

Major Environmental Constraints on Growth of Micro and Small Enterprises in Uganda: A Survey of Selected Micro and Small Enterprises in Mbarara Municipality

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Micro and Small enterprises (henceforth, MSEs) play a key role in economic growth and industrial development of a country. They make vital contributions in improving economic and social sectors of a country through stimulating large scale employment, investment, development of indigenous skill and technology, promotion of entrepreneurship and innovativeness, enhancing exports, and also building an industrial base at different scales. However, Ugandan micro- and small enterprises (MSEs) still perform poorly as a result of a combination of factors ranging from internal to external factors. The paper relies on data collected from selected MSEs for the period of October 2011 to February 2012 in Mbarara municipality. Using a stratified random sampling, a sample of 60 MSEs were surveyed. These included fabrication industry, Milling industry, carpentry and small roadside shops. The paper examines the extent to which the growth of MSEs is associated with environmental constraints. The results reveal that MSEs' growth potential is negatively affected by limited access to productive resources (finance and business services), by high taxes, lack of market access, erratic and costly electricity, lack of infrastructure, lack of human resources, and competitive practices that were dysfunctionally imitative rather than innovative.

Keywords: credit, micro and small enterprises, cooperative societies

Introduction

Micro- and small enterprises (MSEs) in Uganda play a significant role as they employ 90 percent of the active population (UBOS, 2010). Almost ¾ of the Ugandan population are engaged in entrepreneurial activities, particularly MSE's, and there are only a few medium and large enterprises. Most MSE's employ less than 20 employees and majority of the employees are family members. MSEs are not growing as evidenced by not expanding, not increasing on the work force, not opening other branches and their scale of operations remaining low. The industrial sector, which is dominated by MSEs, still contributes less than 20 percent to the GDP and has not been performing impressively.

Compared to large enterprises, MSE's are less efficient and incur high costs per unit of revenue. They use labor-intensive technologies to compensate for the lack of technical capacity in order to perform well. The larger firms are more capital-intensive than the smaller ones. Factors contributing to the unimpressive performance of Ugandan MSE's, as

mentioned in different studies, are limited capital and limited access to finance (Okurut & Bategeka, 2006; Kappel, Lay & Steiner, 2004; Uganda Microfinance Outreach Plan 2001; UCAP, 2001; Mugume & Obwona, 2001). Given MSEs' lack of access to external finance, their decisions to upgrade their equipment and machinery by making new investments are further constrained by limited internal sources of financing. Several papers indicate additional constraining factors such as inadequate provision of public infrastructure and services that affect private investment (Svensson & Reinikka, 2001), unfavorable taxation systems, and a heavy regulatory burden and administrative bureaucracy (Keefer, 2000). Other authors mention limited access to differentiated markets, which might be related to a lack of forward linkages (Kappel, Lay, & Steiner 2004), the concentration of MSEs in low-quality production (Sengendo et al. 2001), high transport and transaction costs (Rudaheranwa 2000, 2006; Wood & Jordan 2000), corruption (Svensson, 2002), low trust and minimalist entrepreneurial strategies (Kappel, 2004; Sorensen, 2001), education and poor managerial and skills competence (Nalumansi et al. 2002; Nel & Shapiro, 2003), weak support institutions

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(Krasemann, 1996; Kyomugisha, 2001), a lack of sectoral competitiveness, and an overall neglect of MSEs in Uganda (Cotton et al. 2003).

Given the role played by MSEs in Uganda, a study that specifically addresses the environmental constraints that affects their growth potential is very important. In line with Reinikka and Svensson's (2001) postulate that the rate of economic growth is positively associated with the rate of investment, factors in the business environment which constrain investment could in turn be the root cause of the poor economic growth of the manufacturing sector in Uganda. The removal of the impediments to entrepreneurship could be a powerful mechanism for growth.

Structure of MSEs in Uganda, Contribution of MSE's Sector

The Micro and small scale enterprise sector is a major economic sector in most African countries including Uganda. In Uganda's case, it is estimated to contribute:

- Over 30% of GDP
- Over 30% of employment
- Over 80% of manufactured output.

