&\mathcal{O} \text{ (observational consequences)}
\end{align*}
\]

The essence of empirical work according to this schema is found in testing of the observational predictions, \(\mathcal{O}\), of a theory, formulated as \(H\), given auxiliary assumptions, \(\mathcal{A}\). However as Hilary Putnam (1975) argues, scientific method is more complex than this schema suggests. Where empirical investigations show that the observational sentences \(\mathcal{O}\) are false, what is falsified is not \(H\) but \(H \& \mathcal{A}\). During the conduct of what Thomas Kuhn (1970) describes as 'normal science', efforts are devoted towards modifying \(\mathcal{A}\) rather than looking for a new \(H\). Where \(H\) represents an otherwise successful theory, scientists are reluctant to reject the scientific paradigm it represents. An oft quoted example of a paradigm shift, or scientific revolution, occurred at the beginning of the twentieth century with the acceptance of quantum mechanics. It is interesting to note here that quantum theory was able to displace Newtonian mechanics because the new theory both accounted for observations which could not be explained within the existing theory (regardless of modifications to \(\mathcal{A}\)) and reduced the earlier theory (Newtonian mechanics can be seen, more or less, as an approximation of quantum mechanics).

2 As noted by Putnam (1975)

3 The *ceteris paribus* condition is obviously demanding: the circumstances must be such that other factors such as price, location, ethnic affinity and so forth are not more significant. However it is possible to control for such factors in a carefully designed study.

4 The University of Nairobi, Department of Economics has co-ordinated a considerable amount of work, reported in two collections by Coughlin & Ikiara (1988, 1991). Both the Central Bureau of Statistics and the Registrar of Industries conduct annual statistical exercises which essentially target large-scale enterprises. The latter is reported in the annual *Statistical Abstract* and *Economic Survey*. Other recent important empirical work includes Himbara (1994b). In relation to micro-scale enterprise, two large scale surveys have been undertaken into the sector under the auspices of the USAID-University of Michigan GEMINI project the (Parker and Torres, 1994; Daniels *et al*, 1995). As argued earlier (§3) both these large-scale and micro-scale enterprise oriented surveys tend to under-represent the middle-scale. Important recent studies into the micro-enterprise sector in Kenya include those undertaken at the Institute for Development Studies in the University of Nairobi (McCormick, 1988, 1991a,b; McCormick *et al*, 1991; Ongle and McCormick, 1996; Kinyanjui and Minullah, 1997; Alila and McCormick, 1997; Atieno, 1997) the long-term studies by Kenneth King (1977, 1996). A very substantial research exercise has been undertaken by the World Bank as part of the African Regional Programme on Enterprise Development (Departments of Economics, Goteborg University and University of Nairobi, 1994, 1995a, 1995b, 1996). This is a longitudinal study which covers all scales of enterprise.

5 See Daniels *et al* (1995). King (1996) also notes the explosion of research into the micro-scale or informal sector in Kenya in the last twenty years.

6 A weak analogy can be drawn with the study of weather in the natural sciences (Waldrop, 1992; Kellert, 1993). The global climate can be regarded as a highly complex system in which it is possible to study experimentally the behaviour of elements of the system in the laboratory but never even the simplest complete system. Although physics provides a well developed science of the behaviour of the elements which comprise the weather system, much of the understanding of weather derives from observations of the actual global weather system itself. The complexity of the system, combined with fundamental measurement issues, undermines any Laplacian project of constructing a science of the weather based on reduction to fundamental physics. Similarly although experimental social psychology can offer clues to regularities of human social behaviour, such findings can only offer the most tentative clues to the behaviour of agents embedded within real social systems.

7 See for example, Pentrose (1959) or relating specifically to growth of the small firm, Gibb and Scott (1985).
The difficulty in obtaining documentary evidence was encountered during the researcher's experiences as a lending banker involved in the middle-scale enterprise sector in Kenya. Even where entrepreneurs were seeking loan facilities which were conditional on obtaining financial data, there was a great reluctance to provide the necessary documentation. A further problem relates to the reliability of documentation such as annual accounts (which in Kenya are a statutory requirement). There is a widely known anecdote in Kenyan business circles that a good firm will have three versions of its accounts: an official version for the tax authorities - showing a suitably low level of profit, a version for the bank which shows exaggeratedly high levels of profit and a final version which shows a true picture of the business for use by the entrepreneur. Needless to say the last version is kept secret. Certainly it was found that management figures extracted from reluctant entrepreneurs (on the basis of strong guarantees of confidentiality and threats to withhold loan facilities) often showed a very marked contrast with from official accounts for the company.

The alternative of offering professional advice, which would have been of greater value, was also considered. However this involves further complications - establishing credibility, time and the ethical demand that any assignments were carried through to successful completion regardless of the research demands. Nevertheless this remains a possible alternative which could have been used and may be appropriate in future work.


The full set of schedules are available on request, only one is included here for brevity.

Other studies outside Kenya are also potentially applicable. However in order to maintain simplicity, the domain of analysis is restricted to Kenya.

This links strongly to the measurement aspect of transactions which is more strongly emphasised by North (1990) and the University of Washington school.

Much of Williamson's analysis is focussed on the circumstances in which a position of ex ante competition is transformed into one of ex post (often bilateral) dependency. A broader analysis is required to consider the impact of physical, technological and institutional factors on market conditions, most especially where these result in an effective monopoly or monopsony. This encompasses some of the more orthodox economic reasoning. Where transactions involve a low weight to value relationship, physical transaction costs may effectively isolate markets. Economies of scale are frequently held to be responsible for the creation of monopolies. Finally, both formal and informal institutions, notably customs duty, have a major impact on the competitive environment. These factors will also, of course, have an impact on transactions more generally. Economies of scale may apply to both transformational and transactional costs. Minimum order sizes dictated by companies can derive from the technological nature of production or a strategy of economising on transaction costs.
8. ANALYSIS OF EVIDENCE

8.1 Introduction

In this chapter, evidence collected from various sources is presented and analysed. The primary purpose is to determine the level of basic empirical support for the argument put forward in chapter 6 which sought to explain Kenya's missing middle. A key question which must be tackled is whether the theoretical frame is broadly found to be convincing in tackling the research problem. A secondary aim, if appropriate, is to enrich the specific argument, much of which remains tentative and exploratory in nature.

The greater part of the evidence is in the form of primary data collected from individual case studies of middle-scale enterprises (§8.2). As discussed in the last chapter case-studies, by their very nature, are rich in qualitative detail. This detail is both a strength and weakness of the method. The difficulty in analysis, regardless of the specific approach taken, is to use this detail economically in a way which appropriately represents the case and its relevance to the question at issue. The detailed evidence for each case is therefore presented in the form of an appendix (D) from which this chapter draws. An introductory overview of the garment sub-sector is presented in appendix D.1 as context to the discussion.

Four cases of middle-scale enterprises are presented, all from the garment sub-sector. Two of the enterprises studied, Ancom and Boncord, are owner-managed by Kenyans of African ethnic origin, while the other two, Zintex and Tykor are owner-managed by Kenyans of Asian ethnic origin. Each of the cases considers the support for the detailed argument presented in the theory, focussing on the specific hypotheses. Each cases is analysed in three parts, considering evidence relating to the formal modes of exchange, relational exchanged and embedded exchange. Much of the explanatory argument is essentially comparative in nature. Following the presentation of the individual cases, a cross-case analysis is made to draw out the comparative evidence.
In the second section (§8.3), the secondary evidence is analysed. Secondary data is used to provide more data regarding the middle-scale but also, critically relating to the micro- and large-scale which have not been the subject of a primary empirical study. The analysis, as before, is based around the specific hypotheses developed in the theory (§6).

8.2 Evidence from the case studies

Four middle-scale enterprise case studies, all from the garment sub-sector, are presented here. All four are wholly owned and managed by families of Kenyan nationality, two being of African descent (Ancom and Boncord), and two of Asian origin (Zintex and Tykor).\(^1\)

In order to indicate how data has been drawn down, a detailed analysis is presented in Appendix D, according to the scheme laid out in the last chapter (§7.6) and examining each of the major task areas of the enterprise. The results of this analysis are presented here in relation to each of the specific hypotheses and the overall argument presented in chapter 6.

8.2.1 Case one: Ancom

Ancom Ltd is a producer of lingerie products, located in a small town approximately twenty kilometres from the centre of Kenya’s capital and industrial centre, Nairobi. It is owned by Janet Kipor and her husband, Peter. Both are African Kenyans, belonging to differing specific indigenous ethnic groups – Janet being Kikuyu and Peter a Luhya. Janet is the managing director and in full day to day control of the business. Her husband is a non-executive director and concentrates on his own electrical contracting business. The company employs 31 staff (28 full time, 3 casual). Organisationally, the company represents a quintessentially middle-scale form. With notable exceptions, discussed later, the company is managed informally. Janet is involved in all aspects of operations – production, buying, designing, marketing and financial control.
Formal modes: exchange by contract, long term contracting and bureaucratic firm

Exchange by contract and long term contracting are not heavily used by Ancom in the areas of transacting considered to be of greatest significance in terms of impact on the company and potential exchange problems. Where these modes, based on formal institutions, are used the impetus almost always derives from the other exchange partner. This is most obviously the case in relation to finance, where the use of the long-term contracting mode is required by the bank with whom Ancom deals. Here, there is a clear desire on the part of Ancom to move to a more flexible, informal mode based on a relation.

Overall however the evidence is ambiguous regarding the hypothesis that Ancom, as a middle-scale enterprise, is significantly less likely to rely on the formal institutional framework than large-scale (hypothesis 1.3). Ancom's erstwhile leading customer, a large-scale organisation showed no greater enthusiasm for formal agreements with its suppliers than Ancom itself. Furthermore on at least one occasion, Ancom has solved a problem of co-operation with a customer by at least implicit appeal to the commercial legal framework.

Within the firm, although a number of key roles are organised according to an entrepreneurial mode, the employment of the production workers is governed by a formal agreement (corresponding to the bureaucratic firm mode). Janet feels she has little option in this question since employment in the sector is subject to employment legislation and collective bargaining agreements, which are strongly enforced. However in relation to this particular exchange task, she also regards the formal institutional structure as useful and appropriate – both acting to reduce transaction costs and uncertainty.

The case of labour contrasts strongly with the use of institutional structure in other areas. The evidence therefore, though not comprehensive (summarised in table 8-1 below), suggests that overall there is little reliance on the formal institutional framework (alternate hypothesis 1.1) and that it is not regarded as an efficient means of tackling problems of co-operation in exchange (alternate hypothesis 1.2).
One explanation for this view is the ineffectiveness of some formal institutions, deriving from rent seeking and nepotism in the state apparatus (alternate hypothesis 1.4). However contrary to the argument it is not felt that formal institutions are necessarily inaccessible or inappropriate (hypothesis 1.5). This is the case in some situations, but not in others. Notably, the effective state establishment and maintenance of product standards could be very useful to Ancom.

Table 8-1: Ancom - evidence for hypotheses relating to exchange by contract, long-term contracting and bureaucratic firm

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>✔ ✔</td>
<td>❓</td>
<td>❓</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td>✔ ✔</td>
<td>❓</td>
<td>❗</td>
<td>✔ ✔</td>
<td></td>
</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
<td>❗</td>
<td>❓</td>
<td>❗</td>
<td>✔ ✔</td>
<td></td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td>✔</td>
<td>✔ ✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs</td>
<td>✔ ✔</td>
<td>❓</td>
<td>❗</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* ✔ ✔ strong support for alternate hypothesis
* ❗ ❗ strong support for null hypothesis
* ❓ weak support for alternate
* ❓ weak support for null
* ❓ ❓ ambiguous between null/alternate

**Relational exchange**

In virtually all significant exchange tasks, relations are regarded as an important means of informally solving problems of exchange (alternate hypothesis 2.1). Where Ancom has the option to determine the mode of exchange which is used then it is
almost always the relational exchange mode. Although it was noted above that a more formal mode of internal organisation was adopted in employing production staff, it is important to observe that for the more significant labour related exchange task of employing supervisory staff, an entrepreneurial mode – based on informal relations – was used.

There is a strongly expressed opinion of difficulties in forming strong exchange relations with large-scale organisations (alternate hypothesis 2.2). Janet clearly sees this as due to the relative size of Ancom: “if you turn up at ICI who would look at you.” On another occasion, referring to an attempt to procure supplies from one large company she says: “they were only interested in talking about economies of scale – 10,000 or finish”.

Table 8-2: Ancom - evidence for hypotheses relating to relational exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>✔️ ✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>✔️ ✔️</td>
<td>✔️</td>
<td></td>
<td>✔️</td>
<td></td>
</tr>
<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.4 The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>✔️</td>
<td>✔️</td>
<td></td>
<td>✔️</td>
<td></td>
</tr>
<tr>
<td>2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
<td>✔️</td>
<td></td>
<td></td>
<td>✔️</td>
<td></td>
</tr>
<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

✔️ strong support for alternate hypothesis  ✔️ weak support for alternate  ☉ ambiguous between null/alternate

☆☆ strong support for null hypothesis  ✗ weak support for null
Only in relation to demand was instability in the operating environment directly indicated as the cause of problems (alternate hypothesis 2.3). Furthermore it was not clear that this was held to account for not forming stronger relations with exchange partners (potential or actual). Clearer however was the sense of a discontinuity between large-scale enterprises and middle-scale enterprises such as Ancom. This appeared most evident in relation to the finance task. Although Ancom had managed to overcome the barriers to obtaining finance from a formal sector bank, it was clear that the relationship was weak. The formal mechanisms used by the bank to assess the lending proposal put forward by the Kipors were not well understood by them (alternate hypothesis 2.4). Equally however Janet feels the bank doesn’t really understand businesses such as Ancom. This appears to derive from a difference in the business processes in the organisations; the bank driven by formal rules, Ancom highly informal, ultimately needing to respond flexibly to numerous stakeholders (alternate hypothesis 2.5). Ultimately this appears to derive from a difference in the way those within the organisations see things – based on differing organisational cultures (alternate hypothesis 2.6). It is summarised in a comment from Janet regarding one conflict with the bank: “the manager starts talking about bank policy. He says ‘this is the bank rule’, I replied ‘I’m your customer!’.”

**Embedded exchange**

In none of the significant exchange tasks faced did Ancom make use of an embedded mode of exchange, clearly consistent with the argument regarding the use of this mode by African enterprises. Operating in an environment in which Asian entrepreneurs are very significant, the Ancom case also produced direct evidence of differences between African and Asian entrepreneurs in this regard.

In each of the hypotheses regarding the use of an embedded mode of exchange, it was found that Ancom, as an African enterprise, did not use them (therefore supporting the null in each case for 3.1, 3.2 and 3.3). However there was strong evidence presented that other Asian entrepreneurs did differentiate between exchange partners on the basis of ethnicity (alternate hypothesis 3.1 and 3.1.1), used socio-cultural structures (alternate hypothesis 3.2 and 3.2.1) and family relationships (alternate hypothesis 3.3 and 3.3.1) to support exchange. Furthermore there was an
indication that there were difficulties for Asian entrepreneurs in solving exchange problems with other (African) ethnic groups.

The use by Asian entrepreneurs of socio-cultural structures to solve exchange problems was most strongly indicated in relation to finance again. Janet referred to the simple reliance on trust in small Asian owned banks in order to facilitate lending. This trust appears to be supported by strong informal, social institutions against failing to meet business commitments within the Asian communities. There is also a strong suggestion that the loss of reputation by malefactors is relevant.

Table 8-3: Ancom - evidence for hypotheses relating to embedded exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
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</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
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</tr>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate cooperation in exchange</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate cooperation.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate cooperation in exchange</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate cooperation.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of cooperation in exchange with member of other ethnic groups.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of cooperation in exchange with member of other ethnic groups.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
</tbody>
</table>

✔️️ strong support for alternate hypothesis
erah hypototes weak support for alternate hypothesis
stitutions between null/alternate
The explanation for the effectiveness of Asian use of social institutions is not clear between rational action — avoidance of censure within the community and simple rule following — the moral force of rules against malfeasance (exploratory question 3.4). Evidence regarding the explanation for Ancom, as an African owned enterprise, not using ethnic based structures is similarly inconclusive (exploratory question 3.5). In many respects the ethnic based social networks of the Kipors, are resource poor (3.5:a) by comparison with Asian middle-scale entrepreneurs. The Kipors have no relatives, close or distant, involved in the garment sector. It is not clear whether there are relatives involved in other areas which would be of use, such as finance or accounting. On the one occasion cited where legal services were required, Janet did make use of her brother, a practising lawyer.

The lack of involvement of any family beyond the Kipor couple in the business contrasts strongly with the use of family in Asian middle-scale enterprises. Janet's own immediate family have all pursued careers in different areas, notably with no intergenerational links. There is no expectation that the Kipor's young son will enter either of the businesses owned by the couple. Janet's comments suggest a strong sense of individualism in her family in which each member pursues their own interests separately. In a broad sense this is indicative of the simple absence of informal institutional structures which would support family based business.

Summary

Broadly the case is consistent with the argument regarding the modes of exchange used by middle-scale enterprise and the exchange environment faced. Across all the transaction tasks, it is clear that wherever significant exchange problems are faced, Ancom tends to rely on a relational mode of exchange. The circumstances in which a non relational mode is used are primarily where Ancom is not able to influence the mode of exchange. Particular difficulties are reported in dealing with large-scale enterprise. The clearest evidence of this was found in relation to raising finance. There is a strong suggestion of a discontinuity here.

The use of exchange by contract is generally weak, although there is some suggestion of some limited reliance by Ancom on this mode in particular situations. Shop-floor
workers are employed on a strongly bureaucratic firm basis. This and other evidence undermines any idea that middle-scale enterprises never see formal institutions as a mechanism for efficient solution of exchange problems. There is a clear willingness to use quality standards for example. The problem Ancom finds with using these formal institutions in Kenya derives from their unreliability. It is interesting to note that in the case of the labour agreement the institutional rules within which this exchange is constructed are largely internal to the garment industry. The state plays relatively little role.

There is virtually no use of an embedded mode of exchange by Ancom. This is explicable by the lack of entrepreneurs in the industry of the same ethnic group as Ancom's owner-manager, Janet. The isolation of the few African entrepreneurs in the industry is emphasised by the perception that Asian entrepreneurs do rely on this mode, thereby excluding those outside the relevant communities.

8.2.2 Case two: Zintex

Zintex Ltd, located in Nairobi's main industrial area, produces high quality shirts and trousers for the domestic market. It is entirely owned by the Puresh family, all Kenyan nationals of Asian origin belonging to the Gujarati speaking Wanza caste of the Hindu community. The company currently employs 85 staff, all full-time, permanent employees. Although in earlier years the company's workforce had reached 200, it has remained essentially informally managed. Kamil Puresh, the current managing director, and his uncle, production director prior to his death, were directly involved in all aspects of the company's operations. Although there is a moderate division of labour in the production process, across the wider company there is little sense of hierarchy or organisational complexity. The capital employed is estimated in the region of KShs 35 million (approximately UK£350,000). The level of technology employed is moderate, with the deployment of specialised sewing machines but far short of the computer controlled, capital intensive plant associated with modern garment production. Zintex is an essentially middle-scale company.
Formal modes: exchange by contract, long term contracting and bureaucratic firm

The evidence is clear that Zintex places little emphasis on the modes of exchange associated with formal institutions, with a notable exception in relation to some employment. Long-term contracting is clearly in use with Zintex's large-scale bankers, but it is evident that the impetus for the use of this formal approach derives from the bank. There is generally strong evidence to support the alternate hypothesis (1.1) that Zintex places little reliance on formal institutional structure.

As noted with Ancom above, production staff are employed on terms which correspond more closely with the bureaucratic mode rather than the anticipated entrepreneurial. Although there is again felt to be very little option here, a more depersonalised approach also appears to be favoured here. However the position is somewhat more ambiguous. The current labour system in Zintex is also regarded as highly inflexible, resulting in a far from ideal employment relation. It is clear that the (transaction) costs of re-aligning the deal are regarded as too high to contemplate change.

There is less evidence regarding the question of how Zintex views the more formal modes of exchange and why they are not used more often. To a significant extent there is a strong sense that using exchange by contract and long-term contracting is simply not the way in which Kamil would consider doing business. Views on the question of the efficiency or otherwise of the formal institutional framework can only be implied by the fact that the company virtually never relies on them. However there is a more positive indication in relation to demand. Here two problems were raised. One is the difficulty of selling directly to public sector buyers in Kenya. The problem is clearly not the bureaucratic process of obtaining contracts but the perceived uncertainty in those processes as a result of the rent-seeking behaviour of officials and the need for political connections (alternate hypothesis 1.4). The other problem relates to duty-free processing for export. Kamil believes that dealing with the complex procedures possess economies of scale in their own right. Essentially the existing institutional framework, in this area at least, is inappropriate to a middle-sized enterprise such as Zintex (alternate hypothesis 1.5). It is notable that Kamil had been involved in a large-scale duty-free processing enterprise. The failure of that company can be traced to a global institutional problem (under the Multi-Fibre
Agreement, implemented by the WTO) which effectively resulted in the Kenyan garment industry’s exclusion from the huge US market.  

Table 8-4: Zintex - evidence for hypotheses relating to exchange by contract and long-term contracting and bureaucratic firm

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>✔️</td>
<td>✔️</td>
<td>?</td>
<td>✔️</td>
<td></td>
</tr>
<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>?</td>
</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✔️</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs</td>
<td>✔️</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

- ✔️ strong support for alternate hypothesis
- ✗ weak support for alternate hypothesis
- ✗ weak support for null hypothesis
- ✗ ambiguity between null/alternate hypothesis

Relational exchange

It is clear that relations are regarded as highly important to Zintex in solving problems of exchange on an informal basis (alternate hypothesis 2.1). The importance of knowing the key stakeholders in Zintex’s exchange environment is emphasised for all tasks, together with the notion of dialogue as a means to settling problems. There is a strong sense of this simply being the basis on which Zintex’s business is organised.
The question of a difference in the approach to exchange between Zintex, as a middle-scale enterprise and other large-scale organisations only arises in regard to the finance task. However it is interesting to note that this appears to be the only area where Zintex is involved with large-scale organisations. Furthermore when presented with the opportunity to move to a smaller finance organisation, Zintex has done so.

There is clear evidence of a discontinuity between Zintex and its large-scale bankers. Kamil referred, somewhat disparagingly, to the practice of the bank visiting the factory “to see if the bricks are still there”. This underlines the sense in which the procedures adopted by the bank are not regarded by Zintex as appropriate to the real exchange problem faced (alternate hypothesis 2.4) – whether it is safe or not to lend. The depth of the discontinuity between the bank and Zintex is most strongly suggested by Kamil’s outrage referring to a case when cheques were returned unpaid:

> Its about the way you want to look at it. To them you’re just another account. They’ve seen us from the start. Right through. They would never have returned cheques. Now they have returned for small amounts. Its important for our reputation. Its appalling service. Day to day we don’t check and balance with the bank – not intensively. … Sometimes something can slip your mind. You expect the bank to go with you. We had been with them for thirty years. They couldn’t explain.

This quote illustrates very clearly the differences in the way Zintex and the bank are organised – the rules and norms (alternate hypothesis 2.5), but ultimately it is “about the way you want to look at it” – organisational culture. Underpinning virtually all Zintex’s dealings with the key players in its exchange environment is the recognition of an inter-dependency. The company, perhaps whether it likes it or not, has to take a stakeholder perspective. Credit terms with suppliers and customers reflect not the relative bargaining positions of the players but recognise the actual needs of either side at a given time. Commenting on the move to the new, smaller bank and comparing with the old, larger one, Kamil observes: “I don’t know how important we are to [the new bank] but they respect us.”
Table 8-5: Zintex - evidence for hypotheses relating to relational exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
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</tr>
<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
<tr>
<td>2.4 The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
<tr>
<td>2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
<td>✔ ✔ ✔</td>
</tr>
</tbody>
</table>

- ✔ ✔ strong support for alternate hypothesis
- ✔ weak support for alternate hypothesis
- ✔ ✔ strong support for null hypothesis
- ✗ weak support for null hypothesis
- ✗ ambiguous between null/alternate hypothesis

**Embedded exchange**

The dominant mode of external exchange in Zintex appears to be embedded. Although, as the table (8-6) below shows, it is difficult to find unequivocal evidence for each of the relevant hypotheses there is sufficient evidence taken as a whole to reach this conclusion. Zintex’s exchange environment is dominated by Asian owner-managed businesses. Furthermore the key roles in the company are occupied by Asians. The obvious counter to this claim is that most of the relevant players in the garment industry are owned by Asians. Concentrating solely on Zintex (putting aside the wider question of why the industry should be so dominated by Asians) it might be argued that there is simply no alternative for the company. Kamil is very keen to
emphasise that the company regards all exchange partners equitably, regardless of ethnic origin.

However there is clear evidence that informal social institutions play a major role in structuring exchange. This evidence arises most readily where there has been an occasional failure. Kamil expresses a strong sense of moral affront when he was let down by a supplier who was a member of the same community. There was no formal or even spoken contract regarding the mutual expectations in this case. However Kamil believes there was an implicit understanding – clear to both – which was broken.

Table 8-6: Zintex - evidence for hypotheses relating to embedded exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate cooperation in exchange</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate cooperation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate cooperation in exchange</td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate cooperation</td>
<td></td>
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</tr>
<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓✓</td>
</tr>
<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td></td>
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</tr>
</tbody>
</table>

✓✓ strong support for alternate hypothesis  ✓ weak support for alternate  ✓✓ strong support for null hypothesis  ✓ weak support for null  ✓✓ strong support for null hypothesis  ✓ weak support for null  ? ambiguous between null/alternate
The importance of community in solving problems of co-operation was made explicit in relation to bad debts:

[It] boils down to the Asian community. Not paying someone is the worst crime. Word spreads around, all through the Asian community. ... Word-of-mouth counts, relationship counts, reputation matters – you’d lose out. It’s a small population. ... The moment a bad debt appears, that’s the end of it”.

This comment is also highly revealing regarding the explanation for the effectiveness of an embedded mode (exploratory question 3.4-3.5.1, Appendix A). There is an indication both that co-operation is rendered rational through community structures (3.4:a) and that there are internalised informal rules and moral values at work (3.4:b). This duality was found re-iterated throughout the case.

Summary

This case is essentially consistent with the argument that middle-scale enterprise rely on less formal modes of exchange. Examining the summary of evidence against specific hypotheses (Appendix D, table D-12), where relevant evidence was found, the alternate hypothesis was supported in most cases. For some hypotheses regarding the comparative position of African and Asian business, unsurprisingly little evidence was found. Broadly it was found that where a significant exchange problem is encountered, an embedded mode of exchange is used.

There is some ambiguity with respect to the organisation of labour transactions. Zintex is subject to formal agreements with respect to its shop-floor staff. Although the use of an exchange by contract mode is effectively imposed on the company, it is not regarded as entirely negative. While the agreements have contributed to a reduction in investment in the company, there are some benefits seen from collective bargaining. On balance it would appear that the reality of formal modes of exchange in Kenya is regarded as unhelpful to the business, but that this is not seen as being necessarily the case. An efficient institutional environment might make a positive contribution.

Although the embedded mode of exchange frequently resembles a simple relational mode, examining the detailed evidence clearly shows that the dominant mode used
by Zintex is embedded. Where the major governance type exchange problems emerge, reputation effects and information flows within the Asian communities are clearly highly significant. Furthermore, the basic co-ordination problems in exchange are also addressed through the information which flows within the communities.

Clear evidence of a discontinuity between the large and middle-scale is suggested by Zintex's shift in its bankers. Zintex's original bankers clearly operate according to a highly formalised, rule driven approach to exchange. This has evidently created problems and Zintex has seized the opportunity to switch to an embedded mode of exchange, in which only a veneer of formality is maintained for the purposes of the Central Bank regulator.

8.2.3 Case three: Boncord

Based in the same small town as Ancom, approximately twenty kilometres from Nairobi, Boncord Ltd is also a producer of lingerie products. It is owned and managed by Grace Mwangi and her husband, George, both African Kenyans of Kikuyu ethnicity. Grace as managing director is involved full-time in day-to-day operation of the business. Although also involved in the business, specifically dealing with finance related issues, George has day-to-day responsibility for the couple's other business venture, a supermarket in the same town.

The company has 39 full-time employees and no casual staff. There is little sense of formality in the organisation. Other than Grace, the only other management role in the company is that performed by the production supervisor. Long-term planning is largely intuitive and qualitative undertaken jointly by Grace and George Mwangi. There are no formalised business plans and cash-flow forecasts. Division of labour is relatively strong in the production process itself, but does not extend far into other roles in the company. Grace is responsible for sales, production management and planning, supply procurement, product design, personnel management and a host of other tasks. Book-keeping for both Boncord and the sister supermarket is undertaken by an accountant under George's supervision. The basic production technology while geared to mass production is relatively labour intensive and a clear step away from the leading edge of global garment technology. The recent purchase
of a computer controlled embroidery machine has been something of a departure from this generally mid-level of technology.

**Formal modes: exchange by contract, long term contracting and bureaucratic firm**

There is not a great deal of positive evidence regarding use by Boncord of those modes associated with the formal institutional structure. In dealing with suppliers and customers, these modes are not used and the alternate hypothesis 1.1 is supported (table 8-7 below). In the procurement of physical technology and formal sector finance there is use of exchange by contract and long term contracting respectively. For labour, once more the employment relation with production

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>✓✓</td>
<td>✓✓</td>
<td>?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td></td>
<td></td>
<td></td>
<td>✓ xx</td>
<td></td>
</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
<td></td>
<td></td>
<td>✓ ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td></td>
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</tr>
<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs</td>
<td></td>
<td></td>
<td></td>
<td>✓ xx</td>
<td>✓</td>
</tr>
</tbody>
</table>

✓ ✓ strong support for alternate hypothesis  ✓ weak support for alternate  ✓ strong support for null hypothesis  ✗ weak support for null  ❓ ambiguous between null/alternate
workers is governed by formal agreements. However in each of these cases it is clear that the impetus for using more formal approaches does not derive from Boncord.

Only in the case of labour does Boncord suggest that the mode represents an effective solution to the exchange problems faced. This constitutes contrary evidence regarding the hypothesis that middle-scale enterprises regard the use of the institutional environment as an inefficient mechanism (alternate 1.2). Furthermore it suggests a rejection of the alternate hypothesis that middle-scale enterprises necessarily see the institutional environment as incompatible with their needs (and leads to an acceptance of the corresponding null hypothesis 1.5). The sole support for the alternate hypothesis here derives from problems relating to import restrictions which have now been reformed.

There is some suggestion of a difference in the use of formal modes between large- and middle-scale in relation to the selling task (alternate hypothesis 1.3). Here Grace observed that the use of more formal approaches, involving precise specifications of product at the insistence of one large-scale customer, tended to increase production costs. It is interesting to note that there is less likelihood of such a requirement creating problems for a larger enterprise which with higher throughput would be better placed to optimise raw material usage even when faced with effectively 'lumpy' orders.

*Relational exchange*

There is clear evidence that Boncord relies on relations with exchange partners to solve problems in all areas considered (alternate hypothesis 2.1). The importance of relations was shown strongly at a time when as a result of a bad payment record (a result of the actions of a former manager) the company had damaged its relationships with suppliers. Until Grace was able to rebuild these relationships the company experienced major problems, being unable to procure sufficient stock for efficient production.

Some evidence was produced of difficulties in relating to larger organisations. Grace referred to one supplier who is proving very uncooperative. She argued that the
problem was simply due to the scale of this supplier – who is not prepared to make any effort with its small customers such as Boncord: “They are difficult because they are big – they deal in millions!”. The situation is less clear in relation to dealing with the large-scale banks. On one hand, George Mwangi argued that the multi-national banks in Kenya “have no personal touch” and were therefore difficult for middle-scale companies such as Boncord to form relations with. On the other, Boncord’s current bankers are one of the largest banks in Kenya and despite the size, it “really takes care of the small man”. It should be noted however that George was introduced to this bank through a social connection at a very senior level in the organisation. This social relationship alone may have been sufficient to overcome

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**Table 8-8: Boncord - evidence for hypotheses relating to relational exchange**

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>✔️</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>2.4 The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
</tbody>
</table>

* ✔️ strong support for alternate hypothesis
* ✔️ weak support for alternate hypothesis
* ✗ ambiguous between null/alternate hypothesis
* ✗ strong support for null hypothesis
* ✗ weak support for null hypothesis
any barriers from discontinuity. Furthermore the largest loan obtained from this bank by Boncord was actually collateralised by a donor small enterprise loan guarantee scheme and the loan assessed outside normal banking practice. Elsewhere there remains some evidence of a discontinuity in this task area with large-scale organisations. George complains particularly about the requirement for particular forms of asset as collateral by banks, which he feels middle-scale enterprises generally do not have available. Much more important he feels is the strength of the business. At the very least banks should accept assets such as machinery which middle-scale businesses are likely to have available. (One of the reasons banks only accept very limited forms of asset as collateral is the difficulty in realising the value in case of difficulty. This suggests support for the claim that the formal institutional structure in Kenya is ineffective). Finally, and suggestive of a discontinuity at the level of organisational rules and norms is the difficulty George finds in dealing with the branch which attributes any unfavourable decisions or problems to the head office (and implicitly the organisational formal rules). As he puts it “why bother having a branch if we are really just dealing with the head office.”

*Embedded exchange*

The Mwangis have a strong sense of the importance of ethnic identity in the garment industry, not least because they see themselves as on the wrong side of this ethnic divide (see table 8-9 below, alternate hypotheses 3.1, 3.1.1). Many of the companies with whom Boncord deals are owner-managed by Asian entrepreneurs, from whom Grace believes they receive poorer terms than similar companies owned and managed by Asians. Regarding the supplier with which Boncord has been experiencing difficulties in rejecting sub-standard fabric for replacement, Grace comments: “If [Boncord] were run by Shahs there would be no problem and they would try again”. She believes that Boncord receives poorer prices and credit terms. Grace believes that there is an ethnic affiliation underpinning this differentiation: “whenever Asians meet they talk their language. They are more loyal to one another”. The strength of ethnic identity is believed especially relevant in relation to employment: “the Asians always take [employ] from their own community”
### Table 8-9: Boncord - evidence for hypotheses relating to embedded exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
<td>✔ ✔</td>
<td>✔ ✔</td>
<td>?</td>
<td>✔ ✔</td>
<td></td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
<td>✔ ✔</td>
<td>✔ ✔</td>
<td>?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate cooperation in exchange</td>
<td>✔ ✔</td>
<td>✔ ✔</td>
<td></td>
<td></td>
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<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate cooperation.</td>
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<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate co-operation in exchange</td>
<td>✔ ✔</td>
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<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate co-operation</td>
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<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of co-operation in exchange with member of other ethnic groups.</td>
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<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of co-operation in exchange with member of other ethnic groups.</td>
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- ✔ ✔ strong support for alternate hypothesis
- ✔ weak support for alternate hypothesis
- ✗ ✗ strong support for null hypothesis
- ✗ weak support for null hypothesis
- ? ambiguous between null/alternate hypothesis

(Alternate hypotheses 3.2). As with Ancom, there appear to be few if any African entrepreneurs in the field and as a result the use of ethnic identity to support exchange necessarily differs between the two communities. Interestingly however, Boncord and Ancom though competing in a number of product areas have cooperated strongly on a number of occasions, with Grace indicating some sense of solidarity based on ethnic isolation in the industry.

Grace also notes that many of the Asian firms with which she deals employ family members, contrasting this with Boncord as an African enterprise (alternate
hypotheses 3.3, 3.3.1). In the past, George Mwangi’s brother was employed in Boncord, with disastrous results. Furthermore difficulties were experienced with an individual who was given a job on the basis of social connections within the community.

The apparent weak use of social institutions in exchange can again be explained simply in terms of the lack of useful partners in the social network (exploratory question 3.5:a). However Grace’s comments regarding the problems experienced when George’s brother worked in the company suggest that the nature of the structure may also play a role. The problem Grace attributed to the expectation that “when it comes to a relative they want special favours”. A similarly problem seems to persist in the wider African community: “I’ve learnt not to trust friendship when it comes to business” (indicating a repudiation of elements of socio-cultural structure, 3.5:e). There is a stronger suggestion that the informal social institutions are inimical to the problem of exchange, in Grace’s final comment on the subject: “it can’t work this sharing thing. It’s the individual in every case.” (3.5.1:b).

Summary

Broadly, the argument that Boncord has faced and continues to face a difficult exchange environment is substantiated by the evidence. There are no signs of any active use of the formal exchange environment. The only sense that it may prove useful to the company is in relation to the formal labour agreements which govern the textile and garment industry. In general exchange problems are dealt with using relationships. However it is clear that these are not always easy to form. Frequent reference is made to the sense of exclusion the company feels from the rest of the industry which it is felt is bound together by a common Asian and possibly Oshwal identity. There are also some indications of difficulties in relating to larger firms. The company’s erstwhile long-term major customer dropped the company as a supplier without offering any opportunity to compete for orders or indeed even notifying them of the change in policy.

In relation to finance, there seem fewer problems than predicted in dealing with very large scale organisation. However it is important to note here that at both critical
points of obtaining finance, other factors were involved. No finance was obtained from formal banks for start-up. It is clear that at this point the fortuitous involvement of the former German partner, a family friend, was critical in obtaining capital, foreign exchange and technical expertise. In the subsequent major expansion of the business which permitted it to firmly develop into the middle-scale, the finance was backed by a non-commercial credit guarantee from the US Agency for International Development. This support also provided technical assistance which Boncord would not have otherwise been able to access.

The evidence suggests that Boncord's very existence is the result of a conjunction of particular circumstances which were unusual and fortuitous for the Mwangis. More positively, despite the concerns over their isolation from the Kenyan business community, there are a number of indications that some of the ethnic barriers have been overcome. A number of instances of important support from Asian entrepreneurs were discovered. However Boncord remains desperately vulnerable at the current time and its survival is clearly in question. The diversification into an essentially unrelated business represented a clear strategy to mitigate the uncertainty faced by the family.

