Small Enterprise Development
Economic Issues from African Experience

John M. Page, Jr., and William F. Steel
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Small Enterprise Development

Economic Issues from African Experience
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Small Enterprise Development
Economic Issues from African Experience

John M. Page, Jr., and William F. Steel

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Abstract

The paper examines the justification for promoting small enterprises by analyzing their characteristics in relation to key socio-economic objectives and by showing that investment in small-scale enterprises (SSEs) is likely to have been curtailed by market distortions and policy biases in favor of large-scale firms. It summarizes available evidence from Africa relating to the definitional and conceptual issues that are raised, focusing on manufacturing activities. SSEs tend to be concentrated in light, relatively labor-intensive industries, which partly accounts for their low overall capital-labor ratio relative to larger firms, which predominate in heavy, basic industries. Differences in labor intensity within an industry are evident mainly when very small firms are compared to relatively large ones. SSEs generally account for the bulk of manufacturing employment in African countries when unregistered, "informal" enterprises are included, although they contribute substantially less to GDP than the large-scale sector.

Evidence is mixed as to whether SSEs use resources more efficiently than larger firms. Their apparent tendency to conserve capital is related to their lack of access to low-cost finance. This suggests that efforts to provide such finance to SSEs risk encouraging uneconomic use of capital. The same is true for industrial estates and other measures to provide infrastructure targeted for SSEs, whose ability to operate with a minimum of infrastructure gives them an advantage where public capital is scarce. SSEs play an important role in the development of entrepreneurship in Africa, as in other low-income countries. Most SSE entrepreneurs are trained within the small-scale sector, which also serves as a proving ground for an emerging business class. Those who are successful may benefit from programs designed to assist them to enlarge or to gain needed skills.

The difficulty of reaching very small firms through direct assistance measures suggests the desirability of a more generalized approach. The economic environment for SSEs can be improved, first, by eliminating the bias of existing policies and regulations in favor of large scale and capital intensity; second, by minimizing regulations and taxes applied to very small establishments and their inputs; and, third, by policies that promote the agricultural sector, which has strong linkages with SSEs through supplies of inputs and through its high income elasticity of demand for the lower-quality, lower-cost products of SSEs.
Le présent document, dans le cadre de la promotion des petites entreprises en Afrique, analyse les caractéristiques de ces dernières par rapport aux objectifs socio-économiques des pays de cette région, en mettant en lumière le fait que les distorsions du marché et l'adoption de mesures favorisant les grandes entreprises ont probablement freiné les investissements dans les petites entreprises. Il présente une récapitulation des données disponibles en Afrique et portant sur les questions de définition et de conception dont il est traité, l'accent étant mis sur les activités manufacturières. Les petites entreprises sont concentrées en général dans les branches de l'industrie légère, comparativement fortes utilisatrices de main-d'œuvre, ce qui explique en partie le faible coefficient des capitaux par rapport à la main-d'œuvre qu'elles enregistrent si on les compare aux entreprises plus importantes, lesquelles prédominent dans l'industrie lourde et les industries de base. Les disparités d'intensité de main-d'œuvre au sein d'une branche apparaissent surtout lorsqu'on compare des entreprises très petites à de vastes entreprises. Pour la plupart, les emplois du secteur manufacturier, dans les pays d'Afrique, sont fournis par les petites entreprises si l'on compte les entreprises non déclarées du secteur non structuré; toutefois, leur contribution au PIB est très inférieure à celle des grandes entreprises.

En ce qui concerne la question de savoir si les petites entreprises utilisent les ressources de façon plus efficace que les grandes, les avis sont partagés. Leur tendance évidente à conserver le capital tient au fait qu'elles n'ont guère accès à une aide financière à faible coût, d'où l'on peut conclure que des efforts visant à leur fournir ce type de financement risquent de les encourager à utiliser le capital sans souci de rentabilité. On pourrait en dire autant de l'établissement de plantations industrielles et d'autres mesures visant à fournir une infrastructure aux petites entreprises, alors que par définition et du fait qu'elles peuvent fonctionner justement avec un minimum d'infrastructure, ces dernières ont un avantage sur les autres quand les capitaux d'investissement publics sont limités. Les petites entreprises jouent un rôle important dans la promotion de l'esprit d'entreprise en Afrique comme dans d'autres pays à faible revenu. Pour la plupart, les chefs de petites entreprises se sont formés dans ce secteur même, qui est également une pépinière d'hommes d'affaires. Les chefs d'entreprise qui obtiennent de bons résultats peuvent avoir accès à des programmes visant à les aider à agrandir leur affaire ou à acquérir les aptitudes techniques nécessaires.

Il est difficile de parvenir à toucher les très petites entreprises par le biais d'une assistance directe, et c'est pourquoi il serait souhaitable d'envisager une stratégie de caractère plus général. Il est possible d'améliorer le climat économique dans lequel les petites entreprises fonctionnent par plusieurs moyens : en éliminant les avantages que les mesures et réglementations actuelles accordent aux grandes entreprises à forte intensité de capitaux, mais également en réduisant la réglementation et les charges fiscales visant les très petites entreprises et leurs produits, et en adoptant des mesures visant à promouvoir le secteur agricole, lequel est fortement lié aux petites entreprises par le biais des approvisionnements en facteurs de production et par le biais de la forte élasticité, par rapport à l'offre, de la demande de produits de moindre qualité et de moindre coûts, ceux, précisément, que fabriquent les petites entreprises.
En este trabajo se examina la justificación de fomentar las pequeñas empresas en África, para lo cual se analizan sus características en relación con objetivos socioeconómicos fundamentales y se muestra que las inversiones en empresas de pequeña escala tal vez se hayan visto restringidas por las distorsiones del mercado y el sesgo de las políticas a favor de las empresas grandes. Se hace una síntesis de los datos disponibles con respecto a cuestiones de definición y conceptuales que se plantean, centrando la atención en las actividades manufactureras.

Se demuestra en el estudio la necesidad de una definición funcional de las empresas de pequeña escala que pueda adaptarse a los criterios específicos usados para satisfacer los requisitos particulares de los diferentes tipos de programas de asistencia o estudio. Estas empresas suelen estar concentradas en las industrias livianas y de uso relativamente intensivo de mano de obra, lo que explica en parte su baja relación global capital-trabajo en comparación con las empresas más grandes, que son las que predominan en la industria básica pesada. Las diferencias en cuanto al coeficiente de mano de obra dentro de una industria son evidentes sobre todo cuando se comparan firmas muy pequeñas con otras relativamente grandes. En los países africanos, a las empresas de pequeña escala generalmente corresponde la mayor parte del empleo en el subsector manufacturero cuando se incluye a las no registradas oficialmente del sector "no estructurado", aunque aportan mucho menos al PIB que las empresas grandes.

Los datos disponibles acerca de si las empresas de pequeña escala utilizan o no los recursos más eficientemente que las grandes no son concluyentes. Su aparente tendencia a conservar capital se relaciona con su falta de acceso a financiamiento de bajo costo. Esto indica que si se hacen esfuerzos para ofrecerles esos fondos baratos se corre el riesgo de estimular un uso antieconómico del capital. Lo mismo puede decirse con respecto al establecimiento de zonas industriales y a otras formas de proporcionar infraestructura a las empresas de pequeña escala, cuya capacidad para funcionar con un mínimo de infraestructura las coloca en situación ventajosa cuando el capital público escasea.

