WHY SMALL FIRMS STAY SMALL
Risk and Growth in Nairobi's Small-Scale manufacturing

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ABSTRACT

Despite abundant literature on the social and economic benefits of encouraging tiny "informal" firms, scholars generally agree that larger enterprises create more unskilled jobs, use resources more efficiently, and are better at building technological capacity. Yet majority of firms will never grow beyond six workers. This paper argues that one very significant reason why small firms stay small is risk.

In Nairobi, the economic and social consequences of business failure are extremely high. Entrepreneurs therefore to protect themselves from failure and, in the process, ensure that their firms remain small. Our research identified four risk-management strategies that work separately and together to discourage firm growth. First, many entrepreneurs manage risk through flexibility. By working in rent-free quarters, using family labour and little capital, they minimise fixed costs and maximise opportunities for additional income. Second, many small manufacturers also avoid risk by manufacturing standard products for a known market. Third, successful entrepreneurs frequently diversify their income and assets rather than expanding a single enterprise. Finally, most prefer to preserve their land and other assets unencumbered by debt. These rational responses to a risky

business environment ensure that most firms stay small and in the process work against formation of a dynamic manufacturing sector.

Policy-makers are challenged to improve the "enabling environment" creating broad policies conducive to firm growth and by targeting specific policies and programmes to small-scale industry. Kenya needs macroeconomic and social policies that indirectly encourage firm growth by removing or reducing business and background risks. It also needs an industrial policy that provides positive incentives for enterprising business owners willing to expand employment, improve efficiency, and upgrade technology and their workers skills.