8.2.4 Case four: Tykor

Tykor Group, based in the central Nairobi business district, is a group of three closely allied garment and textile companies, involved in manufacturing, textile trading, wholesaling and retailing. The group is owned by the Shah family, all Kenyan citizens of Asian origin belonging to the Gujarati speaking Oshwal community. Managing director and part owner of Tykor, Ajay Shah, oversees the operations of all three companies. His two brothers, cousin and uncle, also shareholders, are involved in the management of the businesses. Aside from the uncle who is semi-retired, the other family members are involved full-time. The three companies while legally distinct are strongly integrated operationally and physically. In this analysis the group is considered as a whole.

The group has the primary characteristics identified of the middle-scale enterprise type. There are 46 full-time employees in the group, with no casual or part-time staff. Half of this number (23) are employed in the manufacturing operation. Ajay
involves himself in all aspects of the group’s operations, although there is a degree of delegation of responsibility in all areas, predominantly to the family members involved. Other than the usual business management tasks, Ajay also designs suiting fabrics which business area now make the greatest contribution to the group’s turnover and profitability. The management style is highly informal – the managerial division of labour is implicit and requires no organograms or job descriptions. Garment assembly is carried out on an individual or craft basis rather than in production lines. Production volumes at present do not justify greater division of labour and setting up production lines. The technology used similarly reflects this relatively limited scale of operations.

Formal modes: exchange by contract, long term contracting and bureaucratic firm

In only one significant external exchange situation does Tykor use a mode which relies on formal institutions. Dealing with one of the two banks it currently uses is based on long term contracting. The choice of mode is clearly driven by this very large scale organisation, a subsidiary of a multi-national bank. In dealing with Tykor’s preferred bank, a small Asian owned organisation, the mode is essentially embedded, with the limited degree of formality effectively dictated by Central Bank rules. Tykor faces a number of exchange situations in which the potential problems of exchange are highly significant. This is most notable with regard to its relationship with its leading supplier, where there is clear vulnerability on both sides. There is no written agreement at all between the two. The strong implication (as shown in table 8-10 below) is that Tykor places little reliance on formal institutional structure (alternate hypothesis 1.1).

There is some suggestion that the use of the formal institutional structure is regarded as a somewhat inefficient mechanism for tackling problems of exchange (alternate hypothesis 1.2). Problems were experienced in dealing with a large-scale multi-national supplier. There was no attempt to solve the problem by recourse to legal action, which might have been feasible. Ajay believes that in such situations, “the only solution is exit”. Recourse to formal ordering undermines the sense of cooperation which is essential: “the hand that gives is most important... Its about trying to give a good product versus trying the hard sell.”
Table 8-10: Tykor - evidence for hypotheses relating to exchange by contract, long-term contracting and bureaucratic firm

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
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<tbody>
<tr>
<td><strong>Explanandum</strong></td>
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</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional</td>
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<td>✔️</td>
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<td>framework for solving the problem of co-operation in exchange.</td>
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<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic</td>
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<td>institutional framework as an inefficient mechanism for solving the problems of</td>
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<td>co-operation.</td>
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<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the</td>
<td>✔️</td>
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<td>institutional framework than large-scale enterprises.</td>
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<tr>
<td><strong>Explanans</strong></td>
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<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as</td>
<td>✔️</td>
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<td>being uncertain and highly dependent on the political bargaining power position</td>
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<td>of players.</td>
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<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible</td>
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<td>to them or incompatible with their needs.</td>
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</table>

The notion of a difference in approach between large- and middle-scale with respect to the use of formal supports to exchange has some support (alternate hypothesis 1.3). A change in the management of the large-scale supplier mentioned above also resulted in an attempt to force a more formalised way of doing business onto Tykor. This repudiation of a relationship built over many years was deeply resented by Ajay. On another occasion, Tykor terminated its dealing with another large-scale multinational bank subsidiary which again attempted to dictate terms, formalising dealings to the extent that Ajay believed it became completely inflexible.

Although Ajay believes that there is considerable uncertainty in the Kenyan economic environment generally and the formal institutional framework (alternate hypothesis 1.4), it is not clear that this explains Tykor's avoidance of the formal
modes. There are also indications that Ajay regards the institutional framework as incompatible with the way he does business. The directors had contemplated moving into export but decided that the exposure to official bureaucracy implied by the regulations was too great (alternate hypothesis 1.5). There is a stronger sense that the use of formal modes of exchange is simply not consistent with the business philosophy of Ajay and the company.

Relational exchange

Corroborating the last point is the emphasis placed on relationships by Tykor (table 8-11 below, alternate hypothesis 2.1). Ajay is very clear about the importance of relationships to the business. Talking about the arrangement with his supplier which supports the company’s current success, Ajay observes: “there is an understanding at a very deep level. It has taken a lot of time, 12 to 15 years to get here. I never let him down, he never lets me down. If you have problems you talk it out.”

As noted above, Tykor has experienced difficulties with large-scale enterprises attempting to formalise transactions. The counterpart to this is a difficulty in establishing strong relationships with such organisations (alternate hypothesis 2.2). Referring particular to the bank with whom Tykor used to deal, Ajay complains about the inflexibility: “With the big banks you have to get everything tied up. They wanted a ridiculous security cover. With the big banks, the relationship counts for nothing.” Regarding Tykor’s own recent success in a market which is dominated by micro-enterprises, Ajay notes that “keeping a small customer happy, keeps you happy. The big companies are not keeping them happy.” He feels that the large mills with whom Tykor competes simply don’t know how to relate to smaller scale enterprises.

The explanation for Tykor’s emphasis on strong relations appears to derive from both the need to tackle significant exchange tasks and the organisational culture. There is some suggestion that instability in the operating environment creates particular difficulties (alternate hypothesis 2.3). Sharp fluctuations in the value of the Kenya shilling which occurred during the case study period were cited by Ajay as evidence of the particular problems of doing business in Kenya. The ultimate inputs
to the suiting material are imported and thus Tykor is susceptible to currency changes. Interestingly however Ajay indicated that he was less concerned about the absolute value of the shilling as its stability. It is thus clearly the uncertainty in the operating environment which is regarded as the cause of problems. The strength of the relationship with Tykor's lead supplier was demonstrated in this case. Ajay expressed no concern regarding the re-alignment of the supply agreement, being wholly confident that both sides would ensure that the increased costs were shared equitably.

The evidence also supports the suggestion of an organisational discontinuity between large- and middle-scale. This was most clearly manifested in the attempt by large-

Table 8-11: Tykor - evidence for hypotheses relating to relational exchange

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<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
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<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
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<tbody>
<tr>
<td><strong>Explanandum</strong></td>
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<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>✔️</td>
<td>✔️</td>
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<td>✔️</td>
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<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>✔️</td>
<td>✔️</td>
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<td>✔️</td>
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<tr>
<td><strong>Explanans</strong></td>
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<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>✔️</td>
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<tr>
<td>2.4 The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>✔️</td>
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<td>✔️</td>
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<tr>
<td>2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
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<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
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- ✔️ strong support for alternate hypothesis
- ✔️ weak support for alternate hypothesis
- ✔️ weak support for null hypothesis
- ✔️ strong support for null hypothesis
- ✔️ ambiguous between null/alternate hypothesis
scale suppliers and banks to organise transactions according to formal mechanisms rather than the "word of mouth" arrangement favoured by Ajay (alternate hypothesis 2.4). It is interesting to note that the attempt to use such mechanisms in these large-scale organisations appears to derive simply from the organisational rules and norms of these organisations which determine the modus operandi. There is a clear discontinuity with the informal organisation of Tykor, which appears highly task oriented and essentially ad hoc (alternate hypothesis 2.5). Referring to the difficulties being experienced with the large-scale supplier attempting to impose its own rules on the supply process, Ajay observed: "It takes years to build up a business relationship, but it can be destroyed in an instant". Ultimately the discontinuity can be traced to a basic difference in organisational culture (alternate hypothesis 2.6). On visiting Tykor the observer is struck by the sense of constant frantic activity in the office as well as on the production floor. During the course of the interviews (all conducted at the weekends when the company was apparently less busy), phones rang continually around the office (several on Ajay's desk), faxes appeared, Ajay planned the next yarn order, answered a dozen questions from various of his co-manager relatives while simultaneously taking the interviewer with some pride through Tykor's range of fabric designs. Ajay appears to be in an endless process of personally managing relations with numerous people both inside and outside the firm - essentially his stakeholders. He sums this up with a comment about the marketing process: "its about working out the way people think".

**Embedded exchange**

There are strong indications that Tykor relies heavily on an embedded mode of exchange. Although it is difficult to establish whether Tykor differentiates between potential suppliers or customers on the basis of ethnicity, given the strength of Asian representation in the textile and garment sector (see Appendix D.1), in relation to labour and finance there is less indeterminate evidence (alternate hypothesis 3.1). It is notable that in the past the company has expended considerable effort in finding a factory manager from India rather than employing locally. Ajay makes it clear that this is wholly related to trust in the employment relation rather than technical capacity.
In all areas (other than technology where there was little evidence available), informal institutions play a major role in structuring exchange. Referring to finance, Ajay points out the importance of community based trust in dealing with their Asian bankers: "It's not strictly by the figures – it is by the family's word. In our [Oswal] community, our word counts. The family has a reputation – we are known for making sure that things are done properly" (alternate hypothesis 3.2).

Family relationships are clearly important within the business. All management, bar the factory supervision, is handled by members of the Shah family. Furthermore the

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<th>Technology</th>
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<tr>
<td><strong>Explanandum</strong></td>
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<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
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<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
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<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
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<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate cooperation in exchange</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
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<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate cooperation.</td>
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<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate cooperation in exchange</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
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<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate cooperation.</td>
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<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of cooperation in exchange with member of other ethnic groups.</td>
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<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of cooperation in exchange with member of other ethnic groups.</td>
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✓ ✓ strong support for alternate hypothesis  ✓ weak support for alternate  ? ambiguous between null/alternate

✓ strong support for null hypothesis  ✓ weak support for null
notion of family reputation is also important. There is a strong implication that within the Oshwal community, the socially significant collective entity is not the firm but the family. Ajay refers to business and personal relations between families lasting through generations (alternate hypothesis 3.3).

There is little evidence available regarding possible difficulties between ethnic groups. In many tasks there are simply no African owned businesses with which Tykor could deal. Difficulties in relation to finance seem to have more to do with scale than ethnic based discontinuities. Only in relation to labour was there an indication of a problem. Here it was believed that the effective exchange problem entailed by a supervisory role could not be overcome with an African employee, and an Asian was sought in preference (alternate hypothesis 3.4).

This case provides an interesting insight into the way in which informal institutions play a role in facilitating exchange (exploratory question 3.4). In relation to labour, shared moral values were directly cited as the reason for employing Asians – from Kenya or India – in positions where there are opportunities for malfeasance. More generally, Ajay suggested that these values were tending to break down with the new generation, attributing it to something of a moral decline and “the desire to get rich quick”. Clearly therefore, until recently at least, the notion of moral values is suggested as important to facilitating exchange within the Asian community in Kenya (3.4:b). However in relation to the area where the opportunity for malfeasance is greatest – honouring of debts – the rationale for repaying was readily suggested. Not paying would result in ostracism from the community and lack of access to the benefits of ready exchange within that community (3.4:a). Finally however the strongest relationships are more idiosyncratic than implied by simple membership of the same community. The common ethnic identity forms a basis from which a relationship can be built but it is obviously only the start. It may be a part – even a necessary part here – of the cause of a strong relationship but it is not sufficient. In summary, the explanation of the role of ethnicity in exchange is more complex and subtle than the simple answers suggested in the earlier tentative exploratory questions (3.4).
Summary

The evidence from this case again tends to support the general themes of the argument advanced. Tykor shows little dependency on the formal institutional environment. There is a strong sense that the use of formal mechanisms to support exchange would be inappropriate to the key exchange problems faced. The current success of the group is heavily dependent on a highly flexible, strong relationship with its manufacturing supplier. It is highly significant that no formal safeguards are used despite the clear risk posed to both companies in the event that the informal agreements and understandings were not honoured. There is a strong sense here, as elsewhere, that ethnicity plays a major role.

Strong evidence also appeared of the difficulty a middle-scale, highly entrepreneurial organisation finds in dealing with large-scale organisations. A strong sense of frustration at the rule-driven approach adopted by large-scale enterprises was very evident. This appeared to derive from the essential differences in weltanschauung characterising Tykor and the large organisations with which it was unable to deal. Tykor's current success is based on seeing the opportunity in the market, taking a risk and being able to respond. As Ajay observed, his first few suiting designs were failures in the market, but was prepared to follow his instinct that he would find the right formula. Ajay has no formal training in textile design, drawing out the designs and technical specifications on rough pieces of card to be taken to the mill. Market research consisted of hawking a sample around a few of Tykor's wholesalers. After the first few costly failures, Ajay says he built on the experience and on the seventh attempt finally produced a fabric which was hugely successful, selling out within a few weeks.

8.2.5 Cross-case analysis

Comparing the results from each of the case studies serves two functions. First, it enables an assessment to be made of the existence of the differences between the two case types studied, African and Asian owned enterprise. A number of specific hypothesis (3.1.1, 3.2.1, 3.3.1, 3.4.1) are essentially comparative in form. Second, the extent to which the evidence is consistent across the cases can be assessed. A key
question is whether the patterns of exchange process varies between the cases to the extent that the argument being explored is undermined.

*Formal modes: exchange by contract, long term contracting and bureaucratic firm*

The evidence across the cases converges in supporting the hypothesis that middle-scale enterprises, regardless of ethnicity, do not rely heavily on the formal institutional structure (table 8-13, alternate hypothesis 1.1). The only consistent exception was found for certain forms of employment relation. Where the labour tasks involved could be made explicit easily, a formal employment agreement was regarded favourably. This was reflected in the belief that the formal institutional structure could be an efficient mechanism in this regard, contrasting strongly with

<table>
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<tr>
<th>Alternate hypothesis</th>
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<tr>
<td><strong>Explanandum</strong></td>
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</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>✔ ✔</td>
<td>✔ ✔</td>
<td>?</td>
<td>✔</td>
<td>✔ ✔</td>
</tr>
<tr>
<td>1.2 Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td>✔ ✔</td>
<td>✗ ✗</td>
<td>✔ ✔</td>
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</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
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<td>?</td>
<td>✔ ✔</td>
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<tr>
<td><strong>Explanans</strong></td>
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<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td>✔</td>
<td>✔ ✔</td>
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<tr>
<td>1.5 Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs</td>
<td>✔ ✔</td>
<td>✔ ✔</td>
<td>?</td>
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✔ ✔ strong support for alternate hypothesis

✗ ✗ strong support for null hypothesis

✔ weak support for alternate

✗ weak support for null

? ambiguous between null/alternate
the view in relation to other tasks (alternate hypothesis 1.2). However two factors should be noted here. First, in the case of Zintex it was argued that the agreements while useful in some ways were nevertheless inflexible which was regarded as problematic. Second, all the enterprises are confronted with a sectoral organisation of labour in the form of a trade union. The collective power of labour is thus seen to be substantial. Individual employers therefore feel the need for a corresponding organisation – in the form of the Federation of Kenya Employers (FKE) to counter this power and reach a collective agreement.

There were however other ways in which it was implied that the formal institutional environment could potentially play a positive role. Importation of goods evading duty was damaging to all the companies. Effective implementation of the regulations would therefore be regarded as useful. Another related area is that of effective quality standards (indicated by Ancom).

Evidence of a difference between middle- and large-scale enterprise in reliance on modes of exchange based on formal institutions was clearest with finance tasks (alternate hypothesis 1.3). This is unsurprising since this was the area in which all these enterprises found themselves most strongly brought into contact with very large-scale organisations. Otherwise the evidence was not very strong, partly because the enterprises studied did not appear to deal with many archetypically large-scale organisations. Although some were regarded as large-scale according to the operational definition used here (i.e.: employing more than 100), further information suggests that they were probably closer to a middle-scale type (notably a number were family owner-managed enterprises, see discussion in §2.2).

The explanation for the reluctance to rely on formal modes appeared to derive most strongly from the sense that the institutional framework was simply inappropriate to the enterprises (alternate hypothesis 1.5). This is strongly suggestive of a discontinuity between formal institutions and the middle-scale organisational type. Dysfunction in the institutional framework, deriving from uncertainty and political influence, was considered relevant to those areas where it was felt that the institutional framework was potentially useful (alternate hypothesis 1.4). The argument
that the particular circumstances of Kenya are inimical to middle-scale enterprise is thus partly supported.

Relational exchange

The claim that relationships are important to middle-scale enterprise in solving problems of exchange is strongly supported by the evidence gathered in the cases (table 8-14, alternate hypothesis 2.1). This clearly matches the earlier hypothesis that formal modes were not relied on. It is important to emphasise that across all the cases, a series of highly significant exchange tasks was faced. None of the cases studied appeared capable of survival reliant on a purely traditional market mode of exchange.

Table 8-14: Cross-case analysis - evidence for hypotheses relating to relational exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explanandum</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>✔️ ✔️ ✔️ ✔️ ✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>✔️ ✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Explanans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.4 The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>✔️ ✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
<td>✔️ ✔️ ✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
<td>✔️ ✔️ ✔️ ✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- ✔️ strong support for alternate hypothesis
- ✔️ weak support for alternate hypothesis
- ✗ ambiguous between null/alternate hypothesis
- ✗ weak support for null hypothesis
- ✗ weak support for null hypothesis
Difficulties in relating to large-scale enterprises were reported in connection with finance and selling (alternate hypothesis 2.2). As noted above, the problem with regard to the finance task is expected given the domination of the Kenyan finance sector by very large organisations.

The need to find some shelter from a hostile operating environment in terms of strong relationships has some support from the cases (alternate hypothesis 2.3). That this is the case can to some extent also be implied by the strong use made of relationships. Stronger evidence of why it is necessary to structure exchange (and not use a simple traditional market mode) is difficult to obtain directly from the entrepreneurs' own rationalisations. One feature emerging consistently across the cases was the use of modes such as relational or embedded exchange, as a matter of course. Being in business for these middle-scale enterprises was all about building and managing relationships with suppliers, customers, the workforce, machinery suppliers, technicians, bankers, government officials, accountants and even competitors.

Clear evidence emerges across the cases of a discontinuity between middle-scale and large-scale enterprise. This starts at the level of the instruments deployed in exchange by large and middle-scale (alternate hypothesis 2.4), which appears to be strongly determined by the difference in modus operandi noted generically between the middle-scale and a number of large-scale enterprises (alternate hypothesis 2.5). None of the middle-scale enterprises had formal rules or procedures in any area except production. Even here it was found that a minimal level of formal organisation was used. The job cards essential to mass production techniques were drawn up on pieces of scrap card by hand in one case. By contrast there was a frequent complaint of the intrusion of set internal procedures into relationships with the largest organisations. This was most notable in relation to banks. The discontinuity can ultimately be interpreted as deriving from organisational culture (alternate hypothesis 2.6). The middle-scale enterprises were all quintessentially informally managed with the entrepreneur responsible day to day for most of the important decisions to be made, undertaking many varied tasks personally and crucially personally managing a large number of relations on which the business is dependent. Fundamental is the notion of ownership. The entrepreneur's own livelihood depends on the success of
the business — a point re-iterated especially by the African entrepreneurs who felt more vulnerable. The pressure to succeed is very great and yet simultaneously there is considerable uncertainty in all areas of the business environment. This produces a radically different business world view from that of the lending manager of a large-scale bank whose success is partly measured in simply following set internal procedures faithfully.

**Embedded exchange**

The cross-comparison of cases reveals a very marked ethnic differences in exchange. There is strong evidence that entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity (table 8-15, alternate hypothesis 3.1). This differentiation shows a marked difference between the African and Asian enterprises (alternate hypothesis 3.1.1). Among the Asian enterprises the embedded mode of exchange predominated with a consistent reliance on informal social institutions to structure exchange and mitigate problems of co-operation (alternate hypotheses 3.2). This reliance on informal institutions is not replicated in the two African cases (alternate hypothesis 3.2.1). Furthermore family members were employed in both Asian enterprises with evidence also produced of a similar pattern in other enterprises not directly studied (alternate hypothesis 3.3). This feature was not found in either of the two African cases and there was a strong suggestion that this was a deliberate decision (alternate hypothesis 3.3.1).

Determining whether entrepreneurs faced particular difficulties in working outside their own communities is more difficult. The direct evidence of this is weak, except in relation to labour (alternate hypothesis 3.4). However in the African cases, there was felt to be a considerable disadvantage in dealing with Asian enterprises by comparison with other Asian enterprises in the sector. This was most strongly voiced in relation to supply where it was felt that less favourable terms were received. It was also believed that it was impossible for an African enterprise to gain access to finance from the Asian owned financial sector. Set against this, there was evidence found of some informal co-operation between the African enterprises and other Asian owned companies. There was little found regarding the question of whether there was a difference between African and Asian in the difficulties faced in crossing
the ethnic boundary (alternate hypothesis 3.4.1). This was inevitable given the relative domination of the sub-sector by Asian enterprise (Appendix D.1). Indirectly, the fact that the Asian entrepreneurs relied so heavily on embedded exchange implies that it was considerably easier to transact with members of the same community, offering strong evidence in favour of alternate hypothesis 3.4. This is not pertinent to determining the differences since the use of an embedded mode of exchange is usually simply not an option for the African enterprise in the garment sub-sector.

Table 8-15: Cross-case analysis - evidence for hypotheses relating to embedded exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>?</td>
<td>✓ ✓</td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>?</td>
<td>✓ ✓</td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate co-operation in exchange</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td></td>
</tr>
<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td>✓ ✓</td>
<td></td>
</tr>
<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate co-operation in exchange</td>
<td>✓ ✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3.1 Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate co-operation</td>
<td>✓ ✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.4 Entrepreneurs find it more difficult to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td>✓</td>
<td>?</td>
<td>✓ ✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>3.4.1 Asian entrepreneurs find it more difficult than Africans to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

✓ ✓ strong support for alternate hypothesis
xx strong support for null hypothesis
✓ weak support for alternate
x weak support for null
? ambiguous between null/alternate
Explaining this pattern of exchange is not easy. Regarding the use of ethnic based institutions to support exchange in the Asian cases, the evidence is consistent with both rational social action and the internalisation of rules (exploratory question 3.4:a,b). The implication is that, as argued by theorists such as North (1990), there is a connection between the formation of informal institutions and their rationality for the ‘players’ to which they apply (see §5.4).

That embedded exchange is not used strongly in the case of African entrepreneurs is readily explained in terms of the lack of opportunity to do so in this sector. It is notable that the two African enterprises studied, having a prior connection have co-operated on occasions, with some sense of ethnic solidarity expressed. However this co-operation is relatively limited and is not comparable with that noted in the Asian cases.

There is a manifest difference between the African and Asian cases in reliance on family members in business. In both African cases it was suggested that individualism, repudiating to some degree both family and community links, is prevalent in African business. Grace Mwangi implies that this was necessary to success – “it can't work this sharing thing”. This tends to support the idea that on balance family relations are a greater liability than asset (exploratory question 3.5.1:c). By contrast in terms of the internal organisation of the Asian firm, family relations are seen as an asset.

8.3 Secondary evidence

The literature covering a variety of empirical studies in Kenya was found to contain a considerable amount of evidence relevant to the argument. This evidence is summarised here in relation to middle-, micro- and large-scale enterprise in turn. Although some of the studies have reached conclusions which are directly consonant with the argument put forward, the concern here is with evidence which directly supports or contradicts the specific hypotheses or informs the exploratory questions. The data is presented by hypothesis, in a set of tables indicating the support and a short description of the evidence found. Sources indicated refer to appendix B which summaries the secondary sources consulted (and details the specific references
8.3.1 Middle-scale enterprise

As noted earlier (§3), the literature relating to middle-scale enterprise somewhat is sparse. Relatively little evidence was found which directly addresses the hypotheses put forward. We discuss these hypotheses, as before, according to the relevance to formal, relational and embedded modes of exchange.

*Formal modes: exchange by contract, long term contracting and bureaucratic firm*

Two studies, one relating to finance (Biggs et al) and one to technology acquisition (Collinson) confirmed strongly the notion that middle-scale enterprises do not make strong use of formal modes of exchange, in contrast to large-scale firms (alternate hypotheses 1.1 and 1.3). The failure to use formal modes in technology acquisition is interesting since Collinson's study concerns importation of equipment. Findings from the case studies suggested that importation usually *necessarily* involved use of more formal modes. That the middle-scale enterprises did not rely on formal modes (in contrast to the large-scale also studied by Collinson) appears to derive from a lack of internal legal resource, suggesting again the notion of a weak discontinuity between the middle-scale and formal institutions.

Other evidence regarding the use of the formal modes is somewhat inconclusive. Although Mwaura encountered strong complaints regarding corruption and inefficiency in the implementation of formal institutions, the RPED study showed that a far lower proportion of middle-scale enterprises questioned regarded corruption as a major concern compared with either micro- or large-scale enterprises (alternate hypothesis 1.4). There is no obvious explanation for this apparent contradiction.

*Relational exchange*

The evidence of use of relations in exchange is strong in both the studies by Collinson and Mwaura (alternate hypothesis 2.1). There is also strong evidence in
Table 8-16: Secondary evidence for middle-scale enterprise - hypotheses relating to formal modes of exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>Collinson</td>
<td>✓ ✓</td>
<td>Lack of legal resources resulted in middle-scale firms involved in technology acquisition projects refraining from strong reliance on formal contract in technology supply deals (1991, p.187). (also relevant to alternate hypotheses 1.3 and 1.6)</td>
</tr>
<tr>
<td>1.3 Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
<td>Biggs et al</td>
<td>✓ ✓</td>
<td>In the study by Biggs et al of enterprise finance in Kenya it was found that legal enforcement of contracts in relation to supply (and trade credit) was mainly used by larger firms, offering little protection to smaller, middle- or micro-scale (1994, p.78).</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td>Mwaura</td>
<td>✓ ✓</td>
<td>The most significant problem during expansion indicated by a sample of middle-scale entrepreneurs was the bureaucracy, inefficiency and corruption in processing of import licences (1994, p.147). The business licensing system was described as a 'nightmare' (p.162). Many other uncertainties in the institutional framework were also raised.</td>
</tr>
<tr>
<td>RPED</td>
<td></td>
<td><strong>xx</strong></td>
<td>Although over 20% of middle-scale enterprises surveyed regarded corruption as a large or severe problem, this contrasts with over 60% of large-scale and 55% of micro-scale. In the transition category of micro to middle (employing 6-20 employees), 55% regarded it as a large or severe problem. Over 60% of middle-scale enterprises did not regard corruption as a problem at all as compared with 23% or less in other categories (1996, p.216).</td>
</tr>
</tbody>
</table>

✓ ✓ strong support for alternate hypothesis  ✓ weak support for alternate  ? ambiguous between null/alternate
**xx** strong support for null hypothesis  **x** weak support for null

both these and Biggs et al that forming strong relations with large-scale organisations is problematic (alternative hypothesis 2.2). Explanations are more difficult to find here. Although Mwaura found evidence that middle-scale entrepreneurs regard the exchange environment as uncertain and a reason for curtailing expansion plans (alternate hypothesis 2.3), no indication was found that this uncertainty was a reason for using informal modes of exchange. There was some suggestion of a barrier to stronger relations with large-scale deriving from discontinuity (alternate hypotheses 2.4, 2.6).
**Table 8-17: Secondary evidence for middle-scale enterprise - hypotheses relating to relational exchange**

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>Collinson</td>
<td>✓✓</td>
<td>Studying technology transfer, Collinson noted the use of relations in the search process by middle-scale enterprises.</td>
</tr>
<tr>
<td></td>
<td>Mwaura</td>
<td>✓✓</td>
<td>Middle-scale firms were found to adopt strategies to strengthen the relationship with key employees (1994, p.98). It was found that two thirds of the entrepreneurs spent more than 20% of their time maintaining relationships with customers, (p.105) Many reported only a small number of customers (p.110) 28 out of the 30 firms interviewed used personal contacts to attract customers, 21 used networking with friends, 18 used reciprocal recommendations with other firms.</td>
</tr>
<tr>
<td>2.2 Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
<td>Collinson</td>
<td>✓✓</td>
<td>Middle-scale enterprises involved in technology acquisition projects using large-scale (foreign) suppliers indicated the difficulty in obtaining adequate technical support from the supplier (1991, p.216).</td>
</tr>
<tr>
<td></td>
<td>Mwaura</td>
<td>✓✓</td>
<td>Middle-scale enterprises reported difficulties establishing a supportive relationship with large-scale banks. &quot;The distrust commercial banks have ... continues long after a business has been established and has maintained a solid record of good financial management.&quot; (1994, p.88) Some respondents described the relationships as &quot;cold and impersonal&quot; (p.164).</td>
</tr>
<tr>
<td></td>
<td>Biggs et al</td>
<td>✓</td>
<td>44-46% of middle-scale enterprises had anonymous relations with banks against only 14% of large-scale (1994, p.60).</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.3 Middle-scale enterprises perceive the general economic operating environment in Kenya as characterised by significant instability</td>
<td>Mwaura</td>
<td>✓✓</td>
<td>42% of middle-scale entrepreneurs indicated that they would not expand their businesses due to uncertainties in the economic environment.</td>
</tr>
<tr>
<td>2.4 The governance mechanisms deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
<td>Biggs et al</td>
<td>✓</td>
<td>Among lower middle-scale enterprises 20% indicated that they had not applied for a formal loan with a bank due to inadequate collateral or the complexity of the process, the figure was 13% for upper middle-scale and zero for large-scale. (1994, p.37) By contrast 55% of lower-middle and 67% of upper-middle used informal sources of finance because the formalities were easier (1994, p.49)</td>
</tr>
<tr>
<td>2.6 The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
<td>Mwaura</td>
<td>✓</td>
<td>Middle-scale businesses indicated that &quot;banks in Kenya did not understand how business was conducted in the country, otherwise they would treat their customers the way they did&quot;.</td>
</tr>
</tbody>
</table>

- ✓✓ strong support for alternate hypothesis
- ★ weak support for alternate
- ★★ strong support for null hypothesis
- ★ weak support for null
Embedded exchange

The study by Biggs et al of finance in Kenya very clearly shows the emphasis placed on the embedded mode of exchange by Asian entrepreneurs in marked contrast to African. Statistics from this study were drawn on in table 8-18 below against the specific hypotheses, but do not present a complete picture. Biggs et al found that for all scales of firm the Asian ability to source finance was far higher than that of African firms (alternate hypotheses 3.1, 3.1.1). One caveat to be placed on this finding is that the sample of Asian businesses tended to be larger and older than the African in the sample (1994, pp.31-2). Both size and age have been found to be relevant variables in gaining access to finance. Biggs et al present data showing that access to trade credit differs between African and Asian entrepreneurs markedly. The basis of this access was strongly related to reputation within communities (1994, 1996) (alternate hypotheses 3.2, 3.2.1). Embedded exchange was generally not found to be used with the banks studied by Biggs et al. However it seems likely that in this study, the focus was on the large-scale banks, excluding the less prominent Asian owned banks. It is noted that the Asian entrepreneur has better access to both informal loans and those through finance companies (1994 p.77).

These findings are consistent with the early business history of Madatally Manji, one of Kenya's leading industrialists. He describes how loan capital to buy his first (middle-scale) business in 1941 was provided by a fellow wealthy member of the Ismaili community following a chance meeting in the mosque (Manji 1995, pp.40-1). Similarly an African entrepreneur who had himself failed in business, observed that within the Asian communities in Kenya finance could be provided on the basis that co-operation would be assured through the close monitoring entailed by community contact (Ndegwa 1994, p.56). Marris and Somerset (1971) also offer early evidence of the use of embedded exchange within the Asian community and the implied exclusivity. One African entrepreneur interviewed noted: "When I get supplies from an Indian, I'm sure that I'm paying five shillings where an Indian would get it for four shillings and fifty cents. And he'd give another Indian credit, but not me." (p.190).
Analysis of evidence

Table 8-18: Secondary evidence for middle-scale enterprise - hypotheses relating to embedded exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
<td>Biggs et al</td>
<td>✓✓</td>
<td>Across all scales of firm, 86% of African and 82% of Asian firms wanted to borrow for investment, only 17% of African against 79% of Asian firms were actually able to borrow. For liquidity requirements, 81% of African firms wanted to borrow, 82% of Asian, only 41% of African firms were able to borrow against 91% of Asian. 100% of Asian firms saw formal credit as a source of funds, only 31% of African (1994, p.53).</td>
</tr>
<tr>
<td>3.1.1 Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community.</td>
<td>Biggs et al</td>
<td>✓✓</td>
<td>See 3.1 above</td>
</tr>
<tr>
<td>3.2 Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate co-operation in exchange</td>
<td>Collinson</td>
<td>✓✓</td>
<td>Middle-scale firms were observed to rely on family and community links for technology transfer</td>
</tr>
<tr>
<td></td>
<td>Biggs et al</td>
<td>✓</td>
<td>79% of Asian firms were reliant on “trust and reputation” in strategies to avoid problems with suppliers, against 16% of African firms. 31% of Asian firms used business reputation to avoid problems with clients against only 10% of African</td>
</tr>
<tr>
<td></td>
<td>Biggs et al</td>
<td>✗</td>
<td>Only 11-15% of middle-scale firms relied on community relations with banks to facilitate exchange (1994, p.60).</td>
</tr>
<tr>
<td>3.2.1 Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
<td>Collinson</td>
<td>✓✓</td>
<td>The middle-scale firms relying on family and community links in 3.2 were exclusively Asian owned cases</td>
</tr>
<tr>
<td></td>
<td>Biggs et al</td>
<td>✓</td>
<td>With suppliers, 82% of all African firm scales had anonymous relations with suppliers, only 13% of Asian did. Meanwhile no African enterprises relied on community relations while 38% of the Asian firms did (1994,p.62). (see also 3.2 above)</td>
</tr>
<tr>
<td></td>
<td>Biggs et al</td>
<td>✗</td>
<td>There was no notable difference between the use of community relations by African and Asian firms with banks: 13% and 15% used respectively (1994,p.60).</td>
</tr>
<tr>
<td>3.3 Entrepreneurs do rely on family based relationships to facilitate co-operation in exchange</td>
<td>Mwaura</td>
<td>?</td>
<td>Mwaura found 12 out of 30 middle-scale firms did employ relatives and friends. Only 2 out of 30 had more than 3 employed.</td>
</tr>
</tbody>
</table>

✓ ✓ strong support for alternate hypothesis   ✓ weak support for alternate    ✗ ambiguous between null/alternate
✗ ✗ strong support for null hypothesis      ✗ weak support for null

Evidence regarding the use of family is rather more sparse. Mwaura's study is somewhat inconclusive and does not differentiate between African and Asian
entrepreneurs. Marris and Somerset's early study did find strong evidence of a difference in attitudes: 60% of Asian businessmen (sic) preferred relatives in business, as compared with between 9-19% of African. However 43-52% of African businessmen did actually employ relatives with the Asian figure not dramatically higher at 63% (1971, p.143) (alternate hypotheses 3.3, 3.3.1).

Summary
Although the evidence here is somewhat spare, it broadly corroborates the findings from the primary field work. The major contradiction arises from the RPED study regarding the significance of uncertainty in the formal institutional framework. A number of interpretations are possible. Most consistent with the other evidence is that entrepreneurs are simply unconcerned with the mechanisms supporting formal modes of exchange since they are not relied on. This might ultimately derive from a discontinuity between the middle-scale form and the formal institutions found in Kenya.

8.3.2 Micro-scale enterprise
There is considerable evidence which is consistent with the contention that micro-scale enterprises find significant barriers to growth (or graduation) into the middle (table 8-19, alternate hypothesis 4.1). Quite simply it is clear that growth of such businesses into the middle is rare. Much data is also consistent with the hypothesis that entrepreneurs in the micro-scale, even where successful, often choose not to invest in existing businesses (alternate hypothesis 4.2). The crucial question is whether the lack of graduation from micro- to middle-scale is motivated by the perceived constraints in the exchange environment or whether the choice not to invest can be related to other factors (such as social expenditure obligations or diversion into agriculture as a result of cultural values). Strong evidence in favour of the former is found in McCormick's various studies. However she also observes that a strong value placed on land ownership is culturally embedded (McCormick 1988). King's (1996) studies also indicated a number of cases of successful micro-scale entrepreneurs investing in land. However a key point made here is that the investment in agriculture is entirely consistent with a strategy of managing risk by
diversification. Once again it is difficult to dissociate the roles played by culture and rational calculation.