Se llega a la conclusión de que en África las empresas de pequeña escala desempeñan un importante papel en el desarrollo de la capacidad empresarial. La mayoría de los empresarios africanos se han formado en el sector de pequeña escala, que además sirve como "campo de pruebas" para la clase empresarial que va surgiendo. Los que tienen éxito se pueden beneficiar de los programas concebidos para ayudarles a ampliar sus empresas o adquirir conocimientos necesarios.

La dificultad existente para llegar a las empresas muy pequeñas a través de medidas de asistencia directa indica la conveniencia de adoptar un enfoque más generalizado. El entorno económico de las empresas de pequeña escala se puede mejorar de la forma siguiente: primero, eliminando el sesgo de las políticas y reglamentos actuales a favor de la gran escala y la gran intensidad de capital; segundo, reduciendo al mínimo las reglamentaciones y gravámenes aplicados a las empresas muy pequeñas y los insumos que utilizan; tercero, elevando los ingresos de la población rural de menores recursos, cuya demanda de los artículos de calidad inferior y más baratos que producen las empresas de pequeña escala suele ser muy elástica.
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I. INTRODUCTION

1.01 Small-scale enterprises (SSEs) are increasingly recognized as having a rightful place in strategies for socio-economic development. A fair amount of evidence is available on the role of SSEs in Asian and Latin American countries (see for example the World Bank Studies by Little, Mazumdar and Page, 1984, and Coates and Barry, 1983), although much less is known about SSEs in Africa. Nevertheless, many African governments have found it appropriate to mention SSEs in their national development plans and to establish special institutions or programs to assist them. As part of its strategy for national industrial development, the Lagos Plan of Action (OAU, 1982) urges "creating a network of small and medium-scale industries as well as actively promoting and encouraging the informal sector." SSEs have been the target of substantial financial and technical assistance from national and international development finance and technical agencies, from aid programs of more developed countries, and from private voluntary agencies. Three questions arise from this attention to SSEs. First, is it justified in terms of the potential or actual contribution of SSEs to socio-economic development in Africa? Second, given the characteristics of SSEs in Africa, what measures can best enable them to take advantage of their potential? And third, are the various agents establishing policies and programs that are appropriate in terms of the objectives and successful in terms of the results? This paper responds to the first two questions.
A dynamic and growing SSE sector can contribute to a wide range of development objectives held in common by governments, donors, and international agencies: efficient use of resources; employment creation; mobilization of domestic savings and investment; expansion of the role of domestic entrepreneurs; training of managers and semi-skilled workers; use of local resources; more equitable income distribution; and growth of production oriented toward basic consumer needs. Whether small-scale enterprise promotion represents an efficient mechanism for job creation, entrepreneurial and managerial development, or other policy goals, however, depends crucially on the current size structure of industry, on the costs and benefits of promotional efforts, and, ultimately, on the economic efficiency of small enterprises themselves. In each case, two questions need to be answered. What is the factual basis on which to believe that small-scale enterprises differ in their behavior from industrial enterprises in general? And, second, if they do in fact differ, what is the argument for intervention in the economy on their behalf?

The reason for concern with the rationale for intervention on behalf of small-scale enterprises is simple. Promotional programs, such as financing schemes, industrial estates, extension services, training, and administrative reforms, use scarce resources—both investible funds and skilled manpower—which could be employed elsewhere in the economy. Thus,
to argue that small-scale enterprises deserve support at the expense of other investment projects is to argue that the benefits accruing as a result of committing resources to small enterprise development are at least as great, if not greater, than the benefits that would occur as a result of committing those resources to other types of economic activity.

1.04 The sources of the current interest in SSE development are discussed in Section 2 in terms of the sector's potential role in achieving development objectives. That section also looks at the implications of this role for the characteristics and definition of SSEs. Section 3 examines the size and characteristics of the SSE sector in Africa, reviewing available empirical information. The purpose of characterizing SSEs is better to understand their nature and what conditions are most likely to encourage (or inhibit) their growth. A clear understanding of both the objectives of developing SSEs and their character is essential to arrive at a judgment concerning the design, costs and benefits of programs designed to promote their development. Section 4 gives an overview of the types of programs and policies that have been introduced to assist SSEs, as well as some factors that may work against their success. Section 5 concludes with some comments on the development of SSEs through special assistance programs.
II. THE ROLE AND DEFINITION OF SMALL-SCALE ENTERPRISES

Sources of Current Interest in SSEs

2.01 In the post-independence period of the 1960s, policy and research in Africa focused on expansion of large-scale, "modern" industry, especially to substitute for products imported from the former colonial countries. Development thinking tended to be dualistic, identifying growth with the modern sector and considering the "traditional" sector to be relatively unproductive. The emphasis of policies was on generating investment and attracting it from abroad in large, visible industrial enterprises. Nevertheless, there was some recognition that SSEs would have to play an important role in the development of the non-agricultural economy, in rural as well as urban areas (Singer, 1965). Increasing concern for SSEs in the 1970s arose from several sources: greater interest in aspects of development other than investment and output growth; dissatisfaction with the dualistic model; rising emphasis on a self-reliant approach to development; and the failure of past industrial promotion policies to generate efficient, self-sustaining growth.

2.02 Perhaps the most compelling argument for small enterprise development is that, at least in the present economic environment if not inherently, small enterprises are more efficient (or can be made more efficient) than their large-scale counterparts in their use of all productive inputs—labor, capital, and materials. That is, the unit cost of production in small firms may be lower than that in large firms, when
inputs are properly valued at their opportunity costs to the economy. Greater economic efficiency of small firms can arise from more appropriate factor choices, greater total factor productivity, or a combination of the two.

2.03 Import-substitution industries that were promoted through investment incentives, capital subsidies, and tariff barriers are frequently found to be large and highly capital-intensive, to operate at low levels of total factor productivity, and to require substantial physical and financial infrastructure. Small firms, on the other hand, tend to be less capital-intensive and to depend less on physical infrastructure. If the capital cost savings of small firms more than offset the cost of their greater use of labor and other inputs, then they are economically more efficient. If not, programs to increase the number of SSEs may imply a trade-off between labor intensity and economic efficiency.

The Case for SSE Development

2.04 Programs to promote small enterprise development can yield substantial benefits if investment in SSEs is less than would be optimal from an economic and social point of view. This may be the case either because of policies which reduce investment in SSEs below economically desirable levels or because of divergences between private and social
valuations of the costs and benefits of SSE development.\(^1\) Greater investment in small enterprises would then result in more efficient use of available resources and would promote economic growth. SSE development can also contribute positively to other socio-economic objectives of development. These arguments are reviewed in the paragraphs that follow.

2.05 **Employment** has become a development issue in itself as it became apparent that the very small modern sector in Africa could not absorb the burgeoning number of job seekers, especially rural-urban migrants. Attention has been focused on the wide range of activities between modern sector employment and unemployment that permit a large share of the population to gain some income — that is, the "informal" sector (ILO, 1972; Hart, 1973). Although individually small in size, informal enterprises provide the bulk of employment in manufacturing, services and commerce. A substantial volume of research has been devoted to the employment size and intensity of SSEs as a possible means of absorbing growing labor supplies in both urban and rural areas.

2.06 Economic growth in Africa has been stymied by low rates of domestic savings. Investment opportunities in SSEs may provide an outlet for personal savings at relatively low income levels which would otherwise

\(^1\) One such divergence occurs, for example, when individual lenders are unable to foresee or realize the reduction in costs of lending to SSEs that would come with increased experience, and so tend to avoid such lending. Another occurs when individuals have greater aversion to the risk of investment in SSEs than is appropriate.
go unrealized. Data on the sources of funds for initial capital investments in very small firms in Africa consistently show that eighty percent or more comes from personal savings supplemented by loans or gifts from relatives.

