

**THE ROLE OF SMALL, MEDIUM AND MICRO ENTERPRISES IN  
LESOTHO'S ECONOMY**

by

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**SUBMITTED AS PART OF THE REQUIREMENTS FOR THE MASTER OF  
COMMERCE DEGREE IN ECONOMICS**

**DIVISION OF ECONOMICS  
SCHOOL OF ECONOMICS AND MANAGEMENT  
UNIVERSITY OF NATAL, DURBAN**

September, 2000

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## ACRONYMS

BAPS	Business Advisory and Promotion Services
BEDCO	Basotho Enterprises Development Corporation
GEMINI	Growth and Equity through Micro-Enterprise Investment and Institutions
GOL	Government of Lesotho
IDM	Institute of Development Management
IEMS	Institute of Extra-Mural Studies
LCCI	Lesotho Chamber of Commerce and Industry
LCCUL	Lesotho Council of Credit Union League
LDTTC	Lesotho Distance Teaching Centre
LHWP	Lesotho Highlands Water Project
LMA	Lesotho Manufacturers Association
LNCW	Lesotho National Council of Women
LNDC	Lesotho National Development Corporation
LOIC	Lesotho Opportunities Industrialisation Centre
MTI	Ministry of Trade and Industry
SADC	Southern African Development Community
SMMEs	Small, Medium and Micro Enterprises
UNIDO	United Nations Industrial Organisation
USAID	United States Agency for International Development

## ACKNOWLEDGEMENTS

I would like to acknowledge the assistance and guidance of the following people in bringing this project to fruition:

Professor D. Tewari, my supervisor, without his assistance, encouragement and suggestions, this project would never have gotten started.

Mr. Jumbe, UNIDO consultant in Lesotho, without whose assistance in providing me with necessary material and data, as well as his suggestions, this great work would not have been successful. I also thank the officers in MTI, LCCI and other agencies, who were cooperative and helped me with information pertaining to their departments.

In addition, I extend my greatest gratitude to the staff members at the Department of Economics and Management, UND, from whom I received technical support that uplifted my spirit.

Lastly, but not least, I am grateful to my family and friends, specifically my late brother (who I dedicate this project to) for their support and guidance through the hard times. I say to my family, lets accept God's wish and continue supporting one another, God will see us through as always.

## ABSTRACT

A vibrant industrial sector that includes growing small and medium-sized enterprises is a boon to any economy. By increasing output and incomes, providing jobs for unskilled labourers, and improving prospects for efficiency and technological development, growing small firms offer both immediate and long-term benefits.

These words by McCormick et al, (1997) say it all. The theme of this study is growth, development and promotion of industry through small, medium and micro enterprises (SMMEs). SMMEs are cherished because of their resilience to economic setbacks, their flexibility, innovative capability and above all, their labour-intensive character.

Lesotho is currently faced with a major problem of joblessness (i.e. a huge number of labour force is unemployed). The formal sector, (i.e. public sector or government, private sector and parastatals) is unable to absorb these multitudes of unemployed labour. Moreover, this sector accounts for only 44 percent of employment in the country while the rest must be absorbed in the informal sector. The industrial sector is very small if not non-existent. Henceforth it has been recognised that SMMEs' sector can make a huge contribution to Lesotho's economy through employment and income generation. Most importantly SMMEs' sector is regarded as a stepping-stone to the industrial sector of the country. With agricultural production steadily declining and continuing mine workers retrenchments, the informal sector becomes the employment of last resort. In addition, Lesotho being an economy that is in the mist of restructuring and privatising, entrepreneurship through SMMEs offers an alternative route to employment and growth.

This study is therefore concerned mainly with small-scale manufacturing enterprises. The primary aim is to discover the income and employment generation effects of these entities. Other aspects to be explored include value addition potential and demand effects of SMMEs.

The study has discovered that SMMEs' sector forms an important employer and income source in the country. Most entrepreneurs depend on the income earned from their enterprises as the main source of income to support more than two dependants. Monthly average income generated by most enterprises ranges from 1000 to 10000 Maluti. However there are some exceptional businesses that make more than 20000 Maluti per month. These enterprises have a potential to expand and increase their value addition and since demand for their products is high, there exists better prospects for employment and income generation.

Small-scale sector was responsible for about 12 to 20 percent of industry in the country before the 1990's. Currently it accounts for 66 percent of industry. The difference proves the importance of having this sector in the economy. Employment in small-scale sector makes up to 20 percent of total labour force.

Small-scale manufacturing sector (SMMEs) in Lesotho comprises the following categories: (1) Sewing and Knitting (2) Metal and Leather works (3) Woodworks (4) Handicrafts and Pottery (5) Weaving and Tapestry (6) Electronics (7) Food Processing (8) Candle and Toiletries making.

Most SMMEs in the manufacturing sub-sector are in the activities of sewing and knitting followed by woodworks and leather works. Concentration of activity depends on the level of entry barriers<sup>1</sup>. Sewing and knitting is headed mostly by women entrepreneurs.

There are numerous problems facing SMMEs and their performance is thus retarded. The most frequently cited problem is finance and working capital. This is followed by the market problem though most business owners pointed out that their products are highly demanded. Lack of finance, especially loan financing makes it difficult for the enterprises to expand or grow into prominent business ventures.

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<sup>1</sup> Entry barriers here mainly concerns the costs of starting the particular enterprise.



The Government objectives towards SMMEs sector as stated in the Sixth 5-year National Development Plan are:

- To provide incentives for SMMEs development and growth
- To assist them in acquisition of better management and technical skills
- To identify growth sub-sectors of SMMEs in order to secure donors and other means of finance for them
- To strengthen the capacity of support institutions which assist SMMEs in acquisition of loans and in marketing plus capacity building through management training.

However, none of these plans has ever been effectively implemented. What is lacking is devising appropriate tools that will enable government to carry out its plans. The following strategies are henceforth proposed in the study:

1. To **actively support** skills and management training programmes, especially because the government can secure funds in the form of grants or soft loans.
2. To **co-ordinate** with support institutions so as to establish linkages between government and these institutions and with small-scale and large-scale firms.
3. To expand the share of small-scale products in the market through **publicity, market and financial support**. Most importantly, government must **accept tenders** from SMMEs or make exclusive purchases from SMMEs.
4. To **enforce a policy** that lists products reserved for production by small-scale sector only.
5. To improve productivity and enhance quality through **establishment of ISO 9000 quality standards**.
6. To **Promote specialisation** in production and export-oriented SMMEs
7. To **transfer technology** through the media, for example, T.V programs and published materials such as newsletters and magazines.
8. To increase **provision of well-serviced industrial sites**, appropriate for the needs of SMMEs.

With all the aforementioned proposals put in place, one believes that things could work out for the betterment of SMMEs' sector in Lesotho.

## DECLARATION

Besides the works and views of the referenced authors, I declare that this dissertation is my own work and initiative, and it has never appeared in any academic papers and published material before.



Bolaoane T. Kanono.

# CHAPTER 1

## INTRODUCTION

### 1.1 Background and Problem Statement

This study is about the role of small, medium and micro enterprises in Lesotho's economy. The interest in this topic stems from the problems of unemployment and poverty that are inherent in Lesotho. Having realized the major role played by SMMEs in many economies of the world, it was necessary to explore their role in relation to income and employment generation, and poverty reduction in Lesotho.

The importance of small, medium and micro enterprises (SMMEs) in any economy cannot be ignored. The role that can be played by SMMEs is therefore very vital for the growth, development and health of the economy. SMMEs have proved to be an engine for economic development, distribution of income, employment creation thereby reducing poverty in many developed countries such as the U.K, U.S and even in the former socialist countries. In developing countries including Africa as well, the role of SMMEs in employment generation, income distribution and poverty reduction has been significant. Most research supports this argument, for instance, Gallagher and Robson (1997).

It was argued that the role of small business in generating growth, income and employment, has for a long time been overlooked, (Solomon, 1986, 1). It was only until the 1970's, during the great economic depression that the impact of small business began to be felt in the U.S. This sector generated business innovations and has motivated many Americans to be independent. The innovative character of small business is vital for growth and it stimulates creativity. It is indicated that small business share of GNP stood at 1.3 trillion U.S dollars, representing about two-fifths of current United States of America's gross national product. In addition, it is stated that half the private sector work force was employed in small business, (Solomon, 1986, 1).

In the U.K, small businesses have also played a vital role in the economy, (Burns & Dewhurst, 1989, 68). Small businesses were able to achieve this role because of their innovative capacity, flexibility and the high profitability. It is shown that though the actual number of small businesses in the U.K is smaller than that in any other comparable country in Europe, this sector has performed better than large-scale business sector in terms of return to investment or return to total assets, (Burns & Dewhurst, 1989, 69). It was a widely held argument that small businesses are smaller in number in the U K than in any other comparable country because of lack of government support, restrictive fiscal measures and lack of funding facilities. However, studies by the Economic Intelligence Unit (EIU) together with this one by Burns and Dewhurst, have proved the above mentioned arguments wrong. Instead, they discovered that the U.K small businesses were even in a better position as far as institutional facilities for equity finance are concerned. The incidence of taxation posed neither burden of taxation nor complexity of administration that many European neighbours' face.

In Africa, as already mentioned, countries have increasingly shifted attention to assessing the role that small-scale enterprises might play in their industrial strategies. It is a general argument that industrial strategies of import substitution in developing countries have resulted in the growth of large-scale capital-intensive industries and manufacturing processes, (Chuta & Liedholm, 1985). In this process of development, the small-scale industries and manufacturing processes have been discriminated against. It is argued that these industrial policies have contributed to the biases in the choice of technique and product which have encouraged the proliferation of capital intensive manufacturing processes, (World Bank, 1979). Despite the high growth rates of output in the formal sector, it is shown that this sector failed to keep up with rising urban population, where these industries are concentrated, (World Bank, 1979). Though the World Bank arguments are valid, one could also add that the reason for the massive shift of attention in the early 1970's was that people became aware of the fact that the formal sector couldn't absorb each and every unemployed person. Therefore, if government objectives

include creation of employment for the jobless, it had to explore other alternatives; hence strengthening of the private sector became imperative.