Table 8-19: Secondary evidence for specific hypotheses

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explanandum</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.1 Micro-scale enterprises find significant barriers to growth into the middle-scale</td>
<td>McCormick</td>
<td>✓ ✓</td>
<td>In her study of micro-scale garment manufacturers in Nairobi, McCormick (1988, p.247) reported only 15% of artisanal manufacturers grow. Barriers indicated include: inadequate supplies, declining sales, loss of work space, or adverse economic, political or personal circumstances.</td>
</tr>
<tr>
<td></td>
<td>Daniels et al</td>
<td>✓</td>
<td>In a large-scale survey of micro-enterprises in all sectors Daniels et al found that 86% of enterprises indicated business problems. Only 17.6% of micro-scale firms were found to have grown.</td>
</tr>
<tr>
<td></td>
<td>Buckley</td>
<td>✓</td>
<td>Buckley’s study of micro-scale enterprise targeted finance schemes showed that provision of finance has a potentially strong positive impact on growth of micro-scale enterprises. It emphasised the need for matching of schemes to borrower requirements to ensure success. Given the current narrow outreach of such specialist schemes this evidence tends to confirm access to credit as a barrier to growth.</td>
</tr>
<tr>
<td></td>
<td>Kariuki</td>
<td>✓</td>
<td>Studying finance among micro and lower middle-scale enterprises, Kariuki found that less than 6% of firms had been able to secure start-up capital from large-scale banks and 11.1% for capital expansion. 58% relied on own resources for start-up and 57% on retained profit for expansion. Other finance was provided by development finance institutions. Kariuki argues that transaction costs represent a major barrier by enormously increasing the cost of borrowing to firms.</td>
</tr>
<tr>
<td></td>
<td>Parker and Torres</td>
<td>✓</td>
<td>In a large-scale survey of micro- and lower-middle scale enterprises, Parker and Torres found significant evidence of graduation into the middle, with 96% of middle-scale (11-50 employee) enterprises indicating graduation from the microscale. However it was found that expansion rates in enterprises is negatively correlated with size, with a sharp drop at the 6-10 worker category level. The implication is that graduation is a major source of middle-scale enterprises but there are constraints to graduation.</td>
</tr>
<tr>
<td></td>
<td>Gichira and Onyango</td>
<td>✓</td>
<td>In a survey of informal sector operators it was found that over 75% had not expanded their level of employment since inception (1991, p.8). 60% had approached formal sector banks, none had been granted finance.</td>
</tr>
</tbody>
</table>
# Analysis of evidence

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kinyanjui’s study of micro- and middle-scale enterprises in Central Kenya found a suggestion of a correlation between entrepreneurial motivation and growth on the one hand, and between negative motivation and those stagnating. Crucially however growth was also found subject to familiar supply and demand side constraints.</td>
<td>✓</td>
<td>Kinyanjui</td>
<td>Alternate hypothesis</td>
</tr>
<tr>
<td>Examining a sample of micro, middle and large-scale manufacturing enterprises, it was found that growth was highest in micro-scale firms over the period 1981-1992. By contrast the micro-scale firms showed a decline (1994a, pp.24-5). Furthermore examining informal (mainly micro-scale) firms it was found that the evidence showed these firms “grow by proliferation” (ibid.). There is further evidence showing very low graduation from the smallest, 1-5 employees, to the middle category of 21-75 employees. However data for the period 1990-94 failed to reproduce this finding with no systematic relation between firm growth rate and size (1996).</td>
<td>✓</td>
<td>RPED</td>
<td>Source</td>
</tr>
<tr>
<td>Over 75% of micro-scale enterprises regarded access to bank loans or overdrafts as difficult or impossible. Nearly half regarded access to finance as their most serious business problem (1996).</td>
<td></td>
<td></td>
<td>Detail</td>
</tr>
<tr>
<td>McCormick found that the predominant pattern of success in Nairobi micro-scale enterprises was growth “by proliferation rather than by expanding” (1988, p.359).</td>
<td>✓ ✓</td>
<td>McCormick</td>
<td>Source</td>
</tr>
<tr>
<td>Very small micro-enterprises showed evidence of some capital accumulation (only 19% had capital over KShs 10,000 at start-up, compared with 25% at survey date), at a larger level there appeared little change and even contraction (only 5.0% had capital over KShs 100,000 at start-up, compared with 5.1% at survey date, 0.8% had over KShs 500,000 at start-up, compared with 0.5% at survey date). Finally only 23% of all micro-enterprises indicated a reinvestment of profits into the business</td>
<td>✓ ✓</td>
<td>Daniels et al</td>
<td>Source</td>
</tr>
<tr>
<td>Based on RPED (1996) data for 1994, a calculation of the ratio of investment to gross profit shows the lowest rate of 20% was among the smallest micro-enterprises (1-5 employees). The highest was in the next micro/lower middle category (6-20 employees) of 64%, suggesting a significant difference between the investment behaviour. Limited validity due to the known variability of investment over time.</td>
<td>✓</td>
<td>RPED</td>
<td>Source</td>
</tr>
<tr>
<td>In a study of the impact of micro-finance on micro-enterprises, Sebstad and Walsh found evidence of considerable fungibility of capital in household enterprises. 60% of clients of micro-credit programmes used profits or working capital from an assisted enterprise to fund another enterprise, meanwhile 40% had used retained profits from another enterprise to start the assisted enterprise (1991, p.101).</td>
<td>✓</td>
<td>Sebstad and Walsh</td>
<td>Source</td>
</tr>
</tbody>
</table>
## Analysis of evidence

### Alternate hypothesis

<table>
<thead>
<tr>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sverrisson</td>
<td>✅✅</td>
<td>In a study of a collection of primarily micro-scale wood-working enterprises, Sverrisson (1993) determined that the strategy of the entrepreneurs was strongly dictated by a combination of volatility in the business environment and limited accessible resources. These survival strategies result in minimising the investment in the existing micro-enterprise.</td>
</tr>
<tr>
<td>King</td>
<td>?</td>
<td>King's study, based on a diverse range of case-studies of informal manufacturing sector, micro-scale enterprises shows considerable diversification in the investments of successful entrepreneurs. However it also shows compelling evidence of investment and growth in some enterprises over a long period (1996).</td>
</tr>
</tbody>
</table>

### Explanans

#### 4.3 Micro-scale entrepreneurs see the exchange environment as resulting in a high degree of cost and uncertainty

<table>
<thead>
<tr>
<th>McCormick</th>
<th>✅✅</th>
<th>McCormick &quot;highlights risk as a factor in firm behavior&quot; (1988,p.171). Argued that maintaining a &quot;small-and-flexible&quot; model was the response to this risk (uncertainty). Supported by empirical confirmation of the hypothesis that smallness and flexibility is a strong indicator of profitability.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daniels et al</td>
<td>?</td>
<td>Of business problems facing micro and small-scale entrepreneurs, a risky environment was indicated as a major constraint by only 5.4% of respondents. Macroeconomic problems were cited by 6.8%, and harassment by government, 4.8%. The total therefore directly relating to uncertainty was 17%. However the three leading problems, demands, markets, access to inputs and capital shortages accounted for 69%. Many of these problems are likely to relate to the exchange environment and indicate a transaction cost which renders exchange unviable.</td>
</tr>
<tr>
<td>Gichira and Onyango</td>
<td>✅</td>
<td>53% of respondents indicated that an unconducive legal environment was their greatest policy problem of external problems, excluding access to finance. Additional external problems raised by a majority of respondents included problems of property rights in relation to land, price controls and access to the government procurement. Regarding finance, collateral requirements and a negative perception by lending institutions were held responsible for lack of access to credit by over 30% in each case.</td>
</tr>
<tr>
<td>RPED</td>
<td>✅</td>
<td>Although not distinguishing between firm scales, probit analysis showed that a number of variables taken as a proxy for uncertainty were significant as determinants of the decision to invest in the future (1994a).</td>
</tr>
</tbody>
</table>

✅✅ strong support for alternate hypothesis ✅ weak support for alternate ❓ ambiguous between null/alternate ❒ strong support for null hypothesis ❒ weak support for null
8.3.3 Large-scale enterprise

Although there are a considerable number of studies which have addressed large-scale enterprise in Kenya, there are few which are directly relevant to the questions posed here. The few which are relevant and useful are reviewed here, starting with hypotheses relating to external exchange before turning to those relevant to internal.

**External exchange**

Studies concerning exchange problems entailed by supply (Masinde), technology (Collinson) and finance (Biggs et al and field observation) have been found. In Masinde's study of the motor vehicle assembly industry in Kenya, she found clear indications of a gap between the large-scale assemblers and their middle-scale suppliers (alternate hypothesis 5.4). There was a strong implication that the relative size of middle-scale suppliers was responsible for the weakness of the linkages (alternate hypothesis 5.5). Underpinning this appeared to be a negative view of the lack of formal systems and control within the middle-scale suppliers on the part of the large-scale buyers (alternate hypothesis 5.9). Contrary to expectation however there appeared little reliance on use of formal contract in supply (null hypothesis 5.1).

Collinson's study of technology acquisition provided compelling evidence refuting the hypothesis that large-scale enterprises never rely on relational exchange (null 5.4). However it also indicated support for the notion that the instability of the institutional environment undermines the use of more formal modes (alternate hypothesis 5.6).

Examining finance involving banks offers strong confirmation of the heavy reliance on formal modes of exchange by large-scale organisations (alternate hypothesis 5.1) and especially by comparison with smaller enterprises (alternate hypothesis 5.3). Interestingly, banks do rely of relationships to a significant extent, but while simultaneously appearing to maintain an arms length from clients. A long-term relation allows information to be built regarding exchange partners but in the case of the banks does not appear to result in any mutual obligations. It is a highly mechanistic form of relation (ambiguous regarding hypothesis 5.4). Again however there were strong indications that the large-scale banks found considerable
difficulties in relating to smaller clients (alternate hypothesis 5.5). Explaining this barrier, there was evidence of organisational discontinuity starting from an incompatibility in the mechanisms used in smaller and large-scale enterprise (alternate hypothesis 5.8), deriving from the divergence in organisational rules and norms (alternate hypothesis 5.9), ultimately based on a simple difference in organisational world views (alternate hypothesis 5.10).

The difficulties suggested in using formal external modes of exchange, which the evidence does indicate to be relatively more important to large-scale enterprise leads to a consideration of whether there is therefore a greater propensity to internalise functions.

Table 8-20: Secondary evidence for large-scale enterprise - hypotheses relating to external exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
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</thead>
<tbody>
<tr>
<td>Explanandum</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.1 Large-scale 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 co-operation in exchange</td>
<td>Masinde</td>
<td>✗</td>
<td>Masinde’s study of the motor vehicle industry in Kenya examined the linkages between large-scale buyers and local middle-scale suppliers. In no case was a formal written contract used between the assemblers or franchise holders in Kenya and the local suppliers. The mode of exchange appears to correspond to a weak relational form, with considerable reliance on the relative market strength of the buyer to ensure adherence with quality.</td>
</tr>
<tr>
<td>Biggs et al</td>
<td>✓</td>
<td>In the study by Biggs et al of enterprise finance in Kenya covering various forms of finance and all scales of enterprise, it was found that compared with loans from finance companies, friends or trade credit &quot;banks are those that most heavily rely on the legal enforcement of contracts&quot; (1994, p.74). Given the domination of the banking industry in Kenya by very large-scale organisation, this supports the reliance on formal mechanisms by large organisations. Regarding customers it was found that 38% of firms had consulted a lawyer, 33% had threatened court action and 21% had actually initiated such action. Such action was more likely to be taken by large-scale firms.</td>
<td></td>
</tr>
<tr>
<td>Field observation</td>
<td>✓</td>
<td>In one of Kenya’s largest bank it was found that legally binding contracts were used universally in all aspects of the bank’s operations covering lending, savings and money transmission businesses.</td>
<td></td>
</tr>
<tr>
<td>Alternate hypothesis</td>
<td>Source</td>
<td>Support</td>
<td>Detail</td>
</tr>
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<td>--------</td>
</tr>
<tr>
<td>5.2 Large-scale enterprises regard exchange based on the state-maintained economic institutional framework as an efficient mechanism for solving problems of co-operation.</td>
<td>Biggs et al</td>
<td>✗</td>
<td>Although not distinguishing according to the scale of respondent, Biggs et al found respondents indicating that the legal system in Kenya was both expensive and uncertain (1994, p.73).</td>
</tr>
<tr>
<td>5.3 Large-scale enterprises are more likely to rely on the state-maintained economic institutional framework for solving the problem of cooperation in exchange than middle or micro-scale enterprises.</td>
<td>Biggs et al</td>
<td>✓</td>
<td>Regarding supply relationships, Biggs et al report that &quot;large firms are more likely to call upon lawyers than small firms&quot; (1994, p.73). The implication of the comparative point regarding generally large-scale banks and smaller finance companies or suppliers noted above (5.1) also supports this hypothesis.</td>
</tr>
<tr>
<td>5.4 Large-scale enterprises do not regard the formation of relations with exchange partners as significant to their businesses.</td>
<td>Masinde</td>
<td>✓</td>
<td>In Masinde's study it was found that the relations between buyers and suppliers was consistently weak with no apparent attempt to strengthen them.</td>
</tr>
<tr>
<td>Biggs et al</td>
<td>?</td>
<td>Biggs found that many firms surveyed dealt with banks in an anonymous way. However only a third of the manufacturing firms were classified as possessing anonymous relations with their banks. The banks do rely on information gained from the past dealings with a customer. However the use is constrained to the quantitative - operation of the account, repayment record and so forth.</td>
<td></td>
</tr>
<tr>
<td>Field observation</td>
<td>?</td>
<td>In a large-scale bank, relations were found to be as important in building reliable information regarding the client, and ensuring continuity of business. However the content of the relations were constrained to an &quot;arms length&quot;. Lending managers were rotated regularly, partly to avoid the building of close relations.</td>
<td></td>
</tr>
<tr>
<td>Collinson</td>
<td>XX</td>
<td>A very large-scale company in Kenya indicated the strength of its relationship with its equipment supplier characterising it as based on trust (1991, p.214).</td>
<td></td>
</tr>
<tr>
<td>5.5 Large-scale enterprises find engaging in all but the simplest exchange with middle-scale and micro-scale enterprises difficult.</td>
<td>Masinde</td>
<td>✓</td>
<td>Masinde found that the large-scale buyers in the motor vehicle industry found difficulties in working with the middle-scale suppliers and that linkages are generally weak, characterised as arms-length. She notes that in most cases only minimum information flowed between the transacting parties sufficient to meet the needs of the particular transaction.</td>
</tr>
<tr>
<td>Coughlin et al</td>
<td>✓</td>
<td>A number of large-scale textile manufacturers were discovered to refuse to sell directly to middle- and micro-scale garment manufacturers in small quantities, even at the factory gate (Coughlin 1991c).</td>
<td></td>
</tr>
</tbody>
</table>
There was a marked difference found in the socialisation with bank managers and staff between large-scale and middle and micro-scale. While only 14% of large-scale enterprises characterised their relations as 'anonymous' with banks, the figure rose to 44-6% with middle-scale and 60% with micro-scale (1994, p.60).

Approximately two-thirds of large and upper-middle firms had ever received a formal bank loan, only a third of lower-middle and 15% of micro-scale. Of those applying for loans in the year preceding the study, 83% of large-scale had been approved, 93% of upper-middle, only 43% of lower-middle and none of the micro-scale. Finally although all large and upper-middle scale firms had a simple cheque account, 12% of lower-middle and 50% of micro-scale did not (p.34).

Although not specific to large-scale firms, Biggs et al report that enterprises claim the legal system can be manipulated and is open to bribery.

A large-scale firm formally contracted with equipment supplier to guarantee machinery installed. When problems had appeared the company did not take legal action due to the "costs, bureaucratic complexity and time-scale of such action in the Kenya courts, together with the uncertainty of success." (1991, p.186).

Other problems were indicated relating to the "uncertainty of imposition of much Government legislation" (p.234) This also included Kenya Bureau of Standards. Reference was also made to problems of corruption in the state.

In a large-scale bank, land in many areas of the country was not regarded as an acceptable form of collateral owing to the perception that it would be impossible to realise the value of the security in the event of default owing to the uncertainties of the legal process in Kenya, and the potential for outside intervention.

The widespread use of formal contracts by the large-scale banks is indicative of the perception that the institutional framework is accessible to them and compatible with their needs.

In explaining why they had never applied for formal bank loans, inadequate collateral or the perception that the process was too difficult was cited by 13% of upper-middle, 20% of lower-middle and 38% of micro-scale firms (1994, p.37).

The difference in scale between bank and non-bank financial organisations in Kenya is reflected in some difference in use of collateral. Only 5% of bank loans were unsecured, compared with 14% in the non-bank sector.
**Analysis of evidence**

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coughlin <em>et al.</em></td>
<td>✓</td>
<td>A large-scale electrical cable manufacturer studied by Mwau and Coughlin (1991) was found to regularly import wooden spools despite their local availability from middle- and micro-scale woodworking shops because it is found administratively easier by the company.</td>
<td></td>
</tr>
</tbody>
</table>

5.9 The organisational rules and norms adopted by large-scale and middle-scale organisations are significantly, systematically different.

<table>
<thead>
<tr>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Masinde</td>
<td>✓ ✓</td>
<td>Although large-scale buyers in the motor vehicle industry claimed not to be prejudiced against middle-scale firms, they argued that these smaller companies did not &quot;possess the managerial and technological capacity to provide the quality required by the industry&quot; (1994, p.263). The underlying difficulty was found to relate clearly to the informal way in which the supply businesses were organised.</td>
</tr>
<tr>
<td>Collinson</td>
<td>✓ ✓</td>
<td>Technology acquisition in large-scale firms was found to involve &quot;a greater number of routine procedures for pre-planning and monitoring the transfer and commissioning process&quot; than the middle-scale firms studied which had &quot;few procedural controls or regulatory systems for pre-planning and checking project work&quot; (1991, pp.192-3)</td>
</tr>
<tr>
<td>Biggs <em>et al.</em></td>
<td>✓ ✓</td>
<td>The approach taken by large-scale banks to lending was found to be highly quantitative and mechanistic, drawing on formal documents such as &quot;investment plans, working capital requirements, balance sheets etc&quot; (1994, p.76) This contrasts strongly with the way in which other forms of finance are obtained (non-banks and supplier) and the way in which middle-scale enterprises are managed. It is notable that bank managers were found to have very limited discretion for lending on the basis of informal relationships, though there was clearly demand from middle-scale enterprises and was highly valued (p.75).</td>
</tr>
<tr>
<td>Field observation</td>
<td>✓ ✓</td>
<td>Observations strongly confirm the findings of Biggs <em>et al.</em>. The operations of a large-scale bank were observed to be dictated strongly by the use of explicit internal formal rules, including highly detailed, complex sets of standard operating procedures covering all areas of operation. The bank has a wide set of enforcement mechanisms to ensure that these procedures are followed precisely. This contrasts strongly both with the operation of smaller banks and financial institutions and that of numerous middle-scale businesses observed.</td>
</tr>
</tbody>
</table>

5.10 The organisational culture of large-scale enterprises and middle organisations are systematically different.

<table>
<thead>
<tr>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Field observation</td>
<td>✓ ✓</td>
<td>The organisational culture of the large-scale bank observed was based on the notion that much in the internal and external environment of the organisation could be quantified and controlled effectively. The was most clearly manifested in the approach to lending, based on detailed methods for assessing risk across a wide variety of businesses and contexts. Avoidance was the strategy taken where control could not be achieved through formal, explicit methods. This clearly contrasts strongly with the organisational culture observed in middle-scale enterprises.</td>
</tr>
</tbody>
</table>

- ✓ ✓ strong support for alternate hypothesis
- ✓ weak support for alternate
- ? ambiguous between null/alternate
- xx strong support for null hypothesis
- x weak support for null
Internal exchange

The evidence regarding internalisation strategies in Kenyan large-scale enterprises is thin. Masinde's study provides the best indication. She found that vehicle assemblers were reluctant to out-source, especially it appears, to middle-scale suppliers (alternate hypothesis 6.2). This was confirmed by the vertical integration of a number of supply functions by all the franchise holders, a strategy which was explicitly seen as a means of controlling uncertainty (alternate hypothesis 6.4). Furthermore the behaviour of the one multi-national subsidiary operating in this sub-sector does suggest that there is a difference of strategy in Kenya as compared with other environments. Globally the motor vehicle industry has been characterised by an increasing tendency for manufacturers to outsource (Masinde 1994).

It is known that a large number of large-scale enterprises in Kenya are subsidiaries of multi-nationals (RPED 1993), although there is little agreement on the relative weight of local versus international capital. There are a significant number of studies (notably conducted by Coughlin and various collaborators) which point to a tendency by multi-national subsidiaries to import from parent or related companies rather than developing local linkages (alternate hypothesis 6.3). Explaining this behaviour is more difficult. When exchange controls were in force, there were strong indications that artificially inflating the price of inputs (transfer pricing) was used as a mechanism for the parent company to transfer profits to the centre from the subsidiary. No direct evidence is available regarding the hypothesis that it is used as a mechanism to control uncertainty (hypothesis 6.5).

Summary

The strongest conclusions to be drawn from the secondary evidence regarding large-scale enterprises is that there are barriers to exchange between large-scale and middle- or micro-scale enterprises. These appear to derive from discontinuity in organisational form. Rather less clearly supported, though still suggested by the studies examined, is the argument that large-scale tend to internalise functions rather than externalise as a strategy to reduce transaction costs and residual uncertainty in the face of a generally difficult exchange environment. Finally, the hypotheses
### Table 8-21: Secondary evidence for large-scale enterprise - hypotheses relating to internal exchange

<table>
<thead>
<tr>
<th>Alternate hypothesis</th>
<th>Source</th>
<th>Support</th>
<th>Detail</th>
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</thead>
<tbody>
<tr>
<td><strong>Explanandum</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.1 Large-scale enterprises are more likely to internalise functions in Kenya than in environments characterised by greater stability.</td>
<td>Masinde</td>
<td>✓</td>
<td>General Motors Kenya is a subsidiary of GM the multi-national car company. It is subject to the global policy of GM which it to develop local suppliers in the countries in which it operates. However despite this policy the Kenyan subsidiary only locally sources those supplies which it is legally mandated to do so, seeking the rest from the GM associated Isuzu company (effectively internalising). The indication is thus that the Kenyan operation has a greater tendency to internalise than in other environments.</td>
</tr>
<tr>
<td>6.2 Large-scale enterprises are more likely to internalise functions rather than outsource to middle-scale enterprises.</td>
<td>Masinde</td>
<td>✓</td>
<td>All four major vehicle franchise holders in the motor vehicle industry in Kenya were found to have subsidiaries producing supplies which were legally mandated to be sourced locally. One of these for which figures were available sourced 60% of its local components from its group companies. Masinde found that a large majority of the automotive suppliers in Kenya were middle-scale.</td>
</tr>
<tr>
<td>6.3 Subsidiaries of multi-national corporations are more likely to source from parents or related companies than locally.</td>
<td>Owino</td>
<td>✓✓</td>
<td>In a study of the pharmaceutical industry in Kenya, Owino found that the subsidiaries of multi­nationals sourced virtually all inputs from parent or related companies, despite the availability of local alternatives.</td>
</tr>
<tr>
<td></td>
<td>Teitel</td>
<td>✓✓</td>
<td>Examining the manufacturing sector it was found that large-scale multi-national subsidiaries relied on the parent or related companies for technology acquisition. This finding was also confirmed by RPED (1994, p. 126).</td>
</tr>
<tr>
<td></td>
<td>Coughlin et al</td>
<td>✓✓</td>
<td>In a series of studies covering a range of sub-sectors Coughlin and his collaborators found strong evidence that multi-national subsidiaries very often source raw materials and technology from their parent companies in preference to local companies Coughlin (1988b, 1991c, 1991e), Coughlin et al (1991)</td>
</tr>
<tr>
<td><strong>Explanans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.4 Large-scale enterprises do perceive internalisation as a means of controlling uncertainty in exchange</td>
<td>Masinde</td>
<td>✓✓</td>
<td>The motor vehicle assemblers studied by Masinde indicated that where a service was regarded as critical to the company’s operations – such as computer services – it was internalised. (1996,p.33). One franchise holder considered internalising the supply of radiators. Another vertically integrated as a means of controlling what it perceived as opportunistic behaviour by suppliers (1994, p.204).</td>
</tr>
</tbody>
</table>

- ✓✓ strong support for alternate hypothesis
- ✓ weak support for alternate
- ✓✓ strong support for null hypothesis
- • ambiguous between null/alternate
regarding the use of relational exchange appear somewhat imprecise. Relations do matter to large-scale enterprises, but their use is based on a rather less informal approach than that found in smaller enterprise.

### 8.4 Conclusion

The case studies broadly show compelling support for the argument advanced, which is generally also consistent with the secondary evidence found. Evidence presented here is inevitably clearest regarding the position of middle-scale enterprise having been subject to both primary and secondary studies. However the secondary data does show support for many of the hypotheses put forward regarding micro-scale and large-scale.

There is some degree of support for all the specific alternate hypotheses advanced, with one or two important caveats. The argument that middle-scale enterprises broadly face an unfavourable exchange environment is largely supported. Formal modes of exchange were found to be generally avoided by the middle, as anticipated. This was seen to derive from a combination of an underlying discontinuity between middle-scale and formal institutions, and the general dysfunction of the formal institutions in Kenya. The evidence did not show which of these two factors was the more directly relevant. The use of informal modes was hampered by the difficulty in forming strong relations with other enterprises in the exchange environment. There were good indications that establishing relations with large-scale organisations was difficult and that this derived from a fundamental organisational discontinuity. This was also broadly confirmed by the secondary evidence relating to large-scale enterprise. With the strong presence of large-scale enterprise in the Kenyan environment this therefore appeared to be highly relevant. Although there was evidence found of a perception of instability, it was difficult to establish clearly whether this rendered the formation of exchange relations more difficult.

Clearly all the enterprise case-studies must be regarded as successes having reached the middle-scale and ex hypothesis have overcome the barriers presented by the exchange environment. Crucially, however the Asian cases appear to suggest a systematically different exchange environment is faced by the Asian entrepreneur in
Kenya as compared with the African. Both case studies and the secondary evidence indicate the strong use of embedded exchange, drawing on informal social institutions. By contrast the African success in the middle-scale here has been accomplished as a result of a particular set of circumstances enabling the barriers of the exchange environment to be overcome. Faced with recent instability in demand markets, the African cases appear far more vulnerable than the Asian. While the Asian entrepreneurs had already made some movement of capital into other less threatened areas, the African entrepreneurs appeared to be lacking the support to permit such a move. Ultimately the Asian exchange environment appears far more flexible and resilient in the face of economic uncertainties.

Secondary evidence was found which confirmed the barriers presented by the exchange environment for the growth of micro-scale enterprises into the middle. Furthermore a number of studies indicated that micro-scale entrepreneurs did not invest in the growth of their businesses, using profits elsewhere. More limited support was found for the hypothesis that this behaviour derives from the perception that growth into the middle is too fraught with uncertainty.

A number of studies offered support for the notion that large-scale enterprise are generally more inclined to use formal modes of exchange. However the evidence also challenged the somewhat undifferentiated hypothesis that relational exchange is not relied on by large-scale enterprises. It was found that the nature of the relations sought may in general (though not universally) be somewhat more formal than those found in the middle-scale. Nevertheless as noted, there was strong evidence of a discontinuity between large- and middle-scale. Finally there were some grounds found for supposing that large-scale enterprises do regard internalisation of functions as an option for controlling uncertainty.
Notes

1 Note that all names have been changed in order to protect the identity of all firms, their directors and employees.

3 Source CBK (1997)

3 Kenya's failure to secure a deal to gain access to the US market can be seen in terms of a discontinuity in global political institutions. The evidence from both primary and second sources (see for example Economic Review, October 6-12(1997), pp.4-8) suggests that the Kenyan negotiators did not possess the skills to drive through a better bargain. Furthermore the Kenyan garment industry lobby group though apparently well organised were unable to effectively influence or support the Kenyan government team. This is suggestive of failures and perhaps a discontinuity in the political institutional structures.

4 That such illegal importation does occur is corroborated by widespread newspaper reports and has even been recognised by the Central Bank of Kenya (CBK 1998b)

5 See Kariuki (1993)

6 Based on observations when the researcher worked as a lending banker in Kenya for a very large-scale multinational bank.

7 It is important to note that diversification into agriculture may also be seen as a rational risk management strategy, reducing covariant risk.

8 See for example Swinson (1980), Vaitos (1991), Himbara (1994b) and Cowen and MacWilliam (1996). There are no clear statistics available to settle the debate.
9. DISCUSSION AND CONCLUSION

9.1 Introduction

This study set itself the task of increasing our knowledge and understanding of the middle-scale enterprise in Kenya and beyond. This chapter brings together what has been found in the preceding chapters and assesses what has been learnt, the implications and what remains to be discovered and explained.

In the first section (9.2), a review is made of the argument which has been put forward in this thesis. The aim was to make a fundamental contribution to the theoretical understanding of the middle-scale generally and specifically in Kenya. After examining the existing literature, drawing heavily on institutional theory, a new explanatory frame was introduced (§6) which sought to relate the phenomena of the middle-scale enterprise to the institutional framework and hence to the social, political and cultural context in which it is embedded. At the heart of the explanation offered for Kenya’s missing middle was the notion of discontinuity in the institutional framework.

The evidence relevant to this theoretical stand was elaborated in the last chapter (§8). Three issues are tackled in reviewing the theory (section 9.3): how defensible is the theory in the face of empirical evidence, what limitations were found in the evidence and ultimately how much further forward are we now in understanding Kenya’s middle-scale.

Recalling the necessarily tentative nature of much of this work, section 9.4 considers the implications of the study. The position of this research in the wider institutionalist research programme is considered. Much remained to be addressed in the theory put forward from the outset. Following empirical test and the analysis in the previous section an assessment can now be made of where the theory remains weakest and hence where further work is required. Finally the overarching motivation for research in this area is recalled: what are the practical ramifications for policy makers and development practitioners?
9.2 Summary of the argument

The research described in this thesis started from the attempt to understand a simple but highly distinctive feature of Kenya's industrial structure: the apparent underdevelopment of the middle-scale enterprise sector and the relative success of Kenya's entrepreneurs of Asian origin in this scale. In Kenya and elsewhere in Africa, observers have often noted anecdotally and with some disquiet, the relative absence of the larger, more sophisticated small-scale business amongst the mass of entrepreneurial activity which characterises economies across the continent. However to date the whole understanding of this middle-scale form of enterprise has been limited. Serious questions confront both researchers and policy makers: Does the 'middle' really matter? Is it really missing? What explanations can we offer for its form? Are these really supported by the evidence? In this thesis each of these questions has been addressed.

The sustaining motivation for the attention paid to smaller scale enterprise across the world, derives from its putative role in generating employment. This has generated a long-running debate amongst academics and policy-makers. Examining the claims and counter-claims (§2) shows, perhaps inevitably, that there is intrinsically greater ambiguity than either polar positions will admit. What remains an inescapable fact is that vast numbers of poor people, especially in the developing economies, derive their incomes from small scale, and in most cases very small, enterprise. The critical question is how economies starting from a particular position, can sustainably develop most rapidly. It is argued here that the role or otherwise of middle scale enterprise needs to be located in the answer to this question.

Questions of economic development are poorly served by orthodox economic analysis. Many of the phenomena which seem most vital are simply assumed away in the theoretical economising of the neo-classical paradigm. A broader framework is offered by two emerging strands of thought in economics – evolutionary and institutional theory. It is within this broader perspective that we discern a less ambiguous, albeit highly theory dependent, transformational role for the smaller and especially the middle-scale enterprise. At the level of the firm, the middle-scale enterprise can be seen as representing an intermediate step on a continuous
evolutionary path between pre-capitalist, unspecialised, technologically unsophisticated production and highly specialised, technologically intensive organisation characterising industrial economies. Focussing on the essential link between development and learning at all levels, it has been argued that the relatively high turbulence associated with the sector may positively contribute to learning across the economy. Institutional theory emphasises the context within which economic activity occurs. Here we note that the organisational form of the middle-scale enterprise is more coherent with the quintessentially informal institutional character of pre-industrial societies. Continuing the theme of evolutionary development, it is argued that production based on middle-scale enterprise represents a potentially more flexible arrangement which is more able to adapt successfully to the uncertain conditions associated with rapid economic change. Finally, it is contended that the political economic role of the middle may be the most significant. The development of institutional structure essential to an industrial economy depends on the existence of a polity which has both the material interest and ability to express that interest in just such a development. Middle-scale enterprise and its nascent capitalist owners have the greatest to gain from this project of institutional change.

Turning from the abstract to the reality of Kenya (§3), the imperative to rapid, sustainable economic growth is inescapable. Kenya already suffers from very high levels of absolute poverty. With one of the fastest population growth rates in the world, merely containing this level of poverty represents a major challenge. There are strong signs however that the economy is faltering and that rapid economic growth is more remote now than at any other time in Kenya's short independent history. The question raised is therefore whether Kenya has yet found a route towards the transformation of its economy and raising the living standards of its citizens.

Clear, unassailable data on scale structure in Kenya is not available. However taking data from a variety of sources gives a strong indication of the state of the middle-scale. Its relative under-development seems clear. Turning to the manufacturing sector, where capital intensity is usually expected to be greater, the position is found to be similar. Evidence on the ownership of industry is yet more difficult to find,
much debate has occurred on the basis of essentially anecdotal evidence. An analysis of evidence gleaned from official data was undertaken. Though it is conceded that this analysis is contestable, it largely confirms the commonly held perception that much of Kenya's middle-scale manufacturing is owned by Kenyans of Asian origin. Kenya's indigenous middle-scale appears to be missing. Against the context of the argument put forward for the role of the middle in economic development and Kenya's economic position, there is a clear need to understand this situation.

An examination of the literature (§4) reveals that not only is there no convincing explanation for Kenya's particular situation, but there is a lack of well developed theory to address the broader questions of industrial scale structure. Orthodox economic theory, as originally found in relation to the role of scale, cannot account for many of the empirical features which appear central to the question at issue. In particular, orthodox theory is silent on the relevance of ethnicity and social structure. Many recent studies of small enterprise, across the social scientific disciplinary boundaries, have emphasised the significance of the enterprise context—conceived broadly, taking account of social and cultural phenomenon in addition to the putatively purely economic. Although these directions seem to show great promise in relation to the problem at issue here, an enduring criticism is the lack of a coherent theoretical framework with which to bring these diverse threads together. Institutional economics represents one radical attempt to broaden the theoretical scope of economics. In this study an institutionalist approach has been used to bring together various strands in order to construct a framework within which an explanation for Kenya's middle-scale can be built.

The theoretical approach developed here sees economic analysis as not simply concerned with the transformation of inputs to outputs, but fundamentally about the organisation of those transformational activities. The traditional economic analysis must include not just production costs but transaction costs. However once we concede the fiction of perfect (zero transaction cost) markets within which exchange occurs, we must simultaneously abandon faith in cost minimisation as the actual consequence of economic action. At most we might suppose that economic strategies are intendedly cost minimising and in the long run, under appropriate conditions, poor strategies will not survive. Turning to the question of the middle-
scale, it was argued it fundamentally concerns how exchange is organised. Understanding the middle therefore requires that we elaborate how exchange occurs within given – institutional – contexts. The theoretical foundations for the analysis of exchange were developed in chapter 5, drawing heavily on the new institutional work of Douglass North and Oliver Williamson.

A concept frame for the analysis of the structuring of exchange was developed based on the institutionalist approach (§6). The notion of modes of exchange was introduced as the basis for a simple taxonomy of exchange processes. Seven modes were identified, each associated with the use of formal and informal institutional structures and governance mechanisms in order to solve problems of co-operation and co-ordination in exchange. Two of these modes essentially represent the more and less formal approaches to organisation of exchange within the boundaries of the firm, the others relate to external exchange. Returning to the question of scale it was asserted that we can understand the 'space' or opportunity for middle-, micro- and large-scale enterprise in a particular institutional structure by the generic association between scale types and modes of exchange. The concept of discontinuity was introduced to describe a feature of the structuring of exchange where the result is systematically dysfunctional with respect to the problem of exchange, as a result of the incoherence in structure. Where the institutional environment fails to support the modes of exchange associated with a particular scale type, the scope for organisation at that scale type reduces markedly.

The essence of the argument put forward here is that the formal institutional environment in Kenya affords little space for middle-scale manufacturing or the evolution of the micro into the middle. Problems in exchange are generally exacerbated by a high level of background uncertainty directly in terms of macro-economic performance and the institutional environment. Large scale enterprise as an organisational type enjoys a comparative advantage. By implication, internalisation of functions is favoured wherever external exchange is rendered problematic.

By contrast the relative success of middle-scale enterprises which are owner-managed by entrepreneurs of Asian origin could be explained by the reliance on an embedded
mode of exchange. Asian entrepreneurs have been able to exploit informal institutions which are specific to the ethnic communities to which they belong, in order to support this mode of exchange. By contrast it was hypothesised that the position of the ethnic African entrepreneur has not resulted in a similar solution to the problem of exchange. In summary the relative lack of development of the African middle-scale enterprise can be understood in the lack of real opportunity afforded by the exchange environment.

9.3 Review of the findings

The argument posited gives rise to a large set of claims regarding a broad range of social and economic phenomena. It is essentially concerned with the processes by which exchange is accomplished against a particular social context. Much of the argument is expressed in theoretical terms — institution, culture, discontinuity, uncertainty — which are understood in a sense which cannot be operationalised in a mechanistic fashion. The argument can be most readily explored in depth by the use of research methods which focus on the direct exploration of processes, usually associated with the qualitative approach. Research undertaken here provides a first step in exploring the specific argument and theoretical framework put forward. We first consider the immediate findings from that research effort, before examining its limitations and then looking to see what conclusions can now be drawn regarding Kenya's middle scale manufacturing.

9.3.1 Evidence

The major research conducted consists of a set of in-depth case studies of a number of middle-scale enterprises from the textiles industry. Four of these — two owner-managed by Africans, two by Asians — were conducted in detail and presented in the last chapter (§8). The research was based on an exploration of the ways in which the enterprises undertook various exchange activities (presented in Appendix D). Each case was analysed both against specific hypotheses put forward and in terms of the broader argument itself. A comparative analysis enabled further conclusions to be drawn regarding the relative positions of the African and Asian entrepreneur in
Kenya. Data from other sources was used to further explore these findings and the hypotheses relating to micro- and large-scale enterprise.

The evidence from the case studies confirmed the bulk of the alternate hypotheses supporting the argument advanced. Interpreting these findings broadly, there is a strong suggestion that the middle-scale enterprise in Kenya does face a difficult exchange environment. Significant exchange problems are routinely encountered in the operation of a middle-scale enterprise. The solution of these exchange problems represents a key challenge to the middle-scale entrepreneur.

The formal institutional environment offers little support when it comes to the exchange problems regularly faced by the middle-scale enterprise. Only rarely did entrepreneurs indicate that formal institutions were relied on as a means of mitigating transaction costs and residual uncertainty. Two factors appear to explain the lack of reliance on formal approaches. First there is a degree of fundamental incompatibility between the middle-scale enterprise type and the formal modes of exchange. Second is the dysfunction of the formal institutional environment itself.