Therefore the MSE sector is second only to Agriculture in generating employment and contributing to poverty alleviation. There has not been a comprehensive survey of the MSE sector in Uganda for a long time (over 10 years). The above figures are only indicative.

State of the MSE's Sector in Uganda

A recent UNESCO funded study had the following major findings on the MSE sector in Uganda: (2005). The majority of MSEs surveyed were sole proprietorships because they are easy to form, are managed by individuals and decisions are easy to make without consultation.

The majority of MSE's started business with own savings and accumulated family funds. Gender involvements, on the average (77%) of the businesses were male owned with women businesses accounting for (23%). This of course varies sector. Most MSE's had capitalization levels of less than 50 million with the largest percentages in 1 – 5 million. Most MSE's had machinery valued below UGX. 20 million. The tools, equipment and machinery in use were outdated, inefficient, are low capacity and in some cases inappropriate.

Most MSE's employed 3 – 10 employees who were mostly unskilled. 60% rented their work premises compared with 40% who owned their work

places. Those renting were considering construction of own premises if they were to expand operations but were constrained by lack of investment capital.

Although 94% had mobile phones they lacked access to and use of computer, email, fax and internet for business. These were accessed at local internet cafes and secretary bureaus.

The largest percentage (64%) borrowed from MFIs. Some MSE's comprising 16.6% were able to get loans from banks like DFCU, Stanbic and Centenary and SACCO'S (Savings and credit cooperative societies) all for working capital. There was complaint the MFI loans were unsustainable because the interest rates were high and that ranged from 28 – 48%, there was no grace period, had short payback period usually not more than six months. Market Penetration: 93% were producing for a localized market because of lack of capital to expand operations for export. Only 20% of MSEs had good management and organizational set up. These contracted professional to plan their business, audit accounts and taxation advice. The majority operated without clear plans, had poor records and generally poor management.

All the firms needed technology and long term investment. They had visions and ideas for new products, or improvement of the existing. They needed skills, bigger working space, machinery and equipment for increasing production capacity quality, and innovation.

Literature Review on Micro and Small

There is no generally accepted definition of a small business because the classification of businesses into large-scale or small-scale is a subjective and qualitative judgment. In countries such as the USA, Britain, and Canada, small-scale business is defined in terms of annual turnover and the number of paid employees. In Britain, small-scale business is defined as that industry with an annual turnover of 2 million pounds or less with fewer than 200 paid employees.

Definitions often vary from country to country and, in some cases, even within countries depending on the government agency or economic sector in question. Metrics used typically include the number of employees, revenues, or fixed assets.

This paper defines MSEs as firms with up to 50 workers that are engaged in non-primary activities and sell at least 50 percent of their output. The MSE category includes microenterprises, which have up to 10 workers, as well as small enterprises, which have between 11 and 50 workers.

Characteristics of MSEs

In this paper, we use the generic name MSEs, following UNIDO (1997) and Daniels (1999), among other studies, to refer to small-scale enterprises. In general, MSEs are an integral element of the informal sector in most developing countries. In the majority of cases, these enterprises are initially informal but gradually some of them survive and become formal businesses, thereby providing the foundation of modern private companies (Mkandawire, 1999; Cook and Nixon, 2005). Hence, the growth of these enterprises is part and parcel of a dynamic growth process in the corporate sector, as argued by Liedholm and Mead (1994) and Prasad et al. (2005).

As noted by Cook and Nixon (2005), although a number of measures have been used to identify and describe MSE's, there is no consensus on any one measure and it is customary to use several metrics, including the value of fixed assets of the enterprise, enterprise turnover and the number of employees.

Ryan (2005) has pointed out that the term may be used to cover a wide range of economic activities for an indicative number of employees; for example survival activities (<1 employees), household activities (1p), microenterprise sector (<5), small emergent enterprises (<25) and growth businesses (<100 employees).

