A New Perspective on Small Firms in Kenya
PARTNERS

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Financial Access Initiative NYU Wagner

MFO microfinance opportunities

L-IFT Low-Income Financial Transformation
OVERVIEW OF SMALL FIRM DIARIES

FINANCIAL DIARIES METHODOLOGY
Weekly cash flow data for a year combined with extensive qualitative and quantitative surveys

FOCUS ON 3 SECTORS WITH GROWTH POTENTIAL
Light Manufacturing, Agri-Processing, Services

SAMPLE GLOBAL: 7 countries

SMALL FIRMS: 1–20 non-family employees

FOCUS ON LOW-INCOME COMMUNITIES
~150 FIRMS PER COUNTRY

~30% WOMEN-LED FIRMS
FINANCIAL DIARIES METHODOLOGY

Basic Elements

- **High frequency visits** (weekly) to small firms over 12 months.
- **Quantitative cash flow** data
- **Qualitative interviews** about choices and decision making with firm owners, employees, and suppliers.
- Allows us to **understand the complexity and volatility** being faced by small firms.
SMALL FIRM DIARIES: A GLOBAL STUDY

35,984 HOURS OF INTERVIEWS

- COLOMBIA: 100 FIRMS
- NIGERIA: 150 FIRMS
- KENYA: 155 FIRMS
- ETHIOPIA: 122 FIRMS
- UGANDA: 619 FIRMS
- INDONESIA: 165 FIRMS
- FIJI: 50 FIRMS
KENYA

FIRM OWNERSHIP:

- Male: 33%
- Female: 8%
- Both: 59%

155 Small Firms
03 Research Sites

KISUMU

27
18
9

NAIROBI

31
18
1

KWALE
OVERVIEW OF SMALL FIRM DIARIES

- Focus on firms that are providing jobs in low-income communities, rather than self-employment.
- Focus on firms in industries that can increase productivity and grow to employ many more people.
- Ensure at least 30% of firms are women-led to uncover any gender-specific issues and opportunities.
Most existing research focuses on firms that are smaller or larger than the firms that SFD studies.

### WHO ARE WE STUDYING?

<table>
<thead>
<tr>
<th>MICROENTERPRISE</th>
<th>SMALL FIRMS</th>
<th>MEDIUM FIRMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household enterprises</td>
<td>Firms that have non-family employees but not grown to include professional managers</td>
<td>Firms that have professional managers (e.g. employees whose only job is managing other employees)</td>
</tr>
<tr>
<td>0 non-family employees</td>
<td>1–20 non-family employees</td>
<td>20–100 employees</td>
</tr>
<tr>
<td>Informal</td>
<td>Mix of Formal and Informal</td>
<td>Formal</td>
</tr>
<tr>
<td>Informal financing and/or microcredit</td>
<td>Mix of formal and informal financing arrangements (key question of the study)</td>
<td>Largely have access to formal finance, though depends on context</td>
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</table>
SECTORS AND SUBSECTORS

AGRICULTURAL PROCESSING 26%
1. Meat and fish preservation (58%)
2. Food preparation (28%)
3. Agricultural production (10%)
4. Other (4%)
40 firms

LIGHT MANUFACTURING 54%
1. Carpentry, construction, handicrafts (38%)
2. Garment production/sewing (26%)
3. Leather goods production (21%)
4. Metal working (15%)
84 firms

SERVICES 20%
1. Printing, repair services, hardware (35%)
2. Car, motorcycle, bike repair (23%)
3. Wholesale selling (23%)
4. Private primary/secondary schools (19%)
31 firms
The median firm showed essentially 0 revenue growth during the study

- Firms were between 50,000KES and 700,000KES in average monthly revenue
- Most firms were on the low side of the distribution: less than 100,000KES
- The median firm showed essentially 0 revenue growth during the study
- About 50 firms did grow revenue but most of these grew very little
MEDIAN MONTHLY REVENUES, EXPENSES, AND OPERATING MARGINS

Revenue  Expense  Operating Margin

X  Mean  Median

KES

-100,000 - 0  100,000  200,000  300,000  400,000  500,000  600,000
<table>
<thead>
<tr>
<th>Bucket</th>
<th>Median Monthly Revenue, KES</th>
<th>Count of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Less than 100,000</td>
<td>82</td>
</tr>
<tr>
<td>Medium</td>
<td>100,000 to 300,000</td>
<td>38</td>
</tr>
<tr>
<td>High</td>
<td>300,000 to 700,000</td>
<td>20</td>
</tr>
<tr>
<td>Outlier</td>
<td>700,000 or greater</td>
<td>15</td>
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</table>
ACCOUNTS REPORTED AND USED FOR BUSINESS PURPOSES

- Accounts reported
- Used at least once
- Used for 25% or more of transaction value