At the heart of the organisational form which is the middle-scale enterprise (§2.2.3) is an essential informality which mitigates against the use of formal modes. Entrepreneurs consistently emphasised the need for dialogue in resolving problems, using exit from an exchange relationship as the ultimate resolution when the differences become insurmountable. This is consistent with a form of organisation in which there can be no expectation of influencing the environment in which they operate — either the rules of the game or the players. The route to success or just survival is to remain flexible to be able to respond to whatever arises. This represents an over-arching middle-scale strategy for reducing the uncertainty arising from transacting in an unstable and uncontrollable environment.

There was a clear suggestion that there were areas in which the formal institutional environment could however have been helpful to the enterprises. Perhaps the clearest was in relation to quality standards which directly act to reduce transaction costs and uncertainty. Kenya does have a body charged with the task of establishing, monitoring and policing standards, together with various non-specific consumer
Discussion and conclusion

protection legislation again supported by state implementation agencies. However the enterprises indicated a near total lack of confidence in the efficacy of such institutions. The only aspect of the formal institutional environment which appeared to offer useful support was labour regulation, (somewhat surprisingly given business rhetoric on the subject from industrialised economies). The important finding is that the enterprises do see the potential for formal institutions improving the exchange environment faced.

Transacting with large-scale enterprises was found to present some difficulties for the enterprises. Where significant potential exchange problems were found, the notion of a discontinuity between the large-scale and middle-scale enterprise form was strongly suggested. Nowhere was this clearer than in relation to the dealings with large-scale banks. None of the enterprises was able to look to the large-scale banks for the critical forms of risk finance associated with either start-up or significant expansion. There was a strong suggestion that even where finance was forthcoming from the banks it was provided on the terms of the bank, not the enterprise. A common complaint was the inability to form a stronger relationship with the manager handling the company's account. This further reinforces the suggestion that middle-scale enterprises tend to rely on informal approaches to solving exchange problems.

The evidence from the case studies strongly supports the argument that the relative distinctive success of the Asian entrepreneur in reaching the middle-scale can be understood in terms of the more favourable exchange environment faced by such entrepreneurs. In the bulk of the exchange activities regularly undertaken by enterprises, exchange was found to be assisted by ethnic factors. Exchange is facilitated by the direct mitigation of problems of both co-ordination and co-operation. Information regarding exchange partners and potential exchange partners appears to flow freely within the Asian communities. Simple knowledge of the past performance of a potential partner represents an immediate advantage when considering a transaction. However sometimes critically important is the protection offered by informal institutions against malfeasance or opportunism in exchange. It is difficult to determine precisely the balance here of simple rational self-interest and internalised moral rules. Both clearly play a role. The entrepreneurs jealously guard
reputations within the community, sometimes built up over generations. Where a formal banks casually return a cheque unpaid, through oversight or overzealous following of rules, the response is furious. Reputations can fall on such apparently minor events. Establishing a reputation for straight dealing can be readily understood as playing an optimal strategy within an $n$-dimensional $n$-player Prisoner's dilemma game. That outsiders to this game believe that players will cheat them with impunity tends to imply the pre-eminence of rational choice. However the sense of moral indignation when referring to rare cases of opportunism amongst fellow community members, the pride in a refusal to become involved in, sometimes entirely profitable, corruption and the business ethics directly expressed all suggest that internalised rules of behaviour are also important. It might be speculated that such rules provide the necessary lubrication to establish what appears to be a highly rational co-operative game for the Asian entrepreneur.

9.3.2 Limitations of the empirical work

Although the cases and secondary data indicate a strong degree of support for both the specific hypotheses and the broader argument, it is important to recognise the limitations of the primary empirical work.

The fieldwork was necessarily based on a research approach which can be broadly characterised as ethnographic. However in a number of important respects there were limitations to the implementation which could undermine the work. Ethnography requires long term investigation and immersion in the field. Although the research exercise involved considerable contact on a large number of occasions with the owner-managers of the enterprises, there was little opportunity for direct observation of the events studied. Access is a critical problem here. Although entrepreneurs were for the most part happy to discuss their affairs within the context of their own offices, supported by an explicit undertaking to maintain confidentiality, it was clear that observation would not have been feasible. Practically, the exchanges and processes which the research sought to investigate did not occur in simple one-off meetings or other events. Reliance on the reporting of the participant is thus inevitable. However this leads to the threat that the events reported are subject to systematic bias, most obviously from *ex post* rationalisation by the respondent.
A greater use of triangulation would have been highly desirable in attempting to control for systematic biases in the reporting of events. Interviewing other participants in each of the critical exchange tasks would have been particularly valuable, both as a primary source of comparative data – from the differences in the way participants see things – and as a means of controlling quality – determining whether there is consistent in the evidence. Regrettably access problems rendered such an approach impossible.

Although the study of a single sub-sector has advantages in attempting to control for extraneous factors, it does lead to the question of whether the findings are strictly generalizable to the wider argument. The garment sub-sector has specific characteristics both as an industry type and its specific history in Kenya which it might be argued directly support some hypotheses investigated here. Ultimately further sub-sector studies are required.

The use of secondary data was intended to mitigate some of these problems by examining the findings from a broad range of other work. Although found to be a broadly useful exercise, it is subject to the essential limitation that data from such secondary sources was gathered for different purposes. There is a manifest gap between the data sought to answer the questions posed in this study and that available from other investigations based on different theoretical perspectives.

9.3.3 Explaining Kenya’s ‘middle’?

Finally, we need to consider whether, in spite of the inevitable limitations and caveats, this study has advanced the understanding of Kenya’s middle. In chapter 3 it was suggested that the U-shaped aggregate distribution may actually be composed of two somewhat different distributions – one African and one Asian. The African distribution is dominated by micro-scale enterprise, associated with a relatively early stage of industrial development, the Asian by a more substantial middle and large-scale, associated with a much more mature state of development.

We have argued that the context of the African entrepreneur today produces an exchange environment which renders operation of successful middle-scale enterprise a difficult prospect. The evidence from both the case studies and the secondary
Discussion and conclusion

Evidence strongly supports this contention. The possible causes of an under-development in the middle were identified in chapter 4: a lack of entrants either directly or from micro-scale enterprise growth or a very high exit rate. All of these can be explained by an inimical exchange environment. A difficult exchange environment will both result in direct barriers due to the difficulty in mobilising resources for entry and cause entrepreneurs to perceive investment in middle-scale business as too risky and therefore look for alternatives investments. In relation to the question of graduation from the micro-scale we have found considerable evidence from secondary data to support these arguments. We explain the relative success of the Kenyan Asian entrepreneur by arguing that they face a radically different exchange environment from their African counterparts. To reiterate, based on the use of informal institutional structure, the Asian entrepreneur faces a very much more favourable environment which is broadly supportive of middle-scale enterprise. Comparative evidence from the in-depth case studies of African and Asian middle-scale enterprise strongly supports this argument.

The notion of what is and is not a difficult exchange environment has been based on the concept of discontinuity. This performs two theoretical functions. First it helps identify what underlies a difficult exchange and second it forms part of a theoretical story which relates that context to broader historical processes and events. The latter is crucial to establishing a convincing account of why the evolution of Kenya's scale structure has resulted in an etiolated middle.

We have argued, and found evidence to support the contention, that middle-scale enterprise as an organisational form has a generic discontinuity with large-scale enterprise. As noted above there is evidence to support a further weak discontinuity between the organisational form of the middle and the formal institutional structure which accounts for a stronger reliance on more informal modes of exchange. The evidence showed however that the formal institutional environment remains potentially significant to the middle. This implies rather than a near complete disconnect between the middle and the formal institutional environment (as with the micro-scale), there is a greater vulnerability to the precise form of the formal institutional environment. These findings echo Douglass North's (1990) claim of the
inescapable connection between the development of an efficient formal institutional environment and economic development.

As we have noted, the evidence gathered supports this picture of the exchange environment. We consider now whether we can explain how it occurs. Following this broad argument, three particular factors in Kenya are held to be responsible for producing a broadly hostile exchange environment for the middle-scale. First is a long period of large-scale bias on the part of a highly interventionist state, starting in the colonial period, growing through the early period of independence and only relatively recently abandoned in implemented policy. Second is the degree of uncertainty in the economic operating environment which renders all exchange more problematic. Finally and contributing to uncertainty is the dysfunction of the formal institutional structure as a result of discontinuities. It is speculated that it is discontinuity between formal and informal institutions in Kenya which is perhaps the most pervasive.

Crucially the Asian entrepreneur's exchange environment is modified by the extent to which informal structures can be used to support exchange. Informal modes of exchange are especially relevant to the middle-scale, which as an organisational form is more continuous with these modes of exchange. Why have the Asian communities in Kenya been able to use these informal institutions, where the African have not? It is not possible to provide a simple answer here. However it is notable that the particular circumstances of the Asian communities favoured the development of institutions which supported business. Entrepreneurs in a small community subject to strong discrimination both from the state and the wider population, together with a cultural-religious basis for close affiliation had the motivation - the need - for close internal trade and the information flows to facilitate this flow. There is a discernible evolutionary path by which habits and routines entailing close co-operation within the community would be favoured, rapidly giving rise to informal institutions which seem to explicitly favour exchange.

That similar informal institutions favouring co-operation did not emerge among African communities may be related to the simple difference in the historical paths of these ethnic groups. It is notable that during much of the colonial period, the
imposed formal institutional structure effectively did not allow an African move into trade or manufacturing enterprise. Rather as Robert Bates (1989) demonstrates with regard to Central Kenya and the Kikuyu communities, the major opportunities for the African entrepreneur were found in agriculture. The introduction of formal property rights was critical in creating the potential for rapid accumulation of wealth, precipitating a struggle to capture the rights to land. It is a struggle, born of discontinuity between imposed formal and antecedent informal institutions, which arguably persists to the present day.

The evidence does not seem consistent with simple social determinism and the inheritance of immutable cultural traits. The origin of the Asian communities in Kenya is strongly associated with economic migration. It must be reiterated that many of today's successful middle- (and large-) scale Asian entrepreneurs can trace their origins, across only three generations or less, to subsistence peasant farming communities in Gujarat, apparently very similar to those of many African communities in Kenya. In our study here, it was not found possible to unravel the strong co-operation found among Asian businesses to either a simple explanation of conformance with internalised moral rules and norms or rational action. Rather these two elements appear indissociable. Such a conception is wholly consistent with the theoretical basis of the argument put forward here. The extent to which aspects of the cultural and social values that the Asian migrants brought with them contained the seeds of today's successful entrepreneurial community is hard, perhaps impossible, to determine. Minority status and perhaps, ironically, discriminatory colonial and subsequently independent state policy against a background of racial tension may have played the major role.

In conclusion, it is clear that much regarding Kenya's middle remain unsettled here. However in this thesis a significant contribution has been made to unravelling the question. On an empirical level, a clearer picture of the scale distribution and ownership of manufacturing enterprise in Kenya has been produced. The in-depth case studies of middle-scale enterprises presented here increases our familiarity with a phenomenon which has been previously most discussed in its absence. An argument has been produced which shows convincingly how the current position of Kenya's middle could have arisen. Significant empirical support has been found for this
argument. It can be claimed that a somewhat clearer picture has emerged than was available previously, even if it is not the complete one. We now turn to consider the implications.

9.4 Implications and future work

9.4.1 Theoretical perspectives

The examination of Kenya's middle here has drawn heavily on the emerging new institutional economics. There has been a marked interest in the last decade in the application of these ideas to problems of economic development. This thesis has shown the fecundity of the theory. In doing so we have developed a framework for the analysis of the exchange process which allows the application of institutional thought to a range of questions. The aim has been to show how the institutional approach can be used to describe more clearly how enterprises are embedded within a wider social and cultural context. While the relevance of these questions has long been argued by many theorists and observers alike, there has perhaps been a lack of connection between the two. The work here represents a modest contribution to an emerging empirically based literature on the embeddedness of enterprise.

The key concept of discontinuity has been introduced here in order to increase the richness of the description of the institutional environment. It is a concept which it is argued has special relevance to the context of the late developing economies. Over the course of the last century profound changes have been wrought in the institutional structure of many economies within the developing world. From an institutionalist perspective, the resultant discontinuities can be expected to have a potentially profound impact on the subsequent history of those economies. It is speculated that an important characteristic of discontinuities is the tendency to reproduce. There is the promise of improving the understanding of institutional change by further examination of this question.

Finally the application of the concept frame to understanding questions of scale has been very promising. In the review of the literature there was found to be lack of convincing theories explaining scale distributions. The approach taken here may usefully be applied to other contexts.
9.4.2 Future investigations

Returning to the question of the middle in Kenya, while the empirical work undertaken has increased knowledge of the middle and shown significant support for the argument and concept frame, much work remains. Further work is needed simply to describe the middle in Kenya. More statistics regarding the structure and ownership of Kenyan industry are needed, preferably from a comprehensive study.

More sub-sectors need to be examined in order to determine the generalizability of the conclusions drawn here from the garment sub-sector. Empirically the weakest area of the work here has been that regarding the large-scale. Secondary data is not extensive nor sufficiently detailed to enable strong inferences to be drawn. A set of in-depth case studies of various types of large-scale enterprise is needed.

A number of the specific hypotheses put forward here could be operationalised and tested using survey methods. Among the most obvious would be an attempt to quantify the relative volumes of exchange between middle-, micro- and large-scale. Although a formidable undertaking, this would provide invaluable data to test key hypotheses put forward here.

Turning to a broader theme, one factor notable by its absence from the study here is the role of gender in enterprise. Gender was not considered, either at a theoretical level or directly in the empirical investigations, not due to its presumed irrelevance to enterprise in Kenya but rather because of its very significance. With the clear emphasis in the study on the role of ethnicity, attempting to include the gender dimension risked broadened the work to an extent which could have threatened its focus on the key questions. It is argued that there is no reason to suppose a priori that the role played by ethnicity in enterprise is conditioned by gender. The African and Asian ethnic populations both have a roughly balanced gender division\(^2\) which would suggest that gender is not causally responsible for the phenomena which this study has sought to explain. However in considering future work it is contended that our understanding of the exchange environment faced by the middle-scale enterprise in Kenya could be significantly enriched by consideration of gender.
Discussion and conclusion

It is a striking feature of the case studies that in the two African-owned enterprises, the primary managers of both businesses were women, while in the two Asian-owned enterprises, the primary managers were men. This is suggestive of some differences between the African and Asian communities with respect to gender roles in enterprise. The first task in future work in this area would be to establish whether there is a statistically significant correlation between the gender of middle-scale enterprise owner-managers and ethnicity. Within the framework developed, the investigation would then focus on whether there are instrumentally important distinctions in the exchange environment faced by men and women entrepreneurs from both African and Asian communities.

Evidence from one of the African case studies (Ancom, §D.2) provided a clear indication that gender does play a role in shaping the exchange environment, though there was no suggestion of any ethnic dimension. Existing work, primarily relating to micro-enterprise, in Kenya confirms the importance of gender. Studies by McCormick (1988, 1991), Karanja (1996) and Ngau and Keino (1996), all focussed on African (rather than Asian) entrepreneurs, provide strong evidence that gender has a significant influence on the exchange environment faced. Much of this work shows that women face greater obstacles than men in business. However, there are also some indications that women may face a more positive exchange environment in some respects. For example, strong evidence has been found that women micro-enterprise borrowers are regarded as presenting a lower credit risk to lenders than men (Hulme and Mosely 1996, p.125). Further work in unpacking these gender differences is clearly needed.

Broadly it is argued that further work in this area is of considerable importance. Although the findings from this study are tentative, the implications are highly relevant to policy. There is major donor and government interest in Kenya in encouraging the development of the middle-scale. We have argued at length earlier that such attention is strongly justified given Kenya’s development priorities (§3). If interventions in support of the sector are to be successful then it is crucial that they are designed in the context of an understanding of the problem and its origins. Accepting the tentative nature of the conclusions from this study, we turn now to consider the implications for policy.
9.4.3 **Policy recommendations**

This study places the development of the middle-scale at the heart of Kenya's industrialisation project. We have argued that the non-emergence of an African middle-scale should be a matter of considerable concern. Central to the origin of the missing middle, it is maintained is the notion of discontinuity. Attempts to improve the exchange environment for the middle-scale should therefore focus on how these discontinuities can be eliminated or at least mitigated.

At the outset it is crucial to note that the elimination of discontinuities cannot be achieved by simple deregulation. A policy objective of minimising regulation as a route to enabling enterprise is, according to the analysis developed here, very dangerous. As we have seen for the middle-scale, the formal institutional structure is not of necessity a constraint. Rather it is a double-edged sword. An inappropriate structure *can* create an environment inimical to the emergence of the middle. However this does not imply that its elimination or minimisation will therefore produce a favourable position. The argument is more complex. What is required is an *appropriate* institutional structure. The middle we have suggested is more vulnerable to the nature of the formal institutional structure than either micro-scale which operates largely outside it and large-scale which may either internalise functions or use its relative power to shape the environment in its own interests.

At best a minimal institutional structure may simply preserve the existing large-scale bias in Kenyan manufacturing, which it has been argued contributes in itself to the difficulties faced by the middle. Some minor benefits may be delivered by the elimination of costs associated with over-bureaucratic regulation or corruption. However minimising the institutional structure will not contribute to the solution of the exchange problems of the middle. Worse, with the removal of protection, Kenyan industry will be forced into direct competition with the most efficient producers in the world, working within far more favourable institutional structures and economic environments. Under such conditions, Kenyan enterprise faces a significant competitive disadvantage. The sense of vulnerability was echoed by one African middle-scale entrepreneur: "if we are not protected then this size of company is going to be a thing of the past". The African middle could become extinct before it has properly evolved.
The obvious difficulty with this argument is that it does not lead to a simple set of policy recommendations. Determining what is an appropriate institutional environment is not easy. The argument can be guided by the consideration of discontinuity, and we sketch a few areas below. Ultimately further research is needed into precisely what areas of the institutional environment impact on middle-scale enterprises and how positive changes can be achieved.

Most of the areas for intervention which immediately suggest themselves are ones which are already well established. Eliminating corruption and stabilising the macro-economy are common policy objectives which are clearly pertinent to the question. Duty evasion, for example, is widely cited as a major problem for the garment industry at present. However these are clearly enormously complex subjects which we merely indicate here as relevant.

The problems raised with regard to establishment, monitoring and enforcement of quality standards has been closely linked to problems of corruption. However one solution to the apparent distance between industry and regulators is to involve the industry sectors much more closely in looking after their interests through industry associations. In an analogous fashion to the way in which the accountancy profession often self-regulates through what are effectively industry associations, various sub-sectors with a degree of public or donor support could take greater responsibility for establishing standards appropriate to the sector. The state takes a more distant supervisory role. Clearly appropriate representation of all scales within such bodies would need to be enforced.

Improving access to law for middle-scale business is another obvious area for action. This might involve setting up special fast-track legal processes to deal with smaller claims quickly and at lower cost. Related to this is the question of property rights, especially regarding land. Again this is a major issue and highlights a profound discontinuity between formal institutions which imply the ability to establish comprehensive claims over land and informal which introduces other claims, relating to ethnicity and traditional use. Reforms must be carried out in the context of this discontinuity.
Discussion and conclusion

The power of large-scale organisations is important, especially those in the public sector. State imposed monopolies in, for example, the power and telecommunications sectors have resulted in these suppliers becoming virtually totally unaccountable to customers. Although the introduction of competition and privatisation, a major element of the government current economic reform programme, is intended to contribute to the solution of these problems, it is crucial that such ends remain in focus. The discontinuity between large-scale and smaller organisations is critical.

Tackling discontinuities between large- and middle-scale is highly problematic. As Masinde's (1994) study of the motor vehicle industry shows, coercive policies by the state are unlikely to be successful. It is worth noting however that the state does have a role in the regulation of competition, working to eliminate anti-competitive practices.

One approach to tackling the large-middle discontinuity is through intermediation. There is evidence that this already occurs informally in the finance sector within the Asian business community. Mid-sized Asian owned financial institutions are able to borrow from the very large banks and on-lend to middle-scale businesses. The development of such intermediaries should be encouraged. In the financial sector this is premised on depoliticization and effective regulation by the Central Bank.

Finally an area of tremendous potential importance is breaking down the barriers between the African and Asian business communities. This perhaps starts with a wider recognition that the vast majority of Asian business in Kenya is not foreign but Kenyan. The capacity which has been built within the Asian business community is indigenous in all important respects — it is geographically local, it is adapted to the local environment, and despite the anecdotal evidence to the contrary, Asian capital in Kenya is not fundamentally 'global', subject to the vagaries of world capital markets. As noted over twenty-five years ago by Marris and Somerset (1971), reiterated recently by Himbara (1994b) and King (1996), and confirmed in this research, the capacity developed within the Asian business community has been of greater value to the development of enterprise in the wider Kenyan society than is
usually recognised. The recognition, at all levels, that Asian enterprise in Kenya is an asset may be the first step towards better use of it.
Notes

1 The notion of disconnect used by Dia (1996) has some similarities with the concept of discontinuity developed here. However there are important differences.

2 The African population is comprised 50.4% women while the total Asian population is comprised 47.2% women (Republic of Kenya, 1996).

3 It is interesting to note that in the survey of Kenyan micro-enterprise reported by Daniels et al (1995, p.36) 15.4% of women had received credit against only 5.2% of men. Part of this difference can be attributed to the greater participation of women in informal rotating savings and credit associations, which again also suggests that the exchange environment is gender dependent.

4 It is notable that the RPED study of manufacturing found that government regulation was not regarded as a major problem by many manufacturers, across all scale. Corruption (with the implication of improper implementation of regulation) was regarded as significant by many more companies (RPED 1996).

5 See Biggs, Conning, Fafchamps and Srivastava (1994); also confirmed through field experience (1991-2).
**APPENDIX A**

**SPECIFIC HYPOTHESES AND QUESTIONS**

Table A-1: Middle-scale: exchange by contract and long-term contracting

<table>
<thead>
<tr>
<th>Explanandum</th>
<th>1.1</th>
<th>Null</th>
<th>Middle-scale 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 co-operation in exchange.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Alternate</td>
<td>Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
</tr>
<tr>
<td>1.2</td>
<td>Null</td>
<td>Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an efficient mechanism for solving problems of co-operation.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td></td>
</tr>
<tr>
<td>1.3</td>
<td>Null</td>
<td>Middle-scale enterprises are no less likely to rely on the state-maintained economic institutional framework for solving the problem of co-operation in exchange than large-scale enterprises.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Middle-scale enterprises are significantly less likely to rely on the institutional framework than large-scale enterprises.</td>
<td></td>
</tr>
<tr>
<td>Explanans</td>
<td>1.4</td>
<td>Null</td>
<td>Middle-scale enterprises perceive the institutional framework in Kenya, consisting of formal and informal rules, as reliable, being relatively stable and predictable.</td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Middle-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players.</td>
<td></td>
</tr>
<tr>
<td>1.5</td>
<td>Null</td>
<td>Middle-scale enterprises do not perceive the institutional framework as inaccessible to them or incompatible with their needs.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Middle-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs.</td>
<td></td>
</tr>
</tbody>
</table>
Table A-2: Middle-scale enterprise: relational contracting

<table>
<thead>
<tr>
<th>Explanandum</th>
<th>Null</th>
<th>Alternate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td><strong>Null</strong> Middle-scale enterprises do not regard the formation of relations with exchange partners as significant to their businesses.</td>
<td><strong>Alternate</strong> Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
</tr>
<tr>
<td>2.2</td>
<td><strong>Null</strong> Middle-scale enterprises find no particular difficulties in engaging in any type of exchange activities with any other organisational types found in the task environment.</td>
<td><strong>Alternate</strong> Middle-scale enterprises find engaging in all but the simplest exchange with large-scale organisations difficult.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
<th>Null</th>
<th>Alternate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.3</td>
<td><strong>Null</strong> Middle-scale enterprises do not perceive the general economic operating environment in Kenya as characterised by significant instability.</td>
<td><strong>Alternate</strong> Middle-scale enterprises do perceive the general economic operating environment in Kenya as characterised by significant instability.</td>
</tr>
<tr>
<td>2.4</td>
<td><strong>Null</strong> The effective instruments deployed by middle-scale enterprises and large-scale organisations in relation to exchange are not systematically discernibly different.</td>
<td><strong>Alternate</strong> The governance instruments deployed by middle-scale enterprises and large-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
</tr>
<tr>
<td>2.5</td>
<td><strong>Null</strong> The organisational rules and norms (including strategies, structures and broad processes) adopted by middle-scale enterprises and large-scale organisations are not significantly, systematically different.</td>
<td><strong>Alternate</strong> The organisational rules and norms adopted by middle-scale enterprises, large-scale organisations are significantly, systematically different.</td>
</tr>
<tr>
<td>2.6</td>
<td><strong>Null</strong> The organisational culture of middle-scale enterprises and large-scale organisations are not significantly, systematically different.</td>
<td><strong>Alternate</strong> The organisational culture of middle-scale enterprises and large organisations are systematically different.</td>
</tr>
</tbody>
</table>
## Appendix A: Specific hypotheses and questions

### Table A-3: Middle-scale: embedded exchange

<table>
<thead>
<tr>
<th>Explanandum</th>
<th>3.1</th>
<th>Null</th>
<th>Entrepreneurs do not differentiate between potential exchange partners on the basis of ethnicity.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Alternate</td>
<td>Entrepreneurs do differentiate between potential exchange partners on the basis of ethnicity.</td>
</tr>
<tr>
<td>3.1.1</td>
<td>Null</td>
<td>Asian entrepreneurs are no more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Asian entrepreneurs are more likely than African entrepreneurs to engage in exchange activities with members of their own ethnic community</td>
<td></td>
</tr>
<tr>
<td>3.2</td>
<td>Null</td>
<td>Entrepreneurs do not rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate co-operation</td>
<td></td>
</tr>
<tr>
<td>3.2.1</td>
<td>Null</td>
<td>Asian entrepreneurs are no more likely than Africans to rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Asian entrepreneurs are more likely than Africans to rely on ethnic based socio-cultural structure to facilitate co-operation.</td>
<td></td>
</tr>
<tr>
<td>3.3</td>
<td>Null</td>
<td>Entrepreneurs do not rely on family relationships to facilitate co-operation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Entrepreneurs do rely on family relationships to facilitate co-operation</td>
<td></td>
</tr>
<tr>
<td>3.3.1</td>
<td>Null</td>
<td>Asians entrepreneurs are no more likely than Africans to rely on family relationships to facilitate co-operation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Asian entrepreneurs are more likely than Africans to rely on family relationships to facilitate co-operation</td>
<td></td>
</tr>
<tr>
<td>3.4</td>
<td>Null</td>
<td>Entrepreneurs find it no more difficult to solve problems of co-operation in exchange with members of other ethnic groups.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Entrepreneurs find it more difficult to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td></td>
</tr>
<tr>
<td>3.4.1</td>
<td>Null</td>
<td>Asian entrepreneurs find it no more difficult than Africans to solve problems of co-operation in exchange with members of other ethnic groups.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternate</td>
<td>Asian entrepreneurs find it more difficult than Africans to solve problems of co-operation in exchange with member of other ethnic groups.</td>
<td></td>
</tr>
</tbody>
</table>
### Table A-3: Middle-scale: embedded exchange (continued)

<table>
<thead>
<tr>
<th>Exploratory questions</th>
<th>3.4 If entrepreneurs rely on ethnic based socio-cultural structure, how is the effectiveness of this structure best understood?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) Rational action - backed by incentive/sanction</td>
</tr>
<tr>
<td></td>
<td>(b) Internalised informal rules and moral values</td>
</tr>
<tr>
<td></td>
<td>(c) Other</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3.5 If entrepreneurs make no use of ethnic based socio-cultural structure, why?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Social networks in which they are involved are generally resource poor</td>
</tr>
<tr>
<td>(b) Social networks in which they are involved are insufficiently large</td>
</tr>
<tr>
<td>(c) Relationships within the networks are insufficiently strong and therefore offer little contribution to solving the problem of co-operation or co-ordination</td>
</tr>
<tr>
<td>(d) Competition for scarce resources amongst members of the same ethnic group is too strong to permit co-operation</td>
</tr>
<tr>
<td>(e) Significant elements of socio-cultural structure are repudiated in the process of entering the modern exchange economy</td>
</tr>
<tr>
<td>(f) Other</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3.5.1 If relationships appear to offer little contribution to solving the problem of co-operation and co-ordination, how is this best understood?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Simple absence of supporting or mutable structures</td>
</tr>
<tr>
<td>(b) Structures are inimical to the required forms of exchange</td>
</tr>
<tr>
<td>(c) The relationships, on balance, imply a greater liability or risk than asset or potential reward leading to their repudiation as a whole</td>
</tr>
</tbody>
</table>

### Table A-4: Micro-scale: growth

<table>
<thead>
<tr>
<th>Explanandum</th>
<th>4.1 Null Micro-scale enterprises find no barriers to growth into the middle-scale</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Alternate Micro-scale enterprises find significant barriers to growth into the middle-scale</td>
</tr>
<tr>
<td>4.2 Null</td>
<td>Micro-scale entrepreneurs are as likely to invest in the growth of existing businesses as in other opportunities</td>
</tr>
<tr>
<td></td>
<td>Alternate Micro-scale entrepreneurs refrain from investing in the growth of their existing businesses</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explanans</th>
<th>4.3 Null Micro-scale entrepreneurs do not see the exchange environment as presenting particular barriers of cost or uncertainty</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Alternate Micro-scale entrepreneurs see the exchange environment as resulting in a high degree of cost and uncertainty</td>
</tr>
</tbody>
</table>
Table A-5: Large-scale: external exchange environment

<table>
<thead>
<tr>
<th>Explanandum</th>
<th>Null</th>
<th>Alternate</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1 Null Large-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.</td>
<td>Alternate Large-scale 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 co-operation.</td>
<td></td>
</tr>
<tr>
<td>5.2 Null Large-scale enterprises regard exchange based on the state-maintained economic institutional framework as an inefficient mechanism for solving the problems of co-operation.</td>
<td>Alternate Large-scale enterprises regard exchange based on the state-maintained economic institutional framework as an efficient mechanism for solving problems of co-operation</td>
<td></td>
</tr>
<tr>
<td>5.3 Null Large-scale enterprises are no less likely to rely on the state-maintained economic institutional framework for solving the problem of co-operation in exchange than middle or micro-scale enterprises.</td>
<td>Alternate Large-scale enterprises are more likely to rely on the state-maintained economic institutional framework for solving the problem of co-operation in exchange than middle or micro-scale enterprises.</td>
<td></td>
</tr>
<tr>
<td>5.4 Null Large-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.</td>
<td>Alternate Large-scale enterprises do not regard the formation of relations with exchange partners as significant to their businesses.</td>
<td></td>
</tr>
<tr>
<td>5.5 Null Large-scale enterprises find no particular difficulties in engaging in any type of exchange activities with any other organisational types found in the task environment.</td>
<td>Alternate Large-scale enterprises find engaging in all but the simplest exchange with middle-scale and micro-scale enterprises difficult.</td>
<td></td>
</tr>
</tbody>
</table>

Explanans

| 5.6 Null Large-scale enterprises perceive the institutional framework in Kenya, consisting of formal and informal rules, as reliable, being relatively stable and predictable. | Alternate Large-scale enterprises perceive the institutional framework in Kenya as being uncertain and highly dependent on the political bargaining power position of players. |                                                                                               |
| 5.7 Null Large-scale enterprises do not perceive the institutional framework as inaccessible to them or incompatible with their needs. | Alternate Large-scale enterprises perceive the institutional framework as inaccessible to them or incompatible with their needs. |                                                                                               |
Table A-5: Large-scale: external exchange environment (continued)

<table>
<thead>
<tr>
<th></th>
<th>Null</th>
<th>Alternate</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.8</td>
<td>The governance instruments deployed by large-scale enterprises and middle-scale organisations do not appear to be different in kind.</td>
<td>The governance instruments deployed by large-scale enterprises and middle-scale organisations appear to be different in kind and undermine the formation of exchange relations.</td>
</tr>
<tr>
<td>5.9</td>
<td>The organisational rules and norms adopted by large-scale enterprises, middle-scale organisations are not systematically different.</td>
<td>The organisational rules and norms adopted by large-scale enterprises, middle-scale organisations are significantly, systematically different.</td>
</tr>
<tr>
<td>5.10</td>
<td>The organisational culture of large-scale enterprises and middle organisations are not systematically different.</td>
<td>The organisational culture of large-scale enterprises and middle organisations are systematically different.</td>
</tr>
</tbody>
</table>

Table A-6: Large-scale: bureaucratic firm mode

| Explanandum |
|---|---|
| 6.1 | Null | Large-scale enterprises are no more likely to internalise functions in Kenya than elsewhere. |
| Alternate | Large-scale enterprises are more likely to internalise functions in Kenya than in environments characterised by greater stability |
| 6.2 | Null | Large-scale enterprises are no more likely to internalise functions rather than outsource to middle-scale enterprises. |
| Alternate | Large-scale enterprises are more likely to internalise functions rather than outsource to middle-scale enterprises. |
| 6.3 | Null | Subsidiaries of multi-national corporations are no more likely to source from parents or related companies than locally. |
| Alternate | Subsidiaries of multi-national corporations are more likely to source from parents or related companies than locally. |

| Explanans |
|---|---|
| 6.4 | Null | Large-scale enterprises do not perceive internalisation as a means of controlling uncertainty in exchange |
| Alternate | Large-scale enterprises do perceive internalisation as a means of controlling uncertainty in exchange |
| 6.5 | Null | Subsidiaries of multi-national corporations do not regard use of internal sourcing as a means of controlling uncertainty in exchange |
| Alternate | Subsidiaries of multi-national corporations do regard use of internal sourcing as a means of controlling uncertainty in exchange |
APPENDIX B

STUDY INSTRUMENTS
Appendix B: Study instruments

B.1 Confidentiality agreement

Durham University Business School
Small Business Centre

Managing Director

PO Box
Nairobi
Kenya

CONFIDENTIALITY UNDERTAKING

Dear

Research Project: The “Missing Middle” in Kenya

My thanks for your agreement to participate in the above research project, which is being conducted in association with the Institute for Development Studies, University of Nairobi.

I confirm that confidentiality will be maintained throughout this research. Specifically I undertake that in the publication or any other presentation of results from this research the identity of Ltd., its directors and employees will not be disclosed, either directly or indirectly.

Yours sincerely

D.V.Ferrand
Overseas Development Group

Mill Hill Lane, Durham City, DH1 3LB, United Kingdom.
## B.2 Introductory questionnaire

### Contact information

Name of contact ____________________________

Position ____________________________

P O Box ____________________________ Town ____________________________

Telephone ____________________________ Fax ____________________________

Physical location ____________________________

### Legal status

- [ ] limited company
- [ ] public NSE quoted company
- [ ] partnership
- [ ] sole proprietorship
- [ ] co-operative

### Ownership

- [ ] single owner
- [ ] family interest (inc. trust)
- [ ] business partners (number ______)
- [ ] subsidiary - local quoted company
- [ ] subsidiary - foreign quoted company

Details ____________________________

Active management interest [ ] %

Ethnicity of major interests
- [ ] African
- [ ] Asian
- [ ] European
- [ ] Other ____________________________

Nationality of major interest
- [ ] Kenyan
- [ ] Other ____________________________

Community of owners ____________________________

(ethnic/clan/religious/sect/mother tongue)

Community of management ____________________________
### Output

<table>
<thead>
<tr>
<th>Major type of products</th>
<th>Specific products</th>
<th>Services</th>
</tr>
</thead>
</table>

### Workforce

Average number of employees:

<table>
<thead>
<tr>
<th>Full time, permanent</th>
<th>Full time, casual</th>
<th>Trainees/apprentices</th>
<th>Part time</th>
</tr>
</thead>
</table>

Number of members of immediate family involved

Number of (owner/manager) community members

Role of family/community members

### Basic financials (in last financial year)

<table>
<thead>
<tr>
<th>Annual turnover</th>
<th>KShs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross profit</td>
<td>KShs/</td>
</tr>
<tr>
<td>Net profit</td>
<td>KShs/</td>
</tr>
<tr>
<td>Capital employed</td>
<td>KShs</td>
</tr>
</tbody>
</table>

### Production process

<table>
<thead>
<tr>
<th>Number of distinct production lines</th>
<th>Shifts/day</th>
<th>Max number of workers involved in production of single product</th>
<th>Highest educational qualification of technical-production staff</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estimated value of fixed assets</td>
<td>KShs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(excluding land &amp; buildings)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source of physical technology

- Local - informal
- Local - formal
- Import - direct
- Import - indirect
### History

**Age of current company**

**Previous areas of activity of company**

**Previous activities of owners/managers**

**Source of initial capital**

**Direct involvement of last generation of owners/managers**

**Brief summary of major events in company history**

**Additional notes**
B.3 Interview schedule: supply
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 |
--- | --- |

<table>
<thead>
<tr>
<th><strong>1.1.1 Description</strong></th>
</tr>
</thead>
</table>
| 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 |

<table>
<thead>
<tr>
<th><strong>1.1.2 Items supplied</strong></th>
</tr>
</thead>
</table>
| What do they supply to you?  

• Is it important to use regular suppliers for these items?  

Why do you use or not use key regular suppliers? |

<table>
<thead>
<tr>
<th><strong>1.1.3 Importance</strong></th>
</tr>
</thead>
</table>
| 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]  

• 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)?

\(\text{Why do you use or not use these other regular suppliers?}\)

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?

\(\text{Why is it important that there are supplied by a regular supplier?}\)

1.2.3 Importance

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

[Prompt: loss of suppliers could involve problems for you]

\(\text{Can you describe how they are important to you?}\)

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

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

\(\text{Can you describe how you are important to them?}\)

[Prompt: supplies hard to find elsewhere, used to dealing]
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 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 day?

- Do you find such changes can be accommodated satisfactorily?

  - Why is this the case (satisfactory or unsatisfactory)?
1.5 PROBLEMS & CONFLICTS

Have you ever had significant problems or conflict in dealing with any of your regular suppliers?