2.07 In addition to growth of aggregate income, equitable distribution of this income to the population has received increasing attention as a goal of development. Since more people gain their livelihood from SSEs than from large-scale enterprises, albeit at a lower level, the question arises as to whether SSEs could contribute to improving the income distribution, either through growth in their numbers or by raising productivity in them. A directly related concern is that large import-substitution industries tend to produce primarily for relatively higher-income consumers. This creates problems both for sustaining demand growth once imports have been replaced, and for satisfaction of the demand of lower-income consumers for low-cost, simple goods and services. SSEs offer the possibility both of providing income to the lower-income population and of supplying their needs.

2.08 The desire to increase the role of nationals in ownership and management has stimulated programs to assist SSEs as a means of promoting indigenous entrepreneurs. A central theme in much of the literature on small enterprises is that they provide an outlet and training ground for entrepreneurs. The shortage of able entrepreneurs and managers has been identified as a major constraint on the development of many economies. If small firms assist in identifying and training indigenous entrepreneur/
managers, the small enterprise sector may play an important role in the process of human capital formation.

2.09 The shortage of managerial and middle-level skills has been recognized as an important constraint on the ability to utilize resources effectively in Africa. SSEs offer the possibility of conserving scarce managerial abilities through a less complex organization of production than in large-scale firms and public or parastatal agencies. In addition, SSEs can complement limited technical training facilities through the apprenticeship system, which is a relatively more accessible means of transferring skills in Africa.

2.10 The preceding paragraphs suggest a number of ways in which small enterprise development might help to resolve some of the shortcomings of large-scale industrialization and play a more positive role in socio-economic development. SSEs can fulfill this potential role only to the extent that they may have the following characteristics relative to large-scale enterprises:

- greater labor intensity
- higher total factor productivity
- greater concentration among lower-income population in terms of both income generated and sales of output
- greater share of ownership by nationals
- greater reliance on domestic capital and savings
- lower intensity in managerial and technical skills
- technology more appropriate and adapted to local resources and conditions.
2.11 Given the rationale for interest in promoting SSEs, these characteristics should be of primary concern, not smallness per se. If, as indeed it turns out (see Section 3), small size is closely associated with these characteristics, it is essential to ask what conditions cause this association. Otherwise, programs to assist small firms may change the conditions that give them characteristics favorable to development. In particular, the lack of access to institutional finance is one explanation for relatively high labor intensity and productivity of capital in SSEs. In this circumstance, provision of institutional finance to SSEs may risk encouraging more capital-intensive techniques, thereby reducing the expected benefit. The question of what determines the characteristics of SSEs and how they are affected by assistance programs is not investigated in this paper, but it is an important question for discussion and further research.

Defining "Small Scale"

2.12 The variety of reasons for interest in SSEs explains why there is such a variety of definitions for what is to be included - and indeed why so many terms are used to describe the "sector" and its components. One problem is that "small" is relative, and what is "small" in one economic setting may not be so in another. Another is that although attention is often focused on the manufacturing sector, discussion of SSEs can extend

2/ Further, the commonly-used English term ("small-scale enterprises") does not quite correspond to the usual French term ("petites et moyennes entreprises").
into virtually all non-agricultural sectors of production, each with different relative standards of what is "small." Finally, definitions differ according to the purposes of the definer, and hence are based on different criteria (e.g., employment, capital, credit access, nationality, technology, etc.).

2.13 The productivity of labor in SSEs bears directly on defining what activities are to be considered. Our purpose in reviewing the SSE sector is to provide a basis for improving the design of programs to assist it. Since providing employment is a principal objective of such programs, it is important that the employment provided be productive, and not just a form of "disguised unemployment." If additional jobs created do not in fact provide a net addition to output, then the programs are essentially providing income redistribution rather than economic development. Hence, a suitable definition of the SSE sector should be framed so as to exclude activities in which the marginal product of labor is nil.

2.14 The definition of SSEs must be functional, that is, related to the purpose at hand. For the purpose of this review paper, the definition can be relatively comprehensive both in terms of scale and the sectors to be included. Since the point of view is that of program design, the definition should focus on establishing criteria of eligibility for assistance programs.

2.15 It is perhaps easiest to begin by agreeing on what is not included and then to narrow the definition. At the upper limit, firms
should be excluded if they already have access to capital, credit, technology, skills and established incentive schemes. In Africa, this would generally exclude foreign-owned firms and those with more than about 50 workers. At the lower limit, activities should be included only if they involve some barrier to entry, since an absence of barriers would imply an absence of need for assistance. This would primarily exclude petty trade, unskilled services, and various illegal activities. Activities would be included under this definition if they involve a barrier to entry (such as a fixed capital investment that is significant relative to average income, or an acquired skill), but are not sufficiently large to have access to established financial institutions and public agencies without special assistance. The inclusion of barriers to entry (at least conceptually) in the definition helps to ensure that employment will be productive rather than simply an income-sharing activity (Steel and Takagi, 1983).

2.16 More specific definitions actually used in African countries depend on the nature of the program or use. For lending programs, an upper limit based on size of investment or bank rediscount ceiling is common. Where increased national economic participation is an objective, ownership by a citizen may be a criterion. Number of workers is often a principal

3/ Number of workers is only a convenient proxy, and does not relate directly to most of the functional criteria for including or excluding a firm, except as an indicator of the complexity of the management structure.

4/ Without the latter caveat, an assistance program that gives firms access to these institutions would automatically disqualify them from the definition.
criterion, sometimes as a lower limit (e.g., 5) as well as an upper limit (from 9 to 100; Wynne-Roberts, 1980). Number of workers is not really an appropriate criterion when promotion of employment and labor-intensity is an objective, as it favors firms that substitute capital for labor. However, it is a simple and very convenient criterion for research that can also be readily compared across countries (a classification scheme based on employment is suggested in Annex I). The association between employment size and other characteristics is investigated in Section 3 below.

2.17 Because much of the interest in SSEs stems from concern about problems of industrialization, the focus is often primarily on the manufacturing sector. The concept of small production units clearly extends beyond manufacturing, however, as do many assistance programs. Indeed, programs to assist citizens to acquire businesses from foreigners have included small traders. For this paper, SSEs are taken to include all non-agricultural sectors of production, although much of the analysis and data is based on the manufacturing sector.

2.18 In this discussion of definitions, terms such as "modern," "formal," and even "small-scale" have been avoided, first, because they are relative, and, second, because their wide-spread use for different purposes has rendered them vague and imprecise. Reference in the literature to the "modern informal sector" demonstrates that terms that would seem to

5/ Writers with this orientation often use "small-scale industries" or "SSI" instead of "SSE".
represent opposite extremes may not even be mutually exclusive. The truth is that there is a continuum of sizes and characteristics, from a single person selling a few items on a street corner to an automated industrial plant employing thousands of workers, and the term "SSE" refers in general to the intermediate portion of that continuum.6/

2.19 A broad working definition of the SSE sector, for the purpose of analyzing its role and characteristics with a view to designing programs of assistance, would therefore be: enterprises engaged in activities involving barriers to entry in the form of human or physical capital that do not have ready access to institutionalized credit and incentives without special assistance. The operational definitions used in the empirical studies cited in the following section are generally consistent with this definition, though narrower. Definitions used for specific programs of assistance are necessarily narrower, as they must define an accessible target group.