In the poorest countries, on average almost two thirds of workers are employed in enterprises with less than 5 employees while the majority work for enterprises with less than 100 employees (Cull et al., 2004). Efforts targeted at the MSE sector are often based on the premises that (i) MSEs are the engine of growth, but (ii) market imperfections and institutional weaknesses impede their growth. Skeptics question the efficacy of this policy and point to empirical evidence either in favor of large firms or of a size-blind policy approach (see Biggs, 2002 for an overview). While many country-level and microeconomic studies have assessed the importance of MSEs in the economic development and industrialization process (Snodgrass and Biggs, 1996), Beck, Demircuc-Kunt and Levine (2005) provide the first cross-country evidence on the links between MSEs, economic growth, and enterprise growth.

Compared to their larger counterparts, smaller enterprises typically exhibit limited access to resources such as time, skills, and money (Welsh & White, 1981). Further, due to a lack of slack resources, smaller enterprises in general are more vulnerable to the environmental effects and misjudgments (d'Amboise & Muldowney, 1988; Welsh & White, 1981). Limited resources also force smaller enterprises to allocate more time to adjusting to, rather than predicting and controlling, the turbulence they are faced with (d'Amboise & Muldowney, 1988).

Constraints to the growth of MSE's

Razzaque (2003) argued that the factors that are acting as constraints in case of MSE market development are: quality and standards, marketing, investment and working capital, shortage of skilled workers, lack of entrepreneurship and management skills, physical infrastructure, transport costs, trade policy and incentives, information, legal and regulatory framework, domestic environment etc. Ahmed (2004) argued that it is necessary to review the Government's industrial policy and technology policy to outline the Government's measures to support MSEs in technological up gradation. Bari, Hema and Haque (2005) have shown some similar issues in case of Pakistani MSE sector, those are: inadequate infrastructure, financial barriers and disincentives, adverse government policies, shortage of skilled personnel, technological constraints and lack of innovation and entrepreneurial handicap. Hubner (2000) has pointed out that in case of United States, entrepreneurship development and competitive environment generated through the presence of strong MSEs are quoted to be the leading factors behind the country's recent success in the rivalry against Europe and Japan. Further, financial and institutional deficiencies might prevent SMEs from growing to their optimal size and thus explain the lack of an empirical causal link between MSEs and economic development. Thus, it is crucial to understand obstacles to SMEs' operation and growth and how they vary with country factors.

Both in the developing and developed world, small firms have been found to have less access to external finance and to be more constrained in their operation and growth (Berger & Udell, 1998; Galindo & Schantiarelli, 2003). Recent cross-country firm-level surveys have enabled researchers to not only explore firm-differences within specific countries, but also to compare firms across countries and link differences to country characteristics such as financial and institutional development. The World Business Environment Survey (WBES) is a unique firm-level survey conducted in 1999 and 2000 for over 10,000 in more than 80 countries.

The regulatory and institutional environment in developing countries—notoriously burdensome when compared with developed countries—frequently hampers small enterprise growth. Econometric analyses underscore how these challenges disproportionately harm smaller enterprises (Beck, 2004). For instance, strict regulations and high taxes may keep firms small and informal (De Soto, 1989), thereby contributing to increased transaction costs from problematic property rights protection and contract enforcement. Regulatory and institutional

challenges may also deter MSE owners from making growth-enabling investments. For example, import duties on capital equipment (for example, sewing machines) may disproportionately hurt MSEs. Typically, larger firms can bypass these duties by qualifying for investment promotions, and they may be preferred in allocations processes (Liedholm, 2001). In addition, special subsidies and trade protection may offer greater benefits to larger firms, who are often more capable of lobbying (Tybout, 2000). Smaller firms more frequently report government policies to be unpredictable, and this uncertainty may be yet another factor reducing growth-enabling investments (World Bank, 2005).

Ray (1993) argues that in order to understand why some MSEs become successful and others fail, it is crucial to study the entrepreneur's personality or attributes, the entrepreneur's background and experience, and the entrepreneur's skills, including how they learn. According to Hills and Laforge (1992), some of the competencies that seem to work for entrepreneurs include: The propensity to take risks, the ability to identify customer needs and wants, a level of innovation, and the ability to identify new opportunities.