YES ☐ NO ☑

1.5.1 Description

• Can you describe examples of significant problems or conflicts with regular suppliers?
  ♦ Why did these problems or conflicts arise?

• Do you feel such problems could potentially or actually have harmed your business?

• Is the growth or expansion of business ever limited by these things?

1.5.2 Dealing with problems and conflict

• In what ways did you and your supplier attempt to deal with the problems or conflicts?
  ♦ Why did you choose such an approach?

• Would the approach/strategy you adopt vary according to supplier?
  ♦ Why would you use different strategies/approaches?

1.5.3 Outcomes

• What was the outcome of your attempts to deal with the problems/conflicts?
  ♦ Why did such an outcome arise?

• Did the outcome significantly affect the way you deal with the supplier in question, and if so how?
  ♦ Why did it affect it or not affect it?
2. IRREGULAR SUPPLIERS

Do you make use of any irregular sources of supply?

为何使用或不使用这些不规则来源？  是  否

2.1 IRREGULAR SOURCES OF SUPPLY

What irregular sources of supply do you use?

2.1.1 Description

- Can you describe the irregular sources you use?

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

2.1.2 Items supplied

- What do they supply to you?
- Is it important to use irregular suppliers for these items?

为何如此重要，这些物品由不规则供应商或通过市场供应？

2.1.3 Importance

- How important do you feel such sources of supply are to you?

为何你觉得这些来源对你很重要？

- Can you describe how they are important to you?
2.2 **PROCESS OF SUPPLY**

Can you describe how supplies are obtained from irregular suppliers?

2.2.1 **Day-to-day process of obtaining supplies**

- How do you go about getting supplies from irregular suppliers?
  
  [Prompt: elements include initiation of order, confirmation of order, lead times, delivery, quality inspection, payment and credit periods]

2.2.2 **Achieving effective supply**

- What are the most important things in relation to achieving supply from such sources?
  
  [Prompt: price, assuring quality of product, on-time delivery, size of deliveries (maximum and minimum), credit periods]

- Do you have any difficulties in achieving any of these elements with such sources of supply?

- What potential problems can you see in relation to achieving these elements?

- What can you do to overcome these actual or potential difficulties or problems?
  
  [Prompt: contractual agreements, reputation]

- How effectively do you feel you can control problems?

- Have you ever had a major problem in relation to supply from a non-regular supplier?

- What was the outcome of this problem, both in the short and long term?
## APPENDIX C

### SOURCES OF SECONDARY EVIDENCE

<table>
<thead>
<tr>
<th>Source</th>
<th>Focus</th>
<th>Form</th>
<th>Relevant evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alila and McCormick (1997)</td>
<td>Linkages in tourism sub-sector</td>
<td>Survey</td>
<td>Micro, middle and large scale exchange environment (supply and demand)</td>
</tr>
<tr>
<td>Atieno (1997)</td>
<td>Linkages in food-processing sub-sector</td>
<td>Survey</td>
<td>Micro, middle and large scale exchange environment (supply and demand)</td>
</tr>
<tr>
<td>Biggs, Miller, Otto and Tyler (1996), Biggs, Moody, van Leeuwen and White (1994)</td>
<td>Export by African garment and other manufacturing enterprises</td>
<td>Report</td>
<td>Case study of large-scale export linkage, constraints to international linkages</td>
</tr>
<tr>
<td>Collinson (1991)</td>
<td>Technology transfer by large and middle-scale firms</td>
<td>Cases</td>
<td>Large-scale and middle-scale technology acquisition processes</td>
</tr>
<tr>
<td>Gichira and Onyango (1991)</td>
<td>Barriers to micro-enterprise growth</td>
<td>Survey</td>
<td>Micro-scale enterprise constraints on growth</td>
</tr>
<tr>
<td>Source</td>
<td>Focus</td>
<td>Form</td>
<td>Relevant evidence</td>
</tr>
<tr>
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</tr>
<tr>
<td>Kariuki (1993, 1995)</td>
<td>Credit for micro and middle-scale enterprise</td>
<td>Survey</td>
<td>Micro-scale and middle-scale finance: sources and constraints</td>
</tr>
<tr>
<td>Kinyanjui (1992)</td>
<td>Micro and middle-scale enterprise manufacturing</td>
<td>Survey</td>
<td>Micro-scale and middle-scale background data</td>
</tr>
<tr>
<td>Kinyanjui and Mitullah (1997)</td>
<td>Linkages in construction sub-sector</td>
<td>Survey</td>
<td>Micro, middle and large scale exchange environment (supply and demand)</td>
</tr>
<tr>
<td>Manji (1995)</td>
<td>Growth of an Asian enterprise</td>
<td>Case</td>
<td>Anecdotal case study of growth history of Asian enterprise from middle to large-scale</td>
</tr>
<tr>
<td>Marris and Somerset (1971)</td>
<td>African and Asian micro-scale enterprise</td>
<td>Report, Survey</td>
<td>Micro-scale exchange environment (including cultural factors)</td>
</tr>
<tr>
<td>Masinde (1994, 1996)</td>
<td>Large-small firm linkages in motor-vehicle industry</td>
<td>Cases</td>
<td>Large-scale enterprise decisions and strategy with respect to input sourcing</td>
</tr>
<tr>
<td>Mwaura (1994)</td>
<td>Strategies of middle-scale enterprises</td>
<td>Survey</td>
<td>Detailed data on middle-scale exchange environment (finance, labour, demand, supply, technology, stability)</td>
</tr>
<tr>
<td>Ndegwa (1994)</td>
<td>Middle-scale enterprise</td>
<td>Report</td>
<td>Anecdotal evidence of differences between African and Asian middle-scale businesses</td>
</tr>
<tr>
<td>Oketch and Parker (1991)</td>
<td>Micro-enterprise in furniture sub-sector</td>
<td>Report</td>
<td>Micro-scale enterprise exchange environment (with respect to supply and demand)</td>
</tr>
<tr>
<td>Parker and Torres (1993)</td>
<td>Micro-scale enterprise survey</td>
<td>Survey</td>
<td>Growth data on micro-scale enterprises, broad constraints to growth</td>
</tr>
<tr>
<td>Source</td>
<td>Focus</td>
<td>Form</td>
<td>Relevant evidence</td>
</tr>
<tr>
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<tr>
<td>Sebstad and Walsh (1991)</td>
<td>Micro-enterprise credit impact analysis</td>
<td>Survey</td>
<td>Background data on micro-scale enterprise</td>
</tr>
<tr>
<td>Swainson (1980)</td>
<td>Large-scale and middle-scale enterprise development</td>
<td>Case</td>
<td>Large-scale enterprise exchange strategy</td>
</tr>
<tr>
<td>Teitel (1994)</td>
<td>Technology in manufacturing enterprise</td>
<td>Survey</td>
<td>Comparison of micro, middle and large-scale technology acquisition process</td>
</tr>
</tbody>
</table>
D.1 Overview of the Kenyan garment industry

Studies were made of a number of enterprises in the garment sub-sector, international standard industrial code (ISIC) 3220. Four cases were completed and analysed in depth for this study, two African owned and two Asian. Before a detailed presentation of these studies, it is useful to consider some background on this industry sub-sector.

As Peter Coughlin (1991c) has commented, taken as a whole, the textile and garment industry is one of Kenya’s most strongly developed. Figure D-1 below shows a vertical decomposition of the basic production-distribution systems. Perhaps the most notable feature illustrated by this diagram is the extent of the textile and garment industry in Kenya. Although not indicated on the diagram, Kenya produces a number of the raw materials which are the basic feedstock to the spinners, notably cotton and wool. However all the man-made fibres which have become increasingly important in the mass low and middle-income markets are imported (Odongo 1990, Coughlin 1991c). Furthermore inputs are imported at all stages. Finally in terms of technology there has been relatively little deepening; very little production equipment is produced in Kenya.

The diagram clearly shows the variation of integration in channels. Notably independent converters and tailors in the garment industry are also in direct competition with some fully integrated firms who are also their suppliers of fabric. Pre-liberalisation, the power of the mills was very considerable. This has considerably reduced now that converters and wholesalers have the option of importation.

Concentration in the industry is significant in textiles, but considerably less in garments. Overall it is estimated that 74% of employment in the whole sector is in
Figure D-1: Kenyan garment and textile sub-sector

Appendix D: Middle-scale enterprise case study
micro-scale enterprises, 3% in middle and 23% in large. Looking specifically at the garment sub-sector, which accounts for 27% of employment in the whole industry, 76% are in micro-scale, 9% in middle and 15% in large. Aside from the very substantial numbers of micro-enterprises found in the cordage, rope and twine classification (producing traditional sisal products), textile production is dominated by large-scale firms. There has been substantial government involvement in the development of this sector (Coughlin 1991c). By 1987 the government had a majority holding in six large-scale textile firms, four being integrated (RPED 1994). Cotton production and distribution has been dominated by one parastatal whose inefficient operation has impacted adversely throughout the subsequent production and distribution chain (Coughlin 1991c, RPED 1994).

Entry barriers to garment production are relatively low from a technological perspective. There are also intrinsically relatively low technology related economies of scale owing to the nature of fabric itself (McCormick 1995). In the domestic garment market, micro-, middle- and large-scale producers compete for the large low income and middle-income domestic market. Converters are found at all scales. Although the micro-enterprise sector is believed to be dominated by tailors (integrated production and retailing operations), McCormick and Ongile (1993) also identified micro-enterprises purely involved in manufacturing – small contract workshops and mini-manufacturers. Middle-scale enterprises in the sub-sector are primarily involved purely in converting. Competition from imports is reported as causing difficulties for all scales, especially from second-hand imports in the lower end and more generally where duty is illegally evaded (RPED 1995a, RPED 1996, McCormick 1995). The small upper income market is reported to be dominated by imports although some specialist (micro-scale) tailors may also compete here (McCormick and Ongile 1993).

A recent move into the export market was dominated by large-scale producers, manufacturing under bond (Ng'ang'a, 1989). This activity grew rapidly in the early 1990s, employing nearly 15,000 in over 40 large-scale enterprises by 1994. Both the strength of demand and more detailed efficiency analysis showed that Kenyan manufacturers were competitive in world markets (Biggs, Conning, Fafchamps and Srivastava 1994). Imposition of a US textile quota has had a disastrous impact,
reducing employment to just 3,300 with the closure of over 30 of these firms by March 1996 (Biggs 1996).

There are 75 middle-scale enterprises registered in the garment sub-sector. Of these only 6 (or 8%) can be tentatively identified by the name of the owners as African owned, 55 (or 73%) appear to be Asian owned, 2 (or 3%) as European owned, and for 12 (or 16%) there is no clear indication. Of the 55 firms which appear to be owned by Asians, at least 45 (over 80%) have a name suggesting ownership by members of the Oshwal community. This is consistent with the claim that the garment industry in Kenya is dominated by entrepreneurs of Asian origin (RPED 1994, p.290).
D.2 Case one: Ancom

Ancom Ltd is a producer of lingerie products, located in a small town approximately twenty kilometres from the centre of Kenya’s capital and industrial centre, Nairobi. It is owned by Janet Kipor and her husband, Peter. Both are African Kenyans, belonging to differing specific ethnic groups – Janet being Kikuyu and Peter a Luhya. Janet is the managing director and in full day to day control of the business. Her husband is a non-executive director and concentrates on his own electrical contracting business. The company employs 31 staff (28 full time, 3 casual). Organisational, the company represents a quintessentially middle-scale form. With notable exceptions, discussed later, the company is managed informally. Janet is involved in all aspects of operations – production, buying, designing, marketing and financial control.

Ancom addresses a market niche for relatively high quality but keenly priced lingerie products, primarily in the domestic market. The company has a very clear picture of its target consumer: women belonging to the relatively small middle-income class in Kenya who value quality but whose disposable income is relatively limited. This class, many of whom have traditionally been employed in the public service, have found their standard of living under pressure as a result of the economic reforms implemented over the last five years. The company’s market orientation permeates much of the company’s modus operandi. Quality must be maintained while effectively controlling costs.

The top end of the market, which has fared rather better, is believed to be out of Ancom’s reach. This partly relates to marketing power and the difficulty of a small Kenyan company presenting itself in the market as a supplier of high fashion brands. Process technology also presents a barrier: the highest quality products require the use of finishing machines which have a high unit capital cost. Capital expansion is not regarded as a viable option, as discussed later. Ancom finds its ability to raise capital highly constrained. Furthermore the owner-managers of the business appear reluctant to accept the risk perceived in a significant increase in gearing.
At the lower end of the market, the margins are judged to be too thin. In order to produce a comparable level of profit, Ancom would need to increase the scale of production significantly, switching to a high volume oriented process organisation. The process technology necessary for efficient operation may again present a barrier given indivisibilities in capital equipment. Ultimately however Janet feels that the operating environment in Kenya places this market out of reach of local companies. Amongst the many constraints faced, difficulties in the formal institutional environment are cited as highly significant. An opinion expressed by both Ancom and others in the same sector is that many imported goods in this market evade import duty as a result of rent-seeking behaviour by officials. Meanwhile converters such as Ancom who either choose not to become involved in corruption or lack the appropriate political power to evade, are subject to costs of duty directly on imported inputs, indirectly on the raw materials for locally manufactured inputs and a number of other taxes and costs relating to the regulatory environment.

The choice of market positioning is also to some degree historical. Ancom has been in this sector since foundation and prior to the current owner-manager's involvement. The company is strongly adapted to its market in terms of its production technology and organisation, management and marketing approach. Furthermore Janet has significant prior experience of retailing in this niche. Finally she frequently expresses a strong enthusiasm for producing a good quality product. Ultimately this is where Janet, as the essential entrepreneurial force in Ancom, feels the company belongs.

D.2.1 Supply

Ancom uses a wide range number of material inputs for its products, ranging from specially printed fabric designs through product standard items such as brassiere hooks to widely used garment inputs such as thread. The sources of supply and approaches to exchange are summarised in the table below (D-1).

Obtaining high quality cotton fabric represents probably the most significant supply exchange problems faced by the company. Fabric is a major component of the
## Table D-1: Ancom supply tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jersey knit fabric</td>
<td>Customised product Frequent Large-scale orders Quality difficult to detect</td>
<td>Quality problems only manifest after delivery Post delivery inspection and rejection of sub-standard goods Delivery timing Credit terms</td>
<td>Very high – vital input Quality of fabric determines quality of final product Low quality increases costs of production</td>
<td>Two long-term large-scale local Asian (Oshwal community) family owned and managed manufacturers.</td>
<td>Relational exchange</td>
<td>Exchange by contract (especially reliance on KBS) Market exchange Firm (vertical integration)</td>
</tr>
<tr>
<td>Elastic braids</td>
<td>Customised Asset specificity on part of supplier</td>
<td>Quality problems only manifest after delivery No local alternative suppliers Delivery timing Credit terms</td>
<td>High Vital component of products</td>
<td>One long-term middle-scale local Asian (Oshwal community) family owned and managed manufacturer</td>
<td>Relational exchange</td>
<td>Exchange by contract Market exchange Firm (vertical integration)</td>
</tr>
<tr>
<td>Elasticised fabric</td>
<td>Standard product Frequent</td>
<td>No local sources (either manufacture or wholesale) Susception of African based companies Impossible to deal directly with European or US based manufacturer</td>
<td>High Vital component of high quality products</td>
<td>One long-term large/middle-scale foreign (German) owner-managed export wholesaler</td>
<td>Exchange by contract moving towards relational exchange</td>
<td>Market exchange Firm (vertical integration)</td>
</tr>
<tr>
<td>Embroidery</td>
<td>Standard products Frequent</td>
<td>Quality Delivery timing Credit terms</td>
<td>High Important component of high quality products</td>
<td>One long-term middle-scale foreign (Austrian) specialised manufacturer</td>
<td>Exchange by contract building to relational exchange</td>
<td>Market exchange Firm (vertical integration)</td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
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<td>------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Threads etc</td>
<td>Standard product</td>
<td>Quality</td>
<td>Low</td>
<td>Various Nairobi based wholesalers</td>
<td>Market exchange</td>
<td>Relational exchange</td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Availability</td>
<td>Although critical, very widely used and available from many sources</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hook and eyes</td>
<td>Standard product</td>
<td>Availability</td>
<td>Low</td>
<td>One middle-scale foreign (German) supplier</td>
<td>Exchange by contract</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Infrequent</td>
<td></td>
<td>Although critical to final product, very low value, 2 years stocks maintained</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rings and adjusters</td>
<td>Standard product</td>
<td>Availability</td>
<td>Low</td>
<td>One foreign (Hong Kong) supplier</td>
<td>Exchange by contract</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Infrequent</td>
<td></td>
<td>Although critical to final product, very low value, 5 years stocks maintained</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Packaging</td>
<td>Standard product or</td>
<td>Availability</td>
<td>Low</td>
<td>Various Nairobi based wholesalers</td>
<td>Market exchange</td>
<td>Firm (vertical integration)</td>
</tr>
<tr>
<td></td>
<td>Customised product</td>
<td></td>
<td>Customised product not available locally</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Asymmetrical exchange position</td>
<td>Low</td>
<td>Various Nairobi based wholesalers</td>
<td>Market exchange</td>
<td>Firm (vertical integration)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Supplier has insufficient capacity – frequent power outages</td>
<td>Customised packaging would improve final product</td>
<td>Large-scale packaging manufacturers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>Standard</td>
<td>Asymmetrical exchange position</td>
<td>Critical</td>
<td>Parastatal very large-scale monopoly power generator and distributor</td>
<td>Exchange by contract</td>
<td>Quasi-integration of power function considered by use of generator – transforming to market mode</td>
</tr>
<tr>
<td></td>
<td>Very frequent</td>
<td>All production machinery and lighting is electrically powered.</td>
<td></td>
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</tbody>
</table>
finished product thus having a major impact on Ancom’s product quality and price. The influence on price derives not simply from the cost of the raw material but also on the production process. Poor quality raw materials result in increased costs of production as a result of both inefficient material utilisation and increased rejection of pieces in production. Ancom also uses custom printed fabrics which have even greater potential quality problems. Lack of uniformity in print results in significant material wastage in production.

Delivery lead times are especially important for fabric due its core position in the production process. However delivery timing is also relevant for other supplies. Similarly credit terms for fabric have a major impact on the company’s working capital position, with other supplies having a proportionately lower effect.

Prior to economic liberalisation in Kenya, import restrictions in support of the policy of local industrial protection, rendered importation of common fabrics virtually impossible and Ancom necessarily sourced material locally. There are only three mills in Kenya capable of supplying the fabric Ancom requires. Major exchange problems were associated with this oligopolistic situation. As Janet put it “the mills had very strong power and were able to dictate terms to the market rather than delivering what the market actually wanted”. Liberalisation and the elimination of import licensing has brought some improvement. Ancom can now credibly consider importation as an alternate source of supply. However importation incurs substantial transaction costs in terms of duty, transportation costs, importation formalities, international payments, communication of design variances, lead times, batch sizes and quality resolution. The instability in the macro-economic and formal exchange environment also contributes to an increase in the transaction costs and residual uncertainty of importation.

For its three major local suppliers, the mode of exchange is clearly relational, although the depth of the relation varies somewhat. Problems of both co-ordination and co-operation are tackled by dialogue in the first instance. Ultimately if agreement cannot be reached Janet will simply exit rather than attempt to obtain a remedy through the courts. Although a limited degree of paperwork is
involved in some of the ordering this is never relied on as a legal undertaking. Although difficulties have arisen in various ways, Ancom has never sought legal recourse to the courts. There has been no appeal implicitly or explicitly to the state standards bureau. Exchange by contract or long term contracting is largely avoided.

The significance of relational contracting is demonstrated by the growing closeness between Ancom and its leading fabric supplier. At the outset Janet was shown around the manufacturing facilities at the mill – enabling her to establish the capability of the plant to produce the quality of fabric she needs. This effectively reduces the transaction cost and residual uncertainty when buying fabric since there is a greater confidence in the quality of the fabric \textit{ex ante}. She believes that few other mills would have permitted this inspection. The exchange relationship has developed to the point where there is now some bilateral dependency. Ancom is very dependent on the supplier for the majority of its input. Janet believes that the loss of this supply source would be “devastating”. Although not the largest customer, Ancom is still a big customer for the supplier and there has been investment in additional production capacity. Most significantly, the two companies have developed a new fabric together. This has benefited both – providing Ancom with a local source of a new material it requires and the supplier with a new product. Ancom is extended moderate credit terms, with no formal contractual backing.

The flexibility implied by the relational mode is evidenced by a degree of tolerance on either side. Where Ancom’s cash position is sufficiently strong, Janet will pay early. In difficult periods, the supplier is content to extend the credit period. As Janet puts it: “this sort of give and take is important in the business relationship: its important to have a happy working atmosphere”. More significantly, the supplier will agree to change the size of an order after it has been placed. On the negative side for Ancom, the supplier is not reliable on delivery times. The reason for this Janet believes is that export orders to the mill are prioritised. Here the mill is operating against formal contracts for which there is no flexibility. Although this generates some problems for Ancom, it is tolerated.
There is a strong contrast in the relationship with the other fabric supplier. Janet has found considerable difficulties in building a strong relationship with this company: "there is no trust" and she finds them somewhat "abrasive" in style. Quality is poor and there has been little attempt to work on improving product quality despite pressure. The printed fabric is limited to a single colour and is not of a good quality. Janet's suggestions that the company should invest to upgrade its production process have met with no response. Credit terms are very poor. Ancom is forced to both provide signed bills of exchange to support and pay interest. As a result Ancom now sources all its plain fabrics from the first supplier. However the company has an effective local monopoly in printed fabrics. Janet believes that importation would involve excessive cost (essentially transaction costs), and therefore Ancom has little alternative but to remain with this supplier.

Interestingly, despite the local monopoly held by the supplier of elasticated braids, the relationship is far stronger. Although quality has been a problem, Janet feels that the company is "willing to work hard" on the issue and she now "feels an obligation to continue to work with them". There is a strong sense that the achievement of a satisfactory supply arrangement has emerged from the pressure personally exerted by Janet. Her unwillingness to accept poor quality has earned her the sobriquet of *Mama Kali* (*Swahili*, literally – Mrs Angry or Hot) at this supplier's factory. Janet believes there is "mutual dependency" (bilateral). The company has invested in new machinery as a result of Ancom's requirements.

There are two materials which Ancom is forced to import. In both cases, the initial mode was clearly exchange by contract with all imports backed by the formal governance mechanism of bank supported letters of credit. However Ancom has invested in the relationships, with Janet visiting Europe at least twice a year to maintain contact. The letters of credit mechanism has now eliminated and both are moving towards a relational mode. Credit is now offered without formal governance mechanism by the supplier of elasticised fabric.

The preference of Ancom for the relational mode demonstrated in relation to supply can be understood as partly deriving from the avoidance of direct transaction costs. Establishing letters of credit is a costly and inflexible procedure, as is the drawing up
of bills of exchange. However the explanation may be somewhat more fundamental. Strong communication and flexibility are important to achieving effective supply for a number of the raw materials used regularly by Ancom. There is a strong sense that the way in which Ancom as a business is organised is based on the notion of strong dialogue. Long-term contracting might offer a hybrid solution, but there is no evidence that this is used in supply. The clear implication is that Janet does not see any type of formal governance as compatible with the exchange problems she faces. There is some suggestion that this is partly due to the weaknesses in the formal institutional environment. Quality standards and aspects of commercial law should offer some assistance with the problems of product quality. Janet does not see these regulations as effective. Embedded exchange does not represent an option in exchange for Janet or Ancom. Janet knows of no African suppliers relevant to her business. She feels somewhat isolated in the industry – noting the ubiquity of the “Mr Shahs” (the name suggests membership of the Oshwal community) – and believes there is some distrust of African entrepreneurs.

The relative difficulties experienced with one of the local fabric suppliers in comparison with the other major local and overseas suppliers appears to derive from the approach taken by this supplier to exchange. In part this can be attributed to the use of formal mechanisms (such as the bill of exchange). Allied to this there is some sense of a reluctance to form stronger linkages with customers. Although part of the problem Janet believes to be due to both her gender and African ethnicity, she observed that her problems with them were not unique. Other converters, many of whom are Asian and specifically Oshwal owner-managed enterprises, have expressed frustration at dealing with this company. More puzzling to Janet is that the managing director is what she describes as a “second generation” businessman who has a formal business education as distinct from the “first
"generation" who tended to have relatively limited education. In her experience, she has few problems relating to business people with technical qualifications, who tend to assess her on the basis of her own technical background rather than gender or ethnicity.

The relevance of scale is ambiguous here. Although the problem supplier is significantly larger than the local elasticated braids supplier (based on employment), it appears of a very similar scale to the other local fabric supplier with whom there is an excellent relationship. Both are family owner-managed businesses, which though large-scale according to the definition employed here are relatively small compared with other textile mills in Kenya. The propensity on the part of the first supplier to establish informally governed relationships is more consistent with the *modus operandi* of the middle-scale rather than the large.

Other evidence is consistent with the argument that scale has an impact on the mode of exchange. It is interesting to note that the third potential local source of plain fabric, not used at all by Ancom, is three times the size of the other two suppliers. Janet specifically selected a smaller scale intermediary wholesaler to source elasticised fabric and deals directly with the managing director/owner. She believes that it would have been impossible for her to attempt to source directly from the very large scale European or US manufacturers. Similarly a smaller company was sought when looking for sources of embroidery. Janet feels that the smaller company, especially overseas, is much more likely to concentrate its attention on you. As she puts it, as a small company: “if you turn up at ICI who would look at you?”

Ancom attempted once to procure custom printed packaging for products in order to enhance their brand image. Discussions with a large-scale local packaging firm were fruitless. As Janet puts it, “they were only interested in talking about economies of scale – 10,000 or finish”. This again suggests difficulties faced by the middle-scale manufacturers in dealing with large-scale suppliers. Janet believes that this has more to do with attitudes than technical economies. She observed that in Mauritius a
similar attitude had been prevalent a few years ago. Now with a more dynamic, export oriented economy – "they can do whatever you want".

Electrical power supply represents a major difficulty for Ancom. During the period of the study, power rationing was severely disrupting production. Furthermore the very large scale parastatal power company was not adhering to its published schedule of power outages. In principle Ancom might have been able to take legal action against this breach of contract. Rather however Janet was considering installing a diesel powered generator in order to find an alternative source of power. Interestingly this would have transformed an ineffective exchange-by-contract transaction to either market or relational mode. Although petroleum refining is highly concentrated in Kenya, fuel distribution is strongly dispersed.

D.2.2 Demand

The company's market strategy is firmly focused on ensuring that the products meet the end consumer demand for quality and moderate pricing. Janet believes that appropriate marketing and particularly the final retail presentation is crucial to successfully reaching the target market. Ancom uses a number of sales channels (table D-2).

Ancom's market positioning with the emphasis on quality of product results in particular exchange problems. The quality of the product is not immediately apparent either to the intermediary seller or the end consumer. For the intermediary the issue is whether the cost differential between a higher quality, higher priced product and the lower quality, minimum priced will be accepted in the end consumer market. For the consumer the question is whether the product is actually a better quality product. At the most basic level is whether the product is at it purports to be: does it contain the materials represented (such as cotton, Lycra etc), has it been well made and so forth. Many of the key characteristics which differentiate the product from cheaper rivals will only become manifest in the longer term: durability, comfort and so forth. It is vital that Ancom communicates this information regarding quality effectively to the market.
Until very recently, the two leading customers, both middle-market chain stores, accounted for over half of Ancom’s output. The explanation for this concentration is straightforward. The middle-market which Ancom addresses is heavily represented in Nairobi and the two chain stores have been able to dominate this narrow segment by building a reputation for consistent quality. There are significant economies of scale and scope in this marketing—which equates to an asymmetric form of relational exchange. The ‘own-label’ of the stores is the consumer’s guarantee of high quality. Liberalisation appears to have changed this position radically, both in terms of consumer demand and competition from imports. On the supply side, the appearance of global brands has threatened the hegemony of the Kenyan chain stores.

The formal institutional environment offers little direct support for the exchange problem faced and is not relied on by Ancom. In principle there is both consumer legislation and a standards agency—the Kenya Bureau of Standards—which should support the establishment and maintenance of product quality standards in the market. Janet has been involved with the KBS as a result of her previous employment in the sector. She sat on the committee tasked with producing a Kenyan system of size definitions for the underwear market. The earlier work of the KBS in this area was badly flawed, apparently based on inadequate empirical work. Through her presence on the committee she was able to ensure that the sampling of sizes was conducted and appropriate standard size definitions were produced.

In relation to the monitoring of quality, the results have been less positive. KBS undertakes quality audits but according to Janet clearly does not understand the issues involved. As she puts it: “the KBS officers are not industry people and are not even qualified in the relevant fields.” The last officer who visited had a qualification in textile chemistry and had no idea of what to look for in undertaking the audit and didn’t even take samples for testing. Ancom always receives a clean bill of...
### Table D.2: Ancom demand tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange avoided</th>
<th>Mode of exchange used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail chain (1)</td>
<td>Large volume orders</td>
<td>Heavy dependency on repeat orders</td>
<td>Very high</td>
<td>Large-scale chain of retail stores, African owned, European expatriate managed</td>
<td>Weak relational</td>
<td>Weak relational/ implicit exchange by contract</td>
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<tr>
<td></td>
<td>Fquent</td>
<td>Acceptance of orders regarding production</td>
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<td></td>
<td>Semi-customised products</td>
<td>Delivery times</td>
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<td>Demonstration of quality</td>
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<tr>
<td>Retail chain (2)</td>
<td>Large volume orders</td>
<td>Dependency on repeat orders</td>
<td>High</td>
<td>Large-scale chain of retail stores, Asian family owner-managed</td>
<td>Weak relational</td>
<td>Weak relational/ implicit exchange by contract</td>
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<td>Acceptance of orders following production</td>
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<td>Retail chain a major rival to first chain reduces dependency on first customer</td>
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<td>Sales to this customer</td>
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<td>On-time payment</td>
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<tr>
<td>Wholesaler</td>
<td>Middle volume orders</td>
<td>Market acceptance and demonstration of quality</td>
<td>Low</td>
<td>Large-scale wholesaler, Asian (Chinese community) owner-managed</td>
<td>Very weak relational</td>
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<td>Standard products</td>
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<td>Promotion of goods</td>
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<tr>
<td>Supermarket chain</td>
<td>Middle volume orders</td>
<td>Infrequent</td>
<td>Incomplete</td>
<td>Standard products</td>
<td>Low</td>
<td>Low</td>
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Appendix D: Analysis of evidence
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nairobi retailers</td>
<td>Small volume orders</td>
<td>Market acceptance and demonstration of quality</td>
<td>Medium</td>
<td>Medium-scale retail stores in Nairobi city centre, primarily Asian (Oshwal community) owner-managed</td>
<td>Weak relational exchange/ implicit exchange by contract</td>
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<tr>
<td></td>
<td>Frequent</td>
<td>Payment</td>
<td>Less concentrated channel to market</td>
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<td>Standard products</td>
<td>Relatively high unit cost of promotion</td>
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<td>Small volume sales</td>
<td>Market acceptance and demonstration of quality</td>
<td>Medium</td>
<td>(Small) medium-scale retail operations in other major urban centres, primarily African owner-managed</td>
<td>Relational exchange</td>
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<td>retailers</td>
<td>Frequent</td>
<td>Payment</td>
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<td>One-off sales</td>
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<td>Consumer – middle-class</td>
<td>Market exchange Asymmetrical relational</td>
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<td>Standard products</td>
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<td>Government</td>
<td>Large volume</td>
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<td>Government department (mediated by agent)</td>
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<td>Long term contracting</td>
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<td>One-off</td>
<td>Scale of order – timing</td>
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<td>Government tendering process</td>
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<td>Sub-task</td>
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<td>Large scale European/US retail chains</td>
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<td>Heavy dependency on government and customers</td>
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<td>Large scale European/US retail chains</td>
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<td>Highly customised</td>
<td>Heavy dependency on single customer</td>
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<td>Regional export</td>
<td>Small volumes</td>
<td>Insufficient scale to achieve adequate economies of transaction costs</td>
<td>Medium</td>
<td>Traders or retail outlets</td>
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<td>Promotion</td>
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health but Janet feels this is meaningless. The company has to pursue its own agenda: "[w]e cannot rely on KBS to do anything". Janet suspects that in common with many other state institutions, KBS has been politicised with appointments based on criteria of ethnicity or political connections rather than qualifications. The textiles department is headed by an engineer. Test machines donated and installed by German specialists now lie idle without the staff to use them.

The mode of exchange Ancom uses with its largest customer is slightly ambiguous. An element of formality is certainly present. All orders are made against a local purchase order from the company which details precisely the terms of the order — quantities, styles and delivery dates. This order represents a potentially enforceable agreement on both sides. Interestingly although the use of such formality is instigated by the customer, there is little reliance in practice on the agreement. Prior to buying Ancom, Janet had worked as a buyer for this customer and reports that the company had never attempted to enforce orders where the terms were breached. Rather repeat orders were simply not placed where expectations were not fulfilled — more consistent with a market or weak relational mode. Much of the detail of Ancom's history with this customer also suggests a weak relational form. Minor disputes have been handled by dialogue.

Prior to liberalisation, the relational mode of exchange appeared appropriate to the problem of exchange. There was a limited degree of bilateral dependency. Ancom as one of only two sources of high quality lingerie products in Kenya offered the stores the products they needed, while the store provided Ancom with a highly effective channel to market. Under conditions of mutual dependency with no visible threats to the perpetuation of these conditions, no additional safeguards may have appeared necessary. Liberalisation dramatically changed those conditions and Ancom has found itself dangerously exposed.
There is no single interpretation of this situation. The most obvious reading of the evidence is that neither side had foreseen the rapid changes in the institutional environment. Ancom had simply failed to strategically safeguard its position appropriately – its assessment of the residual uncertainty in its position was flawed. However there is also some evidence to suggest that Ancom had presumed a greater strength to the relationship than its counterpart. During the pre-liberalisation period, Ancom had made no significant efforts to find alternative routes to market. In particular no attempt was made to sell to the second chain store. Following the removal of import restrictions, the customer simply stopped placing orders with Ancom and started sourcing from a very large South African retail-distribution group. Janet was not even notified of this decision by the managing director (whom she knows) or the buyer with whom she dealt more regularly.

This discontinuity in exchange mechanism is consistent with differences between the two companies. The customer is a large-scale entity with separated ownership and management. Its managing director is a British expatriate whose previous career was with one of the UK’s largest garment-food chain stores. There is significant division of labour in the management process itself, with buying handled by a distinct department.

Exchange with the second chain store is also based on a relational mode. The relation has been built slowly. Janet found the initiation of the relationship with this Asian owner-managed company difficult as a result of ethnicity. As she puts it “Mr Shahs are very fond of buying from other Mr Shahs”. She believes that the owner-manager was sceptical of the capability of an African owner-managed company to supply. At the outset, the store was sceptical of the market for the product and goods were provided on a sale-or-return basis – with Ancom therefore effectively assuming the risk of over-stocking. Janet also provided undertook the shop displays. With proof of the market for the products, a weak relation has developed which enables goods to be supplied in bulk on advance
orders. However in the early stages of supply there was an attempt to change an order after production had started. Given that the products are semi-customised — with own labelling — this presented a problem to Ancom and the change was resisted — successfully. Subsequently Janet now insists on a formal undertaking to accept goods once ordered. This suggests an unexpected reliance on a formal governance mechanism. It appears to have arisen primarily from the weakness of the relation between the companies. There has been no testing of the strength of this formal agreement. It is unclear to what extent the use of the agreement carries a greater symbolic significance of Ancom's resolve to assert its position in the relationship or whether it provides a credible threat of third party (court) enforcement.

Other channels to market are similarly based primarily on a weak relational mode. Ancom supplies directly to retailers in Nairobi but is faced with both relatively high costs of promotion and problems of credit. Again Janet feels there are constraints on the strength of the relationship deriving from ethnicity — most of the retailers with whom she deals are Asian owner-managed. On one occasion court action was threatened (via a solicitor's letter) when payment was not forthcoming. The result was immediate, suggesting some efficacy for formal institutions.

Assuming increasing importance is Ancom's own city centre retail store in Nairobi and a factory outlet. The former directly targets consumers while the latter primarily sells to micro-scale enterprises. These channels can be seen as vertical integration in response to the exchange problems created by liberalisation. Although the final consumer demand for Ancom's products has been dampened as a result of both a change in the structure of the demand and exposure to greater competition, Janet believes that the greater problem is reaching the demand. Without the ability to form stronger ties with wholesalers and retailers to ensure the effective promotion of the
products, Ancom has been forced to internalise a part of the sales channel.

Although the government represents a potential market, Ancom has only undertaken a single contract. Janet regards dealing with government departments as involving too much uncertainty. There have been serious, widespread problems in obtaining payments for contracts from government. Such contracts are regarded as effectively unenforceable, regardless of the putative legal position. Obtaining contracts in the first place is believed by Janet to depend on possessing high level contacts in government and a willingness to collude with rent-seeking officials. On a previous occasion, Janet withdrew from negotiations once it became apparent that inducements were sought by procurement officials. The contract Ancom did obtain was offered by an agent who was able to offer a 60% pre-payment and handled all administrative arrangements.

Ancom has not so far become directly involved in export. European export is regarded as involving too much risk. The problem is not one of quality—samples have been sent to Germany and accepted—rather the volume requirement is too great. As Janet puts it “they would end up controlling the company”. Following the recent problems, she is very keen to avoid over-dependency on a single customer—“it nearly killed the company once before”. She is also reluctant to become involved in export processing. The bureaucracy involved in dealing with the specific regulations are regarded as too burdensome: “I don’t want a customs man living in the factory”. Janet believes the EPZ (export processing zone) scheme has failed, largely due to lack of appropriate government support, who she regards as “not switched on or supportive”.