Even though large-scale firms have always been favored (in terms of creation of an enabling environment), for example, in Nigeria, centers were created in the 1970's for promotion of small enterprises, by assisting indigenous businesses in acquiring necessary capital, technical knowledge, and in basic managerial know-how. These centers gave opportunities to many Nigerians to set up businesses, and by the end of the 1979, there were about 30,000 small-scale businesses registered. By 1985, the number had increased to 60,000 businesses registered, (Oshagbemi, 1983, ix).

In Lesotho, as it is in any African country, SMMEs sector is regarded an important employment oriented strategy of economic development. It is stated in the Sixth Five-Year National Development Plan that the development of small and micro enterprises is a key to the development of the economy. The plan shows that promotion of employment in the country depends on the small and informal sector enterprises. Therefore, for these plans to take place, creation of a conducive environment such as provision of better management and technical skills is crucial, (Sixth National Development Plan, 1997). There are institutions established in Lesotho to specifically extend support, whether technical or financial to SMMEs. However, there is still a gap as this sector lacks a coherent and clear cut policy to co-ordinate the efforts of these institutions as well the entrepreneurs themselves.

Unemployment is a major problem in Lesotho, estimated at 35 to 40 percent, (Fisseha, 1992). The problem is currently being exacerbated by the continuing retrenchment of mineworkers from South African gold mines. The recent political chaos has added to the thousands of job loss. A country wide survey on SMMEs in 1991, undertaken by the Growth and Equity through Micro-Enterprise Investment and Institutions (GEMINI) project, with the support of the USAID, revealed that there were 102, 968 small-scale enterprises employing 161,284 people out of 615,000 labour force. This is equivalent to 26.2 percent of total labour force. By 1995, the number of small-scale enterprises had

increased to 130,000 and total employment in the sector was 220,000 (i.e. 28.3%) out of 785,000 labour force. By 1998/99, labour intake should have increased to 30 percent, (Fisseha, 1992).

## **1.2 Hypothesis**

In order to be able to evaluate the prospects for Lesotho's SMMEs in employment and income generation, the study will also engage in the estimation of demand for SMMEs products. The hypothesis is essentially that *demand elasticities, specifically the income elasticity of demand, are high and positive. Hence demand for SMMEs products will not decline as rural and urban households income increases.*

## **1.3 Justification for the Study**

Even though there have been several research works on the subject, not much attention has been paid on the following:

1. The role of SMMEs in generating income and employment, and their potential in reducing poverty in Lesotho is yet to be studied.
2. The magnitude, composition, characteristics and contribution of SMMEs to the national income through value-addition in Lesotho need to be studied. Most importantly, SMMEs are labour-intensive hence the ability to absorb unemployed labour, and they use simple technology. Moreover, they are diverse, flexible and innovative, and hence they can serve the needs of both urban and rural population. By diversity, it is meant that they are numerous in terms of different activities they perform. Flexibility under this context means that SMMEs can be able to respond faster and adapt to changing supply and demand than their large-scale counterparts, whereas innovative character means the artisan ability to innovate, initiate and imitate technology.
3. Further, there has been no study of this kind before.
4. In addition, the study is intended to provide information for the planners (i.e. economic planners), workers, industrialists and entrepreneurs. Demand model that is

estimated in this study is also the first to be undertaken for SMMEs sector in Lesotho and it is going to be very useful for economic planners. Therefore the study will be a contribution to the current efforts by the Government of Lesotho (GOL) and the concerned support institutions in trying to fight unemployment and poverty through SMMEs, as this can serve as an important development strategy for a low-income country like Lesotho.

#### **1.4 Objectives**

The primary aim of this study is to address the problem of unemployment at micro level in the country and to document empirically the extent, nature and importance of SMMEs in Lesotho's economy, but more specific objectives are:

1. To analyse and understand the profile, characteristics, constraints and other socio-economic properties of SMMEs in Lesotho.
2. To explore and assess the effects of SMMEs in reducing poverty through income and employment generation.
3. To reveal the value-adding potential of SMMEs and analyse how they can be complementary to large-scale enterprises, as well as identifying how they can contribute to the Gross Domestic Product (GDP) of the country.
4. To estimate demand for SMMEs products in an attempt to address the disillusion about the nature and degree/magnitude of demand elasticities for these products.
5. To review policy environment and institutional support under which Lesotho's SMMEs are prevailing and to scrutinize other socio-economic characteristics and problems in relation to government policy and institutional support.

#### **1.5 Methodology, Data, and Scope of the Study**

Besides analysing data on income and employment generation aspects by use of tables and figures, and by running regression on demand for SMMEs products, an interview questionnaire type of approach was adopted, in order to explore the entrepreneurial



profile, characteristics and problems of SMMEs. This was directed at business owners and managers who are involved in manufacturing. The questionnaire was structured in such a way that it reveals typology of business owners, kinds of activities that the business is involved in, performance of business and problems facing the business. The format of the questionnaire is presented in the appendix. The number of SMMEs covered by the questionnaire is 62. These business enterprises are situated in Maseru, Leribe, Teya-teyaneng, commonly known as TY, Mafeteng, and Mochale's Hoek.

The study is based on primary and secondary data. Primary data is collected through questionnaire directed at small-scale Lesotho manufacturers. Secondary data is collected from the Ministry of Trade and Industry through its industry section and the United Nations Industrial Organisation (UNIDO) Lesotho, Basotho Enterprises Development Corporation (BEDCO), Lesotho Chamber of Commerce and Industry (LCCI) and other institutions set up to promote SMMEs in Lesotho. Published information regarding small, medium and micro enterprises is also used. The study is specifically based on the manufacturing sector of SMMEs in Lesotho. Manufacturing is considered to include those activities involving transformation of a product and these activities are non-farm activities, for instance, handicrafts, pottery and earthenware, sewing and knitting, steel and metal works, and food processing.

## **1.6 Outline of the Study**

The arrangement of the rest of the chapters is as follows; Chapter 2 gives a descriptive profile and characteristics of SMMEs in Lesotho. This will help reveal the characteristics such as size, employment, income, and types of SMMEs in the country. In addition, it will show past and the current situation under which the SMMEs are prevailing. Chapter 3 discusses the income and employment generation and poverty reduction aspects of SMMEs. Chapter 4 explores the value addition potential of SMMEs, which is also another critical issue when discussing the role of SMMEs in the economy. Chapter 5 concerns the estimation of demand for SMMEs products. Review of policy environment

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and institutional support and problems of SMMEs follows in chapter 6, while the final chapter is the summary of major findings and major policy implications.

## **CHAPTER 2**

### **DESCRIPTIVE PROFILE AND CHARACTERISTICS OF SMMEs IN LESOTHO**

This chapter is intended to give a descriptive profile of SMMEs in Lesotho and to reveal the context under which they are operating (i.e. in terms of the socio-economic situation of the country). First of all, there are some technical terms that have been used in the literature in various senses or meanings. Since I will be applying them in the text, there is need to define them clearly. For example, how does the literature define small business, and what does small, medium and micro enterprise mean in the context of Lesotho. This therefore is the purpose of section one. Section two describes the economic and industrial structure of Lesotho, while section three gives the profile and characteristics of SMMEs in the country. The last section is the summary to the chapter.

#### **2.1 Defining key Terms**

##### **2.1.1 Small Business, Medium and Micro-Enterprise**

There are numerous definitions of small business suggested in the literature. The following definition is quoted in Keeble et al (1992/93), that small business is

A business in which one or two persons are required to make all the critical management decisions: finance, accounting, personnel, purchasing, processing or servicing, marketing, selling without the aid of internal specialists in only one or two functional areas.

The above qualitative approach to defining small business is said to be less preferred to quantitative definition, which is usually based on the attributes such as number of employees, annual sales or total worth. More precisely, the quantitative definition takes into account the following attributes to define a small business:

1. Size- the number of people the business can employ,
2. Value-added – turnover or value of the business enterprise that is calculated by estimating business assets,
3. Licensing – whether business is registered or not, by any government agency,
4. Location – where does business operate from, and
5. Growth – by estimating how much the enterprise accounts for to GDP.

There are basically two types of small business enterprises described in the literature. The very small business where the proprietor is the chief worker and any employee works largely as direct assistance, and (2) the larger small business where the proprietor mainly directs the work of his employees. As per Solomon (1986, 21), the small business refers to the following:

The little individually operated business for example, grocery shop, merchant, filling station, shoe store, jewelry store, whose owner works himself, earns or tries to earn, a small or fair living, and employs one or two employees to assist him.

Solomon (1986, 21) argues that businesses that fall under the first category usually show little or no tendency to grow, whereas the second category does have growth tendencies. Things such as business turnover and the number of new jobs generated will show growth tendencies.

Micro-enterprise is defined as the tiniest business with one or four employees. From five upward, depending on the researcher's definition will comprise small-medium enterprises. In the U.K, micro businesses are defined as those with turnover below the value-added tax (VAT) threshold and this was equivalent to 23,600 pounds in 1989-90, (International Small business Journal, vol. 3, 1991-92).

### 2.1.2 Formal and Informal Sectors

Formal sector includes businesses officially licensed by government and paying taxes. Formal sector is also defined as 'modern' as it is characterised by the existence of one or more wage employees. This character differentiates formal sector from the informal sector where the latter employs non-wage family members (i.e. workers do not receive regular wages).

Informal sector includes businesses operating without full compliance to the law. This sector is usually characterized by low level of capital or low capital intensity, a low level of productivity, small and usually poor clientele, a low level of formal schooling, intermediate technology, preponderance of family labor and ownership, and lack of support or recognition on the part of government. The character of the informal sector is also typified by fluctuating and discontinuous employment, (Ozcan, 1995, 16).