Bank Account
Cash Box
Mobile Wallet

0%  20%  40%  60%  80%  100%
DISTRIBUTION OF FIRMS BY MONTHLY REVENUE GROWTH

*Monthly revenue growth is defined by the value of the slope of the best linear fit for monthly revenue.*
## 4 Key Takeaways

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<tr>
<td><strong>1</strong></td>
<td><strong>2</strong></td>
<td><strong>3</strong></td>
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<tr>
<td>An Invisible Middle</td>
<td>Stability Entrepreneurs</td>
<td>Missing Ingredient: Working Capital</td>
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THE INVISIBLE MIDDLE
From Missing Middle to Invisible Middle

Development policy from the 50’s to the 70’s focused on large, subsidized, “national champion” firms

- These firms were supposed to deliver “trickle down” benefits to the entire country
- It slowly became clear this was not working and poor communities were not benefitting from any gains

In 70’s and 80’s focus shifted to explicit focus on poverty and to “micro” firms

- “Microcredit Revolution” promised lots of growing businesses and people escaping poverty
- It slowly became clear these microfirms were not growing

In the 90’s idea of “missing middle” came to fore

- Claim that there weren’t firms between micro and large
- It slowly became clear that the middle wasn’t missing, it just wasn’t counted well—it was invisible

The small firms have not been well understood and that is why we call them the “invisible middle”
SMALL FIRMS: THE INVISIBLE MIDDLE

- They are not at the base of the pyramid, nor are they big enough or fully formalized so don’t appear in the statistics
- They are banked, but still operate mainly in cash
- They are not served by traditional “micro”-focused finance
- They are dynamic—but they are not growing and they are not "escaping"
- They are resilient and long-lived
- They provide a lot of jobs, but these jobs are volatile and fleeting
- They have a different group of employees—their employees are not growing out of micro or shifting down from larger firms
DO FIRMS GROW?

- While most firms did not grow in terms of revenue or employees, they are not stagnant.
- Firms face a great deal of volatility in revenue, and without tools to manage this volatility this turns into high volatility of expenses and especially of margins.
- Firms are expending a lot of effort riding up and down “waves” rather than moving forward.
SEEKING STABILITY
The average CV of revenue for Kenyan firms is .44, meaning this firm has more stable revenue than average.
STABILITY ENTREPRENEURS: VOLATILE REVENUE

- Revenue
- Expense
- Operating Margin

Coefficient of variation

[Box plot showing volatility in Revenue, Expense, and Operating Margin]
• Policy and program has long focused on the idea of the high-growth entrepreneur, starting small and growing very large (and wealthy)

• Considerable efforts by funders, governments and investors to find the “gung-ho”, “gazelle”, “rocketship” entrepreneurs (and avoid the “reluctant” or “survivor” entrepreneurs)

• Common idea is that only some firms want to grow

• We see that binary doesn’t capture the largest group: firms that want growth AND stability, not rapid, rocketship growth
The largest group of firms aspires to both growth and stability.

**STABILITY AND GROWTH ARE NOT MUTUALLY EXCLUSIVE**

What is your vision for your business over the next year?

- 11% Gaining Stability Only
- 61% Both “Stability Entrepreneurs”
- 25% Growing in Profit Only
“Growth is stability”

“Growth means I’ll be here in this market 50 years from now”

- Aspirations for Growth + Stability is much larger than Growth or Stability
- These firms want to grow...but step by step
- They face a great deal of risk, and are unwilling to take on much more
- They are not stagnant--but volatility means they cannot consistently move forward
Male owned leather shoe making business in Kwale -
“For me, growth, it doesn't matter, but I only wish I could do it for the next 50 years. It doesn’t matter how you are going to grow, but the issue of day in and day out, today, next year, 50 years to come, you are still doing the same-same thing, the only thing is, you’ve improved your product.”

“I do believe we have guys the last like 20 and 30 years they are still in the industry, and the product is still in the market. I only wish that I’ll have a product in the market for the next 50 years, here. There are so many companies that are around for the last 60 to 100 years and they are still making the same thing.”
LIQUIDITY IS THE PRIORITY

- Firms are actively saving to manage risk, keeping liquidity aside rather than using it for current opportunities.
- Firms are reluctant to take loans because of volatile revenues vs. fixed payments.
- What they do want loans for are almost all related to working capital, NOT assets or capital investments.
- Supply chain credit is underused.
LIQUIDITY IS THE PRIORITY
HOW DO FIRMS MANAGE RISK?

- Reserving funds
- Risk-averse strategies
- Diversify
- Avoid taking loans
- Household members
- Insurance
- Invest little
- Mutual support system
- Other
HOW DO FIRMS MANAGE RISK?