Export to the Africa region is difficulty again due to distribution problems. Although there is demand in East and Southern Africa, Ancom is unable to find distributors and the volumes are simply too small to address directly. Currently a trader from Uganda does buy
small quantities directly from the company in Kenya. More promising, ironically
given the source of threat to Ancom's domestic market, has been interest from South
Africa. Contact has been made through personal social networks
with a South African buyer. Janet believes that the development of
the South African garment industry has been supported by effective
standards and government support.

D.2.3 Labour

There are three primary roles in Ancom: supervisory, skilled production and
unskilled ancillary support (table D-3). In the last category are casual packers,
cleaners and guards. The first two represent the more complex exchange problems.
Three supervisory staff are employed, covering production, design/cutting and
quality control. Production staff cover the highly skilled cutting role, drawers,
machinists and finishers/quality control/packers.

The production supervisor is tasked with the overall control of the production
process and is capable of managing production in Janet's frequent absences. It is a
key position in the company since Janet cannot directly monitor production while
engaged in other activities, notably managing suppliers and sales. Trust is vital.
When Janet travels to Europe on business, the supervisor is in day to day control of
the company - the opportunities for malfeasance are many. Many aspects of the role
are defined by circumstances and therefore difficult to define *ex ante*. A flexible
employment relationship is therefore essential. It is a relationship in which both
sides have necessarily invested significantly, the supervisor having built up significant
company specific, tacit knowledge. There is a condition of very strong bilateral
dependency.

Janet's approach to the exchange problem presented is very clearly
typified as the entrepreneurial firm mode. There is no employment
contract. Janet recruited a new supervisor when she bought Ancom
so that she could build a new relationship in which the supervisor's
loyalty is to her personally. Janet In particular she deliberately
sought to make a break with the previous ownership and style of work. The working
relationship between the two is very important - Janet feels that the supervisor needs
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing director (1)</td>
<td>Continuous</td>
<td>Bilateral dependency</td>
<td>Critical</td>
<td>Kenyan African owner-manager</td>
<td>Long-term African employee, with formal qualifications and on the job and formal training by firm</td>
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<td>Production supervisor (1)</td>
<td>Continuous</td>
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<td>Long-term African employee</td>
<td>Long-term African employee, trained on the job both within the firm and in Germany through the firm</td>
<td>Entrepreneurial firm</td>
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<tr>
<td>Cutting table supervisor/</td>
<td>Continuous</td>
<td>Bilateral dependency</td>
<td>Very high</td>
<td>Long-term African employee</td>
<td>Long-term African employee, trained on the job both within the firm and in Germany through the firm</td>
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<td>mechanic (1)</td>
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<td>Quality control supervisor</td>
<td>Continuous</td>
<td>Tasks difficult to specify precisely</td>
<td>High</td>
<td>Long-term African employee</td>
<td>Long-term African employee, trained on the job within the firm</td>
<td>Entrepreneurial firm</td>
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<td>Variable task set</td>
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<td>Moderate degree of uncertainty</td>
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<td>Firm specific tacit skills</td>
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<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-------------------------------</td>
<td>--------------------------------------------------------</td>
<td>------------------</td>
<td>------------------------------------------------------------</td>
<td>----------------------------------------</td>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Cutter (1)</td>
<td>Continuous</td>
<td>Tasks difficult to specify precisely</td>
<td>High</td>
<td>Long-term African employee, trained on the job within the firm</td>
<td>Bureaucratic firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Variable task set</td>
<td>Bilateral dependency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moderate degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Industry specific tacit skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinists,</td>
<td>Continuous</td>
<td>Productivity and quality of work critical to final production costs</td>
<td>Medium</td>
<td>Locally recruited full-time African employees, with basic machining skills, limited training on the job</td>
<td>Bureaucratic firm</td>
<td>Employment covered by industry specific state regulation</td>
</tr>
<tr>
<td>drawers and quality control/packers (24)</td>
<td>Definable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Garment industry specific tacit skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Casual packers,</td>
<td>Very frequent</td>
<td>Minor</td>
<td>Low</td>
<td>Locally recruited African casual employees</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td>cleaners and guards (3)</td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unskilled</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salesperson</td>
<td>Continuous</td>
<td>High vulnerability to malfeasance</td>
<td>Medium</td>
<td>Sales effort a major constraint to business expansion</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>High degree of uncertainty</td>
<td>Difficult to monitor</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Generic skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Appendix D: Analysis of evidence
to know how she - Janet - thinks. When first recruited, the supervisor was given a six month probationary period to see how she worked in practice. There seemed little difficulty in finding someone with basic technical qualifications.

The other supervisors are similarly important to the business. There is a particular dependency on the designer/cutter/mechanic who was involved in the company from the outset and was trained in Germany by the previous owner-managers. Although some of his skills have been transferred to his assistant, Janet believes he may be resisting passing on too much in order to maintain his indispensability.

It is notable that again here there are no formal or informal safeguards beyond the current mutual benefit from the relation. The company does however pay what is believed to be a generous salary by industry standards. Janet holds that offering trust, respect and responsibility will induce precisely the honesty and commitment which is essential. She contrasts this to the approach she has noted in similar factories owner-managed by Asians. The owner-managers of these factories find it hard to understand how she is able to travel for weeks at a time without having a relative in the factory. Janet believes that it is precisely because the owner-manager consistently fail to trust their staff, adopting a more adversarial approach, that problems of dishonesty and slacking arise. There appears no question of employing relatives either close or distant. In the case of the former, the explanation is simply that members of the family have trained in other fields and have their own interests. Even Janet's husband (a co-owner of Ancom) has very little involvement in the business.

The employment relation with the shop floor workers contrasts strongly with that for the supervisory staff. An essentially bureaucratic mode of exchange is employed. Clock cards are used to monitor arrival and departure times. A system is used to monitor all phases of production for individual worker productivity and quality. Spot checks are made to
prevent theft of stock or work-in-progress. There is a complex set of terms and conditions which determine many aspects of the employment relation.

The explanation derives from a number of factors. First, Ancom is subject to a collective agreement negotiated between garment sector employers and the trade union, with which the company is legally bound to comply. Failure to adhere to these terms would lead to penalties – the union is highly active in pursuing cases against employers. Second, the implied transaction is far more amenable to close control. Tasks can be very readily defined and measured. A production line mode of operation, with moderate division of labour, is potentially vastly more productively efficient than individual craft work. Finally, although Janet still emphasises the relevance of teamwork and trust in the wider workforce – “if you have a workforce – it’s the person on the shop-floor that makes it tick” – the opportunities for dishonesty and shirking appear far more likely to be taken at this level.

In this case, the formal institutions applicable to labour appear to function reasonably effectively. Janet is happy to avoid the task of negotiating terms and conditions annually and to have a framework within which rights and obligations on both sides are very clear. She doesn’t find the system inflexible – Ancom has been able to create its own incentive mechanism within the overall framework. Workers have rights regarding appropriate procedures for dismissal in case of poor performance. Janet has no objection to this – she feels it is both fair to give employees a second chance and advantageous to her insofar as it partially depersonalises the unpleasant task of disciplinary procedures. The agreement allows instant dismissal for theft – which Janet holds to be very important. Occasional minor problems have been experienced with what Janet describes as ‘inciters’ in the union whom she believes have attempted to use their position as shop steward for more personal ends. However on balance this appears to be a case where the formal institutional environment works effectively. It is notable that much of the detail...
of the design, policing and enforcement of these institutions are internal to the
industry and its association rather than dependent on the state (though the state may
become involved through the Ministry of Labour in cases of dispute).

D.2.4 Technology

Much of the equipment currently used in Ancom was procured and installed by the
previous German owner-managers. Most was imported from Germany. Janet does
not know how it was bought. There are no remaining relationships between Ancom
and any equipment suppliers.

The machinery represents a relatively modest level of sophistication by comparison
with the current state of garment technology. However Janet argues that it is crucial
to use machinery which can be maintained adequately in Kenya. The new computer
based technology simply cannot be supported locally. As Janet puts it: “I’d rather
stick with my ‘museum’ than end up with machinery which cannot be serviced. I
know people in the [Nairobi] Industrial Area who don’t produce for days because
their machines cannot be maintained adequately in Kenya.” If the company does
move forward technologically it will be “something mid-way between the ‘museum’
and the leading edge”.

There is a significant amount of maintenance undertaken in-house by the
mechanic/cutter. Ancom has a small workshop in which there is a certain amount of
improvisation undertaken by the mechanic to save buying spare parts which are only
available from Germany (Janet buys spares when she visits her supplier in Germany).
An entrepreneurial mode is evident here. Although the mechanic works on a very
flexible basis, it is essential to have the immediate capacity to correct machinery
breakdown readily to reduce the impact on production. For more complex jobs,
beyond the skill levels of the mechanic, Ancom uses a self-employed African
technician. Although there is a long-term informal relationship, this
is comparatively weak. Janet has a telephone number with which to
contact him, and knows little about him beyond his ability to do the
job technically. It can take a couple of

Weakly supporting
alternate hypothesis (2.1): Middle-scale enterprises
regard the formation of
relations as an important
means of informally
solving problems of
exchange.
Table D-4: Ancom technology tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery procurement (including upgrades)</td>
<td>High value</td>
<td>No Kenyan based machinery manufacturers</td>
<td>Originally high</td>
<td>German based large-scale manufacturer</td>
<td>Exchange by contract (?)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Infrequent</td>
<td>Now medium – machinery largely unchanged since factory founded</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Complex characteristics – difficult to measure readily</td>
<td>Search for appropriate suppliers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Determining quality and performance of machinery ex ante</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery installation (including upgrades)</td>
<td>Infrequent</td>
<td>Measurement – determining quality of service</td>
<td>Medium</td>
<td>Micro-scale African owner-managed-operated enterprise</td>
<td>Weak relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Complex characteristics – difficult to measure readily</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery repair</td>
<td>Infrequent</td>
<td>Flexible, rapid response needed</td>
<td>High</td>
<td>Micro-scale African owner-managed-operated enterprise</td>
<td>Weak relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Irregular</td>
<td>Production threatened by machine down-time</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Uncertainty in</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery maintenance</td>
<td>Frequent</td>
<td>Very rapid, flexible response needed</td>
<td>Very high</td>
<td>Long-term African employee, trained on the job both within the firm and in Germany through the firm</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Irregular</td>
<td>Production depends on efficient operation of machinery</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spare parts</td>
<td>Frequent</td>
<td>No sources in Kenya – suppliers in Germany</td>
<td>Very high</td>
<td>German based suppliers</td>
<td>Market exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Irregular</td>
<td>Production depends on efficient operation of machinery</td>
<td></td>
<td></td>
<td>Exchange by contract</td>
<td></td>
</tr>
</tbody>
</table>
days before she can get hold of him. She feels he has probably never taken his business anywhere, which in turn constrains her ability to move to the next level of technology. The demand in Kenya for garment machinery servicing is relatively limited which limits the interest. Although the mode of exchange clearly corresponds to a weak relational form, Ancom appears to have little choice.

D.2.5 Finance

The most significant finance problem Ancom has faced under its current ownership has been associated with the buy-out in 1991 (table D-5). Against a purchase price of KShs 5.5 million (approximately UK£104,000 at 1991 exchange rates), Janet and Peter Kipor were able to raise KShs 2 million (approximately UK£38,000) in equity from the sale of personal assets and savings. The remaining 64%, KShs 3.5 million (approximately UK£66,000) was raised by way of a bank loan.

Raising finance at all for this venture represented a major challenge for the Kipors. Finance presents significant exchange problems deriving most notably from the uncertainty of repayment. Although the finance exchange problem is strongly associated with co-operation issues, the underlying question of co-ordination must be emphasised. For the lender, understanding the nature of the lending proposition is crucial. In this case the source of repayment for the proposed loan was from the business profits. With a proposed net gearing ratio of 175% and no dependable alternative income stream for repayment, the lender needs to have a good understanding of the capacity of the business to generate a sufficient return. Anticipated rates of return in a manufacturing business in the mature garment industry are unlikely to be especially high. Interest rates in Kenya are comparatively high; since 1990 the minimum lending rate for the commercial banks has not fallen below 15% (CBK, 1997). Finance is therefore required over a long period with relatively low interest cover. The corollary is that the lender must be able to judge with a reasonable degree of confidence the stability of the business. Finally the familiar problems of co-operation are present – how to be sure that the borrower will repay (often referred to in this context as ‘moral hazard’).
## Table D-5: Ancillary finance tasks

<table>
<thead>
<tr>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Exchange partner</th>
<th>Significance</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-task</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>Very infrequent</td>
<td>Life savings of current owner-managers</td>
<td>Critical</td>
<td>Long-term contracting</td>
<td>Relational</td>
</tr>
<tr>
<td>Medium-term debt</td>
<td>Very infrequent</td>
<td>Very large-scale subsidiary of international bank</td>
<td>Medium</td>
<td>Long-term contracting</td>
<td>Relational</td>
</tr>
<tr>
<td>Working capital debt</td>
<td>Infrequent</td>
<td>Very large-scale subsidiary of international bank</td>
<td>Medium</td>
<td>Various (not universal?)</td>
<td>Relational</td>
</tr>
<tr>
<td>Supplier credit</td>
<td>Linked to demand</td>
<td>Essential to secure some large orders</td>
<td>Medium</td>
<td>Limited - not micro-scale enterprises</td>
<td>Important for all transacting especially up-country</td>
</tr>
<tr>
<td>Money transmission</td>
<td>Very frequent</td>
<td>Very frequent</td>
<td>Quality of service</td>
<td>Exchange by contract</td>
<td>Relational</td>
</tr>
</tbody>
</table>

The table indicates the frequency of exchange and the significance of the tasks, along with the modes of exchange used and the modes avoided.
Appendix D: Middle-scale enterprise case studies

The bank which eventually agreed to lend to Ancom, one of the largest in Kenya and a subsidiary of a multi-national bank, used a number of highly formal approaches to tackle the exchange problem. A formal feasibility study with projections was required from Ancom. Collateral was required for the loan in the form of a debenture over the company assets, a legal charge over both the Kipor's family home and the couple's remaining investment property and a personal guarantee from Peter Kipor. Approval for the loan within the bank took five months and involved both the local branch and head office. Janet was surprised by how long the whole process took and noted that the opportunity might easily have disappeared in this time.

The feasibility study was carried out by the accountant from Peter Kipor's company. Although Janet feels that she would have carried out some sort of study regardless of the bank's requirement, it would have been rather different in form. At the time she had had no training in formal financial management and she did not see the project in terms of concepts such as return on equity or discounted cash-flow projections. She already knew a great deal about the company from her relationship with it as a buyer. Janet found the volume of information required by the bank rather surprising and daunting. She was relatively unknown to the bank, having only operated a personal cheque account previously. However her husband had had a business account for eight years with the branch and his own business was flourishing at the time. It was clear that his support for the project was an important factor. Janet is doubtful as to whether she would have had succeeded in obtaining finance without both his guidance through the process, access to the manager and a degree of credibility with the bank. As she observes at the outset even the banking terminology was unfamiliar. The Kipor's did approach another government owned very large bank with the funding proposal, but it was found to be impossible to fulfil the collateral requirements of this bank. There is a clear suggestion here of significance in the pre-existing relationship between Peter Kipor and the first bank.

Subsequently, when faced with the need to fund a comparatively large order, Janet was able to secure a short-term overdraft facility of KShs 0.5 million (approximately...
UK£5,000 at 1993 exchange rates) within three weeks. She explains the relative ease with which this transaction was accomplished as based on a combination of an emerging strong trading record, her own growing experience in dealing with the bank and the particular manager in charge of Ancom's account. This manager was interested in the business and impressed following a visit to the factory. Relatively unusually at the time, the lending manager was a woman, and thus, according to Janet, more inclined to accept that a woman could have the ability to run a business.

The terms of exchange here were strongly dictated by the lender and correspond to a long-term contracting mode. Relationships do matter, but the essential parameters of the deal are set by highly formalised legal contracts. There is little doubt that without additional sources of collateral – beyond the assets of the company – the loan would not have been provided. The capacity to build a stronger relationship is curtailed in a number of ways. There may, Janet believes, be a problem in banks understanding businesses of her type: "The banks shouldn’t just shut their doors. Sometimes you cannot put across your convictions to others. You might go in [to the bank] and not convince the person listening." Part of the difficulty Janet feels is related to the way in which bank managers tend to follow written rules. This was exemplified in the case where an Ancom cheque was returned by the bank, unpaid against uncleared effects. Returned cheques have a very damaging impact on the company's credibility with its suppliers. On complaining Janet reports that "the manager starts talking about bank policy. He says 'this is the bank rule', I replied 'I'm your customer!'. The manager should look at the consequences for the relationship and look at the cheques we were drawing against". Ultimately she feels that her business falls into a gap between the very large banks which are primary aiming at the large corporate market and the small-scale development finance organisations which target micro-enterprise. As she puts it "we are being squeezed. If
we are not protected then this size of company is going to be a thing of the past".

Janet notes that the small banks owned by members of the Asian communities appear to operate in a wholly different way. Here she observes that trust within the community is high significant. She cites the attitudes of a garment company owner-manager she knows well, who is also a member of the Oshwal community. He referred to the extraordinary event of a fellow community member appearing at a community social event despite the recent failure of his business. This behaviour her informant regarded as utterly disgraceful. Janet observed that such an injunction would not apply within African communities. She also believes that it would be very difficult for a non-Asian to obtain even a personal account with an Asian owned bank, let alone a business loan.

Credit from regular suppliers represents another important source of finance to Ancom. It is important to be able to offer credit to customers. Supplier credit enables the company to balance its working capital position. The basis on which supplier credit is obtained is mainly relational. Ancom's major fabric supplier offers 45 days credit, with no security. Similarly the largest overseas suppliers gives 60 days credit “on trust”. There are strong prospects for credit soon from the other major overseas supplier soon. In each case it has taken time to build a relationship. With the overseas suppliers the transactions started as exchange by contract, using the relatively high (transaction) cost formal international letter of credit system. The second local fabric supplier however unusually both charges for credit (equivalent to a relatively high annualised rate of 36-48% pa) and insists on a bank issued bill of exchange in advance. A formal exchange-by-contract mode is in use here. The inability to form a relationship with this supplier Janet finds problematic. It partly explains why much of the business has
been switched to the first supplier “the trouble of working with them is not worth it
given the poor quality of the product”.
Table D-6: Summary of evidence for specific hypotheses (Ancom)

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Reliance on formal contract/environment</td>
<td>✔</td>
<td>?</td>
<td>?</td>
<td>✔</td>
<td>-</td>
</tr>
<tr>
<td>1.2 Efficiency of formal contract/environment</td>
<td>✔</td>
<td>?</td>
<td>✔</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>1.3 Difference in use of formal, large and middle</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Stability of formal environment</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>1.5 Perception of compatibility of formal environment</td>
<td>✔</td>
<td>?</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Importance of business relations</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2.2 Difficulties in forming business relations with large</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2.3 Instability in economic operating environment</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2.4 Governance differences large and middle</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2.5 Organisational rules differences large and middle</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>2.6 Organisational culture differences large and middle</td>
<td>-</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.1 Differentiation on basis of ethnicity</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.1.1 ⇒ Differences between African and Asian use</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.2 Use of ethnic based structures in exchange</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>3.2.1 ⇒ Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.3 Use of family relationships in exchange</td>
<td>-</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.3.1 ⇒ Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.4 Difficulties between ethnic groups</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>3.4.1 ⇒ Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
</tbody>
</table>

✔✔ strong support for alternate hypothesis  ✔ weak support for alternate  ? ambiguous between null/alternate  ✔✔ strong support for null hypothesis  ✔ weak support for null
D.3 Case two: Zintex

Zintex Ltd, located in Nairobi’s main industrial area, produces high quality shirts and trousers for the domestic market. It was started immediately after Kenyan independence in 1963 by the late father of the current managing director, Kamil Puressh. Until his very recent death, Kamil’s uncle was also involved as an executive director in the company. The company is entirely owned by the Puressh family, with the shares held by Kamil’s mother and late uncle. Premises are shared with a sister company in an unrelated manufacturing activity which is managed day-to-day by Kamil’s younger brother and two cousins. This company is also owned jointly by the family. The Puressh family are of Kenyan nationality and Asian origin. Kamil’s great grandfather emigrated to East Africa from the Gujarat region of India. Hindus, the Puressh’s belong to the relatively small Wanza (‘tailoring’) caste.

The company currently employs 85 staff, all full-time, permanent employees. Although in earlier years the company’s workforce had reached 200, it has remained essentially informally managed. Kamil and his uncle, prior to his death, were directly involved in all aspects of the company’s operations. Although there is a moderate division of labour in the production process, across the wider company there is little sense of hierarchy or organisational complexity. The capital employed is estimated in the region of KShs 35 million (approximately UK£350,000). The level of technology employed is moderate, with the deployment of specialised sewing machines but far short of the computer controlled, capital intensive plant associated with modern garment production. Zintex is an essentially middle-scale company.

Zintex targets the upper end of the middle-market in Kenya. Product quality and price are critical in this market, with fabric design also of some importance. The company does not address the upper end of the market in which there is a lower sensitivity to price but greater emphasis on design and quality. Kamil believes that this market is relatively small in Kenya by comparison with those of the industrialised economies. The majority of Zintex’s output is based on a mixed synthetic-natural (polyester-cotton) fabric which has better durability than a pure natural (cotton) fabric.
Appendix D: Middle-scale enterprise case studies

The outlook for the company is bleak. Although Kamil believes that Zintex's productivity is good, it is facing severe competition from importation. He believes that substantial quantities of imported products are entering Kenya without duty. Since Zintex pays 35% duty on the imported fabric which constitutes the major input to its products, it is at a severe competitive disadvantage. Furthermore, there is also competition from the flood of very cheap second-hand clothes from Europe and the United States. The perceived financial pressures on middle-class consumers in Kenya, combined with the high quality and very low consumer price of some of these second-hand goods have resulted in a stronger impact on Zintex's market than would be anticipated. Most damaging has been the illegal, but largely unrestrained, practice of laundering, pressing and packaging to present as new, the best quality of these imported used goods. Kamil believes that the authorities are to blame for not curbing these violations.

Prior to taking over the family business, Kamil had started and operated a large-scale export processing garment company. Exporting primarily to the United States, the company had performed strongly in its first few years of operation, reaching a maximum workforce of 500. Following the introduction of quotas by the US, noted above, the company lost its market and was forced to close. Kamil again attributes the demise of this company to the inability of government negotiators to secure access to US markets. He concludes that there appears little future in manufacturing in Kenya and is considering moving into the trading business, closing Zintex.

D.3.1 Supply

A wide range of raw materials are required by Zintex for its products (table D-7). The most important material both in terms of contribution to input and output value is the shirting fabric. Buttons and threads although of relatively low input value can have a significant impact on production costs. A number of other elements such as shirt labels and packaging materials are regarded as relatively insignificant.

Not only does the fabric comprise the greatest material cost of the shirt, but the quality and design of the fabric make a major contribution to the final product and
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shirting</td>
<td>Large orders</td>
<td>Determination of fabric quality</td>
<td>Moderate</td>
<td>Middle-scale importers, Asian (predominantly Oshwal community) owner-managed (4-6)</td>
<td>Embedded</td>
<td>Exchange by contract</td>
</tr>
<tr>
<td>material</td>
<td>Recurrent</td>
<td>Important to production process but fierce competition</td>
<td></td>
<td></td>
<td></td>
<td>Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Quality difficult to detect</td>
<td>Exclusivity of designs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>ex ante</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Specialised designs</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Buttons</td>
<td>Small value orders</td>
<td>Determination of button quality</td>
<td>Moderate</td>
<td>Local middle-scale manufacturer, Asian owner-managed</td>
<td>Embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recurrent</td>
<td></td>
<td>Low value but few competitors and contributes to both productivity and product quality</td>
<td></td>
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<tr>
<td></td>
<td>Quality difficult to detect</td>
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<td></td>
<td>ex ante</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Standard product</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Threads</td>
<td>Standard product</td>
<td>Quality</td>
<td>Low</td>
<td>Local manufacturer, Asian owner-managed</td>
<td>Weak embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td></td>
<td>Imports available</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labels</td>
<td>Customised product</td>
<td>Quality</td>
<td>Low</td>
<td>Local manufacturer, Asian owner-managed</td>
<td>Weak embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td></td>
<td>Imports available</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cartons</td>
<td>Standard product</td>
<td>Minimal</td>
<td>Low</td>
<td>Local manufacturer, Asian owner-managed</td>
<td>Weak embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td></td>
<td>Imports available</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Polythene</td>
<td>Standard product</td>
<td>Minimal</td>
<td>Low</td>
<td>Local manufacturer, Asian owner-managed</td>
<td>Weak embedded</td>
<td></td>
</tr>
<tr>
<td>bags</td>
<td>Frequent</td>
<td></td>
<td>Imports available</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>Standard product</td>
<td>Minimal</td>
<td>Low</td>
<td>Local manufacturers, Asian owner-managed</td>
<td>Weak embedded</td>
<td></td>
</tr>
<tr>
<td>packaging</td>
<td>Frequent</td>
<td></td>
<td>Imports available</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>material</td>
<td></td>
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</tbody>
</table>
its marketability. The fabric design of the shirt is vital to distinguish Zintex products from those of its competitors. Kamil therefore looks to obtain exclusive rights to particular fabrics in Kenya. The consistency of quality throughout a fabric roll also has an important impact on production costs. Even relatively minor flaws can substantially increase the wastage rate of material at the cutting stage.

Zintex has a number of options for acquiring fabric, broadly – direct importation, local sources of imports and local manufacturers. Historically the company has always used imported fabric. When an importation ban was introduced in 1971, the company was forced to source from local mills. Achieving an acceptable level of quality was found to be very difficult. As a consequence the company suffered a loss of market and contracted, halving the workforce. By the late eighties, the severity of the problems lead the Puresh family into backward integration. In partnership with another family, a textile mill was started with the intent of supplying Zintex and other Kenyan producers. However the technical problems of producing high quality fabric were never satisfactorily addressed. Kamil withdrew from the project, having incurred significant losses. Following liberalisation, the company reverted to imported fabric. Zintex requires a wide range of fabric designs and relatively large quantities of each order size. The fabrics derive primarily from a number of Asian economies where it is possible to find an appropriate balance between price and quality. Rather than attempting to import directly, Zintex uses four or five Kenyan importers. There are transactional economies available in importation which Zintex would be unable to reap whilst maintaining the diversity of sources and designs.

There is no formality to the process of ordering. Suppliers frequently bring Kamil swatches of cloth for inspection prior to importation. However there is no commitment for Zintex to buy at this point – the importers simply need to know what type of fabrics Zintex is likely to buy. Once importation has occurred, Kamil chooses fabrics from the stock of the importer. Quality is checked following delivery and in the unusual case where there are problems a discount is agreed or the item is returned. The notion of what is an acceptable level of quality is understood between the companies – there is no appeal to external quality standards. This has some immediate transactional benefits. As Kamil puts it, his regular suppliers "know not
to bring riffraff" or poor quality and designs. No contracts are used at any point. Disagreements are always handled by dialogue.

All the suppliers are middle-scale and owner-managed by Kenyan Asians. The leading supplier, responsible for approximately 30% of all supplies, and most of the other suppliers are owned and managed by members of the same – Oshwal – community as the Puresh family. These suppliers have all been supplying to Zintex over a very long period, to the time when Kamil’s father was running the business. As Kamil puts it “I was born into the system”. The relationships are close; Kamil describes them as “friends of the family”.13

There is good evidence that fabric supply is based on an embedded mode of exchange, and that the social features surrounding the business are not unconnected. This was most strongly indicated by Kamil’s reaction when difficulties which arose with the leading supplier. The supplier started to sell to some of Zintex’s competitors the same design of fabric bought by Zintex. Kamil regards this as a major problem since it creates head-to-head competition on the basis of price alone, which necessarily results in the erosion of profit margins. Previously the supplier had not dealt with Zintex’s competitors. Although Kamil indicates that while there was no formal agreement it is well understood by both parties that this is unacceptable. Kamil believes that the supplier “became too greedy” and that “there is a betrayal of trust”. The result has been that Zintex has suspended ordering from this company. Kamil discovered the problem indirectly and has such a strong feeling of injury that he is not prepared to even talk to the supplier about the problem. Both are members of the same Oshwal community and Kamil believes that the basis of the disagreement is clearly known by both sides. The offering of credit clearly involves potential exchange problems. As discussed later (§5.4.5), the credit terms obtained are good and there is considerable flexibility if payments are delayed. Trust again figures large in the granting of credit.
The next most significant raw material for Zintex is buttons. Although a relatively low value input, it can have a significant impact on output value. Poor button quality slows production through breakages and Kamil believes that the final finish of the shirt is strongly affected by the button quality. Problems were experienced with the previous supplier, who enjoyed a monopoly for many years. Deliveries were late, no credit was offered and quality was poor. Kamil encouraged a friend to enter the business. All Zintex's business has now been shifted to this new supplier. There is a strong relation between the two companies permitting credit to be offered immediately. Deliveries are made on time and the quality is very much better. Kamil believes there is a good understanding: “he knows what I need and I know what he needs”. There has deliberately been no attempt by Zintex to improve the credit terms – Kamil does not wish to put the other company under excessive pressure.

D.3.2 Demand

Zintex sells all its products through local wholesalers and retailers. The vast majority of output is finally sold in the domestic market. A small quantity is believed to end up in other parts of East Africa through unofficial export by micro-scale traders. Other significant potential markets which are not addressed include direct export, duty-free export and government. Zintex's sales channels are summarised in table D-8.

Accounting for 60-70% of total output, four Nairobi based specialist garment wholesalers are the most significant buyers of Zintex products. The remaining 30-40% of production is sold to approximately 30-40 retailers spread throughout the major towns. There is some commonality in the exchange problems raised. Both wholesalers and retailers are concerned with the marketability of the final product. Quality is vital here. The product is aimed at a final consumer market in which the basic quality of the product is crucial. Zintex has very long standing relationships with its customers which provide the basis on which the buyers are assured of the product quality. Kamil sees the situation as quite straight-forward: "Its good quality production – so they [the customers] value it – they know they make money."
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesalers</td>
<td>Large volume</td>
<td>Demonstration of quality</td>
<td>High</td>
<td>Middle-scale wholesalers, Asian (Oshwal community) owner-managed, Nairobi based (4)</td>
<td>Embedded</td>
<td>Exchange by contract, Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Exclusivity of designs</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Specialised designs</td>
<td>Payment</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Credit periods</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Price determination</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retailers</td>
<td>Small volume</td>
<td>Demonstration of quality</td>
<td>Moderate</td>
<td>Middle-scale (lower) clothing retailers, predominantly (90%) Asian (mostly Oshwal community), few (10%) African owner-managed, major towns</td>
<td>Embedded/relational</td>
<td>Exchange by contract, Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Payment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Some semi-customised products</td>
<td>Credit periods</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Price determination</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct export</td>
<td>Medium-large volume</td>
<td>Price (including duty on inputs)</td>
<td>Potentially moderate-high (EA region small, others large)</td>
<td>Various export markets</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Demonstration of quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export processing</td>
<td>Very large volume</td>
<td>Government regulation</td>
<td>Potentially very high (very large markets)</td>
<td>United States and European large-scale enterprises</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Importing country trade restrictions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality</td>
<td>Demonstration of quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government</td>
<td>Large volume</td>
<td>Tendering process</td>
<td>Moderate</td>
<td>Government departments, parastatals</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Infrequent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Specialised design</td>
<td></td>
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</tbody>
</table>
Alternatives do exist, but the shop-keepers need good standard items to sell”. Credit is always expected by customers, leading to issues of repayment.

There are again few signs of formality in the way in which the transactions are handled. Zintex produces samples once a month which are examined on different days by the wholesalers. Orders are given by phone. The lead time is sixty days, but there is no formal undertaking, either to deliver or accept: “We don’t give dates. Sometimes customers might ask for it quickly. We try to accommodate – don’t often miss it.” The only documentation produced at any stage is an invoice.

There is clear evidence that the mode of exchange is embedded. Kamil reports that there has never been a case of a customer reneging on an order, nor a single bad debt. It "boils down to the Asian community. Not paying someone is the worst crime. Word spreads around, all through the Asian community. ... Word-of-mouth counts, relationship counts, reputation matters – you’d lose out. It’s a small population. ... The moment a bad debt appears, that’s the end of it”.

There has been an on-going discussion in the company of the sales strategy taken by Zintex. Kamil sees it as a question of which intermediaries to use to get to a limited market. Relationships with the customers were established by his father twenty or more years ago. The last significant change occurred twenty years ago when a major wholesale buyer expanded vertically, establishing a garment manufacturing plant. Zintex simply switched to a new wholesaler. Otherwise the only change has been a steady reduction in volumes as the market has declined. Kamil considered whether Zintex should concentrate on either the wholesalers or retailers. The profit margins from the retailers are significantly higher. However Kamil considers that this is more than offset by the advantages of dealing with a smaller number of large customers. Zintex faces fewer direct costs in delivery and managing credit. Furthermore, the costs of production are affected – larger order sizes enables more efficient production to be planned. There is clear evidence here of a strategy of reducing both

Strongly supporting alternate hypothesis (1.1): Middle-scale enterprises rarely place much reliance on the institutional framework for solving the problem of co-operation in exchange.

Strongly supporting alternate hypothesis (2.1): Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange. Strongly supporting alternate hypothesis (3.2): Entrepreneurs do rely on ethnic based socio-cultural structure to facilitate co-operation in exchange.
costs and uncertainty in exchange. New retail customers will not be sought but there will be no attempt to reduce the existing retail customer base. These retailers have been customers of Zintex over a long period and are reckoned to be "good paymasters". Furthermore it provides Kamil with a useful source of market information.

Exporting is only held to be feasible under duty-free schemes. With 35% duty on the major raw material inputs used by Zintex, it is impossible to compete. The problem Kamil believes lies with the regulation of manufacturing under bond. Based on his previous experience with manufacturing under bond, he strongly believes that Kenya can compete at conversion. However it is not possible to mix production which is liable for duty in the domestic market with that which is duty exempt for export. Furthermore Kamil believes there are effectively economies of scale in dealing with the bureaucracy of manufacturing under bond. As a result there is little point in attempting export processing for the regional African market – the volumes are not sufficient.

Zintex also does not sell to the government or parastatals, although Kamil believes that the company could supply a lot of items and he would like to sell here. Most of the state buying occurs through tenders, which according to Kamil are rigged. The only way to secure orders would be to pay "chat" (Swahili, literally, tea; informally, a bribe). Kamil believes that the whole process becomes very complex and he is morally opposed to the paying of bribes. As he puts it: "fast money goes out fast, every action has a reaction. Any company which has a solid base – it will stay. But it will not stay if it is quick."

D.3.3 Labour

The labour force in Zintex can be broadly divided into three categories: managerial, supervisory/technical and shop-floor. There are differing skill sets required within each of these categories. However the categories are useful with respect to the exchange problems posed. There is a descending difficulty of task specification and monitoring, together with opportunity for malfeasance.
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing director (1)</td>
<td>Continuous</td>
<td></td>
<td>Very high</td>
<td>Owner-manager (family), masters in international business administration (US), trained in firm and started other businesses</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Production director (1)</td>
<td>Continuous, Highly variable, complex task set, High degree of uncertainty</td>
<td>Tasks difficult to specify, Hard to monitor</td>
<td>Very high</td>
<td>Owner-manager (family)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Senior production supervisor (1)</td>
<td>Continuous, Variable, complex task set, Highly firm specific, tacit knowledge</td>
<td>Tasks difficult to specify, Difficult to monitor precisely</td>
<td>Moderate</td>
<td>Very long-term African employee, school leaver, trained on the job</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td>Head accountant (1)</td>
<td>Continuous, Technically specialised task set</td>
<td>Difficult to monitor precisely, Vulnerable to malfeasance</td>
<td>Moderate</td>
<td>Asian employee (Patel community), university graduate in commerce</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td>Sales (1)</td>
<td>Continuous, Firm specific, tacit knowledge</td>
<td>Difficult to monitor precisely, Vulnerable to malfeasance</td>
<td>Moderate</td>
<td>Asian employee, school leaver, trained on the job</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
</tbody>
</table>
## Appendix D: Analysis of evidence

<table>
<thead>
<tr>
<th>Characteristics of transaction</th>
<th>Sub-task</th>
<th>Exchange partner</th>
<th>Significance</th>
<th>Exchange problems</th>
<th>Modes avoided</th>
<th>Modes used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continuous</td>
<td>Draftsman (1)</td>
<td>African employee, technical college, master cutting diploma</td>
<td>Moderate</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
<tr>
<td>Continuous</td>
<td>Storekeeper (1)</td>
<td>Asian employee, university graduate in computer science</td>
<td>Moderate</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
<tr>
<td>Continuous</td>
<td>Production supervisor (3)</td>
<td>African employee, school trained within the firm</td>
<td>Moderate</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
<tr>
<td>Continuous</td>
<td>Cutters (5)</td>
<td>Asian employee, CPA, on-the-job training (2)</td>
<td>Moderate</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
<tr>
<td>Continuous</td>
<td>Bookkeeper/ office clerks (3)</td>
<td>Production workers (60)</td>
<td>Minimal</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
<tr>
<td>Continuous</td>
<td>Dispatch workers (3)</td>
<td>Definable task sets</td>
<td>Minimal</td>
<td>Continuous</td>
<td>Continuous</td>
<td>Continuous</td>
</tr>
</tbody>
</table>

- **Enterprise firm**: Entrepreneurial firm
- **Bureaucratic firm**: Bureaucratic firm
Overall management of the company is the responsibility of Kamil, until recently in partnership with his late uncle. The task set of the managers is very broad and difficult to specify. Although Kamil does not directly own shares in the company, these are held by his mother. There is a strong sense that the legal ownership is irrelevant - the shares are held for the family as an entity. The family relationships thus strongly underpinned the division of labour in management, solving problems of coordination and co-operation.