### 2.1.3 Entrepreneurs and Entrepreneurship

Entrepreneurs are owners, those who invest, use new ideas and are innovative and willing to take risks. Entrepreneur is the one who personally takes care of most business functions. Moreover, the literature shows that a successful entrepreneur is that individual who can correctly interpret the risky situation and then determine policies that will minimize the risk involved.

Entrepreneurship is defined as the personal ability to establish and keep a business going. Other definitions interpret it as a process of undertaking or owning an own business venture, whereas others define it as an act of founding a new business venture where none existed before. Early economists such as Schumpeter, maintain that the innovative, risk-taking and creative characteristics of entrepreneurs are all components of entrepreneurship.

It is pointed out in the literature that a private enterprise system is a prerequisite to successful entrepreneurship, and successful entrepreneurship contributes to effective production.

Moreover, Mannan (1993, 12) stipulates the following requirements for a successful entrepreneur from the viewpoint of owner-manager hierarchy.

- (1) Availability of resources,
- (2) Economic and financial opportunities,
- (3) Employee co-operation, and
- (4) Luck plus individual's abilities, attitudes and motivation.

## **2.2 Economic and Industrial Structure of Lesotho**

Lesotho is a small country covering an area of 30,355 square kilometres, situated in the southern region of Africa. It is completely surrounded by South Africa, economic giant of Southern Africa. It has a population of approximately two million people, whose number is growing at the rate of 2.6 percent annually. Total arable land has declined from 13 percent since independence in 1966 to 9 percent, due to soil erosion, (Central Bank of Lesotho, 1996; UNDP, 1998, 7-9).

The economy is primarily subsistence-based agriculture, though the contribution of this sector to GDP has declined steadily over the years. Agricultural contribution used to be 30 percent during the 1970's, but it has gone down to 13 percent currently. Agriculture constitutes major part of the incomes of households in Lesotho, particularly of rural households, where 85 percent of these rural households depend on agriculture for livelihood. Table 2.1 below presents major contributors to economic performance disaggregated into primary, secondary and tertiary sectors.

Table 2.1: Gross Domestic Product (in percent) by Kind of Economic Activity

Sectors	1992	1993	1994	1995	1996
<b>Primary Sectors</b>	<b>11.5</b>	<b>13.4</b>	<b>13.0</b>	<b>10.0</b>	<b>13.0</b>
Agriculture	10.7	12.9	12.9	9.5	12.9
Mining and Quarrying	0.8	0.4	0.1	0.5	0.1
<b>Secondary Sectors</b>	<b>39.5</b>	<b>37.8</b>	<b>41.4</b>	<b>44.3</b>	<b>44.1</b>
Manufacturing	14.1	14.6	13.8	15.2	15.3
Electricity and Water	2.0	2.2	1.8	1.7	1.7
Building & Construction	23.4	21.1	25.8	27.4	27.2
<b>Tertiary Sectors</b>	<b>49.0</b>	<b>48.8</b>	<b>45.6</b>	<b>15.7</b>	<b>42.8</b>
Wholesale and Retail Trade	8.7	8.9	8.8	9.3	9.5
Transport and Communication	4.2	4.7	4.4	4.7	4.6
Finance & Insurance	9.5	8.3	8.3	6.9	5.8
Real Estate and Bus Service	3.0	2.9	2.6	2.4	2.2
Education	9.9	9.9	9.0	9.1	8.4
Other Services	1.5	1.5	1.4	1.3	1.3
<b>GDP at Factor Cost</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Central Bank of Lesotho, 1996 Annual Report.

From the table, we can see that agriculture contributes a major part of GDP under the primary sector. Mining and Quarrying is almost non-existent. The contribution of the manufacturing sector has remained around 14 to 15 percent over the years. Building and construction constitutes the largest share of GDP under the secondary sector with 27.2 percent. This sector has been boosted by the activities of Lesotho Highlands Water Project (LHWP). Under the tertiary sector, wholesale and retail trade comprises the largest activity.

The country is endowed with very limited natural resources and its productive and export base is very narrow. The current comparative advantage of the country lies in water and human resources. Lesotho is currently engaged in a water project with South Africa whereby the former will be exporting water to the latter.

Lesotho is highly dependent on:

- Remittances from Basotho mine- workers employed in South Africa,
- Customs union remittances,
- Agriculture – As already pointed out, agricultural capacity to absorb the growing labour force is extremely limited, hence the need for generating income and employment opportunities in other sectors of the economy.

Industrial sector is very small in Lesotho, comprising largely of foreign-owned companies. These are mainly manufacturing industries in textile, footwear and clothing. In contrast, the indigenous native population primarily owns SMMEs' sector. Foreign small business enterprises are rather widely dispersed in the service sector for instance, retail and wholesale, restaurants and hotels. It is shown that when Lesotho gained independence in 1966, there was no indication whatsoever of the existence of small-scale enterprise. Only twenty-four years later, in 1990, about 7, 267 small-scale enterprises (plus 25 large scale) were discovered to exist, (Fisseha, 1991). The manufacturing sector in Lesotho therefore, can be divided into 3 distinct segments:

- State-owned segment – consisting of projects identified by state planning apparatus, largely financed by public investment, mainly import-substituting and highly capital intensive, for example, state-owned enterprises in brewing and food processing.
- Private segment – consisting of labour-intensive, export-oriented projects, financed most entirely by foreign capital and normally subject to the control of foreign based commercial. This segment consists largely of textile enterprises (clothing and footwear) owned by Asians and South Africans. Total merchandise of exports from this segment is estimated at 75 percent of all Lesotho exports.



- Indigenous private enterprise – consisting of a large number of enterprises, the majority of which operates small-scale manufacturing activities on an informal, artisan scale.

### 2.3 The Profile and Characteristics of SMMEs in Lesotho

In Lesotho there is still no explicit definition and classification of small, medium and micro enterprises. However, from some pieces of information gathered from workshop reports on small and micro enterprises held in Maseru, Lesotho, during the 1996 and 1997, one observes that in the context of Lesotho, small-scale enterprise is the one which employs between 1 and 15 people, (UNIDO, 1997). Usually these enterprises exclude farm enterprises. They are mostly engaged in market-oriented production, though some of them are still being encouraged to commercialise their enterprises.

There are different sub-sectors within which SMMEs fall in Lesotho and these include (1) mining and quarrying, (2) construction, (3) retail trade (4) wholesaling, (5) repairs of personal household goods and the service sector, for example, restaurants, hair salons, lodging houses, bakeries etc. The sectorwise distribution of SMMEs is given in table 2.2 below.

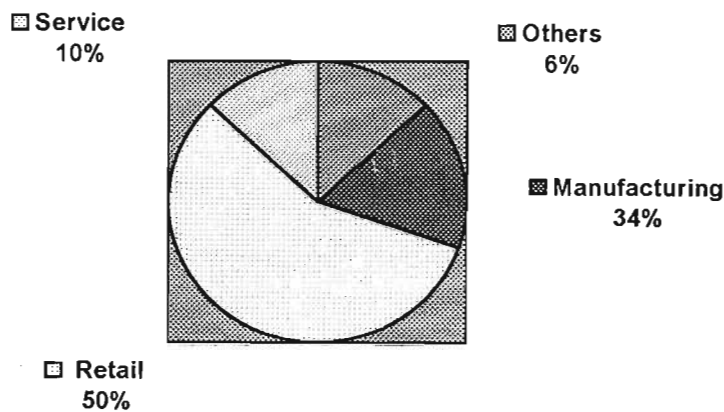
Table 2.2: Sectorwise Distribution of SMMEs in Lesotho:

Category	% Distribution
Mining and Quarrying	0.1
Manufacturing e.g. sewing, knitting, leather and metal works.	22.0
Retail and Wholesaling	60.9
Service e.g. restaurants, real estate	11.0
Others e.g. construction, building	6.0
<b>TOTAL</b>	<b>100.0</b>

Source: UNIDO, (1996)

As can be noticed from the table, retail trade sub-sector comprises the biggest component of SMMEs in the country. It is followed by the manufacturing sub-sector, with 22 percent and then the service sector with 11 percent. Mining and quarrying however, comprises a very negligible part at micro level, almost nil. The reason why retail trade is the biggest business sub-sector in Lesotho is that there exists relatively easy entry and exit in this sub-sector, (UNIDO, 1995/96).

It has been discovered that the majority of people who enter SMMEs are mostly housewives (54.6 percent are women entrepreneurs); about 15.7 percent are ex-miners while 9.7 percent are retired civil servants. The rest (20.0 percent) is other previous jobs including those who were never employed, (UNIDO, 1995/96). Further, the survey by UNIDO which is currently under the auspices of the Ministry of Trade and Industry (MTI), found that most SMMEs are mainly small and micro enterprises, employing 1 to 3 persons and have sales between M12, 000<sup>1</sup> and M48, 000 which is about US\$2,856 and \$11,424 respectively. Figure 2.2 below shows the percentage share of employment by sector.



**Figure 2.2: Percentage Share of Manufacturing by Sector**  
**Source: UNIDO, (1996)**

Most surveys have discovered that most business owners have low levels of education, and most of them are family-based. About 90% of them started their businesses from scratch. Their sources of funding are mostly personal savings and a few got credit from financial institutions available in the country. There are also financial groups of people called 'stockvels' (slang) that lend money to individuals who start businesses, but the condition of the loan is that a person must be a member. Very few businesses get grants from foreign donors. Most of them rely on local market for their produce, (UNIDO, 1997).

The study has further observed that SMMEs in Lesotho are very labour-intensive. Unlike in the retail shops where one or two persons besides the owner, can work, in the manufacturing sector, there is a large scope for employment generation as the division of labour is high. For example, in a leather works business, one person makes variety of leather shoes, one concentrates on making bags, another on repairs of leather products etc. Whereas in a small retail shop (not supermarket), one person becomes a sales clerk and the other does administrative work and in most cases it is the proprietor.