Myers (2004) citing Hillebrandt (2000) suggested that management expertise is one of the scarcest resources in MSEs. Kayanula and Quartey (2000), and Ramokolo and Smallwood (2008) stated that lack of managerial know-how places significant constraints on MSE development. Even though MSEs tend to attract motivated managers, they can hardly compete with larger firms. The lack of support services or their relatively higher unit cost can hamper MSE effort to improve their management because consulting firms are often not equipped with appropriate cost effective management solutions for MSEs. Furthermore, absence of information and/or time to take advantage of existing services result in weak demand for them.

Various reasons for these failures have been proposed by scholars in this area, among them: lack of supportive policies for MSE development (McCormick, 1997, 1998), intense competition with replication of micro-businesses (Manning & Mashego (1993); unavailability of funding (World Bank, 1993); manager characteristics including lack of skills and experience (Ray, 1993); marketing techniques used including quality of service and markets served (Blankson et al, 2006).

Institutional constraints- associations and collective action

The World Bank (1992) stated that the lack of cohesiveness and the wide range of MSE interests

limit their capacity to defend their collective interests and their effective participation in civil society. Associations providing a voice for the interests of MSE's in the policy-making process have had a limited role compared to those of larger firms. Many of the entrepreneur associations have yet to complete the transition of their goals from protectionism to competitiveness.

The government of Uganda recognizes the important role the sector plays in the national economy and has established a number of institutions to support the activities of the sector. The institutions are categorized as parastatals and state owned enterprises. The support institutions provide entrepreneurship training, laws and regulations, business advisory services, market information, registration and appropriate technologies.

While there appears to be consensus on what constitutes a negative business environment, much less has been written about what a positive one looks like. There are a few generally agreed upon characteristics. These include consistency, so that business owners know what to expect and can assess risks; a stable macroeconomic environment, again, knowing what to expect from the future can be as or more important than having support from government, access to finances, better marketing strategies, having skilled personnel and cohesion among the MSE's.

Research Methodology

A questionnaire was developed for data collection purposes mainly from relevant MSE's literature. The questionnaire consisted of three sections: biographical, small business activities and perceptual data. A 5-point Likert scale ranging from 1-5 where 1 (strongly disagree), 2 (disagree), 3 (not sure), 4 (agree), 5 (strongly agree) was used to gather the data. The questionnaire designed by the researchers consisted of questions pertaining to major environmental constraints to the growth of MSE's. Owing to the small sample size, only descriptive and non - parametric data analysis procedures were done for this specific study (Mazzocchi, 2008). The instrument was pre-tested among undergraduate students doing a Bachelors degree in Entrepreneurship and project planning at Uganda Christian University. The aim of pretesting was to see whether respondents understood the questions, whether pertinent questions had been captured and to ensure content validity. For the purpose of this paper, data was only presented in percentages.

Discussion of the Findings

The survey was conducted in the Mbarara municipality and involved 60 Micro and small

business owners that were stratified into milling machines, metal fabrication, carpentry and small road side traders. Of the 60 questionnaires issued, all were returned. This made a response rate of 100% which

was good enough. The findings (Table 1) reflects the respondents' perceptions regarding Environmental Constraints on Growth of Micro and Small Enterprises and each respond is discussed below.

Table 1. Environmental constraints on growth of micro and small enterprises.