None of the supervisory or technical roles is governed by a formal agreement. As Kamil puts it “there are no contracts, if they want ‘offs’ [holidays], we just give it to them .. leave, loans, advances ... whenever ... little, little things that matter”. Kamil monitors performance frequently on a daily basis through informal physical checks to see what it is being done. There are no formal systems; Kamil describes his management approach as “very informal”. There have never been problems with the senior staff - “we’ve not had people letting us down. Just sometimes have to verbally tell them off. If things weren’t right, we’d discuss but ultimately we’d just have to get of rid of them”. Most of the staff have been with the company for many years. Kamil believes that they are “quite committed. Its not just a job for them. The company is part of their lives.” The mode of exchange clearly corresponds to the entrepreneurial firm.

It is notable that three of the four senior white-collar positions are filled by employees of Asian origin, belonging to the Gujarati speaking, Hindu community. These are ones where there is the greatest opportunity for malfeasance, thus presenting particular exchange problems. However Kamil is adamant that there is no difference between the African and Asian employees, maintaining that the only difference is in the jobs they happen to be doing. It is unclear however whether this merely reflects Kamil’s desire not to be seem to discriminate on the basis of ethnicity. There is no shortage of technically qualified Africans in these areas.
The shop-floor staff are employed on formal contracts. Kamil suggests that there is a certain reluctant inevitability to the use of an essentially bureaucratic mode of exchange: "nothing else works". It is essential to maintain both quality and efficiency in production. Both of these are relatively easily monitored with on line quality control and a card system to monitor individual production in the line.

Employment contracts are standard for the industry and are derived from the Ministry of Labour. A separate production contract, agreed in the mid 1970s between Zintex and the Tailors and Textile Workers Union covers the specialised production system used by Zintex. Each production task is broken down in terms of explicit stitches and standard production rates specified. Exceeding the rate results in a performance bonus, failing to meet it leads to disciplinary action. The result is a system of production which is somewhat inflexible. Changes in production are often resisted by the workforce. Kamil wanted to move to a piece-rate production system. He believes that this would have enhanced productivity and increased workers' pay. However the idea met with resistance from workers – possibly Kamil believes due to fear of exploitation. Without the assent of the workers, any change is nearly impossible. A dispute would need to be referred to the Ministry of Labour and would take four years to resolve. Investment in new technology has been avoided partly as a result of this inflexibility. The agreement effectively eliminates the possibility of gains from such capital investment.

The basic employment contract is viewed rather more positively. All wage negotiations are conducted centrally, avoiding the need for Zintex to become directly involved. This depersonalises the process, "reduces hassles and stops any misunderstandings".

D.3.4 Technology

Zintex's production is based on a relatively low level of technology by comparison the state of the art in garment technology. The division of labour whilst significant is still lower than that typically found in the most modern factories. The company
has not invested in new technology, partly as a result of falling demand and partly
due to the difficulty implied by current labour agreements in capturing the returns
from such investments. With current output significantly lower than previously
experienced, the company has over-capacity. Spare parts can be obtained by
cannibalising the unused machines. Since much of the technology was acquired
before Kamil’s involvement in the company there is little evidence of how Zintex
goes about exchange tasks in this area.

D.3.5 Finance

All Zintex’s long-term finance is in the form of equity. The company reached a peak
in output nearly twenty years ago and has not invested substantially since that time.
The original start-up capital derived from a combination of retained earnings from
the earlier family wholesale business and a small bank loan from the
large-scale subsidiary of a multi-national bank. It is interesting to
note that the first family business was started with partners from the
Wanza community. Kamil’s father was the only partner directly
involved in operating the business and eventually bought out the
other investors from accumulated profits.

Working capital finance for customer credit and stock is provided through a
combination of bank overdraft and trade credit facilities together with supplier credit.
Two banks are used, one the large-scale organisation which originally provided the
original start-up loan, the other much smaller and locally owned. The latter bank was
started in 1990 as a finance company, only registering as a bank in 1996. It is owner-
managed by Kenyans of Asian origin. There are 6 shareholders, all from either the
Oshwal or Patel communities. Approximately 80% of Zintex’s finance business is
now conducted through this bank.

The move to a new bank reflects both a growing dissatisfaction with Zintex’s original
bank and the perceived opportunity presented by the new bank. Many of the
problems experienced with the original bank are attributed to the weakness of the
relationship. Kamil puts it thus:
### Table D-10: Zintex Finance Tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>Long-term</td>
<td>Uncertainty of return on investment</td>
<td>Critical</td>
<td>Immediate family</td>
<td>Embedded exchange</td>
<td>Exchange by contract or long-term contracting</td>
</tr>
<tr>
<td>Direct working capital debt</td>
<td>Short-term</td>
<td>Uncertainty of repayment Terms</td>
<td></td>
<td>Very large-scale subsidiary of international bank</td>
<td>Long-term contracting</td>
<td></td>
</tr>
<tr>
<td>Frequent</td>
<td></td>
<td></td>
<td></td>
<td>Middle scale Kenyan Asian (Hindu/Gujarati community) owned local bank</td>
<td>Embedded exchange</td>
<td></td>
</tr>
<tr>
<td>Trade credit (demand)</td>
<td>Short-term</td>
<td>Uncertainty of repayment Terms</td>
<td></td>
<td>Very large-scale subsidiary of international bank</td>
<td>Long-term contracting</td>
<td></td>
</tr>
<tr>
<td>Frequent</td>
<td></td>
<td></td>
<td></td>
<td>Middle scale Kenyan Asian (Hindu/Gujarati community) owned local bank</td>
<td>Embedded exchange</td>
<td></td>
</tr>
<tr>
<td>Trade credit (supply)</td>
<td>Short-term</td>
<td>Uncertainty of repayment Terms</td>
<td></td>
<td>Very large-scale subsidiary of international bank</td>
<td>Long-term contracting</td>
<td></td>
</tr>
<tr>
<td>Frequent</td>
<td></td>
<td></td>
<td></td>
<td>Middle scale Kenyan Asian (Hindu/Gujarati community) owned local bank</td>
<td>Embedded exchange</td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
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</tr>
<tr>
<td>Supplier credit</td>
<td>Short-term</td>
<td>Uncertainty of repayment</td>
<td>High – interest-free credit</td>
<td>Middle-scale Kenyan Asian owner-managed</td>
<td>Embedded exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Uncertain</td>
<td>Terms</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Frequent</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Linked to supply</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer credit</td>
<td>Short-term</td>
<td>Uncertainty of repayment</td>
<td>High – essential to sales</td>
<td>Middle-scale (predominantly Kenyan Asian) owner-managed</td>
<td>Embedded exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Uncertain</td>
<td>Terms</td>
<td></td>
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<tr>
<td></td>
<td>Frequent</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Linked to demand</td>
<td></td>
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</tbody>
</table>
Its about the way you want to look at it. To them you're just another account. They've seen us from the start. Right through. They would never have returned cheques. Now they have returned for small amounts. Its important for our reputation. Its appalling service. Day to day we don't check and balance with the bank - not intensively. ... Sometimes something can slip your mind. You expect the bank to go with you. We had been with them for thirty years. They couldn't explain.

Kamil attributes the problem to the scale of the organisation: "[the bank] is too big - the managers change every two months - no one person knows the account or history". He believes that also the original bank is indifferent as to whether they win or lose a client of the size of Zintex: "in my own circle, I know of ten or so accounts ... [the bank] has lost. It's the same problem - service".

Kamil’s uncle had a business relationship starting twenty years ago with another part of the group involved in the new bank. When the new bank started Zintex was asked if they would try the new bank. Starting with relatively small facilities, the new bank quickly showed that it was able to provide a superior service in all areas. Kamil values the standard of service higher than a few percentage points on the interest rate, but was pleasantly surprised to find that a more competitive rate was offered. According to Kamil, the essential improvement is based on the relationship. He doesn’t think the bank necessarily understands the business particularly well - “they can’t know the company that well”. However he does feels that they have a good regard for the company: “I don’t know how important we are to [the bank], but they respect us”. He now knows all the people with whom he is dealing in various section of the bank, emphasising the importance of relationships not just at the most senior level but also at the operational. There is a strong suggestion that scale is important: “this is a medium sized bank - its more like a medium-sized business ... it addresses the medium-size very well ”.

The relationship is clearly very strong: “If tomorrow I want a million shillings, I just pick up the phone. With [the first bank] it would have to go through writing,
management approval and so on. It took a month. [The new bank] would go with us unsecured, [the first] would not.” The relationship is attributed both to the knowledge that the new bank has of Zintex and the family through the Asian community and the previous family business relationship. This indicates an essentially embedded mode of exchange. Interestingly there are signs of further strengthening of the relationship now: “we have become friends, we play golf etc.” Although there was a certain amount of formality at the outset, submission of balance sheets, cash-flows, charging of securities and so forth this appears to be largely driven by the bank’s need to comply with Central Bank regulation. There have been no formal visits to inspect the factory, unlike the previous bank who “want to see if the bricks are still there”. The only visit has been highly informal – to buy some shirts. Furthermore there has been no revaluation of securities – a normal practice in banks placing strong reliance on the securities.

Credit from suppliers is an important source of finance, used to support a matching demand from Zintex’s customers. The terms vary between 60 to 120 days and average at around 90 days. Such arrangements are somewhat informal – suppliers “don’t worry if you don’t pay on time”. The basic exchange problems posed by supplier and customer credit are met using an embedded mode, as described previously (§7.3.2).
<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Reliance on formal contract/environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>1.2 Efficiency of formal contract/environment</td>
<td></td>
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<tr>
<td>1.3 Difference in use of formal, large and middle</td>
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<td></td>
<td></td>
<td>✓</td>
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<tr>
<td>1.4 Stability of formal environment</td>
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<tr>
<td>1.5 Perception of compatibility of formal environment</td>
<td></td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Importance of business relations</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>2.2 Difficulties in forming business relations with large</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
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<tr>
<td>2.3 Instability in economic operating environment</td>
<td></td>
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<tr>
<td>2.4 Governance differences large and middle</td>
<td></td>
<td></td>
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<td>✓</td>
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</tr>
<tr>
<td>2.5 Organisational rules differences large and middle</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>2.6 Organisational culture differences large and middle</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 Differentiation on basis of ethnicity</td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>3.1.1 ⇒ Differences between African and Asian use</td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2 Use of ethnic based structures in exchange</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2.1 ⇒ Differences between African and Asian use</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>3.3 Use of family relationships in exchange</td>
<td></td>
<td></td>
<td>✓✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3.1 ⇒ Differences between African and Asian use</td>
<td>✓✓</td>
<td></td>
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<tr>
<td>3.4 Difficulties between ethnic groups</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>3.4.1 ⇒ Differences between African and Asian use</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

✓✓ strong support for alternate hypothesis  ✓ weak support for alternate  ✓ ambiguous between null/alternate  ✗✗ strong support for null hypothesis  ✗ weak support for null
D.4 Case three: Boncordon

Based in the same small town as Ancom, approximately twenty kilometres from Nairobi, Boncordon Ltd is also a producer of lingerie products. It is owned and managed by Grace Mwangi and her husband, George, both African Kenyans of Kikuyu ethnicity. Both are also committed Christians and active members of the local Presbyterian church. Grace as managing director is involved full-time in day-to-day operation of the business. Although also involved in the business, specifically dealing with finance related issues, George has day-to-day responsibility for the couple's other business venture, a supermarket in the same town. The company was originally started as a partnership with a German friend, whom George had met whilst studying in Germany. As a result of illness and some disagreements, the Mwangis bought out the German partner within a few years of start-up.

The company has 39 full-time employees and no casual staff. There is little sense of formality in the organisation. Other than Grace, the only other management role in the company is that performed by the production supervisor. Long-term planning is largely intuitive and qualitative undertaken jointly by Grace and George Mwangi rather than a formalised, quantitative process with business plans and cash-flow forecasts. Division of labour is relatively strong in the production process itself, but does not extend far into other roles in the company. Grace is responsible for sales, production management and planning, supply procurement, product design, personnel management and a host of other tasks. Book-keeping for both Boncordon and the sister supermarket is undertaken by an accountant under George's supervision. The basic production technology while geared to mass production is relatively labour intensive and a clear step away from the leading edge of global garment technology. The recent purchase of a computer controlled embroidery machine has been something of a departure from this generally middle-level of technology. Total capital employed in the business is estimated at KShs 9-10 million (approximately £90-100,000).

Boncordon targets the same domestic middle market as Ancom — good quality but competitively priced lingerie. The importance of maintaining quality at an affordable price is the major preoccupation of the company. However once again, liberalisation
Appendix D: Middle-scale enterprise case studies

has had a profound impact on the company. A switch to importation by Boncord's major customer produced a major threat to the company. George Mwangi likens the position pre- and post-import controls to learning to swim with water-wings and then having them abruptly removed. It produced a great deal of instability and the company seriously considered closure in 1994: "we had to learn to deal with uncertainty". George had taken early retirement from his career in the public sector to start Boncord. There was an urgent need for an alternative source of income, especially with the Mwangis' children still in education. The supermarket was opened as a consequence. Some degree of confidence has returned although a high degree of uncertainty remains over future demand.

D.4.1 Supply

Boncord depends on a relatively small number of regular suppliers for most of the raw materials used. Although the bulk of the materials used are standard products, significant exchange problems nevertheless arise. Quality in the inputs is vital to maintaining final product quality. Boncord also depends on obtaining credit from suppliers. The major supply tasks are summarised in table D-13.

Fabric represents the single most important input. Although following liberalisation, the company now has the option to import, practically it has been found to be "a very expensive way of obtaining supplies". Consequently Boncord has only a choice of two or three firms from which to buy most of the fabric required. A good relationship has been established with the leading supplier. This company Grace believes has a positive attitude towards quality and there is rarely a problem. Although the number of employees is over two hundred, suggesting that it is large-scale, the company is owner-managed and Grace deals directly with the managing director. She contrasts this with her dealings with the supplier of yarn. Serious problems are being experienced in reaching a satisfactory quality standard. The supplier is now resisting returns of sub-standard supplies and has refused to attempt to improve.
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fabric</td>
<td>Frequent</td>
<td>Determination of quality</td>
<td>Very high – vital input</td>
<td>Two long-term large scale Kenyan Asian family owner-managed local manufacturers</td>
<td>Relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality difficult to determine ex ante</td>
<td>Credit period</td>
<td></td>
<td>Middle-scale Kenyan African owner-managed local manufacturer</td>
<td></td>
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<tr>
<td></td>
<td>Standard product</td>
<td>Price determination</td>
<td></td>
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<td></td>
<td>Price stability</td>
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<tr>
<td></td>
<td></td>
<td>Order size</td>
<td></td>
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<tr>
<td>Elastics</td>
<td>Frequent</td>
<td>Determination of quality</td>
<td>High</td>
<td>One long-term middle scale Kenyan Asian family owner-managed local manufacturer</td>
<td>Relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Standard product</td>
<td>Credit period</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Price determination</td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Price stability</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Yarn</td>
<td>Frequent</td>
<td>Determination of quality</td>
<td>High</td>
<td>One large scale Kenyan Asian owner-managed local manufacturer</td>
<td>Market exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Standard product</td>
<td>Credit</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Price determination</td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Price stability</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lace trimmings</td>
<td>Frequent</td>
<td>Determination of quality</td>
<td>High</td>
<td>One long-term foreign (German) wholesaler</td>
<td>Weak relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Standard product</td>
<td>Order size</td>
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Table D-12: Boncord supply tasks
Grace attributes the problem to a combination of ethnicity and scale. "If [Boncord] were run by Shahs there would be no problem and they would try again. They are difficult because they are big – they deal in millions". No credit is offered from this company. By an employment measure, the company is large, with over 750 employees. Boncord has now switched to sourcing yarn from the fabric supplier who can achieve an adequate level of quality, although offering a highly unfavourable price, some 17% higher (a result Grace believes of the fabric supplier's dependency for raw materials on the same company).

The importance of the relationship with suppliers was demonstrated during an earlier period of the company's history. An expatriate (Yugoslavian) technical manager worked for Boncord in the early 1980s and managed all the procurement. When this individual left the company it was found that very large debts had been built up with all the suppliers with the result that the relationships deteriorated to a very poor state. Supplies were subsequently only offered on the basis of cash imposing a major strain on the company's liquidity. As a result the company maintained insufficient stocks and could only purchase small quantities. Boncord was very fortunate to continue to obtain wholesale prices from the suppliers despite order quantities which would normally have disqualified the company from such preferential prices. Over a period of a year, Grace was able to gradually rebuild the relationships.

There is no formality involved in the supply process. For the repeat of normal order, it is sufficient for Grace to simply call the company: "they know what I want". Delivery lead times vary from one to three weeks, but are not considered problematic. The general level of credit is 45 days, again with no formal agreements. Sometimes when liquidity is under pressure, Boncord does not pay on time, but this causes no difficulties: "I think they do trust us – I hope so!".

According to Grace there are clear limits on the strength of the relationship. She believes that Boncord obtains less favourable prices than those offered to "fellow Asians". She cites a case where she was offered a keener price from a wholesale
Appendix D: Middle-scale enterprise case studies

Distributor than she obtains directly from the factory. However she still prefers to go straight to the factory rather than the distributors since this offers greater control over the quality and variety of the product. Furthermore she believes Asian owned manufacturers also generally obtain longer credit terms from the suppliers.

D.4.2 Demand

Most of Boncord's output is sold through a relatively small number of outlets (table D-14). Until recently a single large retail department chain accounted for 80% of output. This company, the leading such store in Kenya (discussed earlier in relation to Ancom) recently ceased buying from Boncord, switching to a South African source. Boncord has been unable to replace such a major customer and has cut back production substantially, laying off workers.

From the perspective of the buyer, according to Grace, the major question in exchange is whether Boncord can actually produce a quality product similar to the samples shown. She encounters considerable scepticism from potential buyers both due to the factory's non-central location and that it is not Asian owned and managed. Grace feels that there is a widespread belief that "only Asians can do this sort of business". All the company's current buyers are Asian owner-managed. The only solution is to "build up slowly. Supply and then repeat." Eventually in this way it is possible to establish a relationship. In general she finds that her regular customers trust the company to produce a high quality product.

The major immediate problem faced by Boncord in exchange derives from payment uncertainty. Here the larger scale customers proved to be the easiest: "30 days means 30 days". For others, there is considerable uncertainty, especially at the outset, as to whether payments will be made on time or at all. Considerable efforts are sometimes required to extract payments from
<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
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<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail chain</td>
<td>Large volume orders</td>
<td>Demonstration of quality</td>
<td>Previously very high (80% of total output)</td>
<td>Large-scale chain of retail stores, Kenyan African owned, European expatriate managed</td>
<td>Weak relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Delivery times</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Semi-customised product</td>
<td>Acceptance of orders following production</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Heavy dependency on repeat orders</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supermarket chain (1)</td>
<td>Medium volume orders</td>
<td>Market acceptance and demonstration of quality</td>
<td>High</td>
<td>Large-scale chain of general supermarkets (large urban centres only), Kenyan Asian family owner managed</td>
<td>Relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Determination of price</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supermarket chain (2)</td>
<td>Medium volume</td>
<td>Market acceptance and demonstration of quality</td>
<td>Moderate</td>
<td>Large-scale chain of general supermarkets (large urban centre only), diverse ownership (NSE listed) formerly parastatal, Asian management</td>
<td>Relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Determination of price</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nairobi retailers</td>
<td>Small volume orders</td>
<td>Price</td>
<td>Moderate</td>
<td>Middle-scale retail stores in Nairobi city centre, primarily Kenyan Asian owner managed</td>
<td>Relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td>Demonstration of quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Standard products (some customisation)</td>
<td>Credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Up-country retailers</td>
<td>Price</td>
<td>Demonstration of quality</td>
<td>Moderate</td>
<td>Micro and middle-scale retail stores in other major urban centres</td>
<td>Relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
</tr>
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<td>---------------</td>
</tr>
<tr>
<td>Traders</td>
<td>Very small volume sales Infrequent Standard products</td>
<td>Market acceptance and demonstration of quality</td>
<td>Low</td>
<td>Micro-scale retailers and traders, Kenyan African owner-managed</td>
<td>Market exchange</td>
<td>Relational exchange</td>
</tr>
<tr>
<td>Consumers</td>
<td>One-off unit sales Infrequent Standard products</td>
<td>Demonstration of quality</td>
<td>Low</td>
<td>Consumers – middle-class</td>
<td>Market exchange</td>
<td>Relational exchange</td>
</tr>
<tr>
<td>Government</td>
<td>Large volume One-off Customised</td>
<td>Payment Demonstration of quality Demonstration of ability to produce Rent-seeking</td>
<td>Moderate</td>
<td>Government department</td>
<td>Exchange by contract</td>
<td></td>
</tr>
<tr>
<td>Export</td>
<td>Very large volume orders Frequent</td>
<td>Demonstration of quality Price</td>
<td>High</td>
<td>North American chain stores</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
customers: “Eventually for some of them you wonder why you supplied them. You end up begging for the money.” Aside from the immediate costs of pursuing outstanding accounts, the company has incurred losses from bad debts. At the outset all supply is on a cash basis, only offering credit once the company has established some confidence in the customer.

Once again the buying process is largely informal. Often these are telephoned through or placed at the time the preceding order is delivered. With the exception of the previous largest customer, there is no paperwork involved. In this case there was “a real order” with a specification of colours, quantities and ratio of sizes. This was regarded as somewhat inconvenient by Grace since there was a much greater possibility of making losses in cutting in order to meet the precise specification. By contrast the other customers are flexible regarding the colours and sizes of product, allowing the company to optimise the fabric cutting. A strong relationship has been built with the supermarket chain which is now Boncord’s leading customer. Grace simply visits the stores and determines what is needed. Boncord then produces and supplies without reference to the customer. Although there is a minor cost implied by the need for Grace to visit the outlets, the arrangement results in more rapid orders for Boncord and the customer is relieved of the stocking problem.

The close relationship between Boncord and the supermarket chain suggests that ethnicity is not as great a barrier as Grace suggests elsewhere. The supermarket managing director belongs to the Oshwal community. After a chance meeting which lead to the start of the supply relationship, Grace now describes the managing director as a “good, good friend”. He advised the Mwangis on their diversification into the supermarket business. She does however believe that this is of little consequence when it comes to negotiating prices: “Friendship has to be put aside – he sells at twice as much!” With other customers, there is some social contact and Grace has been able to obtain some information from the Asian community regarding the credit worthiness of potential
customers. Nevertheless she still feels excluded from this business and social community. Another manufacturer, again owner-managed by Asians, has started to compete directly with Boncord. She is finding it difficult to match prices and believes that the competitor may be facing lower raw material costs as a result of preferential treatment by Asian suppliers. Furthermore she believes that customers are turning to this competitor on the basis of ethnic affiliation. "Whenever Asians meet they talk their language. They are more loyal to one another. They will go to him. Sometimes even our regular Asian customer take ours [products], take them to him and then he copies for a lower price".

Economic instability was cited as creating problems in selling. One such problem in mid 1997 occurred as a direct result of IMF suspension of an enhanced structural adjustment facility (ESAF) to the Kenya government. The Kenya shilling fell sharply, the exchange rate was highly volatile for a period, the government increased valued added tax by 1% in order to compensate for the loss of budgetary support and interest rates rose. Raw material prices therefore increased and Grace was planning to seek price increases from her customers which she knew would be resisted: "we are going to have a rough time".

D.4.3 Labour

There are essentially five roles within Boncord: managerial, supervisory, technical, skilled production and ancillary (table D-15). For the majority of the work force, as noted in the previous cases, there is little choice as to the mode of exchange. In common with the other cases, Grace believes that the formal labour agreements with the shop floor staff provide an efficient framework for employment. Boncord also uses a highly structured card control system to monitor performance. This is believed to be the most effective...
### Table D-14: Boncord labour tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing director (1)</td>
<td>Continuous</td>
<td></td>
<td>Critical</td>
<td>Kenyan African owner-manager</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Director (1)</td>
<td>Frequent</td>
<td></td>
<td>Critical</td>
<td>Kenyan African joint owner-manager</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production supervisor (1)</td>
<td>Continuous</td>
<td>Tasks difficult to specify</td>
<td>Very high</td>
<td>Long-term Kenyan African employee with vocational technical training, on the job training in the firm</td>
<td>Entreprenurial firm</td>
<td>Bureaucratic firm</td>
</tr>
<tr>
<td></td>
<td>Highly variable, complex task set</td>
<td>Hard to monitor</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>High degree of uncertainty</td>
<td>Vulnerability to malfeasance</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Highly firm specific tacit skills</td>
<td></td>
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</tr>
<tr>
<td>Accountant (1)</td>
<td>Continuous</td>
<td>Limited vulnerability to malfeasance</td>
<td>Moderate</td>
<td>Recent Kenyan African employee, part qualified accountant (CPA)</td>
<td></td>
<td>Entreprenurial firm</td>
</tr>
<tr>
<td></td>
<td>Variable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moderate degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mechanic (1)</td>
<td>Continuous</td>
<td>Tasks difficult to specify precisely</td>
<td>Moderate</td>
<td>Long-term Kenyan African employee trained on the job with previous firm</td>
<td></td>
<td>Entreprenurial firm</td>
</tr>
<tr>
<td></td>
<td>Variable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moderate degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cutters (2)</td>
<td>Continuous</td>
<td>Tasks difficult to specify precisely</td>
<td>Moderate</td>
<td>Long-term Kenyan African employees trained on the job within the firm, some prior training</td>
<td></td>
<td>Bureaucratic firm</td>
</tr>
<tr>
<td></td>
<td>Variable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moderate degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
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</tr>
<tr>
<td>Machinists (30)</td>
<td>Continuous</td>
<td>Productivity and quality of work critical to final production costs</td>
<td>Moderate</td>
<td>Long-term Kenyan African employees trained on the job within the firm, some prior training</td>
<td>Bureaucratic firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Garment industry specific tacit skills</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Watchmen (3)</td>
<td>Continuous</td>
<td>Minor</td>
<td>Low</td>
<td>Locally recruited Kenyan African employees (casual)</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definable task set</td>
<td>Some vulnerability to malfeasance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unskilled</td>
<td></td>
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</tr>
</tbody>
</table>
Appendix D: Middle-scale enterprise case studies

means of ensuring that the twin objectives of quality and productivity are met. The supervisor represents an interesting role in the firm. As Grace puts it “she is the one who handles the place”. She is responsible for all other staff in the factory – pivotal given Grace’s frequent absences dealing with suppliers and customers. This is a role which involves a highly variable and difficult to define task set. The mode of exchange clearly corresponds to the entrepreneurial firm. There is no contract of employment or job description. There is a high degree of mutual dependency. Referring to the possibility of losing the supervisor, Grace’s response was “let us not even talk about it – it would be a disaster”. The supervisor has worked her way up from the shop floor as a machinist and much of her skill is tacit and specifically relates to Boncord. Nevertheless, Grace has consciously worked on strengthening the relationship between the firm and supervisor. The Mwangis now pay for the education of the supervisor’s son: “its better to pay the fees. We can’t give her the money when there is no work, but we can pay the fees”. Grace believes that this helps the long-term relationship – the supervisor is a single parent and would find it difficult to pay school fees.

There is considerable reluctance to use family relationships in business. The previous mechanic employed by Boncord was George Mwangi’s brother. Grace discovered that he was disruptive in the workplace, physically abusing staff and stealing. In relation to the stealing there is a feeling that as a relative “it is ok” – more like sharing than theft. The difficulty she says is that she could do very little: “I didn’t know what to do. I didn’t want a fight at home. I didn’t tell my husband”. Custom made it difficult for her to raise any objections: “In-laws are not tended to be liked. My mother-in-law was very protective”. Part of the difficulty she says that in the African community is that “when it comes to a relative, they want special favours”. Fortunately the brother left of his own volition. Grace concludes: “It can’t work this sharing thing. It’s the individual in every case”. Similarly she now resists employing members of the community. She cites difficulties with the previous accountant, the son of a friend and respected member of the community. The

Continued …

Strongly supporting null hypothesis (1.2): Middle-scale enterprises regard exchange based on the state-maintained economic institutional framework as an efficient (in terms of transaction costs and uncertainty) mechanism for solving problems of cooperation. Strongly supporting null hypothesis (1.5): Middle-scale enterprises do not perceive the institutional framework as inaccessible to them or incompatible with their needs.

Strongly supporting alternate hypothesis (2.1): Middle-scale enterprises regard the formation of relations as an important means of informally solving problems of exchange.
accountant was discovered to be defrauding the company. On the first occasion, the *mzee* (*Swahili*: literally *old man* but *with a strong implication of respect*) intervened and the employee was not dismissed. A second fraud occurred, by which time the father had died, and he was sacked. There is some pressure to employ people through the church community to which the Mwangis belong. Again problems have been experienced – “there are pretenders in the church”. In conclusion she says: “I’ve learnt not to trust friendship when it comes to business”. Grace contrasts this with the attitude of Asians: “the Asians always take [employ] from their own community”. Close family members often work in the Asian owned businesses with which Boncord deals.

D.4.4 Technology

Much of the basic production machinery Boncord currently uses was imported from Germany when the company was started. The previous German partner had been involved in the textiles industry in Germany and was able to procure the machinery directly from suppliers. Difficulties in obtaining foreign exchange at the time would have made this procurement difficult without the German partnership. There are no machinery manufacturers in Kenya. However Kenyan agents of the manufacturers were available to assist with the importation process and installation, although George did not regard their input as especially valuable.

Boncord have made greater investments in more modern machinery than found in comparable Kenyan firms. Specialised equipment has been imported, including a bra cup forming machine, an elastic strap weaver and most recently a computer controlled embroidery machine. The Mwangis visit the major regular international textile exhibitions in Cologne and Atlanta in order to gather information on production technology. Ultimately however, the physical remoteness of the manufacturers from Kenya and the lack of technical capacity of the local agents has generally circumscribed the strength of the relationship with the suppliers. Boncord has had to build much technical expertise within the company. Two expatriate
Table D-15: Boncord technology tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery procurement</td>
<td>High value</td>
<td>No Kenyan based machinery manufacturers</td>
<td>High</td>
<td>US, German, Swiss, Japan large-scale manufacturers (local Kenyan agents)</td>
<td>Exchange-by-contract</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Infrequent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Complex characteristics</td>
<td>Search for appropriate suppliers</td>
<td>New investment must generate adequate return</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- difficult to measure readily</td>
<td>Determining quality and performance of machinery <em>ante</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery installation</td>
<td>Infrequent</td>
<td>Measurement - determining the quality of service</td>
<td>High</td>
<td>Local Kenyan agents of large-scale manufacturers</td>
<td>Exchange-by-contract</td>
<td>Exchange-by-contract (linked to original procurement)</td>
</tr>
<tr>
<td></td>
<td>Complex characteristics</td>
<td></td>
<td>Set up essential to effectiveness of machinery</td>
<td></td>
<td></td>
<td>Relational exchange</td>
</tr>
<tr>
<td></td>
<td>- difficult to measure readily</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Major machinery repair</td>
<td>Infrequent</td>
<td>Rapid, flexible response to problems needed</td>
<td>High</td>
<td>Micro-scale Asian owner-managed-operated enterprise</td>
<td>Weak relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Irregular</td>
<td></td>
<td>Down-time threatens productivity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minor machinery repair and</td>
<td>Frequent</td>
<td>Very rapid, flexible response needed</td>
<td>Very high</td>
<td>Long-term African employee, trained on the job in Boncord and industry</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td>maintenance</td>
<td>Irregular</td>
<td></td>
<td>Down-time threatens productivity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spare parts</td>
<td>Frequent</td>
<td>No Kenyan based parts manufacturers</td>
<td>High</td>
<td>Micro-scale Asian owner-managed-operated enterprise</td>
<td>Weak relational exchange</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Irregular</td>
<td></td>
<td>Down-time threatens productivity</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
experts, a long-term Yugoslavian manager and a short-term American consultant contributed significantly to the building of this capacity. The latter consultant improved productivity significantly and was funded largely by US Agency for International Development.

The acquisition of the computerised embroidery machine shows the importance of business relationships. Internalisation of the embroidery process arose from the realisation that the company’s embroidered products were becoming uncompetitive as a result of the costs incurred from outsourcing. The idea of investing was discussed with another middle-scale Asian owner-managed garment company with whom Boncord came into contact as a supplier of elastics. This company will offer sub-contract work in embroidery of company logos which will utilise the spare capacity of the machine. Importation and installation was carried out by another Asian owner-managed garment company. Some degree of on-going support will be provided, in particular providing training to the operator and translating designs into the computer discs needed to control the machine. Without such support the machine would be of little use. Although Grace believes that the company is somewhat isolated, as a result of ethnicity, from other, predominantly Asian owner-managed, manufacturers, in the sector, it is clear that Boncord has nevertheless succeeded in forging important business relationships.

Most maintenance and repair is carried out by the skilled technician employed by Boncord. However the new machinery is beyond the scope of the technician and a local Asian owner-operated enterprise is currently providing maintenance. Fluctuations in power supply resulted in damage to the machine. A major exchange difficulty is posed due to the asymmetry in information here. The company lacks the technical expertise to determine the precise cause of faults. As a result it depends on the opinion of the Asian technician. This is problematic since George is highly suspicious. A stronger relationship is clearly needed but
cannot be formed, it would be appear, due to an ethnic divide. George wants to train the company's own technician as soon as possible in order to internalise this maintenance and repair function.

D.4.5 Finance

Boncord was initially a joint venture between the Mwangis and a German partner. The Mwangis financed their equity stake with a mixture of life savings and liquidation of assets. The contribution of their partner, crucially at a time of exchange controls, was in deutschmarks. When the Mwangis took over the business this equity was converted to loan and repaid over four years. Given the strength of the personal relationship between the partners there was no difficulty in arranging this earn out.

A number of loans have been used to finance the business subsequently. One, relatively small, from the employment related co-operative society of which George Mwangi was a member, the other from a very large-scale government owned bank. The loan from the co-operative society was not conditional on its application. Credit is provided on a highly structured basis, with repayments derived directly from salary.

A relationship had been established with the bank prior to seeking the start-up loan, through a personal connection to a senior figure in the organisation. This had enabled the Mwangis to borrow in order to purchase land on which to build a house. Although the financing was formally secured by a first legal charge and a lien over George's salary (from a parastatal – thus carrying a high degree of certainty in its continuity), "being known to someone in the bank was obviously very important". The successful repayment of this first loan was crucial in establishing a track record for the subsequent business loans.

A multi-national bank subsidiary with whom George had saved for some years was found very reluctant to lend. George believes that the local bank, despite its size "really takes care of the small man. There is a personal touch. For international business the multi-national banks are ok. But they have no personal touch." The Mwangis use one of the multi-national bank subsidiaries for the supermarket business. George complains of the inflexibility. He notes with
### Table D-16: Booncorp finance tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>Long term</td>
<td>Uncertainty of return on investment</td>
<td>Life savings of current owner-managers</td>
<td>Relational contracting</td>
<td>Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Medium term</td>
<td>Uncertainty of repayment</td>
<td>Very high</td>
<td>Long-term contracting</td>
<td>Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Medium term</td>
<td>In frequent</td>
<td>High degree of uncertainty</td>
<td>Long-term contracting</td>
<td>Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Medium term</td>
<td>Frequent</td>
<td>High degree of uncertainty</td>
<td>Long-term contracting</td>
<td>Long-term contracting</td>
</tr>
<tr>
<td></td>
<td>Working capital debt</td>
<td>High</td>
<td>High</td>
<td>Various (not universal)</td>
<td>Various (limited – excludes micro-scale enterprise customers)</td>
</tr>
<tr>
<td></td>
<td>Supplier credit</td>
<td>Short term</td>
<td>Linked to supply</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td>Customer credit</td>
<td>Short term</td>
<td>Linked to demand</td>
<td>Very frequent</td>
<td>Very frequent</td>
</tr>
</tbody>
</table>

**Appendix D: Analysis of evidence**
particular irritation the frequency with which problems or unfavourable decisions are blamed by the bank branch on its head office: "why bother having a branch if we are really just dealing with the head office?".

A major expansion was financed through a loan from the same bank, but backed by a guarantee from the US Agency of International Development as part of a rural enterprise programme. This enabled a much larger amount to be borrowed than would otherwise have been possible, at a subsidised interest rate and over a six year period rather than the usual maximum of three. Boncord's current machinery loan, on normal commercial terms, is again over three years although George estimates that it will take around five-six years before the machine earns back the investment.

George feels that the requirement for specific types of collateral by all the major banks places a major constraint on businesses of the size of Boncord. Often these securities are not available despite the strength of the business. Banks will not accept moveable machinery (such as sewing machines) as collateral.

As noted earlier, supplier credit is an important source of working capital finance. Here Boncord feels again that it receives a worse deal than other Asian owned firms in the sector. Grace believes that her suppliers will offer up to 120 days credit to other Asian firms where Boncord only receives 45 days. Beyond the 45 day point interest of 5% is levied.
Table D-17: Summary of evidence for specific hypotheses (Boncord)

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Reliance on formal contract/environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>?</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>1.2 Efficiency of formal contract/environment</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>1.3 Difference in use of formal, large and middle</td>
<td></td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Stability of formal environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5 Perception of compatibility of formal environ</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>2.1 Importance of business relations</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.2 Difficulties in forming business relations with large</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.3 Instability in economic operating environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.4 Governance differences large and middle</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>2.5 Organisational rules differences large and middle</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>2.6 Organisational culture differences large and middle</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>3.1 Differentiation on basis of ethnicity</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td>?</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.1.1 Differences between African and Asian use</td>
<td>✓✓</td>
<td>✓✓</td>
<td></td>
<td>?</td>
<td></td>
</tr>
<tr>
<td>3.2 Use of ethnic based structures in exchange</td>
<td></td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2.1 Differences between African and Asian use</td>
<td></td>
<td>✓✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3 Use of family relationships in exchange</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>3.3.1 Differences between African and Asian use</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>3.4 Difficulties between ethnic groups</td>
<td></td>
<td></td>
<td></td>
<td>?</td>
<td></td>
</tr>
<tr>
<td>3.4.1 Differences between African and Asian use</td>
<td></td>
<td></td>
<td></td>
<td>?</td>
<td></td>
</tr>
</tbody>
</table>

✓✓ strong support for alternate hypothesis  ✓ weak support for alternate  ? ambiguous between null/alternate  ✓ strong support for null hypothesis  ✓ weak support for null
D.5 Case four: Tykor

Tykor Group, based in the central Nairobi business district, is a group of three closely allied garment and textile companies, involved in manufacturing, textile trading, wholesaling and retailing. The group is owned by the Shah family. Managing director and part owner of Tykor, Ajay Shah, oversees the operations of all three companies. His two brothers, cousin and uncle, also shareholders, are also involved in the management of the businesses. Aside from the uncle who is semi-retired, the other family members are involved full-time. The three companies while legally distinct are strongly integrated operationally and physically. In this analysis the group is considered as a whole. Ajay’s grandfather founded the group in trading with ten other partners in 1950. The factory, Tykor, was started in 1969 on a small scale. Ajay’s father joined the business and by 1974 had bought out the other partners bringing the group into the current family ownership. Ajay started work in the retail outlet at the same time.