The division of labour is a very important characteristic of SMMEs that is advocated in the literature. The theory of flexible specialisation embodies all these characteristics that must be displayed by a small business. Existence of flexibility and specialisation and consequently employment, is highly likely to result. Flexibility enables a small business to respond quickly to changes in the level and composition of demand. For example, flexibility in SMMEs would mean the artisan capacity to respond to new design requirements and market signals due to flexible use of labour.

Another reason for concentrating on the manufacturing sector is that previous studies have discovered that most SMMEs in Southern Africa are involved in manufacturing activities, (Leidholm and Mead, 1998, 129). The manufacturing activities they concentrated on were the textiles and wearing apparel, food and beverages, wood and

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<sup>1</sup> M stands for Maluti, the currency of Lesotho.

forest products. Their study discovered that all make up to 75 percent of manufacturing in the urban areas and 90 percent in the rural areas.

The following categories of SMMEs are the most popular and occupation of indigenous entrepreneurs in the country and hence are the ones covered by the study:

- (1) Sewing and Knitting – bedding/linen in general and school uniform
- (2) Traditional Dress-Making, Fashion wear
- (3) School Uniform<sup>2</sup>
- (4) Wood and Metal works (under wood is carpentry in general, whereas metal works include gas stoves, flower and pot stands, window and burglar proofs, metal gates etc.)
- (5) Leather works and Repairs
- (6) Tailoring – mainly men’s clothes
- (7) Welding and Windbreakers
- (8) Food processing – Agro-industry products and bakeries
- (9) Electronics – TV and Radio repairs
- (10) Handicrafts – Basotho traditional hat (mokorotlo), straw hats, baskets, sheepskin products for instance, mats, all sorts of weaving and tapestry.

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<sup>2</sup> There are those small enterprises, which deal with school uniform only, and there will be specific schools that they supply.

Table 2.3: Frequencies of the SMMEs Categories in Lesotho

Broad Categories	Frequency	Percentage
Sewing and Knitting	29	46.8
Wood work	14	22.6
Leather works	4	6.5
Metal works	9	14.5
Food Processing	2	3.2
Electronics	1	1.6
Handicrafts & Pottery	1	1.6
Weaving, Tapestry	1	1.6
Candle Making	1	1.6
Total	62	100.0

Source: Field Survey, 1999.

Based on table 2.3 above, the largest share of small-scale manufacturing is found in sewing and knitting which accounts for roughly 47 percent of total small-scale manufacturing establishments. This finding is compatible with previous studies in Africa, (Fisseha, 1992; Liedholm and Mead, 1998). Previous studies also discovered that small-scale manufacturing employment is largest in the clothing sector, which accounted for 30 to 50 percent of total small-scale employment but currently it has increased to between 44 to 60 percent level of employment. Tailoring is also largest in countries where clothing manufacturing appears high. It is reasoned that the ease of entry due to low capital requirements makes the clothing sector the largest in Lesotho, (Field Survey, 1999).

Woodwork (Carpentry and furniture) manufacturing represents the second largest small scale manufacturing activity, accounting for 22.6 percent of establishments. This sector has been found to employ 8 to 20 percent of the labour force. The commodities that are produced in this sector are intermediate goods, such as tables, chairs and bookshelves, (Field Survey, 1999).

Metal works is also one of the most important small-scale manufacturing in Lesotho. We

notice that it is the third largest component of manufacturing activities and it comprises 14.5 per cent of manufacturing establishments, (Table 2.3). The study has discovered that entrepreneurs who do metal works (specifically welding) are also involved in vehicle repairs. Previous studies have found that vehicle repair is apparently the most important non-manufacturing activity in Africa. The studies revealed that unlike small-scale manufacturing, this sub-sector reflects substantial complementarity between the intermediate and formal sectors in the economy. In addition it has been revealed that both the employment structure and capital requirements of vehicle repair differ significantly from those encountered by the small manufacturing establishments. Initial capital requirements are thus among the highest of all small-scale enterprises.

Leather works as well forms one of the most significant part of small-scale manufacturing. This sub-sector may be under-represented in this sample. This is because there are entrepreneurs in this category who could not be contacted because they are not always available at the business premises (entrepreneur is not owner-manager).

Basic handicrafts, pottery and weaving may also be under-represented in the sample because the study could not cover the districts in the mountain rural areas of the country. In any case, previous studies show that the more traditional crafts such as blacksmithing, weaving and pottery are relatively more important in rural areas. More modern small-scale industry such as tailoring, carpentry and furniture, and vehicle repair tend to predominate in the urban areas, (Liedholm and Chuta, 1985).

The study has revealed another important behaviour of small-scale manufacturing enterprises that as we move from Maseru (major town) to the rural towns, wage employment becomes less important. This agrees with previous studies that in the urban areas, wage employment in small enterprises and size of enterprise is significantly higher than in the rural based enterprises. Rural enterprises have been found to rely more on family labour than their urban counterparts. As the urban location increases, share of total employees who are wage paid increases.

Electronics and candle making are new sub-sectors of the small-scale manufacturing in Lesotho. Besides being new, these establishments are constantly being undermined by the dominance of large-scale foreign enterprises in the country. Food Processing especially in juice making and soya processing is growing, though imports from South Africa places a tough competition.

The study has discovered very interesting attributes about the aforementioned manufacturing enterprises. Let us look at these attributes, specifically the typology of business owners in order to understand for example, motivation behind starting the business, age, education level and affiliate of business association.

Table 2.4: Age of Business Owners in the Sample.

Age Category	Frequency	Percentage	Cumulative Percentage
18-25	4	6.9	6.9
26-35	15	25.9	32.8
36-45	19	32.8	65.6
45 <sup>+</sup>	20	34.5	100.1
Total	58	100	100

Source: Field Survey, 1999.

The sample size (n) is 58 and not 62 because some of the businesses are partnerships and co-operatives. Therefore, the question, age of business owner was not relevant. The survey discovered that the majority of business owners are between the age of 45 and 60 years. This age group makes about 34 percent of the total small manufactures interviewed. The next highest age group in SMMEs is between 36 and 45 and it accounts for roughly 33 percent of manufacturers.

Analysing the motivation of the entrepreneurs could help explain why most of them are in the age group 36 to 45 and over. Most of the entrepreneurs who fall under the

aforementioned age group, are housewives and widows who are bread-winners in their families. Some are mine workers' wives who fear that their husbands may be retrenched (being aware of the continuing high rate of retrenchment), thus they must be prepared. Others are ex-miners who have to support their families, pay children's school fees and so forth. However, there were not so many ex-miners found to be involved in small-scale manufacturing. This is not surprising because the recent countrywide study of SMMEs by GEMINI discovered that most ex-miners are involved in retail trade. It has been discovered that entry into retail trading is not difficult due to low initial capital requirement, (Fisseha, 1992).

Retired civil servants were not many. About four out of the sixty-two businesses interviewed were retired civil servants. The study discovered that small manufacturers involved in knitting and sewing are mostly women. The study could hardly find women in welding, carpentry and shoe repairs or leather works.

There are few young people between the age of 18 and 25 who are involved in SMMEs. Some of the reasons are that young people in Lesotho have this notion that being a shoe repairer or being a carpenter is low class job (the uneducated). They believe that this type of work is for those who could not attain formal education or those who fail at school. Young people therefore aspire for formal jobs. Other reasons cited in the literature are that school-leaving, young people do not have capital to start businesses. Even when they have started them they do not last.

### **Education level, Training and Experience**

The study found out that, out of 62 businesses, 23 entrepreneurs have gone up to primary level, 29 have secondary education, 3 have college/technical level of education, while 4 have never been to school. However, most of them at least are literate and have gone up to secondary school level.



Most entrepreneurs have relevant training and experience, and they regularly attend training and workshops organised by support institutions. Basotho Enterprises Development Corporation (BEDCO) and Lesotho Manufacturers' Association (LMA) give regular workshops and training. Most respondents have acquired training from various vocational schools in the country and from previous jobs.

### **Occupation Before Start of Business**

This was classified into student, retired civil servant, ex-miner and others. 'Others' includes previous occupation such as factory/firm or any construction company where the respondent got experience in the same work that he/she is now doing. The previous occupation could also be hotels, restaurants, retail shops and other private companies, where the respondent got motivated to become their own businessmen and women. 11 out of 59 were students, while 4 were civil servants. Around 5 were ex-miners while 31 were involved in other jobs. There were 8 entrepreneurs who have no education whatsoever. These were mainly single mothers who are just trying a living.

### **Member of Association**

The respondents were asked whether they have joined any association whereby these associations are entrepreneurs' initiative, with an intention to help one another. There were 17 entrepreneurs out of 62 in the sample, who have joined associations and they represented about 27 percent of the SMME population covered. About 31 entrepreneurs have not joined any association and 10 intend to join during 1999. Even though most of the entrepreneurs are not members of any association, some of them have received intensive training from BEDCO through its Business Advisory and Promotion Services' (BAPS) sector. The researcher has noticed that people used to have a negative attitude towards BEDCO and LMA, but now it seems that they are beginning to realise how beneficial support institutions could be.

It has been revealed that general business associations, sectoral and sub-sectoral

associations, are all ways in which firms especially small-scale can share information and increase their business operation knowledge and hence productivity. Associations are defined by their common purpose of defending and promoting functionally defined interests, (McCormick et al, 1997).

## **2.4 Summary**

This chapter has highlighted on the important definitions concerning small, medium and micro-enterprises such as formal and informal sectors, entrepreneurship, as postulated in the literature. This has enabled us to see what small business is in Lesotho. We saw the economic and industrial structure in the country and various types of SMMEs that play major role. Then we were able to note the position of the manufacturing sector of SMMEs.

It is argued that Lesotho is an ideal location for manufacturing concerns, particularly those identified as labour-intensive. This is because of the huge labour force that prevails in the country and using capital-intensive technology would be expensive for the country. From the questionnaire that was conducted, the following characteristics were discovered about Lesotho' small-scale manufacturing entities; that they are:

1. Labour-intensive, hence
2. Employment generating
3. Capital saving because capital is scarce (hence costly) in Lesotho
4. Innovative and flexible.