6/ Some would argue that it is inappropriate to attempt any differentiation of this continuum, as it will inevitably be arbitrary (Breman, 1976).
III. NATURE AND CHARACTERISTICS OF SSEs IN AFRICA

Relative Size of Employment and Output

3.01 Both qualitative and quantitative data show that small enterprises account for the bulk of employment in the manufacturing sector in most African countries. A sample of data from seven countries shows only one (Egypt) with less than 59 percent of manufacturing employment in SSEs, while four countries (Ethiopia, Ghana, Nigeria and Sierra Leone) have over 82 percent (see Annex II). The size distribution of firms appears to be bimodal, at least in countries at early stages of industrialization, with relatively little employment between the two extremes of large firms with 100 or more workers and small, unregistered establishments with fewer than 10 (Page, 1979).

3.02 SSEs account for a considerably smaller share of manufacturing output than employment, although the data are less reliable. SSEs contribute more than half of industrial output in Botswana and Burundi, but less than a quarter in Tanzania, Kenya and Ghana (Wynne-Roberts, 1980). Available estimates of contribution to GDP include 8.2 percent for SSEs and 4.6 for large-scale firms in Burundi in 1976 (Wynne-Roberts, 1980), and 2.9 percent for SSEs and 8.1 percent for large-scale firms in Ghana in 1970 (Steel, 1981).

3.03 There is a general presumption, but little systematic evidence, that increasing industrialization tends to weaken artisanal or cottage
industries and to reduce the bimodality by increasing the proportion of medium-scale firms. Some data appear to support this: the SSE share of industrial output in Tanzania fell from 19 to 12 percent over 1966-74 (Wynne-Roberts, 1980); and medium- and small-scale manufacturing firms in Ghana declined from 3.1 to 2.9 percent of GDP over 1965-70 while the share of large-scale firms rose from 6.6 to 8.1 percent (Steel, 1981). Nevertheless, a relative decline of the SSE share does not necessarily mean that the sector is stagnating, and in any case it may be able to contribute significantly to employment and output growth if policies were less biased toward large-scale firms. Although its share of GDP was falling and large-scale employment growing twice as fast, manufacturing SSEs in Ghana still managed to increase their employment by 6 percent per annum during the 1960s and to absorb 5 times as many new manufacturing workers as the larger firms (Steel, 1981). In Sierra Leone, SSE employment in manufacturing grew at 6 percent per annum over 1974-80 in spite of general economic stagnation and negligible growth in large-scale manufacturing employment (Chuta and Liedholm, 1981). There is some suggestion that SSEs may tend to flourish, at least relatively, when economic stagnation drives people to seek supplementary income sources and causes production to fall in large-scale firms due to inability to import materials, spares and equipment.

3.04 Most studies focus on small-scale manufacturing and (usually) repairs, because these generally account for the largest share of SSE employment. In Accra, Ghana, for example, manufacturing and repairs were found to employ 54 percent of all SSE workers, excluding transport and construction (Steel, 1977). Sales (excluding petty traders with no fixed
investment in a kiosk or shop) accounted for 22 percent, food, drink and lodging for 16 percent, and services for 9 percent.\footnote{If the "informal" sector (including petty trade and all unrecorded employment) is combined with the "intermediate" (SSE) sector, sales and commercial employment outside the large-scale sector exceeds that in manufacturing and repairs, and services are over half the size of manufacturing and repairs. Transport and construction account for very small shares of intermediate/informal employment, while public utilities and mining have negligible shares. (Steel, 1977).}

Although empirical evidence is lacking on the relative size of SSE employment in sectors other than manufacturing, it appears that the large-scale sector generally predominates in mining, public utilities, construction and public services (i.e., government), while informal petty trade dominates commerce.

Small-Scale Industries and Competition with Large-Scale Products

3.05 Enough studies have been done of small-scale manufacturing in Africa to give a reasonably clear picture of the types of industries that predominate (see bibliographies in Anderson, 1982, Page, 1979, and Steel, 1977). The discussion below attempts to give an overall impression, recognizing that actual figures vary considerably between countries, even though they show consistent patterns. A relevant question is the extent to which SSE products compete directly with those of large-scale manufacturing. This bears both on whether large-scale production is likely to displace SSEs over time and whether special assistance is needed to help SSEs overcome distortions that favor competing large-scale firms.
3.06 Clothing is consistently the largest SSE activity in African countries, generally accounting for a third or more of employment in SSE manufacturing and repairs. Furniture and wood-working generally comes second, with on the order of an eighth of total SSE employment. When vehicle repair is included in a survey, it is often in the third position. Other important industries are metal-working (especially in terms of output value), food products (especially baking), shoemaking and repair, watch and electrical repairing, and (in some cases) printing. In rural areas, artisanal "crafts" tend to be relatively larger, especially blacksmithing, pottery and weaving, while agro-processing activities such as grain milling raise the share of food products.

3.07 The industrial distribution of SSEs appears to be somewhat different from that of large-scale firms, although they overlap at the aggregate level. Large-scale manufacturing in Africa, especially in the early stages of industrialization, is heavily concentrated in food, beverages and tobacco, and there is little direct competition even with the relatively few SSEs in these industries. Although textiles and apparel usually becomes a major modern manufacturing industry, its production is concentrated in cloth, while SSEs produce mostly custom clothing (which does not necessarily compete directly with mass-produced clothing). Wood products is another industry that is often quite large in the modern as well as the SSE sector, but generally because of sawmilling more than furniture making.
3.08 In general, SSEs are more concentrated in light, relatively labor-intensive industries, while there are proportionately more large-scale firms in heavy, basic industries. Handicrafts and artistic production are almost exclusively in the SSE sector, while chemicals, cement, iron and steel, and equipment are in the province of large-scale production. Metal products is the most important "heavy" industry among SSEs, and it tends to be organized more along "modern" than "artisanal" lines and to be at the larger end of the SSE size distribution.

3.09 Even when small and large firms produce substitutable products, they are not always in direct competition. For one thing, SSE products are often custom-made to individual orders and hence marketed directly by the producer, whereas large-scale products are mass-produced and marketed by wholesalers and retailers. For another, the generally lower quality and price of SSE goods enables them to supply the lower-income market, which often cannot afford the cost of modern sector products.

3.10 This is not to say that large and small firms do not compete. The notion that rapid growth of large-scale industry tends to retard growth of SSE production appears to be borne out in reality, at least in the aggregate. For specific products, there may be direct competition, especially where a subsidized large factory can supply the market for a good previously produced in SSEs. But on an industry-by-industry basis, small and large firms differ substantially in both their distribution and their markets.
Key Characteristics of SSEs

3.11 This section reviews what is known about the key characteristics of SSEs. The focus is on those factors that would enable SSEs to meet the objectives discussed in Section 2.1.8 Some suggestions are made as to reasons why SSEs might exhibit these characteristics.

3.12 Labor intensity: Aggregate data consistently show that increasing size is associated with decreasing numbers of workers relative to capital. Differences in labor intensity between industries, and between countries for the same industry, however, are often much greater than differences within an industry in one country.9 The correlation holds within individual industries to varying degrees, most sharply between very small and very large firms. The latter observation suggests that the important determinant of labor intensity may be whether an enterprise is in the "informal" or "formal" sector. Informal sector firms lack access to institutional credit and incentive schemes, while they are often able to pay workers (especially apprentices) less than the legal minimum wage.

8/ Broad conclusions are drawn from the evidence cited in the bibliography, without trying to quantify the data or list the specific sources.