The Shahs are Kenyan nationals of Asian descent, belonging to the Oshwal community. Ajay’s grandfather emigrated to East Africa from the Gujarat area of India in the 1920’s. The Oshwal ethnic group is relatively small; Ajay estimates that the total population around the world is only 65,000. More than half of this number are believed to live outside India. Kenya has the second largest Oshwal community outside the Gujarat province of India, estimated by Ajay as 14,000 (or 22% of the total). It also comprises a significant proportion of the total Kenyan Asian population (16% based on 1989 census figures\(^{16}\)). The Oshwals follow the Jain religion. Despite the commonality of language they therefore form a somewhat distinct community from other Asian communities in Kenya deriving from Gujarat, who are primarily Hindu by religion.

The group has the primary characteristics identified of the middle-scale enterprise type. There are 46 full-time employees in the group, with no casual or part-time staff. Half of this number (23) are employed in the manufacturing operation. Ajay involves himself in all aspects of the group’s operations, although there is a degree of delegation of responsibility in all areas, predominantly to the family members involved. Other than the usual business management tasks, Ajay also designs suiting
fabrics which now make the greatest contribution to the group's turnover and profitability. The management style is highly informal – the managerial division of labour is implicit and requires no organograms or job descriptions. Probably the most overtly systematic aspect of the groups operations is in the computer based monitoring of (externalised) fabric production. However this appears to have little impact on the organisation's modus operandi – it is used more as an information storage mechanism rather than as an organisational tool. Garment assembly is carried out on an individual or craft basis rather than in production lines. Production volumes at present do not justify greater division of labour and setting up production lines. The technology used similarly reflects this relatively limited scale of operations.

Total capital employed in manufacturing is estimated at KShs 8-9 million (approximately £80-90,000). Significantly greater capital is tied up in working capital within the trading operation. The requirement peaks at around KShs 30 million (approximately £300,000).

Tykor targets a broadly middle market for the garments it manufactures. Two particular niches are addressed. Trousers are sold as a part of local school uniforms, and safari suits are primarily aimed at the tourist market. Once more this market is regarded as very weak as a result of liberalisation and the rise of cheap imports. There is little Ajay feels which the company can do to counter this threat. The manufacturing side is effectively being carried financially by the group's other operations. Certainly without the other businesses, Ajay believes the manufacturing would have already closed. The manufacturing workforce has declined dramatically since its peak when 80 people were employed. Ajay's strategy in the short-term is to concentrate on the textiles while continuing the garment operation at a relatively low level in the hope that conditions will improve. The textile business is focussed on the design and distribution of suiting materials which are manufactured locally. Ajay sees the target consumer as independent tailors. These micro-enterprises effectively represent a middle market for quality, design and price. Although there is significant general competition from other textile manufacturers and importers, Ajay believes that there is an important niche to be found in responding to the needs of the small tailors found throughout Kenya. The group's long experience in both wholesale and retail trading is critical here.
D.5.1 Supply

All supplies for the Tykor Group are routed through the trading operation. With current low levels of demand, the manufacturing company requirement comprises a relatively small component of the group's total buying operation. However for manufacturing, trading and distribution alike, the major supply task is fabric procurement (table D-19). Fabric is the major raw material for the garment manufacture and the major product line for the trading and distribution arms. Quality, price determination and speed of delivery are regarded as the key characteristics of the fabric supply task. Ajay believes that for suiting material in particular it is essential to maintain very high quality standards – just two incorrect threads in a pattern can make a very significant difference to the final product.

The majority (75%) of fabric is now sourced from a local manufacturer. Tykor and this textile mill are very closely involved in the production process. Tykor specifies and controls the yarns, machinery and designs used by the mill. This enables a very close control to be maintained over the quality of the product. Prices are agreed on the basis of a fixed percentage for manufacturing over the cost of materials. Tykor even controls the raw material stocks for the mill. The mill has invested heavily in machinery to produce the quality required. Tykor's business now accounts for roughly 20% of this large-scale mill's output. There is a clear condition of bilateral dependency between the two companies. Neither could readily replace the other. Tykor's primary source of competitive advantage in the market derives from its designs and established quality. The mill obviously has access to these designs, but it is central to the arrangement between the companies that these are not sold on to other customers.

There is no formal written agreement between the two companies. The family owner-managers of the mill are also members of the Oshwal community and there has been a strong personal relationship between the families since the previous generation. The arrangement which has been highly successful for both companies...
### Table D-18: Tykor supply tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Garments – all materials</td>
<td></td>
<td>Quality problems only manifest after delivery</td>
<td>Critical</td>
<td>Wholly through related trading company</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Variable order size</td>
<td></td>
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<tr>
<td></td>
<td>Frequent</td>
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</tr>
<tr>
<td></td>
<td>Standard products</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality difficult to detect</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td><em>ex ante</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading company – fabric (1)</td>
<td>Highly customised product</td>
<td>Price determination</td>
<td>Critical – responsible for 75% of core product line</td>
<td>One long-term large scale Kenyan Asian (Oshwal community) owner managed manufacturer</td>
<td>Embedded/ relational</td>
<td>Exchange by contract</td>
</tr>
<tr>
<td></td>
<td>Designs specified</td>
<td>Quality problems only manifest after delivery</td>
<td></td>
<td></td>
<td></td>
<td>Long term contracting</td>
</tr>
<tr>
<td></td>
<td>Yarns specified</td>
<td>Speed</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Very large orders</td>
<td>Mutual exposure to malfeasance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Strong asset specificity</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Rapid order turnaround required</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality difficult to detect</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td><em>ex ante</em></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading company – fabric (2)</td>
<td>Customised product</td>
<td>Price determination</td>
<td>High – responsible for 20% of core product line</td>
<td>One long-term large scale Kenyan Asian (Sikh community) owner managed manufacturer</td>
<td>Weak embedded/ relational</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Large orders</td>
<td>Quality problems only manifest after delivery</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exclusive designs</td>
<td>Speed</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rapid order turnaround required</td>
<td>Mutual exposure to malfeasance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality difficult to detect</td>
<td>Exclusivity of design</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><em>ex ante</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
</tr>
<tr>
<td>----------------------------------</td>
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</tr>
<tr>
<td>Trading company – fabric (3)</td>
<td>Customised product</td>
<td>Price determination</td>
<td>Moderate – previous major supplier</td>
<td>Local subsidiary of Indian owned (public) multi-national</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Large orders</td>
<td>Quality problems only manifest after delivery</td>
<td>Speed of turnaround</td>
<td>Exclusivity of design</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exclusive designs</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Rapid order turnaround required</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality difficult to detect ex ante</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trading company – zips, buttons, threads etc</td>
<td>Standard products</td>
<td>Quality problems only manifest after delivery</td>
<td>Low – alternatives readily found</td>
<td>Various large and middle-scale local manufacturers</td>
<td>Embedded</td>
<td>Relational</td>
</tr>
<tr>
<td></td>
<td>Medium order sizes</td>
<td>Quality problems only manifest after delivery</td>
<td>Low – alternatives readily found</td>
<td>Various large and middle-scale local manufacturers</td>
<td>Embedded</td>
<td>Relational</td>
</tr>
<tr>
<td></td>
<td>Speed of delivery</td>
<td>Price determination</td>
<td>Low – alternatives readily found</td>
<td>Various large and middle-scale local manufacturers</td>
<td>Embedded</td>
<td>Relational</td>
</tr>
<tr>
<td></td>
<td>On-time delivery</td>
<td></td>
<td>Low – alternatives readily found</td>
<td>Various large and middle-scale local manufacturers</td>
<td>Embedded</td>
<td>Relational</td>
</tr>
</tbody>
</table>
in its two years of operation: the mill has improved its capacity in this area to the point where it can contemplate export and Tykor is emerging as the leading source of suiting material in Kenya. Ajay believes trust is crucial here: “there is an understanding at a very deep level. It has taken a lot of time, 12 to 15 years to get here. I never let him down, he never lets me down. If you have problems then you talk it out”. The exchange corresponds to a combined embedded and relational mode. Although initially based on common ethnicity – corresponding to the embedded mode, over time the relationship has developed its own particular identity. It represents a remarkably transactionally efficient arrangement. Problems of co-ordination and co-operation here are potentially highly significant. However the costs and uncertainty in exchange have been reduced to minimal levels, while simultaneously preserving the incentives associated with the maintenance of independent ownership of the two companies. Underpinning the deal appears to be a basic understanding of each side’s role and a presumed mutual absence of opportunism. There is thus no requirement to define ex ante how possible future events will be treated – these can be dealt with as they arise. It is interesting to note the ease with which problems of currency instability were treated. Allocation between the partners of the increased input costs arising from a slide in the Kenya shilling was established effortlessly. Crucially neither side appeared to make any attempt to improve their own position as a result of these changes. A more formal mode of exchange would necessarily have resulted in increased transaction costs and/or residual uncertainty as compared with the mode actually adopted.

Prior to this current major supply relationship, Tykor sourced the majority of its fabric from the Kenyan subsidiary of an Indian-based multi-national. This is one of the largest textile mills in Kenya, employing nearly fifteen times as many workers as the mill with whom Tykor currently works. Although in the past Tykor had had a satisfactory relationship with the company, in recent years the company “tried to dictate terms. We are shown one sample and then a different (sub-standard) material was produced.” Ajay associates the deterioration with the change in management. Previously the executive chairman was a Kenyan from the Sikh community who was
also a shareholder in the Kenyan company. A new chairman was appointed from India who “had no idea about the relationship”. According to Ajay it seems as if the new chairman “thought people from Kenya were fools”. The basis of supply was made highly formal. On one occasion the mill attempted to force Tykor to buy a material previously bought directly, though another supplier. Ajay found the situation impossible - there was no opportunity for negotiation when problems arose and communication became poor. This exemplifies discontinuity manifest in the particular governance mechanisms used in the process of exchange, but driven by a discontinuity in organisational rules, but ultimately deriving from a discontinuity in organisational culture. “It takes years to build up a business relationship, but it can be destroyed in an instant”. Referring to the building of a relationship with Tykor’s second fabric supplier, Ajay says: “it is all about ways of talking. It makes a very big difference who it is you are dealing with.”

Tykor has virtually totally ceased buying from the large mill. There was no attempt to rectify any of the problems using legal action. Ajay feels this simply won’t work: “the only solution is exit”. He explains this in terms of his fundamental approach to business: “If there is the wrong motive - the goods will not sell. … The hand that gives is most important … Its about trying to give a good product versus trying the hard sell.”. This belief is underpinned by the significance of the Asian community in business: “Word gets around. We work in a community. Its very important”.

D.5.2 Demand

A diverse range of channels is used by Tykor to reach the final market for its products (table D-20) These extend from direct supply to manufacturers and wholesalers through to retail selling to tailors. The group includes a wholesale and retail operation enabling this wide range of customers to be serviced.
Table D-19: Tykor demand tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Garments – retailers</td>
<td>Middle volume orders Frequent Some semi-customised products</td>
<td>Market acceptance and quality of the product On-time payment</td>
<td>Moderate – no single major customers</td>
<td>Middle and small-scale retail stores, primarily Asian owner-managed</td>
<td>Embedded Relational</td>
<td>Exchange by contract</td>
</tr>
<tr>
<td>Fabrics – wholesalers</td>
<td>Large volume orders Frequent Standard products</td>
<td>Market acceptance and quality of the product Continuity/availability of design On-time payment</td>
<td>Moderate – no single major customer</td>
<td>Middle-scale wholesaler, primarily Asian owner-managed</td>
<td>Embedded</td>
<td>Exchange by contract</td>
</tr>
<tr>
<td>Fabrics – retailers</td>
<td>Middle volume orders Frequent Standard products</td>
<td>Market acceptance and quality of the product Continuity/availability of design</td>
<td>Moderate – no single major customer</td>
<td>Middle and small-scale retail stores, primarily Asian owner-managed</td>
<td>Weak embedded</td>
<td>Exchange by contract</td>
</tr>
<tr>
<td>Fabrics – tailors</td>
<td>Small volume orders Frequent Irregular Standard products</td>
<td>Market acceptance and quality of the product Small size of transaction</td>
<td>Moderate – no single major customer</td>
<td>Micro-scale tailors, primarily African owner-managed-operated</td>
<td>Asymmetrical relational</td>
<td></td>
</tr>
<tr>
<td>Fabrics – manufacturers</td>
<td>Middle volume orders Irregular Standard products</td>
<td>Demonstrating quality and design</td>
<td>Low – few customers</td>
<td>Middle-scale garment manufacturers – primarily Asian owner-managed</td>
<td>Embedded</td>
<td>Exchange by contract</td>
</tr>
</tbody>
</table>
The primary end customer Tykor is currently aiming to reach is the micro-scale tailor, for its fabric products. A diversified sales strategy is continued not simply for historical reasons (the group started in retailing), but because Ajay believes it is essential for the group keep in touch with the end users of their products. “People don’t realise that keeping a small customer happy keeps you happy. The big companies are not keeping them happy”. Part of Tykor’s current success in the suiting market against strong competition from large-scale mills is attributed to this understanding of the customer: “I’ve had first hand experience in the shop. Its about working out the way people think”.

The key problem in selling according to Tykor is demonstrating that the products are marketable. Wholesalers and retailers will not want to buy something which will not sell readily. The key facets of the product are design and quality. Both of these are difficult to measure ex ante; the former is ultimately only proven in the marketplace.

Another key issue which starts with the end-users of the fabric, but cascades through the various intermediaries relates to stock holding. None of these predominantly middle and micro-scale customers is able to hold large stocks of fabric. Simultaneously however where a particular design is successful, it is essential that adequate supplies can be obtained. Ajay believes that maintaining the availability of the different designs is the key to this particular market, one which is overlooked by the large-scale mills. Tykor is able to meet this need, without simultaneously involving itself in heavy stockholding, as a result of the closeness of its relationship with its lead supplier which enables orders to be turned around within three weeks.

Once more there is no use of formal contract, or reliance on the formal institutional environment in tackling demand exchange problems. The solution to the exchange problem presented varies somewhat with the customer type. An embedded mode of exchange is evident with the middle-scale enterprises with which
Tykor deals. Most of these enterprises are owner-managed by members of the Asian community. Ajay regards his reputation and those with whom he deal within the community as vital. “There are those who don’t keep their word. We have to control these – it’s all strictly cash terms with these”.

The mode of exchange with the multitude of micro-scale enterprises with which Tykor directly and indirectly deals is rather weaker, corresponding to an asymmetrical relational form. Tykor has worked hard on establishing a strong reputation in the market: “we supply what you say”. Ajay believes that the group is now well known and respected amongst their target customer group, such that these customers trust the company to meet their requirements.

Instability in the macro-economic environment is creating difficulties for Tykor. Ajay’s reaction to a loss in value of the Kenya shilling was less a concern over the loss per se, but a concern over the loss of stability which impacts on business confidence and demand: “Stability is the key. Otherwise it will cause panic. People [investors] will move out [of Kenya] straight away”. However Tykor feels an immediate impact due to its dependency on imported raw materials.

The fall in demand for Tykor’s garment products are blamed firmly on unfair competition from smuggled imports. “We need the people abiding by the law”. Ajay feels that it is impossible to compete against duty free goods. He also cites other problems relating to the regulatory (formal institutional) environment: “People [government officials] harass you when you are doing things right. Take VAT. We pay millions of shillings in a year. If you make a mistake of just KShs 5,000 and they come looking for chāi [Swahili: literally tea, idiomatic for a bribe]. We need stability”. Ajay relates see this as part of a wider problem of instability in the government which he believes undermines the manufacturing sector. The company had contemplated export but decided that the “bureaucrats were impossible. They should be
assisting us in the work not hindering it. Instead a lot of Ugandans come and do the exports themselves.”

**D.5.3 Labour**

The labour tasks within Tykor appear to be divided into three broad types: managerial, supervisory/technical and shop-floor (table D-21).

The managerial posts are filled by members of the Shah family, the two supervisory/technical roles by Asians and the shop-floor workers are all African. The tasks implied by these three levels are in descending order of difficulty to specify and monitor, together with decreasing opportunities for malfeasance. Family members, who are also owners of the business, occupy all the positions which are regarded as sensitive and directly involve contact with cash.

The factory manager — essentially a supervisory role — and the accountant are both Kenyans of Asian origin. Ajay is clear that this is a deliberate choice and one which is motivated not by questions of technical capability but trust. Referring to the factory manager, he says: “I have to have an Asian. People [Africans] are very prone to take things away. They will take things at night.” He claims that there is a difference in values between African and Asian employees, which enables him to trust the latter, even though they do not belong to the same Oshwal community. “Asians won’t take other people’s things”. Ajay rationalises this in terms of the needs of African families and the generally high cost of living: “Even when you increase [the salary], the African’s needs expand faster.” The current factory manager was an Indian whom Ajay recruited through an agent. This individual left the company abruptly, attempting to emigrate to the United States. Although this was perceived as a breaking of trust with Tykor, Ajay remains adamant that only Asian employees can be trusted in these roles.
## Table D-20: Tykor labour tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing director</td>
<td>Continuous</td>
<td>Critical</td>
<td>Owner-manager</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Highly variable, complex task set</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Wholesaler managers</td>
<td>Continuous</td>
<td>Very high</td>
<td>Owner-managers, brother and cousin of MD</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Variable, complex task set</td>
<td></td>
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</tr>
<tr>
<td>Shop manager</td>
<td>Continuous</td>
<td>Very high</td>
<td>Owner-manager, brother of MD</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Variable, complex task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Factory manager</td>
<td>Continuous</td>
<td>Opportunity for malfeasance Monitoring</td>
<td>Moderate</td>
<td>Kenyan Asian employee, trained on the job by previous factory manager</td>
<td>Entrepreneurial firm</td>
<td>Bureaucratic firm</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>Constrained initiative</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountant</td>
<td>Continuous</td>
<td>Opportunity for malfeasance</td>
<td>Low</td>
<td>Kenyan Asian employee</td>
<td>Entrepreneurial firm</td>
<td>Bureaucratic firm</td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Cutters</td>
<td>Continuous</td>
<td>Tasks difficult to specify precisely</td>
<td>Moderate</td>
<td>Kenyan African employee</td>
<td>Bureaucratic firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Variable task set</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moderate degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>Garment industry specific tact skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
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</tr>
<tr>
<td>Machinists</td>
<td>Continuous</td>
<td>Productivity and quality of work critical to final production costs</td>
<td>Low – manufacturing operation in strong decline</td>
<td>Kenyan African employee</td>
<td>Bureaucratic firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definable task set</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Retail and wholesale assistants</td>
<td>Continuous</td>
<td>Minor</td>
<td>Low – unskilled</td>
<td>Kenyan African employees</td>
<td>Entrepreneurial firm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low degree of uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unskilled</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
In common with the other cases, Tykor is required to conform to formal agreements for the shop-floor workers. However for all other roles, there is no reliance on formal employment contracts. Monitoring of workers is relatively straightforward since the factory does not currently operate on a production line basis. If a production item fails to meet the quality standard, it is simply returned to the production worker for re-working. Ajay monitors the work of the factory and the factory manager directly by random visits to the shop-floor. There is no standard reporting structure.

D.5.4 Technology
The factory was started thirty years ago using second-hand machinery procured locally by Ajay's father. Technologically, the manufacturing process is relatively simple, with no modern machinery employed. The majority of the plant consists of general purpose industrial sewing machines. New machines have been bought imported in the past directly from foreign manufacturers. With the sustained slump in demand for the garments manufactured by Tykor, there have been no fresh investments in equipment for a considerable period. There are also no plans for any new investment.

Unsurprisingly given the relatively simple level of technology employed, there are no formal arrangements with foreign manufacturers or agents for the maintenance of machinery. Many spare parts can be obtained locally through importers/traders and maintenance is carried out by a mechanic in the factory. None of the workforce has any formal technical training in the industry, including Ajay and the factory manager. Ajay himself learnt the garment business on the job when we first joined the family firm. (His formal training was in commerce in India).

D.5.5 Finance
The Tykor group is primarily financed through family held equity. Much of this is tied up in the land and buildings, which located in central Nairobi represent a significant investment. The capital in plant and machinery is relatively limited given the sustained downturn in manufacturing. A very major working capital has been
### Table D-21: Tykor finance tasks

<table>
<thead>
<tr>
<th>Sub-task</th>
<th>Characteristics of transaction</th>
<th>Exchange problems</th>
<th>Significance</th>
<th>Exchange partner</th>
<th>Mode of exchange used</th>
<th>Modes avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>Long-term Uncertain</td>
<td>Uncertainty of return on investment</td>
<td>Critical</td>
<td>Immediate family</td>
<td>Embedded</td>
<td>Long term contracting</td>
</tr>
<tr>
<td>Working capital debt</td>
<td>Short-term Uncertain Frequent</td>
<td>Uncertainty of repayment</td>
<td>High</td>
<td>Local large-scale Kenyan Asian (Oshwal community) owned and managed bank</td>
<td>Embedded (nominal exchange by contract)</td>
<td>Long term contracting</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Very large scale subsidiary of international bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Subsidiary of Indian based international bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplier credit</td>
<td>Short-term Uncertain Frequent</td>
<td>Uncertainty of repayment Terms</td>
<td>High - interest-free credit</td>
<td>Large-scale Kenyan Asian owner-managed</td>
<td>Embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-task</td>
<td>Characteristics of transaction</td>
<td>Exchange problems</td>
<td>Significance</td>
<td>Exchange partner</td>
<td>Mode of exchange used</td>
<td>Modes avoided</td>
</tr>
<tr>
<td>-------------</td>
<td>-------------------------------</td>
<td>----------------------------</td>
<td>---------------------------</td>
<td>------------------</td>
<td>-----------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Customer credit</td>
<td>Short-term</td>
<td>Uncertainty of repayment</td>
<td>High – essential to sales</td>
<td>Middle-scale</td>
<td>Embedded</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Uncertain</td>
<td>Terms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Frequent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Linked to demand</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
generated by the suiting fabric business. The group meets this requirement from bank borrowing and supplier credit (table D-23).

Tykor borrows from two banks. One of these is the very large scale subsidiary of a multi-national bank, the other a small local bank owned by members of the Oshwal community. The Shah family are shareholders of this latter bank. This bank was established recently by the Oshwal community to provide support to the community, especially to growing small-scale (essentially middle-scale) enterprises which are unable to raise finance from the traditional large-scale banks which dominate the finance sector in Kenya. Shareholding is spread throughout the community which Ajay believes ensures that it is run in an appropriate way – for the benefit of the community. The shares may only be sold within the Oshwal community. Tykor’s two banks are regarded as complementary: the interest rate from the very large bank is slightly cheaper, the local bank is far more flexible. Ajay feels that the community bank is the one he can rely on: “In real hard times they will back us”. However simultaneously he also does not wish to exert too much pressure on the community’s bank while Tykor is able to access finance from the larger banks. The strength of the relationship is such that he feels he could push them too far.

Borrowing from the multi-national bank subsidiary is strongly rule driven. All loans must be fully collateralised, formal business plans presented and so forth: “it takes a long time - you have to go through all the processes”. This corresponds to the long-term contracting mode of exchange. It can be strongly contrasted to the embedded mode employed with the community based bank: “It’s not strictly by the figures – it is by the family’s word. In our [Oshwal] community, our word counts. The family has a reputation – we are known for making sure that things are done properly”. It was borrowing from this and another older Asian community owned bank which enabled the new suiting business to be built so rapidly.
Tykor had previously banked with the local subsidiary of an Indian based multi-national bank. However Ajay found that this organisation was becoming increasingly inflexible: “With the big banks you have to get everything tied up. They wanted a ridiculous security cover. With the big banks, the relationship counts for nothing.” Tykor has now stopped dealing with this organisation, believing that the difficulty of doing business with it were too great. With the current multi-national bank used, Ajay cites a number of problems which have prevented the formation of a strong, flexible relationship. Most common is the attempt by the bank to “dictate terms”. Ajay has strongly resisted this pressure, with some success.

Supplier credit is important and derives from an embedded mode of exchange, as described earlier (§7.6.1). Interestingly, Tykor is at pains to ensure that securing favourable credit terms from the major supplier does not cause this company difficulties. When the supplier manufacturer has a particular liquidity requirement, Tykor will pay early: “This is what an understanding means”. Much of the credit ultimately derives from the Indian based yarn supplier, with whom the two Kenyan companies have built a reasonable degree of trust. Up to 4 months credit is provided although interest is levied. However the relatively low interest rates prevalent in India still make this an attractive source of finance.

The initial source of capital for the family businesses preceding the current Tykor operations derived primarily from retained earnings. Little external finance was used, which Ajay believes explains the relatively slow growth in the early stages. The manufacturing was started thirty years ago on a relatively modest scale, with some financial participation from partners within the Oshwal community. With a good reputation in trading, it was not difficult to find partners. These partners have subsequently sold their stake to the Shah family members.
Table D-22: Summary of evidence for specific hypotheses (Tykor)

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Reliance on formal contract/environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1.2 Efficiency of formal contract/environment</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1.3 Difference in use of formal, large and middle</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>1.4 Stability of formal environment</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1.5 Perception of compatibility of formal environment</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2.1 Importance of business relations</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.2 Difficulties in forming business relations with large</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.3 Instability in economic operating environment</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2.4 Governance differences large and middle</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.5 Organisational rules differences large and middle</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.6 Organisational culture differences large and middle</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.1 Differentiation on basis of ethnicity</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.1.1 ( \Rightarrow ) Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.2 Use of ethnic based structures in exchange</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓✓</td>
<td>-</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.2.1 ( \Rightarrow ) Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.3 Use of family relationships in exchange</td>
<td>✓✓</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.3.1 ( \Rightarrow ) Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.4 Difficulties between ethnic groups</td>
<td>-</td>
<td>-</td>
<td>✓✓</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3.4.1 ( \Rightarrow ) Differences between African and Asian use</td>
<td>-</td>
<td>-</td>
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</tr>
</tbody>
</table>

✓✓ strong support for alternate hypothesis  ✓ weak support for alternate  ? ambiguous between null/alternate  ** strong support for null hypothesis  * weak support for null
D.6 Cross-case analysis

D.6.1 Supply

Across all the enterprises it was clear that a formal approach was never used to tackle exchange problems in supply. All regarded the formation of relationships with customers as important in tackling the potential problems, which were never insignificant. The essential reason for avoiding the formal modes in favour of the informal is strongly implied in the descriptions offered in each case of how the enterprises tackled exchange. Formal modes, relying on contracts are simply not seen as ways in which problems could be mitigated – reducing transactional costs and uncertainty. Even when Boncord's ability to trade with its suppliers was compromised, there was no move on either side to substitute a legal contract for the previous relational form of contracting.

Although a large number of other factors influence choice of supplier, it is notable that very large scale suppliers appear to have been consistently avoided. Specific problems were raised in a number of instances which were related to the way in which the largest companies approached business. There is the strong suggestion that this derives from fundamental discontinuities between large and middle-scale, from the particular governance mechanisms, through to the organisational rules and deriving essentially from the organisational culture. The comment from Ancom is most compelling: “if you turn up at ICI who would look at you?”. Ancom's solution was to use an intermediary enterprise of a scale bridging this perceived gulf.

The differences faced by African and Asian owned enterprises is very clear in relation to supply. This is most obviously manifest in the comparative terms of trade. Boncord complained that it thought it received worse terms of trade than Asian owned enterprises in the sector. Comparing the terms received by the two African and Asian cases corroborated this claim. The Asians received a credit period at least twice as long as that received by the Africans, and with significantly greater ease. Ancom, Boncord and Tykor have one supplier in common. Tykor, Asian owner-managed, receives far better credit terms from this Asian owner-managed enterprise than either of the two African owned businesses. Whether the Asian enterprises
actually receive better prices from the Asian owned suppliers than the African enterprises, as claimed, is rather more difficult to establish. However it is clear that the process by which prices were established appeared far more problematic in the African cases.  

More subtle is the question of whether there is an important difference in the potential depth of relations formed in particular instances. It is clear from the cases that all the enterprises were involved in a large number of exchange activities for which effective performance was important. However there is also suggestion that a (necessarily) few, stronger or deeper ties could offer significant strategic benefits to the enterprise. Here the evidence is more ambiguous. Both Ancom (African owner-managed) and Tykor (Asian owner-managed) were involved in collaborative work with their Asian owner-managed supplier. Although the Tykor collaboration is obviously closer than the Ancom, it is important not to draw too much from the evidence; other factors are clearly highly relevant in determining the opportunity presented by collaboration.

**D.6.2 Demand**

Many of the findings relating to supply were replicated in the demand exchange activities. In general there is little reliance on formal approaches to exchange, there are suggestions of discontinuities between large and middle-scale enterprise and ethnicity plays a similar role as before.

Interestingly there is some suggestion that the formal institutional environment could be a positive factor in facilitating exchange. Effective state maintained standards could provide a low cost means by which consumers can determine the quality of product. All the four cases target a middle market for which product quality is vital. The potential role of formal institutions is not simply to confirm the quality of the goods offered by the enterprise, but to exclude sub-standard, low priced goods from the market. A common complaint was the failure of the authorities to police the (legally proscribed) misrepresentation of imported second hand goods as new.
D.6.3 Labour

The process by which labour transactions were achieved was again largely consistent across the cases, but with a strong ethnic variation between the African and Asian enterprises in certain respects. Interestingly however the formal institutional environment was seen far more positively here than in relation to other exchange activities.

The type of garment manufacturing activity studied lends itself to mass production techniques at a relatively small scale as compared with many industries. For three of the four cases – middle-scale in most other relevant respects – production lines were used with strong division of labour. The exchange problem implied by labour in this situation appeared more readily solved by a more formal approach than associated with the middle-scale type from theory. Here the formal institutional environment was seen as playing a positive role. Enforcement of the institutions appears, admittedly somewhat unusually, effective. There is a clear implication that appropriate formal institutions can be seen as compatible with the needs of middle-scale enterprise.

D.6.4 Technology

Evidence gathered regarding the process by which technology was acquired was less clear than that for the other exchange activities studied. To a significant degree this merely reflects the fact that much technology acquisition tends to occur at discrete time intervals whereas enterprises are involved in the other exchange activities more or less continuously. During a sustained downturn in the garment industry, there was relatively little investment being made in new embodied technology.

The most significant finding from the study of the technology acquisition in the enterprises was the importance of relevant sources of information. Here the Asian businesses appeared to face an environment in which key information could be obtained relatively easily. In one Asian owner-managed company studied (not presented here), the owner-manager described how despite a total lack of knowledge, formal or informal, of the industry (having formally trained as a computer scientist), he was able to start-up a middle-scale garment manufacturing enterprise. His father,
who was involved in the industry, methodically arranged contacts with local firms in the industry, provided the equipment for his first line and seconded a highly experienced supervisor and workers to the enterprise. Although floundering at the outset, this owner-managed was rapidly able to acquire the necessary expertise to operate in the industry successfully.

It is notable that both the African cases were somewhat unusually placed in being able to acquire the basic technological know-how to run their enterprises. In the case of Ancom, although Janet had a formal training in the industry, it was her work as a garment buyer from which she was able to acquire key practical understanding of the industry. For Boncord, a chance friendship combined with significant support from a development project was instrumental in building technical capability within the company. More positively, there are indication that now established in the industry, despite perceived barriers, both of the these African owner-managed firms have established relationships with other Asian manufacturers from which important process related information and advice is derived.

D.6.5 Finance

Again there was a strong consistency in the pattern of the exchange process across the cases. The difficulties in middle-scale organisations transacting with large-scale was most clearly manifested here. This is unsurprising since the finance sector in Kenya is highly concentrated with the leading four banks controlling 54% of the lending market (CBK 1998c). There is strong evidence of discontinuity between middle-scale enterprise and very large-scale banks. Such a discontinuity seems to derive clearly from organisational form – the essential way in which the enterprise as an organisation operates, from governance mechanisms employed in transacting, through internal rules to culture. Each entrepreneur's primary complaint in working with large-scale banks was the inability to deal directly with the decision maker and the sense of being subject to remote non-negotiable rules. In middle-scale enterprises the rules are made up as the entrepreneur goes along; he or she is accustomed to making decisions continually and without reference to anyone or anything else.
Once again the Asian enterprise faces a radically more favourable environment than the African enterprise. Both Asian cases had access to finance from Asian owned, relatively small banks, obtained credit from suppliers more readily and had obtained informal finance from the community at some point in the company's history. The *modus operandi* of the Asian banks is far closer to that of the enterprises themselves. Not only can credit facilities be agreed on the basis of a simple telephone call and a promise, but the service received appears significantly better from the perspective of the client.

Ethnicity is clearly vital here. The trust which enables this hugely lower cost form of transacting is explicitly derived from membership of the Asian community. It is important to note the rationality of the transacting here. The Asian banks, suppliers and informal financiers are able to finance at this low (transaction) cost due to the ability to reduce the residual transactional uncertainty using informal institutions.
### Table D-23: Summary of cross-case analysis for specific hypotheses

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Supply</th>
<th>Demand</th>
<th>Labour</th>
<th>Technology</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Reliance on formal contract/environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>1.2 Efficiency of formal contract/environment</td>
<td>✓✓</td>
<td>-</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>1.3 Difference in use of formal, large and middle</td>
<td>✓</td>
<td>?</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>1.4 Stability of formal environment</td>
<td>✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>1.5 Perception of compatibility of formal environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✗</td>
<td>✓</td>
<td>✓ ✓</td>
</tr>
<tr>
<td>2.1 Importance of business relations</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.2 Difficulties in forming business relations with large</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.3 Instability in economic operating environment</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.4 Governance differences large and middle</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>2.5 Organisational rules differences large and middle</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
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</tr>
<tr>
<td>2.6 Organisational culture differences large and middle</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.1 Differentiation on basis of ethnicity</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.1.1 ➔ Differences between African and Asian use</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.2 Use of ethnic based structures in exchange</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.3 Use of family relationships in exchange</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.3.1 ➔ Differences between African and Asian use</td>
<td>✓✓</td>
<td>✓✓</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
<tr>
<td>3.4 Difficulties between ethnic groups</td>
<td>✓</td>
<td>?</td>
<td>✓</td>
<td>✓</td>
<td>✓✓</td>
</tr>
</tbody>
</table>

- ✓✓ strong support for alternate hypothesis
- ✓ weak support for alternate
- ? ambiguous between null/alternate
- ✗ strong support for null hypothesis
- ✓ weak support for null
Notes

1 This draws on the approach put forward by Boomgard et al (1992).

2 Source: Field notes

3 Source: Data was drawn primarily from the Register of Industry as at 1996 (courtesy of Ministry of Commerce and Industry) and GEMINI/K-Rep 1993 National Baseline Survey of Micro and Small Enterprise database (courtesy of K-Rep). The results were compared with those from the Central Bureau of Statistics published figures (Republic of Kenya, 1996) to ensure there were no major inconsistencies (beyond those implied by the scope of the different sources). There remains some concern over under-reporting of the middle-scale businesses from these data sources. The GEMINI/K-Rep study identified very few middle-scale enterprises, for methodological reasons. Registration of enterprises, though a statutory requirement, is not universal. Smaller formal enterprises are most likely (of the population addressed) to avoid registration; larger-scale by simple virtue of their prominence are less likely to attempt or succeed in avoiding official detection. King (1996) reported cases of middle-scale enterprises, graduating from the micro-scale, which still remained invisible to officialdom.

4 Source: Register of industries

5 Source for all data is field notes unless otherwise stated.

6 Note that all names have been changed in order to protect the identity of all firms, their directors and employees.

7 Source: Register of industries and field notes.

8 The construction industry has been particularly badly hit by payment problems with the government. A number of large and middle-scale building contractors faced serious financial problems, some going into liquidation, when payments were not forthcoming following contract completion.

9 Source: CBK (1995)

10 Indeed Janet was staggered to discover that the bank required a formal letter of consent from her husband for the project before proceeding. Had she not been married she would have had to obtain the consent from her father, which probably would not have been forthcoming given that he has not experience of business and has a strong antipathy towards any form of debt.

11 Source: CBK (1995)

12 Source: CBK (1997)

13 There was no direct evidence of discrimination against suppliers from other ethnic groups and there are few non-Oshwal or Asian owner-managed suppliers in this business in Kenya. However it was clear that the potential exchange problems were mitigated the common socio-cultural identity. Thus there is support for alternate hypotheses 3.1 and 3.2.

14 Source: CBK (1997)

15 Source: CBK (1998)


17 Source: CBK (1997)

18 The finding that actually determining prices was regarded as potentially problematic directly undermines one of the central simplifying assumptions of neo-classical theory – that markets are able to determine prices costlessly.

19 Ironically this enforcement succeeds despite the implication of some corruption in the state agency involved. The penalty for breaking the rules was likely to be a bribe to the appropriate officer rather...
than a fine. However the effect is the same: bribe or fine can both be readily avoided by simply keeping to the rules – which are broadly judged as fair and helpful.
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