Sewing and Knitting (falls under garment making) comprise the largest manufacturing activity in this sector. Women mostly head this activity. There are fewer women found in carpentry, welding and leather works. However garment making being the largest activity, this shows that women play a major role in entrepreneurship in Lesotho. Therefore if given a chance and support, women could make a difference in small-scale industry in the country. In the next chapter, we examine the role of SMMEs in income and employment generation, and in poverty reduction in the economy of Lesotho.

## **CHAPTER 3**

### **INCOME AND EMPLOYMENT GENERATION EFFECTS AND IMPACT ON POVERTY REDUCTION**

This chapter sets out to reveal and discuss an extent to which SMMEs in Lesotho can be major sources of income and employment in the economy, thereby reducing poverty. The socio-economic impacts will be explored with special reference to what the literature suggests in regard to these issues. The chapter is organised as follows. The income and employment generation aspects of SMMEs are discussed in section one. Section two analyses the SMMEs' role in poverty reduction, while the last section is the summary of the chapter.

#### **3.1 Income and Employment Generation**

Income and employment are central issues when considering the role of SMMEs in any economy. Both items are the most important socio-economic contribution SMMEs make for the country, as pointed out in the literature. For instance, Liedholm and Mead (1998, 125) discuss the contribution of SMMEs in Southern Africa as follows:

The contribution of micro and small enterprises (MSEs) in generating employment and income has become increasingly recognised not only in Southern Africa but also around the world. In most developing countries these contributions appear to have been increasing over time.

However, in many instances the dynamic contribution of SMMEs is overlooked or it is not recognised. Among a few studies that have been conducted in Southern Africa, GEMINI project is the most recent survey taken, (Fisseha, 1992). This survey has discovered that about 20 percent of the labour force is employed in micro and small enterprises in the six countries of the Southern African region. These countries include Botswana, Kenya, Lesotho, Malawi, South Africa, Swaziland and Zimbabwe. The

number of people engaged in micro and small enterprises' activities per 1,000 persons in the population was found to range from 70 to 90 persons in Botswana, Kenya, Lesotho, Malawi and South Africa. In Zimbabwe and Swaziland it ranged up to 110 or more. Furthermore, estimated employment in these micro and small enterprises was found to be twice the level of employment in registered large-scale enterprises and the public sector. Therefore, SMMEs are no doubt major source of livelihood for a big portion of the population in the region, (Liedholm & Mead, 1998, 126-128).

Income generated by small-scale enterprises becomes an important part of the contribution of this sector to the economy as a whole. Determining the level and magnitude of this is necessary. However, this is difficult due to lack of statistical data, as SMMEs themselves, do not keep accounting books. However, by estimating the monthly or annual sales of businesses one can be able to assess the income generated by SMMEs in Lesotho.

In Lesotho, income generated by SMMEs is mainly used to take care of dependants and in most cases they range from 5 to 10, as families are mostly extended families. Even those entrepreneurs, who use business income as supplementary to formal jobs salaries, still depend to a larger extent on business income. In the study conducted by GEMINI as Fisseha (1992) reports, proprietors of SMMEs were asked to rank whether their primary income contributed half, less than half, or more than half of total household income. Most of them explained that it contributed more than half of total household income. In Lesotho, as already shown, the average income generated by each SMMEs was found to range between M12, 000 to M48, 000 per year. These estimates seem to correspond with the ones recorded in the questionnaire undertaken by this study. The following table shows monthly average income the enterprises generate.

Table 3.1: Monthly Average Income Earned by SMMEs in Lesotho.

Amount	Frequency	Percentage	Cumulative Percentage
> 500	4	7.3	7.3
500-1000	9	16.4	23.6
1000-5000	28	50.9	74.5
5000-10000	10	18.2	92.7
10000-20000	2	3.6	96.4
< 20000	2	3.6	100.0
Total	55	100.0	

Source: Field Survey, 1999.

55 out of 62 businesses disclosed their business average monthly/annual sales. The rest, (for their own reasons) did not want to reveal this. However, it has been discovered that most SMMEs do not pay income tax, they pay license fees and these do not exceed M20.00 per year. Even from those who answered the question, it is doubtful if they were genuine. About 4 businesses out of 62 are new as they started towards the end of 1998 (Sept/Dec). 3 of them could not say how much income the business has generated so far.

The highest income earning business as already pointed out was found to be the shoe repair business enterprise, sole proprietorship, with monthly average income of 7,916 maluti. This business employs 20 people and it is 13 years old. The owner has secondary education.

These figures could be much higher than this if the factors such as existence of proper management strategy, relevant technology, flexibility and division of labour, coherency in production systems, were effected. These would lead to increased productivity and efficiency. As a result, growth hence income and employment would precipitate. Competitiveness and innovation would also be enhanced.

Importance of employment in SMMEs sector is increasingly emphasised in the literature. Among other things, employment is the mechanism by which income can be distributed to the unemployed (Bae, 1987, 70). As we know, economic growth unaccompanied by employment and income distribution leads to inequalities. Measures designed to redistribute income in favor of the poor (unemployed) have not been successful in many less developed countries, (Bae, 1987, 71). Employment then, may be the only mechanism by which income can be redistributed to those who would otherwise remain unemployed. Therefore, other alternatives should be promoted. One way of distributing income is by generating employment in small business enterprises. For small businesses to be able to perform this role, they must be promoted. Tabulated below is the structure of employment in the small-scale manufacturing enterprises in Lesotho.

Table 3.2: Number of Workers Employed in Lesotho's SMMEs.

Range of Labour size	No. of SMMEs	Total labour size	Percentage
No person hired	23	0	0.0
1 person	4	4	2.8
2-3 persons	22	55	38.7
4-5	6	27	19.0
6-10	5	40	28.2
11-20	1	15.5	10.9
21-50	0	0	0.0
Total	62	142	100.0

Source: Field Survey, 1999.

There are 39 SMMEs out of 62 that have hired labour. Most SMMEs employ two to three persons on average. These make 38.7 percent of total labour size absorbed by these SMMEs. Self-employment is very common as it could be noticed from the table that only 39 SMMEs have hired labour. The majority of enterprises surveyed employ fewer than 6 workers including self-employed or independent workers. Enterprises with 11 to 20 workers represent roughly 11 percent of the sample. The study found no enterprises

employing more than 20 persons. It can therefore, be concluded that there exist mainly small and micro enterprises in the manufacturing sector.

Most economists agree that to achieve equity, it is best to promote employment rather than through income distribution. In Korea, no specific policies were adopted to alleviate poverty and inequality, (Bae, 1987). By expanding employment opportunities through creation of labour-intensive and export-oriented industrialisation, Korean government was able to realise its goals. Exports of fabrics, clothing and footwear, which are typically labour-intensive grew rapidly in Korea during the 1960's to the 1970's. Export-oriented industrialisation is what is needed in Lesotho. Most SMMEs in Lesotho produce for domestic consumption because they are still at the infant stage. The government can select those SMMEs that show signs of growth and expansion.

There is a general agreement in the literature that small business flourishes in labour-intensive industries and even within industries; it tends to use more labour-intensive technology. Furthermore, it has been discovered that small businesses in developing countries tend to employ lower-skilled and thereby lower-income or potentially unemployed workers. In this way small business contributes to absorbing unemployment, especially unskilled unemployed which is prevalent in developing countries. Equality of income distribution is also improved in the process, (Bae, 1987; Chuta & Liedholm, 1985).

In his study, Bae (1987, 84) proved that small business is labour-intensive. However, with small business employing more than 50 workers, more capital and labour is required. He used capital-labour ratio ( $K/L$ ), output-capital ( $Y/K$ ) and output-labour ( $Y/L$ ) ratios to measure whether small business enterprises are more labour-intensive or capital intensive. Though in this study extensive computations of the ratios could not be performed due to lack of data, SMMEs in Lesotho are also labour-intensive. This was discovered when the enterprises' sites were visited.

In many developing countries, there exists a surplus of labour and a shortage of capital. Small business enterprises, being more labour-intensive, have comparative advantage in production of commodities requiring labour-intensive skills. These activities include among other things basic handicrafts and artistic work. Small towns and rural areas can benefit more, as these activities do not require sophisticated capital or machines, which are unaffordable. Rural employment and hence incomes would increase and in the process migration to urban areas would be reduced. Urban employment already cannot absorb massive population growing in the cities. There is a surplus of labour in Lesotho and the continuous retrenchments have increased this excess. Manufacturing enterprises covered in this study are all labour-intensive; for example, the Mine-Workers Association formed by the retrenched workers is involved in the creation of labour-intensive projects.

Ozcan (1995, 14-17) also stipulates the importance of SMMEs in displaying flexibility, specialisation as well as innovation. This is because if SMMEs have these attributes, employment is highly likely to result from the high division of labour. If a firm is growing, there are likely prospects for expansion, hence employment and income generation.

From the questionnaire that has been undertaken in this study, it has been discovered that there is potential for high division of labour among SMMEs in Lesotho. In leather works there already exists a high division of labour. An example of an enterprise that displayed this attribute is M.M Leather Works and Shoe Repairs, situated in Maseru. This enterprise is among the highest income earning business with annual income ranging between 90,000 and 120, 000. The number of workers employed by this business is 20.

Adopting technologically improved production systems in SMMEs could result in positive impacts on the production side. Efficiency would be enhanced provided entrepreneurs are effectively trained on how to use these technologies. SMMEs' sales are boosted in the process. In Lesotho, support institutions such as Basotho Enterprises Development Corporation and NGO's such as Lesotho Manufactures Association, could afford the entrepreneurs such training. Keeble (1988) indicates that high technology has



increased the importance of small firms despite the dominance by large firms in various sectors of the manufacturing. However, in Lesotho as it is in other developing countries, technological assimilation is hampered by lack of computers, which today are regarded as the most effective way of transferring technology and information. Technological improvement and innovativeness in small firms is therefore hampered.