9/ Similar results are found for non-African developing countries. Studies in Korea, the Philippines, Colombia and India all indicate that although aggregate capital intensity increases with firm size, when sectors are disaggregated and firms ranked according to capital intensity there is great irregularity in the relationship between size and factor proportions.
Large, formal sector firms, on the other hand, often can borrow capital at favorable interest rates, and may pay workers even more than the required minimum to attract a skilled, stable work force. Workers in SSEs are generally found to earn less than corresponding workers in large firms and more than agricultural workers. They do not necessarily earn less than the minimum wage for unskilled workers. The difficulties of adjusting for skills, experience, turnover, etc., make it difficult to estimate the exact magnitude of wage gaps. This means that differences in labor intensity may simply reflect the impact of differences in the wage/rental ratios facing small and large firms on their choice of both technique and industry. If this is the case, then programs that attempt to promote small enterprises by bringing them into the formal sector through low-interest loans would not necessarily lead to relatively labor-intensive investment. The goal of employment might be pursued more effectively by stimulating demand for the labor-intensive products in which SSE production predominates at the prevailing factor prices. On the other hand, the relationship between size and capital intensity may reflect economies of scale, in which case favoring small over large firms in a particular industry would lead to higher unit costs.

3.13 **Total factor productivity:** Data on total factor productivity in African industries are virtually non-existent. Some evidence exists that small firms use capital more productively than large ones, although the data are much less reliable and consistent than for labor intensity, and no general conclusion can be drawn. The variations between industries and countries are also great, and even within particular industries the data
often do not show a smooth progression by size group. Once again, the difference seems most pronounced for the smallest, "artisanal" firms, and differences in factor prices provide a plausible explanation. Since small entrepreneurs face much higher costs of borrowing capital, if they have access to credit at all, they naturally tend to conserve their scarce capital and to use it more productively than do large investors using funds borrowed on favorable terms. Differences in capacity utilization could also explain higher capital productivity in SSEs, although evidence is scanty on whether capacity utilization is relatively higher in small than large firms.\textsuperscript{10} Although lower labor productivity in small firms does appear to be generally offset by higher capital productivity, it is not clear whether the net result is greater or lower total factor productivity in terms of the true economic costs of these factors. Even in the positive case, a danger exists that measures to provide additional capital to SSEs may raise their capital/output ratio to the point at which they are inefficient in terms of relative total factor productivity.

3.14 Dependence on infrastructure: Within the SSE sector, differences in the degree of dependence on infrastructure are evident. Medium-scale firms are similar to large-scale ones in their dependence on public utilities, repair services, transport facilities, industrial buildings, etc. Very small and artisanal establishments, however, generally provide

\textsuperscript{10} In any case, severe difficulties arise in comparability and in defining "full capacity," especially as SSEs generally operate only one shift. Full capacity production in SSEs may be difficult to maintain because of relatively low barriers to entry, which permit new firms to enter when profits are high at full capacity operation.
their own power (mechanical, hand, or generator) and can adapt to different types of physical location and shelter. For this reason, a much higher proportion of SSEs are found in small towns and villages, whereas large-scale firms are heavily concentrated in the major urban centers, with the exception of resource-based processing. Provision of industrial estates, therefore, can assist primarily the largest of the SSEs, but also risks raising their overall capital/output ratio.

3.15 Technology and efficiency: SSEs are widely presumed to use technologies that are less "modern" than in large firms and that are more "appropriate" to factor proportions and local conditions in Africa. The evidence is not sufficient to confirm or deny this empirically, or to conclude whether observed differences are due to choice of techniques on a single production function (due to relative factor price differences) or to different production functions. It seems likely, however, that programs to improve utilization of the existing technology would contribute to greater technical efficiency.

3.16 Entrepreneurship: SSEs are consistently described as an outlet for indigenous entrepreneurship, in contrast to the domination of large-scale industry by foreign-owned firms. In general, the owners of small enterprises in Africa originate from within the small enterprise sector. Data from enterprise surveys indicate that more than sixty percent of the entrepreneurs of small firms received training as apprentices in other small-scale enterprises. A surprising finding of many enterprise surveys conducted in Africa is the limited extent to which skills learned in
larger firms form the basis for subsequent investments in small-scale enterprises. Where general surveys of SSEs have been undertaken, less than ten percent of the respondents among small entrepreneurs indicated that their prior experience had been in modern, large-scale industry. In large measure, the few owner/managers with experience and training in large-scale industry are concentrated in modern small enterprises which are directly linked to large firms, either through sub-contracting or by production linkages.

3.17 The levels of formal educational attainment among small business proprietors are quite modest, although as a group they reflect a higher level of formal education than the population in general. On the average, approximately one-half of the proprietors surveyed had not achieved functional literacy. The picture which emerges from the data is of a sector characterized by low formal educational barriers to entry, with skill formation largely concentrated in the apprenticeship programs of the individual trades. Owners of enterprises, particularly the more traditional small-scale activities, are generally either craftsmen-entrepreneurs who are technically proficient in the manufacturing process but lack extensive training in marketing, financial management or business organization, or merchant traders who usually have little formal education or technical training.

3.18 Small firms, therefore, have an important role to play during the process of industrial development in providing business opportunities and experience to entrepreneurs who have technical or commercial skills and are
capable of adapting craft-based production to more modern factory methods. In the absence of opportunities for small enterprise development, it would be difficult for those individuals with business talent but without formal educational credentials to establish themselves in the industrial sector.

3.19 Managerial skills and efficiency: It is generally observed that SSEs are not managed as efficiently as they could be, especially in such matters as financial records and bookkeeping. This shortcoming is, however, also an asset, in that SSEs conserve on scarce managerial skills. Their owner/managers are often craftsmen or tradesmen who happen to have gone into business for themselves and are not trained managers. Large-scale production of the same goods requires trained, specialized managers and supervisors. In Africa, this often means expatriates and a drain on foreign exchange. Production skills, too, tend to be generated within the SSE sector, whereas large-scale firms depend on outside training. That is, SSEs provide on-the-job training through the apprenticeship system, self-generating the skills that will be the basis for new SSE ventures and avoiding a drain on scarce and costly technical skills provided through public training programs. SSEs provide a means for utilizing and generating basic managerial and technical skills that would not be sufficient for the modern sector and would otherwise go unused and undeveloped. Programs to improve these skills on the job could enhance managerial and technical efficiency in SSEs, raising the productivity of both capital and labor.

3.20 Sources of finance: Investment in SSEs is financed overwhelmingly by the personal savings of the owner, supplemented by gifts or loans
from relatives. These savings come from trading, agriculture, and wages saved from employment in the large-scale sector. SSE investors have relatively little access to bank and public sector lending, nor is there evidence of any significant borrowing from moneylenders for initial investments. The paucity of funds obtained from commercial banks or public development agencies for initial or continuing finance is striking. Combined borrowings from public and private lending institutions rarely approach ten percent of initial investment. In general, less than one percent of SSE owners report that institutional leading was an important source of financing for them.

3.21 Demand: It is commonly observed that SSEs provide much of the consumer goods demanded by the lower-income population, whereas modern sector products are disproportionately directed toward the upper-income population. This pattern is partly attributable to different consumption patterns across industries (e.g., clothing vs. chemical products), partly to low-cost/high-cost substitutes within an industry (rattan vs. mahogany furniture), and partly to quality differences for the same product (local vs. bottled gin). The SSE sector itself caters to a wide range of demand, since the quality and cost of many custom-made products (e.g., clothing, furniture) depend on the skill of the artisan and the quality of the materials that can be afforded. Thus, although the SSE sector may be more oriented toward lower-income consumers than is the large-scale sector, it has the potential to supply the demand of higher-income consumers as well, so that it may be able to shift away from inferior goods as incomes increase. Although the evidence is scanty, one study concludes that
expenditure elasticities for the products of SSEs are high and positive and that its products are not inferior with respect to higher income categories (Liedholm and Chuta, 1976).