Environmental Issues	Strongly disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly agree (5)
Competition related issues			15 (25%)	10 (17%)	35 (58%)
-Erratic and costly electricity				5 (8%)	55 (92%)
-Lack of supportive services	2 (3%)	2 (3%)		20 (33%)	36 (60%)
-Access to external funds			5 (8%)	15 (25%)	40 (67%)
-Marketing			5 (8%)	10 (17%)	45 (75%)
-High taxes				40 (67%)	20 (33%)
-Poor infrastructures				15 (25%)	45 (75%)
-Lack of cohesion				5 (8%)	55 (92%)
-Lack of skilled human resources				20 (33%)	40 (67%)

Competition related issues

Based on the findings in table 1 above, 75% of the respondents argued that competition has impact on the growth of MSE's. The respondents in the metal fabrication and wood workshops argued that customers prefer buying imported products than theirs. This significantly affects their market share and hence inability to grow. Competition law and industrial policies need to be strengthened to counteract these factors. The mediocre performance of the small, medium and micro business sector in terms of contribution to GDP and employment partly arises from the sub-optimal regulatory environment where even sub standard cheap imported products are allowed in the economy hence outcompeting the local ones.

Erratic and costly electricity

The study result shows that 100% of the respondents agreed that costly and erratic electricity negatively impacts on the growth of MSEs. This is in agreement by the findings Raynor and Weinberg (2004) mentioned that Small business owners normally seek assistance from the authority for providing uninterrupted energy supply. This however is not the case in the Ugandan context. The Ugandan government, in agreement with the IMF and World Bank policies privatized the electricity sector where by the private investors are out to maximize their profits. This has resulted into costly electricity that has made MSE's constrained. Electricity is a fundamental resource in most of the MSE's visited because virtually all of them were using electricity One respondent had this to say:

"I receive small monies from milling Maize but the Umeme people bring the lump sum bill at once. We are fed up these thieves. I wish the electricity sector can go back to government. These thugs have no mercy".

Lack of supportive services

100% of the respondent agreed that there is lack of supportive services from the government as regards the MSE's. The situation is even worse from the perspective of the smaller firms. It is almost impossible for them to think about exporting without intense assistance from the govt. In general, an export movement can be handled by the operator in several ways. "The government has failed to identify for us a central place where we can operate. The owners of the premises keep on increasing rent month by month without any government intervention" were the sentiments of one of the respondents. Respondents from the different MSE's were of the view that the government of Uganda is not bothered about them. They had a perception that government is only interested in big firms who pay big taxes.

Access to external funds

92% of the respondents agreed that inability to access external funds is a constraint to the growth of MSE's. The MSE's capital provides the money that the business needs to operate and function on a daily basis. There are a variety of ways business can obtain small business capital. However, most lenders will not finance small business without any credit history. This means that small business owners need to separate personal credit from business credit. Small businesses often face a variety of problems related to their size. A frequent cause of bankruptcy is undercapitalization. This is often a result of poor planning rather than economic conditions Failure to obtain external funding was found to be a major constraint to the growth of MSE's. The respondents revealed that lengthy and legal process required of them makes it had to obtain external funds.

Marketing

92% of the respondents agreed that Marketing is an important environmental constraint to the growth of MSE's. They contend that they have not done enough to aggressively market their products. That the customers look at their products as being inferior compared to the imported ones. This requires a lot of marketing to a liking for these products. Results showed that some millet flour packing firm had potentially lucrative business opportunities, but was unable to take full advantage of them due to inadequate capabilities. However, inadequate capabilities inhibited them from achieving this goal because inappropriate technology prevented them from satisfying the formal packaging requirements of supermarkets (Nichter, 2004). Good marketing strategies as regards pricing, packaging, branding and the processes in the MSE's was lacking as a result of the owners background. For example none of the MSE's surveyed agreed that they carry out promotion. They looked at promotion as a waste of the firms resources.

High taxes

100% of the respondents agreed that high and different taxes impact on the growth of MSE's. The respondents revealed that they pay both local and national taxes which impact on their profitability. Worse still, the tax bodies do not explain to them which taxes they are paying. There was consensus among the respondents that there is an element of double taxation. We pay local service tax, ground rent, income tax and trading license. Worse still, we do not see the benefits from these taxes.

"I cannot imagine paying the same ground rent with my neighbor who has a big shop. Municipal council must be cheating us" was the feeling of one respondent.