Technology also affects firms' production, survival and growth. Consequently income and employment generation are affected. The study has discovered that manufacturers of leather products in Lesotho could expand their plants into assembly of plastic handbags and similar products. The problem is acquiring appropriate technology and this technology is expensive. Demand for leather products in Lesotho, far exceeds production.

It is suggested that labour mobility in combination with learning on the shop floor may be an effective instrument for the diffusion of manufacturing techniques. Informal arrangement between owners and employees must be eliminated in order to ensure more stable labour and to reduce firing and hiring all the time.

Employment is also important for social and political stability. We know that there are political disadvantages and dangers when people are unemployed. For example, strikes, wars and criminal activities erupt. There is also a belief that work is intrinsically good and that unemployment has a demoralising effect. The SMMEs in Lesotho provide an escape from unnecessary or dangerous activities as it absorbs all age groups. However the young college and university graduates still have to be attracted to entrepreneurial activities. Measures are underway to introduce entrepreneurship courses in institutions of higher learning in Lesotho.

### 3.3 Small-Scale Enterprises and Poverty Reduction

Another objective of this study is to analyse the role of SMMEs in poverty reduction. This role is however closely linked to the two roles discussed above, that is, employment and income generation. Poverty can be explained from many dimensions. Poverty is generally defined as lack of adequate shelter, food, lack of access to health and education. Having no job without any other source of income is also part of poverty, as a person has no income to live on<sup>3</sup>.

A variety of indicators are used to measure the extent to which a person is living in poverty. These include income and consumption-based measures. The most commonly used poverty measures at country level are based on income or consumption levels. A person is considered poor if his or her consumption / income falls below some minimum level necessary to meet basic needs. This minimum level is usually called the poverty line. However, what is necessary to satisfy basic needs varies across time and societies. Therefore, poverty line varies in time and place. Each country uses lines that are appropriate to its level of development. From section 3.1, tables 3.1 and 3.2 above, it has been discovered that SMMEs in Lesotho contribute to poverty reduction by generating income and employment. SMMEs are a source of living for the poor.

In Lesotho, poverty reduction is one of the major development objectives for the country. It is stated in the Sixth Five Year National Development Plan that for sustainable human development it is imperative to pursue policies directed to poverty reduction. Promoting employment growth is certainly the foremost development strategy towards combating poverty. About 9 percent of Lesotho's labour force is employed in the formal sector, 20 percent in the informal sector, whereas 15 percent is migrant workers in South Africa, (Sixth National Development Plan, 1996/97-1998/99). The rest of the labour force is either openly unemployed or engaged in subsistence agriculture.

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<sup>3</sup> (Journal of Development Economics on Internet)

In Lesotho, anyone whose monthly average income falls below 250 maluti is living in poverty. The lower paid civil servant (cleaner) in Lesotho earns between 300 and 400 maluti per month. The problem is in the small and micro enterprises whose monthly average sales do not even exceed 1000 maluti. They do not afford to pay minimum wage. Those enterprises that earn more than 5000 maluti a month (42 enterprises out of 62), can afford to pay minimum wage. Moreover, government only absorbs 30 to 35 per cent of formal employment. This means that the rest of the population lives in poverty. It is stated in the plan that about a half of the population lives below the poverty line.

Existence of an informal sector relieves the formal sector and lowers the high rate of poverty. The entrepreneurs support their families and the families of those hired by them, though the wages are very low.

Using consumption-based measures, the poor are also defined as those who spend 50 per cent of their total household income to obtain their daily adult diet of 2500 calories. The poorest are those who spend over 60 percent of income to obtain the same amount of calories. Based on these definitions, it is estimated that roughly 50 percent of households in the country are poor and more than 25 percent are the poorest that live in the rural areas, (Sixth National Development Plan, 1996/97-1998/99). Under this situation then, the country has to focus its attention to other alternatives. Formal sector expansion seems to be stagnating if not declining. Informal sector has to be promoted by increasing productivity, thereby giving rise to incomes as well.

### **3.4 Summary**

There are three important arguments raised in this chapter. The first one is that SMMEs in Lesotho do generate income. This income is used to take care of dependents and as a supplement to formal jobs. However, most entrepreneurs indicated that their businesses are the primary source of income. Most of these SMMEs have a potential of increasing their income prospects if only major problems such as finance, technological and management skills could be addressed.

The second important argument raised is that SMMEs in Lesotho generate employment. Out of 62 businesses, 39 have hired labour. This means that 63 percent of these SMMEs have a potential of generating new jobs. Most enterprises employ between 2 to 3 persons followed by those employing between 4 and 10. Now taking into account that formal sector (i.e. government, parastatals and the private companies) absorbs only 44 percent of labour force, the informal sector plays a major role in employment generation in Lesotho.

The third argument that is equally important in this chapter is poverty reduction. SMMEs in Lesotho are a source of living for the poor, the joblessness and the retrenched mine workers. There exists hired labour (besides apprenticeship) in these enterprises, even though average wage paid per month is sometimes below the minimum wage. It is henceforth concluded that SMMEs in Lesotho contribute towards poverty reduction.

In the next chapter, we explore further the role of small, medium and micro manufacturing enterprises in value addition. This is important because it is a way of measuring the contribution of SMMEs to the economy as a whole. Value addition also is vital for the growth and expansion of SMMEs themselves.

## CHAPTER 4

### VALUE-ADDING POTENTIAL OF THE MANUFACTURING SECTOR OF SMMEs IN LESOTHO

The purpose of this chapter is to explore the value-adding potential of small, medium and micro enterprises in the manufacturing sector of Lesotho. From the list of the manufacturing sub-sectors that the study covers, each will be discussed in turn to highlight the current and potential value adding activities. This is covered in the first section. It is argued in this chapter that if the small-scale manufactures in Lesotho were export-oriented, value addition of their activities would increase. We explore this issue in details in section two after the current value-addition activities are examined. The literature on how SMMEs contribute to the economy through their relationship with large firms, for example, through sub-contracting is also examined. It is argued in the literature that calculation of value added is a far more accurate way of determining an industry's contribution to overall economy than by simply calculating gross sales; since it indicates how much has been contributed by manufacture, (Dictionary of Business and Economics, 1984, 484).

#### **4.1 Current Value Addition of Manufacturing SMMEs in Lesotho**

Firstly, let us explain what is meant by value addition in the context of small-scale manufacturing. According to Fletcher and Hardill (1997), the concept value-added has two dimensions. One is quantitative, whereas the other is qualitative.

The quantitative definition of value-added by a manufacture refers to the difference between the price of purchased raw materials, semi-finished raw materials, finished parts that are used to make a product and that product's final selling price. In other words, value-added is the increase in price of these purchased elements created by firm's production processes. Thus a company with total annual sales of M6 million (equivalent

to \$1 million) and purchases of M3,600,000 (\$600,000) per year would have value-added either by manufacture or by distribution of M2,400,000 (\$400,000). This is why calculating value-added is more preferred to just calculating gross sales since it indicates how much has been contributed by manufacture.

The qualitative value-added is defined as the various stages of processing a product passes through before reaching the ultimate consumer. For example, cotton is first processed into a textile or a piece of cloth, and it is processed into wearing apparel (dresses or trousers). Therefore, value has been added to the raw cotton.

In Lesotho, value-added is calculated by subtracting the direct costs of materials used including transport costs, minus net profit, depreciation, overheads cost and total employee compensation from gross sales. The net sales value is then equal to value-added. Using M.M Leather Works and Shoe Repairs factory as an example, it was discovered that on average, the enterprise makes value-added of roughly 20,000 Maluti per month. This was arrived at by subtracting 55,000 Maluti (material and transport costs equaling 17000, overhead costs such as rent equal to 1000, employee compensation equaling 37,000 Maluti) from monthly average gross sales of 75,000 Maluti.

Having highlighted what is meant by value addition, we now turn to the discussion of current value addition activities of the manufacturing entities concerned. All these were discovered during the interviews with the enterprise owners. The structure of the questionnaire is indicated in appendix A.

#### **4.1.1 Sewing and Knitting**

Under sewing and knitting the small-scale manufactures cut the fabric into dresses, trousers, shirts, jackets / coats etc. The value-added is realised especially when different and attractive patterns are made. Manufactures of traditional dresses (especially Basotho traditional wear called 'seshoeshoe'), have added new designs to these dresses. In the old days it used to be a plain skirt with an outer half skirt like coat. A full dress would be an

inner part that goes with an outer coat. These traditional dresses used to be worn during special occasions such as Moshoeshoe's day<sup>4</sup>. But now they can be worn to office work as they have been turned into formal dressing. The following table displays trend in value-added of small-scale garment producers in the country.

Table 4.1: Value-Added of Small-Scale Garment Producers in Lesotho

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Output	5.8	5.9	6.1	6.2	6.4	6.5	6.7	6.9	7.1	7.3	7.4
Value-added	2.3	2.4	2.4	2.5	2.6	2.6	2.7	2.8	2.8	2.9	3.0

Year	1991	1992	1993	1994	1995	1996	1997
Output	7.6	7.7	7.9	8.1	8.2	8.4	8.6
Value added	3.1	3.1	3.2	3.2	3.3	3.4	3.4

Source: Bureau of Statistics Lesotho, 1998 Statistical Report.

From the table, it can be noticed that value addition of small-scale garment producers has been slowly increasing. This is not surprising considering the rising market share of small-scale sewing, knitting and tailoring in the country.

#### 4.1.2 Steel and Metal works

Manufactures of steel and metal works turn steel into usable household utensils. These products include gas stoves, lamps, pot-stands and flower stands, door and window frames, burglar proofs, farming equipment such as hoes and planters etc. Welding is the basic work here because steel and metal are imported.

#### 4.1.3 Woodwork

Carpentry is very famous in Lesotho. Chipboard and other material required for manufacturing wooden products are imported. Desks and chairs for school, coffins,

<sup>4</sup> This is the day celebrated for Moshoeshoe's birthday, Moshoeshoe being the founder of Basotho nation, as the legend goes.

shelves and cabinets for both office and households, household furniture for instance, kitchen units are made, plus various other wooden products.