3.22 **Sub-contracting:** In some countries, such as India and Pakistan, sub-contracting of specific (often labor-intensive) components of a product has provided a stimulus to development of the small-scale sector. Sub-contracting relationships between large and small firms seem to be rare, however, in Africa. One reason for this is the dominance in the modern sector of foreign-owned import-substitution firms, which tend to import most of their inputs.

3.23 **Inter-sectoral linkages:** An important linkage of the SSE sector to other sectors is through its use of raw materials. Agro-processing activities have a direct linkage to the agricultural sector, although there is little evidence on the extent to which SSEs have an advantage over large-scale firms in processing. SSEs do have an advantage in utilizing and recuperating waste materials, often from large-scale firms (scrap metal, wood, rubber, packing containers, etc.). The growth of large-scale industries also may generate additional demand for goods and services provided by certain small-scale industries. This occurs primarily because the location of industrial sites and areas draws workers away from home, either through migration or during the working day. Certain activities previously done in the home may then be replaced by SSEs, especially food preparation, clothing (including uniforms), transport, construction of kiosks or small dwellings, etc.
IV. OVERVIEW OF APPROACHES TO ASSISTING SSEs IN AFRICA

Objectives

4.01 The analysis of characteristics of SSEs in Section 3 suggests that on the whole they have the potential to satisfy the various objectives and concerns raised in Section 2.1. The next step would be to verify whether special assistance to SSEs is justified. Intervention may be justified if various constraints and distortions lead to less investment in SSEs than is economically efficient. It may also be justified by an existing bias of policies and programs toward large-scale firms – though removal of this bias would be more appropriate (if politically feasible) than introducing offsetting measures to favor SSEs. The justification for intervention depends heavily on the conditions prevailing in a particular country.

4.02 There are two elements of the economic environment which probably result in insufficient investment in SSEs. The first is the result of trade, investment and other policies that have implicitly favored large-scale industry in many countries. The second is the result of capital market failures which may preclude adequate levels of investment in small-scale industry even where policies are neutral with respect to size.

4.03 A common problem of SSEs in LDCs is inadequate access to imported capital goods, intermediate inputs, and spare parts. Foreign trade regimes which employ rationing systems for imports, coupled with overvaluation of
the exchange rate, tend to favor large-scale, modern enterprises which can exercise substantial political and economic power. Direct allocations of import licenses to large-scale firms provide an implicit subsidy. Small firms which are excluded from direct access to import licenses are subject to both higher prices of imported inputs and greater uncertainty of supply. Even where foreign exchange allocations are potentially available to small firms, they remain at a disadvantage relative to larger enterprises due to their limited administrative resources and their consequent inability to undertake the protracted bureaucratic procedures required to obtain an import license. Even in those economies where direct controls are not employed, the structure of protection evolved in support of an import-substitution strategy frequently discriminates against small firms. In Kenya, Cameroon, and Sierra Leone, for example, small firms producing manufactured goods were not entitled to duty drawbacks on imported intermediates of the same scope and magnitude as large firms, during all or part of the 1970s.

4.04 Government policy in many African countries since the 1960s has acted to suppress the real rate of interest for both deposits and loans from the banking system. Faced with competing demands from potential claimants in excess of the funds available, the banking system has generally responded by rationing credit to traditional customers and by holding portfolios characterized by low risk of default. Venture capital for industrialization was provided to large-scale firms via public sector loan windows, often at highly subsidized rates of interest, and small-scale enterprises have been excluded from the commercial credit market both by
their higher level of risk and because of the greater unit costs of administering small loans. Government regulations concerning quality standards, technical specifications and procurement also are biased against the output of small enterprises.

4.05 Current policy initiatives in several countries appear intended to redress this bias against small enterprises by creating additional public lending institutions, by providing guarantees for a portion of commercial bank loans to small enterprises, and/or by restricting a specific portion of commercial bank funds for the exclusive use of small-scale borrowers. In very few cases, however, have these programs achieved significant results. Where public lending institutions have been created to channel credit to the small enterprise sector, rates of interest have generally been lower than or similar to those charged to large-scale enterprises. Requirements that a portion of the loan portfolio of the commercial banks be reserved for the use of small enterprises have resulted in slow disbursement and have not reached the relatively smaller intended recipients. The higher costs and risks of small industrial projects tends to bias credit rationing schemes toward the largest and most politically adept of those eligible and to favor commercial and trading firms rather than manufacturing enterprises.

4.06 Thus, in most countries, interventions by the state in the markets for foreign exchange and capital have tended to discriminate against small firms. These considerations support the presumption that small enterprises represent a smaller proportion of industrial firms than would be the case under more neutral policies with regard to the structure of protection and the structure of interest rates.
4.07 In designing programs and policies, it is essential to know the ultimate development objective. Is it increased employment per se, or higher and more equitably distributed incomes? Since in African countries there is very little open unemployment in the sense of workers unable to find any source of income, it may be argued that it is the nature and productivity of employment that is important, not the number of jobs as such (Anderson, 1982). Although employment and productivity ideally grow together, measures to promote employment simply by favoring increased labor intensity may reduce the average level of output per worker. Investments that use labor unproductively do not promote development, whereas investment that raises output by improving productivity or efficiency may be beneficial even if it does not increase employment. In other words, the object of expanding the SSE sector should be not simply to provide employment but to increase productive employment in such a way as to improve the utilization of resources and the distribution of income.

4.08 Keeping in mind the preceding argument and other reasons for aiding small entrepreneurs, the next question is whether it is supply or demand constraints that cause employment and productivity in SSEs to be less than is desirable. Analysis of these constraints in a particular situation is necessary to determine the appropriate measures to take. Otherwise, the measures risk introducing new distortions instead of correcting existing ones. Supply constraints that are commonly found include lack of access to investment and working capital, problems of raw material supply, lack of skilled labor, insufficient training and knowledge, inadequate infrastructure, and inappropriate equipment. Demand
side problems include weak aggregate demand, unequal distribution of income with relatively few middle-income consumers, and competition from subsidized large-scale industries and imports (often implicitly subsidized through an overvalued exchange rate). Government regulations also may discourage investment or growth in SSEs. 11/ Analysis of the relative importance of these different constraints is left to other studies. The remainder of this section looks at measures typically introduced to offset these constraints and evaluates them in terms of SSE characteristics and the likely impact on objectives.

Supply-Oriented Measures

4.09 Financial assistance: Programs to channel more credit to SSEs are probably the commonest approach used to assist them during the last decade, and one of principal interest to international financial institutions. Such programs are intended to overcome the lack of access to institutionalized credit that characterizes SSEs. The risk of this approach is that if lack of access is the reason for relatively high labor intensity and capital productivity in SSEs, making capital available on favorable terms may encourage small firms to use capital more intensively and less productively. Subsidized credit programs also risk replacing the personal savings that typically are the source of investment in SSEs.

11/ It is often observed that small entrepreneurs tend to use profits to diversify their investments rather than to enlarge profitable activities beyond the point at which they come under the purview of government regulations.
Inadequate attention is often given to financing working capital in established SSEs, which can make existing investment and workers more productive. Where the credit for special finance programs comes from outside the country, there is a risk of substituting foreign for domestic capital, contrary to the intended objective. Hence, programs financed by outside donors must be designed carefully to ensure that they complement rather than replace domestic savings and that they lead to increased productivity.