- Men
- Women
- Mixed

- I never need a loan
- I rarely need a loan
- I occasionally need a loan
- I constantly need loans
- I often need a loan

- Y-axis: Number of responses
- X-axis: Frequency of need for a loan
ATTITUDE TO CREDIT

- I never need a loan: 19%
- I rarely need a loan: 36%
- I occasionally need a loan: 31%
- I often need a loan: 10%
- I constantly need loans: 3%
FOR WHAT DO YOU USE CREDIT?

Do you sometimes use or want to use loans to address the following issues?

- Expand stock: 43%
- Take advantage of an opportunity: 32%
- Make an investment: 27%
- Buy inputs in advance: 26%
- None: 19%
- Address cash-flow issues: 11%
- Give credit to customers: 3%
- Other: 3%
- Hire more staff: 1%
SUPPLY CHAIN FINANCE

Does your firm use 'supply chain finance'?
- No
- Yes

Yes: 47%

What type of supply chain finance do you use?
- Giving credit
- Getting credit

- Agri-Processing
- Light Manufacturing
- Services
MISSING INGREDIENT: WORKING CAPITAL

- Given volatility and assets owned, firms exhibit a greater need for working capital than for fixed asset investment.
- Firms need more tools to manage risk and smooth spikes and dips of revenue, seize opportunities.
- Most large purchases the firms make are raw materials, not fixed assets.
- Building on supply chain finance is a promising avenue for extending the kind of credit that firms need.
FRAGILE EMPLOYMENT, VULNERABLE EMPLOYEES
SMALL FIRM EMPLOYEES

- Volatility is passed on to employees
- Jobs are unstable
- Employees rotate in similar businesses in the same industry, with the same unfavorable conditions
- ⅓ of employees lacked money to meet their basic or food needs in the last month
PAYMENTS (KES) PER EMPLOYEE AT AN AGRI-PROCESSING FIRM IN KISUMU

- Employee 1
- Employee 2
- Employee 3
- Employee 4
MEDIAN MONTHLY REVENUES, EXPENSES, AND OPERATING MARGINS
<table>
<thead>
<tr>
<th>Number of months paid to a single employee</th>
<th>Number of employees</th>
<th>Percent of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 month</td>
<td>20</td>
<td>5</td>
</tr>
<tr>
<td>2 to 4 months</td>
<td>91</td>
<td>20</td>
</tr>
<tr>
<td>5 to 7 months</td>
<td>115</td>
<td>26</td>
</tr>
<tr>
<td>8 to 10 months</td>
<td>218</td>
<td>49</td>
</tr>
</tbody>
</table>
VULNERABLE EMPLOYEES: EMPLOYEE WELFARE INDICATORS

Does your household ever run short of money for food or other necessary items?
Yes: 65%

In the last week were children in your household not eating enough because there wasn’t enough money for food?
Yes: 26%
VULNERABLE EMPLOYEES: OTHER INCOME SOURCES

None | 69%
Self-employment | 17%
Informal work | 7%
Other | 5%
Sales of livestock | 4%
Community in Kenya | 3%
Formal employment | 1%
Interest on savings | 1%

*No reported income from "community outside of Kenya," "subletting," or "government programs or jobs"
FRAGILE JOBS, VULNERABLE WORKERS

- Small firms are an important source of employment and income in low-income communities.
- But the jobs the firms can provide are volatile and fragile, because the firms cannot manage the volatility they face.
- High employee turnover is likely a large drag on the firms productivity and growth.
- Workers in these firms are mostly drawn from a distinct labor pool that works in small firms exclusively.
RECOMMENDATIONS

1. More Attention
2. Changing the Focus of Programs
3. Liquidity and Working Capital Financial Tools
4. Better Jobs
More and Sustained Attention

RECOMMENDATIONS

Small Firms are a distinct group

a. They are not only understudied, they feel understudied and underserved by products, programs and policies.
b. Attrition in the study, despite its intensity, was very, very low because the firms wanted to tell their story.

While we have a year of data, questions remain

c. Are there firms that grow quickly out of the “small firm” domain?
d. Which firms, if any, are achieving their growth and stability goals?
e. How is use of financial services evolving?
f. How does firm ownership affect longer-term outcomes for owner households?
Changing Focus

RECOMMENDATIONS

Changing the focus of programs

a. Most interventions are still built on the myth of “picking winners” and focusing on “high-growth” entrepreneurs

b. Training programs are common but probably are teaching the wrong skills

c. Need to develop programs focused on helping entrepreneurs gain stability, cope with volatility, manage liquidity
Liquidity and working capital financial tools

a. Working capital credit is very tough for banks to provide

b. Hard to assess risk and profitability

c. New alliances are needed to overcome these challenges (FinTech+Banks+Suppliers+Government)

d. New product innovation will likely be needed
Better Jobs

Aid to small firms is not enough—benefits of stability may not be passed on to workers

a. Help firms realize benefits of worker stability

b. Develop social support programs targeted to small firm employees directly
Thank you