#### **4.1.4 Leather works**

Under leather works, shoes, bags, saddles, jackets, belts etc. are produced. However leather repairs and alteration of leather jackets is also part of the work. With the aid of advanced electric machines for cutting, quality products are made especially leather sandals.

#### **4.1.5 Food processing**

Soya products, dairy products, wheat product and spices are the main type of food the small-scale food manufactures of Lesotho are occupied with. Under soya products, items such as soup and jelly are processed. Under dairy products, milk and soft drinks (juice) are processed. The juice is a dairy mixed juice. Wheat products include mainly bread. Most often the manufactures in this sector also manufacture candles, vaseline and soap. These products are very useful and highly needed by the poor, low-income population, who cannot afford for instance, expensive toiletries.

#### **4.1.6 Handicrafts**

Handicrafts are also popular in Lesotho. Very attractive and fine handicrafts are produced. These include sheepskin and cow-skin products such as shoes, mats, hats and so forth. Grass products such as hats (the famous hat is the traditional Basotho hat called mokorotlo), mats, brooms, flower stands and other decorative items are also part of the produce. Besides handicrafts, pottery is also common. Among pottery vessels, items such as a clay pots, clay beads and ceramic vases and other decorating material made of fired clay, are the main job. There used to be two major marketing outlets in the country. The first one is in Maseru and the other in Kolonyama, a small town next to Teyateyaneng<sup>5</sup>.

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<sup>5</sup> Teyateyaneng is a major town north of Maseru (capital town)



The one in Kolonyama was dissolved some years back due to lack of funds to run it. Actually, it was basically a privately owned pottery firm and market outlet. The one in Maseru got burned during the 1998 political unrest. This has been major set-back in the value-adding potential of small-scale manufactures involved in pottery, because these marketing outlets served as motivation and a surest way that their products will sell. Hence, they had the edge to improve or add value to their products.

#### **4.1.7 Electronics**

One of the major important and major services SMMEs' sector add to the economy is electrical repairs and electric objects designs, especially toys. Major items include, television and aerials, radios, heaters, stoves and other electrical appliances. These electrical specialists also directly extend services to the households by fixing and connecting electrical appliances at houses.

Innovative character of small-scale manufactures truly comes here under electronics sector, where one discovers invented electrical and battery functioning objects. One of the respondents who specialises in TV and radio repairs, informed me that he knows how to imitate a roger-roger (it is an object by which messages are received by signaling).

### **4.2 Value Addition Potential of SMMEs and Import Substitution**

#### **4.2.1 Import Substitution and Value-Addition**

The policy of import substitution is inward-oriented and results in protectionism. This policy has been tried as an industrial strategy in developing countries including Lesotho for so many years but it has not worked. As already pointed out in chapter one, many studies do not support the policy of import substitution, for example, World Bank Technical Papers, (1979 and 1984), Chuta and Leidholm, (1985). Knowing that they are protected, manufactures will not improve the quality of their products. Over 80% of raw materials of producers in Lesotho are imported from South Africa, therefore,

entrepreneurs have to maximise on the efficient use of resources. SMMEs would be better off if government adopts an export-oriented strategy (as was done in Korea) in which incentives are provided to SMMEs sector. This would enable SMMEs to be outward oriented and expand their activities. The sub-sectors of manufacturing where the country has potential to increase its value-added are dairy products and cereal preparation (i.e. food processing including bread making and beer brewing), leather manufacturing, wooden products, metal products, garments, and toiletries (for example, soap).

We will now review how small manufacturing firms can be complementary and competitive to large firms.

#### **4.2.2 Subcontracting**

Complementarity between small and large firms: Subcontracting of specific (often labour intensive) components of a product has provided a stimulus to development of small-scale sector, (World Bank Technical paper, No.26, 1984). Though it has been found that subcontracting is very rare in developing African countries, with growing emergency and recognition of SMMEs in development of the economy, this set back can be eliminated over time. The prevalence of foreign-owned large import-substituting firms creates a problem because they import their inputs. This is true of Lesotho as well. Large import-substituting firms in the country are mostly foreign owned and are mainly clothing, textile and shoe industries. However, there is a potential for subcontracting links to be established between these firms and the garment producing SMMEs in the country. With these links established, it is believed that value-added per product of SMME's would increase. For example, 'Hatooa-Mose-Mosali' Weaving and Designs enterprise could work with one of the Thetsane large-scale weaving firm to hand-sew creative and traditional designs on the products.

### **4.2.3 Competitive Relationship**

According to Bae, (1987, 84), small and large businesses could be competitive in an industry. This may take place when small and large firms produce same (or similar) commodities. In such a case therefore, competition could result in an increase in value-added of SMMEs. However, it is often questioned as to the extent to which SMMEs products compete directly with those of their large counterparts, particularly in developing African countries. This is because earlier studies in Africa found that large-scale manufacturing, especially in the early years of industrialisation, was heavily concentrated in food, beverages and tobacco, (Liedholm and Mead, 1998, Page and Steel, 1984). There was little direct competition even with the relatively small-scale firms that fall in the same industry. However, large-scale firms are now also concentrated in textiles and apparel and small-scale manufactures exist in these industries. It is observed that for specific products, there may be direct competition, especially where a subsidised large factory can supply the market for a good previously produced by small-scale firm, (The World Bank, 1984, No.26, 18). However, on an industrial-to-industrial level, small and large firms differ substantially both in their distribution and markets.

### **4.2.4 Efficiency**

The issue of efficiency is also related to the two issues discussed above. As it has been discovered that small-scale enterprises are more concentrated in labour-intensive industries, they can therefore perform the same tasks as their large counterparts but using more labour than capital. This results in efficient use of resources because in developing countries capital is scarce and costly. One of the key characteristics of small business namely that they are flexible and can respond to market signals (demand) more quickly than their large counterparts, comes in here. Letting other things to remain constant (i.e. market imperfections), small business can deliver the product demanded as soon as the order comes in because there are no hierarchical structures to go through before an order is attended to. Small businesses also produce in small and specialised quantities unlike

large firms whose products are mass-produced. In the same manner when there is efficiency, value-added per product increases, hence gross sales would double.

#### **4.2.5 Establishing Inter-Industry and Intra-Industry Linkages**

It is widely recognised that firms need to develop linkages with one another as this has a positive effect on their success and growth. Firms establish networks with suppliers, machine vendors, and even with customers. Contact with suppliers could be direct or could go through non-government organisations (NGOs). Interaction with suppliers results in establishing market linkages. In provision of raw materials or inputs, linkages could be established between and within industries. In Lesotho, in the food-processing sub-sector, a link can be established between the farming sector and the manufacturing of food products sector. For instance, farmers who rear dairy cows, Lesotho Dairy, Basotho Fruit and Vegetable Cannery<sup>6</sup> could establish links with small-scale manufacturers in food processing. Lesotho Flour-Mills should improve its ties with small-scale bakeries. The former and Maluti Mountain Brewery are members of Lesotho Chamber of Commerce and Industry. The two firms can assist in establishing links and promoting small-scale food processing. In any case, there has been some food 'shows' and competitions organised by the aforementioned firms. However their efforts have not been articulated towards promotion of entrepreneurship but were centered on advertisement of their products. Therefore, the way in which small firms create and add value in economic links with other small firms and large firms is an important way of measuring the role of small firms in socio-economic development of a country.

#### **4.3 Summary**

In this chapter it has been discovered that value-added is the best way of measuring or assessing the contribution of SMMEs to the overall economy. Using the qualitative definition of value-added which mainly looks at the various processing stages a product

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<sup>6</sup> Lesotho Dairy and Basotho Fruit and Vegetable Cannery are parastatals.

goes through before being sold as a finished product, manufacturing enterprises in Lesotho do add value to the economy.

SMMEs have a potential of contributing more to the economy if the government can adopt an export-oriented strategy and provide them with incentives. Activities of SMMEs would henceforth expand. The categories of these SMMEs that have the potential to increase their value-added have been identified as those involved in production of dairy products and cereal preparation, electronics, leather and wooden products, garment making specifically traditional wear and the toiletries sector.

Subcontracting and establishment of industry linkages is very important as it leads to competitiveness and efficiency. Inputs can be secured very easily and quickly and at the same time transport costs are lowered. Moreover, subcontracting helps expand market for SMMEs products and hence boosts their gross sales or value addition. However, in this study it has been shown that subcontracting is very rare in countries such as Lesotho. There is absolutely no competition between SMMEs and their large-scale counterparts in the country. Establishment of linkages in terms of inputs on the other hand is very possible in Lesotho. The Food-Processing sub-sector has been given as an example.

In conclusion, SMMEs manufactures can be termed 'scaled-down versions' of mass production, that produce finished garments for the market. There are some manufacturers who make high fashion garments of expensive material (besides the fact that there are those who produce for lower end of the market or lower income population, specialising in one or two standard products).

Having revealed the role SMMEs can play in income and employment generation, poverty reduction and value addition, it is now necessary to evaluate the importance of having a high level of demand for SMMEs products. With the existence of a high level of demand, sales are boosted; hence income and employment would precipitate. This is the purpose of the next chapter.

## CHAPTER 5

### ESTIMATION OF DEMAND FOR SMMEs PRODUCTS

This chapter analyses major determinants of demand for SMMEs products. Demand considerations are important in determining the viability and growth of small-scale industries (Chuta and Liedholm, 1985, 52). One of the major reasons why new SMMEs are started but fail is lack of demand. Section one therefore, discusses the main reasons for estimation of demand and presents the hypothesis. Section two presents the model and economic interpretation of the variables. Section three shows the kind of data used and limitations in collection as well as the method of estimation. Supply side factors, which indirectly influence SMMEs through price, are covered in section four. The last section is the conclusion to the chapter.