4.10 Technical assistance and training: Assistance and training in managerial, financial and technical skills are essential components of any program to develop SSEs, both to ensure that the firms are technically efficient and to enable the sector to fulfill its potential role of raising the productivity of the workforce outside the modern sector. Especially for smaller firms, whose owners tend to be tradesmen rather than experienced entrepreneurs, such assistance may be more important than credit. Development of entrepreneurial, financial and management skills make the entrepreneur a better risk for institutional credit, e.g., when needed for expansion. For SSEs with machinery, assistance in its utilization, maintenance and repair can raise the productivity of capital. There is insufficient knowledge, however, about how to provide technical services and training effectively. Past efforts to provide technical assistance have had difficulty in identifying and reaching recipients.12/ These

12/ The drawback of centralized assistance centers that depend on small entrepreneurs to take the initiative was noted in the ECA/OAU/UNIDO Programme for the Industrial Development Decade for Africa (New York, 1982, p. 173): "It must be kept in mind that most small-scale entrepreneurs are unaware of the need for these services."
services must be provided through extension programs that reach managers and workers in their establishments, a process that is at least as difficult as agricultural extension. A nominal charge may be useful to make potential users appreciate the value of the services offered.

4.11 Technology: Lack of appropriate technology is rarely cited by SSE entrepreneurs as a problem. Nevertheless, development of techniques that can be used efficiently in small-scale units is a potentially dynamic approach to stimulating both employment and productivity growth. Public as well as private funds for research and development have been concentrated almost exclusively in the past on techniques suitable for large, capital-intensive undertakings. In this context, greater support for intermediate technology development may be justified, although it must be accompanied by measures to ensure marketing, proper utilization, and servicing of new techniques. Such research centers should be designed to work closely with SSEs so as to assist them in adapting techniques. Technical assistance and technology development can readily be combined.

4.12 Infrastructure: Direct provision of infrastructure, usually in the form of industrial estates, has been used in some countries (especially in Asia) to help SSEs get established. This approach, however, does not seem suited to the relatively small SSEs found in Africa, except where the principal objective is to help medium-scale domestic enterprises to compete
with foreign firms. Industrial estates would not be attractive to entrepreneurs wishing to remain outside the formal sector, and in any case the total investment per worker is likely to be so high as to contradict the labor intensity argument for promoting SSEs. Part of the rationale for a SSE strategy in Africa is that they can initiate the industrialization process without requiring substantial prior investment in infrastructure.

4.13 **Input supplies:** Although SSEs are much less dependent on imported inputs than larger firms, their ability to produce is often constrained by the lack of certain critical materials (e.g., baking powder and yeast), spare parts (e.g., grinding wheels for small corn mills), or capital goods (e.g., carpenter's tools). SSEs in Africa encounter two types of input supply problems: obtaining imported materials and spare parts when imports are licensed or otherwise restricted; and obtaining supplies that are controlled by a state marketing agency. SSEs are too small to be able to deal effectively with government administrative mechanisms, and so have difficulties obtaining these supplies directly. A government that is serious about assisting SSEs must consider their needs in allocating foreign exchange and domestic materials. Where cooperatives and manufacturers associations already exist, governments can encourage them to act as agents for their members in obtaining materials. Credit to these agencies for the stocking of raw materials could help raise capacity utilization and productivity by ensuring a steady supply.\(^{13}\)

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\(^{13}\) For example, the quality of SSE wood products would be raised if they were able to hold stocks of wood long enough to age them properly. Care must be taken, however, to avoid transforming producers' associations into small bureaucracies or monopolies.
Demand-Oriented Measures and Policy Environment

4.14  **Income level and distribution:** Demand side measures are a less obvious way of assisting SSEs than supply-oriented interventions, but they may well be more important for the achievement of dynamic, self-sustaining growth of the SSE sector. SSEs have consistently been found to be very responsive to market opportunities. Conversely, supply-oriented assistance will not be very effective if demand for SSE output is insufficient. Since the income elasticity of demand for SSE products is thought to be relatively high among the lower-income population, measures that promote rapid growth of their income would tend to stimulate the SSE sector. One important approach to achieving this is pricing and other policies that raise agricultural incomes (Anderson, 1982).\(^{14}\) SSEs have a definite advantage over large-scale firms in being able to locate closer to dispersed rural sources of increased demand for non-agricultural goods and services.

4.15  **Protection:** Large-scale firms are often subsidized through low interest rates, incentive schemes, tax rebates, allocation of scarce foreign exchange, and protected from foreign competition by tariffs and import restrictions. Such measures may give them an advantage over more economically efficient SSEs. Restoring competitive conditions by reducing subsidies and protection may be politically difficult, especially if the government wishes to take visible measures to promote private investment.

\(^{14}\) These policies also assist on the supply side by encouraging production of an agricultural surplus that can stimulate processing industries.
and industrialization. Devaluation can be used to reduce the need for tariff protection and quantitative restrictions; a higher cost of imported goods protects all producers (including agriculture as well as industry) and provides incentives to export and to utilize local inputs. A second-best solution is to provide corresponding protection to SSEs. Efforts to include SSEs under incentive/tax rebate schemes, however, are likely to benefit only the larger SSE firms that can deal effectively with formal requirements, to the worsening disadvantage of the smaller (and more labor-intensive) enterprises. A more suitable approach is to avoid giving special benefits to large-scale investments in particular industries known to be supplied by SSEs. Large-scale firms should not, however, be prohibited if they can take advantage of economies of scale to produce at lower cost without special incentives.

4.16 **Regulations:** The environment created by public laws, regulations and policies often has a negative effect on SSEs, even when the government has an official policy of promoting them. Registration and tax laws that apply to enterprises too small to be able to comply readily force them to remain clandestine or to submit to police harassment. On the other hand, exemption of SSEs would sharpen the line between formal and informal sectors, and discourage firms from expanding to the size covered by the laws. Local governments can maintain a conducive environment through zoning regulations that permit small enterprises and by refraining from unnecessary clearance of areas inhabited by small (including informal) businesses.
V. CONCLUSIONS

5.01 The increasing importance attached to the role of small enterprises in the economic development of Africa is based on characteristics that are often found to be associated with relatively small-size, especially comparing very small firms to the largest ones. They make a significant contribution to income and especially employment. They have potential for self-sustaining growth in that they are an important source of income for workers outside the formal sector and also are oriented toward supplying the demand generated by rising incomes of these workers. They are relatively intensive in low-skilled and semi-skilled labor, and they serve to economize on scarce capital and managerial and technical skills. They are capable of utilizing capital productively in terms of output generated, though this depends on the degree of managerial and technical efficiency and is more evident for very small than for medium-scale firms. They provide an avenue for investment of personal savings and for the testing and development of entrepreneurial ability.

5.02 SSEs can best be encouraged by creating a neutral policy environment that is not biased in favor of competing large-scale investments and that minimizes regulation and harassment of small business activity. Policies that increase rural incomes will stimulate demand that is most readily satisfied by small-scale producers. Special assistance programs have tended to be biased toward medium-scale investments that do not necessarily have the appropriate characteristics, and have not been very successful in the important area of stimulating and supporting the development of entrepreneurial skills and experience.
5.03 Given the characteristics of SSEs in Africa, measures to assist them are unlikely to achieve development objectives unless they raise productivity as well as employment in the sector and provide incentives to invest personal savings in SSEs and to use capital economically. This means that programs to provide finance for SSEs must be carefully designed to minimize any adverse effects on capital intensity and utilization and on personal savings. Consideration should be given to focusing on credit for extensions and working capital in existing enterprises. SSE finance can also be a tool for introducing a package of technical assistance and other services, and it can serve the objective of helping nationals to compete more effectively with foreign corporations.