Poor infrastructure

100% of the respondents reported Poor infrastructure as a substantial inhibiting factor for effective firm operation and growth. This arises in the form of electricity, telephone connection, and road network. Some respondents revealed that in times of rain, there aren't enough vocational schools to teach students skills to enable them acquire entrepreneurial skills. Consistent with other studies (see, for example, Dowswell et al. 1996; Sender et al. 2005), low labor productivity is also highlighted. The low level of education of employees leads to a need for close supervision in terms of both decision making and theft. A vicious circle would appear to be perpetuated

as business proprietors seek low wage employees to the detriment of productivity and social capital (Hyden, 2001). Alternatively, SME's proprietors often seek technology as a substitute for an unreliable and unproductive workforce (Chowdhury, 2006).

Lack of cohesion

80% of the respondents agreed that there is lack of cohesion and cooperation among the MSE. Instead, these MSE's look at each other as a competitor not as an associate. This has resulted into unfair business practices that eventually, impact on their growth. The lack of cohesiveness and the wide range of MSE interests limit their capacity to defend the collective interests and their effective participation in civil society. Most MSE's were found to be lacking associations and collective action as a result of competition.

Associations providing a voice for the interests of MSEs in the policy-making process have had a limited role compared to those of larger firms. Many of the entrepreneurs associations have yet to complete the transition of their goals from protectionism to competitiveness. Additionally, the potential economies of collaborative arrangements in production and sale among MSEs have not been adequately explored.

Lack of human resources

100% of the respondents agreed that they do not have qualified and skilled personnel. This was seen in the fact that majority of the employees in these businesses are family members, friends or relatives. All the MSE's agreed that they do not employ skilled personnel because they are looked at as being expensive and hard to manage. However, failure to employ skilled personnel is itself a problem as these MSE's do not have competent who write proper books of accounts, do not do enough marketing and can write a business plan to source for external funds.

Implications

It is arguable that though some environmental factors are constraints to the growth of MSE's, it should not be taken for granted that where these environmental factors prevail, business growth is curtailed. There is need by the owners of these businesses to understand how to operate in such environments so that they can grow and survive because the research found out that though all the MSE's are faced with similar constraints, some have survived and grown.

Conclusion and Policy Recommendations

The aim of this paper was to find out major environmental factors that constrain the growth of MSE's taking Mbarara Municipality as a case study. The empirical findings reveal that environmental constraints such as high taxes, limited access to market, costly and erratic electricity supply, lack of cohesion, high taxes and lack of skilled and competent human resources hinder the growth potential and performance of MSE's. Furthermore, when MSE's experience limited access to market, their growth potential is likely to decrease. Thus, access to market is an important factor for MSE's to perform better and to grow. Managers in MSE's may need to position their firms by producing relatively high quality products and undertaking joint marketing strategies in order to penetrate differentiated market segments. From the policy perspective, stakeholders trying to address the problems faced by MSE's in Uganda need to undertake different measures such as subsidizing MSE's, joint marketing to increase their access to differentiated markets, subsidies electricity and improve on the infrastructure.

Policy makers and other stakeholders need to encourage MSE's to upgrade their productive assets. This can be done by enhancing the availability of production equipment and spares in the local market and through the provision of technical services at favorable rates. On the other hand, MSE's may need to try to become integrated in global value chains in order to obtain better access to technology, knowledge, managerial skills, and also export markets. MSE's need access to market at low transaction costs—hence increasing efficiency and sales—and to technical information and knowledge through networking. High taxes limit the performance and growth potential of MSEs in several ways. They reduce their internal sources of financing and discourage them from expanding, formalizing and, hence need for tax reliefs.

Much as the study concentrated on one area—Mbarara Municipality, the findings this particular study are common to many developing countries. The findings can therefore apply to other economies and policy actions taken to address these constraints can as well help the economies that have similar constraints. International audience can learn from this and where possible lend a hand so as to address these issues.

Limitations of the Study

The study has been conducted in one particular area—Mbarara may not have been exhaustive enough. The findings in that particular area cannot be conclusive

of all the environmental factors since different MSE's in different areas have different issues.

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