5.04 More important than direct supply-oriented assistance is the establishment of a policy environment conducive to growing demand for the goods and services produced by SSEs. This requires agricultural pricing and other policies that favor incomes at the lower end of the scale, and avoidance of excessive regulation and harassment of small enterprises.

5.05 Programs need to be designed for the situation prevailing in the particular country, based on an analysis of actual supply and demand constraints on SSEs. A well-designed program would include components addressed simultaneously to the different constraints and to supporting the key characteristics of SSEs that are conducive to development objectives, rather than assisting those SSEs that need it least. Program design needs to be based on further research on key issues of small enterprise development, particularly: (i) the relationship between firm size, labor
intensity, and total factor productivity at the disaggregated activity and product level; (ii) the nature of demand served by production in small enterprises, and the extent of competition between products of large and small firms; and (iii) the relative importance of initial capital, working capital, management and supervisory ability, business skills, and technical capability in constraining output and productivity in small enterprises, and how these can effectively be provided at the firm level.

5.06 Small enterprises are by definition difficult targets for assistance by large institutions. This paper has highlighted some aspects of the rationale for such assistance and the characteristics of SSEs as a framework for the design and evaluation of programs and policies to assist them.
## ANNEX I

### SIZE CLASSIFICATION OF ENTERPRISES BY NUMBER OF WORKERS

<table>
<thead>
<tr>
<th>Dualistic Terminology</th>
<th>Description</th>
<th>Criterion a/</th>
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<tbody>
<tr>
<td>Formal (modern)</td>
<td>Large scale</td>
<td>More than 50 workers</td>
</tr>
<tr>
<td></td>
<td>Intermediate or small enterprise sector:</td>
<td>Some investment in fixed or human capital and fewer than 50 workers:</td>
</tr>
<tr>
<td>Formal</td>
<td>Medium scale</td>
<td>30-49</td>
</tr>
<tr>
<td>Formal b/ Informal</td>
<td>Small scale</td>
<td>10-29</td>
</tr>
<tr>
<td>Informal</td>
<td>Artisanal</td>
<td>6-9 and some degree of specialization</td>
</tr>
<tr>
<td>Informal</td>
<td>Residual or casual</td>
<td>No fixed investment or full-time employees</td>
</tr>
<tr>
<td>Informal</td>
<td>Home production</td>
<td>Non-agricultural production done in the home and not sold or traded.</td>
</tr>
</tbody>
</table>

**a/** Number of workers includes working proprietors.

**b/** Formal/informal division is based on 10 workers often being the lower limit for inclusion in recorded employment and also large enough to risk being regulated under applicable laws.

**c/** Could also include larger firms in which there is no specialization; that is, each product is made exclusively by an individual worker. Artisanal firms are generally excluded from the French concept of "petites et moyennes entreprises."
### ANNEX II

**LARGE- AND SMALL-SCALE SHARES OF MANUFACTURING EMPLOYMENT IN SELECTED AFRICAN COUNTRIES**

(percentage)

<table>
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<tr>
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<tbody>
<tr>
<td>Large-scale (50 or more)</td>
<td>37.4</td>
<td>15.0</td>
<td>64.0</td>
<td>41.0</td>
<td>14.5</td>
<td>17.3</td>
<td>4.4</td>
</tr>
<tr>
<td>Intermediate (under 50) (of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
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A Brief Review of the World Lube Oils Industry
A. Ceyhan, H. Kohli, L. Wijetilleke, and B.R. Choudhury
This report assesses the structure, background, and outlook for the world lube oils industry. Presents the historical and projected lube oils demand and trends in manufacturing technologies and production capacity and provides an indicative assessment of the economics of lube oil production with detailed market and economic data.


Capital Utilization in Manufacturing: Colombia, Israel, Malaysia, and the Philippines
Romeo M. Bautista, Helen Hughes, David Lim, David Morawetz, and Francisco E. Thoumi
The authors surveyed 1,200 manufacturing firms in four developing countries to establish actual levels of capital utilization. The information collected was the first and remains the only data base available for the study of capital utilization. It was found that capital utilization is not as low as had been supposed. The study is concerned with factors that cause differences in levels of capital utilization and the policies that might be used to increase it.

Oxford University Press, 1982. 288 pages (including bibliography, index).

The Construction Industry: Issues and Strategies in Developing Countries
Ernesto E. Henriad, coordinating author
Presents a profile of the construction industry. Points out that construction work represents 3 to 8 percent of the gross domestic product of developing countries. Fostering a domestic capability in construction, therefore, is important. Discusses problems and constraints of the industry and formulates strategies for future actions. Draws heavily from the experience of the World Bank in supporting domestic construction industries over the past ten years. Useful to contractors, engineers, and administrators in construction industry.

1984. 120 pages.

Cost-Benefit Evaluation of LDC Industrial Sectors Which Have Foreign Ownership
Garry G. Pursell
Stock No. WP 0465. $3.

Development Finance Companies
Examines the role of development finance companies as major mechanisms for assisting medium-scale productive industries, assesses their potential for aiding small enterprises in meeting socioeconomic objectives of developing countries, and discusses the evolution of World Bank assistance to them.
Stock Nos. BK 9040 (English), BK 9058 (French), BK 9041 (Spanish). $5.

Employment and Development of Small Enterprises
David L. Gordon, coordinating author
Examines the potential role of the World Bank in encouraging developing countries to assist small enterprises and suggests that efficient substitution of labor for capital is possible in a broad spectrum of small-scale manufacturing and other activities that are able to absorb a rapidly growing labor force.
Stock Nos. BK 9060 (English), BK 9061 (French), BK 9062 (Spanish). $5.

Estimating Total Factor Productivity Growth in a Developing Country
Anne O. Krueger and Baran Tuncer
Staff Working Paper No. 422. 1980. 64 pages (including references, appendix).
Stock No. WP 0422. $3.

Financing Small-Scale Industry and Agriculture in Developing Countries: The Merits and Limitations of "Commercial" Policies
Dennis Anderson and Farida Khambata
Staff Working Paper No. 519. 1982. 41 pages (including references).

Fostering the Capital-Goods Sector in LDCs: A Survey of Evidence and Requirements
Howard Pack
Staff Working Paper No. 376. 1980. 64 pages (including references).
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Incorporating Uncertainty into Planning of Industrialization Strategies for Developing Countries
Alexander H. Sarris and Irma Adelman
Stock No. WP-0503. $3.
Occupational Structures of Industries
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Eighty-four tables profile the occupational composition of industries in each of twenty-six countries. Data show the structure of employment by sectors and industries for each country; cross-classify 120 occupations with fifty-eight industries; and provide information about productivity (value added per person engaged), energy consumption per person engaged, and employment.

Policies for Industrial Progress in Developing Countries
John Cody, Helen Hughes, and David Wall, editors
Analysis of the principal policy issues that influence the course and pace of industrialization in the developing countries. The text, organized along lines of governmental administrative responsibility for various industrial policies, includes chapters on trade, finance, labor-technology relations, tax, licensing and other direct production controls, public enterprises, infrastructure and location, industry-agriculture linkage, and the international environment.

The Planning of Investment Programs
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The analytical approach with special emphasis on the complications arising from economies of scale; a helpful introduction to linear and mixed-integer programming, facilitating understanding of subsequent volumes in the series.
The Johns Hopkins University Press, 1979. 144 pages (including index).

Volume 2: The Planning of Investment Programs in the Fertilizer Industry
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