#### 5.1 Demand for SMMEs Products

Expanding demand for SMMEs as already pointed out, is very crucial because it is a way in which SMMEs' efforts can be sustained. Many programmes have been launched to assist SMMEs in increasing their production, but major problem has been how to market these products. Lack of demand remained at the center of SMMEs constraints. Either household's income must rise in order for SMMEs increased output to be absorbed or government and other sectors of the economy must make room for SMMEs output. In addition, output of SMMEs must be directed to the outside market, i.e. export market. Without demand expansion then, there will be no incentive to extend SMMEs and their establishment will result in involutory not evolutionary growth, (ILO, 1994).

There is a general belief that the primary market for small enterprises throughout Africa is consumer demand, i.e. SMMEs do not produce items that are used as inputs by large-scale enterprises. They produce directly for final consumption. This is because most of the major small-scale industries represent simple consumer goods such as clothing, furniture, shoes, baked food and metal products. These goods are said to cater for low-income rural and urban population. Moreover, it is argued that markets for the products

of small firms are highly localised with very limited spatial distribution of output<sup>7</sup>. By spatial distribution of output it is meant that output of small-scale enterprises is concentrated in one place, (i.e. small firms are not able to distribute their output to other locations).

Though there is virtually no empirical evidence, researchers have pointed out that demand for small-scale products is severely limited especially in the rural areas (Chuta and Liedholm, 1985; McCormick et al, 1997). The researchers further maintain that the demand for these products will decline absolutely as the level of rural income increases. Even though there is a general belief that SMMEs' sector provides much of the consumer goods demanded by lower income population, it is also observed that this pattern of demand is attributable to a number of factors. Firstly, different consumption patterns across industries affect demand. Secondly, the observed pattern of demand is attributable to the low-cost and high-cost substitutes within industries. Finally, it is partly associated with the quality differences for the same product. Therefore, this means that depending on the skill of the artisan and quality of the materials, SMMEs have the potential to supply the demand for higher income consumers as well.

There are various approaches that can be applied in order to secure demand for SMMEs products. These include macroeconomic policies that would result in increased income and employment in both urban and rural areas where SMMEs are found (i.e. targeted interventions). Income is the important factor that induces demand. In rural areas agricultural output must increase so that rural incomes rise. Macroeconomic policies include for instance lowering of prices of seeds and fertilisers, subsidisation of input prices, extending infrastructure to rural areas especially roads. In this way rural SMMEs' output would be easily transported to market centres and access to suppliers of inputs is ensured. In urban areas, taxes must be lowered, though in the low income and less developed countries (Lesotho is one example), SMMEs especially small and micro enterprises are hardly taxed.

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<sup>7</sup> (World Bank Staff Working Paper, no.363, 1979)

With all these arguments in mind, the purpose of this chapter is to measure the demand for SMME's products in Lesotho in order to assess the income elasticity of demand, price elasticity and cross price elasticity. Our hypothesis is essentially that demand for SMMEs products will not decline as household incomes (both rural and urban) increase. In addition, one argues that SMMEs have a potential to expand their market to higher income population and for export market, if the constraints facing them are addressed.

Analysis of demand in this study is based on the empirical evidence established by Chuta and Liedholm (1985) in their study of demand for SMMEs products in Sierra Leone. In their study, Chuta and Liedholm established three sources of demand for small-scale products. These were demand generated from incomes of rural and urban consumers, demand arising from backward and forward linkages with the agricultural and large-scale sectors, and demand from foreign or the export sector. Chuta and Liedholm then estimated income elasticities of rural and urban households' income and income elasticity of foreign demand for traditional goods produced by small-scale sector. All these elasticities proved to be high and positive.

## **5.2 Model Specification and Economic Interpretation of Variables**

In the present study, demand for products of SMMEs is derived demand and is specified as a function of the following variables<sup>8</sup>.

- (1) Households income
- (2) Price level of SMMEs products
- (3) Price of substitutes (imports price index)
- (4) Time trend
- (5) Economic Performance, measured by GDP
- (6) Location
- (7) Other random factors.

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<sup>8</sup> A wide range of independent variables including shift factors was considered so that one can choose the most reasonable from the list.



## Mathematical Representation of the Model

$$Q_d = f(Y_i, P_i, P_j, E_i, T_i, L_i, U_i)$$

Where,  $Q_d$  = Quantity demanded (Output)

$Y_i$  = Households income

$E_i$  = Economic performance

$P_i$  = Price of the good

$P_j$  = Price of a substitute

$T_i$  = Tastes and preferences

$L_i$  = Location of enterprise

$U_i$  = Error term

### Income of households

It is expected that as households' income rises, demand for SMMEs products will increase as well. Income increases purchasing power of economic agents. If the consumable goods of SMMEs are of good quality, they will certainly be bought. The relationship between households' income and demand is therefore positive.

### Price level of SMME products

Price level will be negatively related to demand. According to the theory of demand, we know that price and quantity demanded are inversely related, if it is a normal good meaning that as price of a product increases, demand will decline and as price falls, demand is expected to increase. This is why demand curve is downward sloping. The coefficient of price measures price elasticity of demand. The expected sign on the coefficient of price is negative.

### Price of Substitutes (imports price)

Except for traditional wear and basic handicrafts, the rest of small-scale enterprises products can be substituted by imported goods, for instance furniture, clothing and metal products. According to the theory of demand, an increase in the price of a substitute good causes the demand for the good in question to increase. Similarly, an increase in the price of a good in question will cause demand to shift to a substitute. As price for substitute rises, its price goes up as well. Price of all related goods increases. It is for this reason that price of substitutes tend to move in the same direction. Therefore, the sign on the coefficient of price of substitutes may be positive or negative.

### Time trend

Time trend is included to capture changes in production technology, tastes, preferences etc. It is argued that as new methods of production, use of modern equipment, changing preferences and tastes of consumers take place, demand will also change. The sign on the coefficient of this variable may be positive or negative.

### Economic performance (GDP)

As economic activity increases, it is expected that demand for SMMEs products will increase. The increase in economic activity means that output is rising and thereby employment. As more jobs are created, people's incomes rise, hence demand for consumable products increase. The expected sign on the coefficient of GDP is therefore positive. Empirical evidence shows that when the macroeconomy is doing well, employment growth through the expansion of existing small enterprises is also high. When the economy is going through periods of slack growth or of stagnation, by contrast, expansion growth would be more limited, but this would be counterbalanced by a more growth through new startups.

### Location of an enterprise

The location where an enterprise is situated is very important in demand analysis. This factor has also been found to affect the growth of the firm. Enterprises that are situated in urban centres and near market centres have been found to have high rates of growth, and

growth of the firm means sales or turnover is high. Turnover has been precipitated by high demand. Growth also means activities of these SMMEs are increasing. This means that their output and employment will increase. The coefficient of the variable location is expected to bear a positive sign.

#### Other random factors

This is the error term to take care of other effects not included in the model.

The functional form of the model will assume semi-log model. This is based on the empirical models by other researchers when estimating demand for small-scale industrial products. The income elasticity of demand is one of the crucial parameters, as it will indicate the kind of relationship that exists between rural and urban incomes and quantity demanded of small-scale products. Chuta and Liedholm (1985, 53), argue that both the magnitude and sign of the income elasticity of demand coefficients for small-scale products, are central debate over the future role of these activities. The arguments that small-scale products are 'inferior' goods and thus their demand and production will decline as rural incomes rise have been tested. However, there is little evidence so far, to verify the magnitude and sign of these elasticities. Some studies have concluded that demand elasticities of small-scale enterprises commodities are high and positive and that SMMEs' products are not inferior to higher income categories. Chuta and Liedholm study (1985) of Sierra Leone's manufacturing and Deb and Hossain (1984) have proved this argument consistent.

In the model we have other elasticities as well, and price elasticity of demand is equally important. This factor will indicate how responsive is the quantity demanded of SMMEs products to the market price changes.

### 5.3 Data and Method of Estimation

The data to be used in this analysis is based on national accounts and industrial statistics collected from the Bureau of Statistics and UNDP Lesotho. Data on the number of SMMEs establishments and the number of people they employ is based on the surveys undertaken by UNIDO (United Nations project) in collaboration with the Ministry of Trade and Industry. However, there are shortages in the data because most of the variables are not covered by the data.

Ordinary Least Squares (OLS) method is firstly applied but it is not appropriate method if one wants to test whether small-scale industrial products are mainly inferior goods with negative or very low income-elasticity of demand. Estimation of income elasticity using semi-log helps to measure the percentage change in demand for a particular commodity in response to a change in total expenditure (income), whereas marginal propensity to consume measures the proportion of incremental income devoted to a particular commodity.

National Disposable income has been taken as a measure of income of households because it measures economic position (in terms of total goods that could be purchased) of all individuals in the country.

OLS regression results give significant parameter estimates, but the signs are wrong specifically the sign on the coefficient of price. Also the elasticities cannot be evaluated. The model is tested for the problems of multicollinearity and autocorrelation. Multicollinearity occurs when two or more explanatory or independent variables are correlated. This poses a problem because individual parameter impacts cannot be obtained. In cases of high collinearity, it is possible to find that one or more coefficients, are individually statistically insignificant on the basis of t-tests. But on the F-test basis (joint test of significance) that  $\beta_2 = \beta_3 = \dots \beta_k = 0$ , they are significant, (i.e. insignificant t-values but high overall R-squared). Autocorrelation is a problem of correlated disturbance or error terms. Using time series data entails encountering this problem. Data

involving time series such as GDP, Personal Consumption Expenditure (PCE) and Personal Disposable Income (PDI) often tend to move in the same direction reflecting an upward or downward trend.

Both the problems of multicollinearity and autocorrelation can be solved, though with a high level of multicollinearity nothing much can be done about it. This is because there are two conflicting solutions involved. Empirical research suggests that if multicollinearity is severe, one can treat it by dropping the variables that are suspected of causing it. However, as this is performed, the researcher runs into another problem, which is omission of relevant variables. This result (i.e. omission of important variables) is violation of one of the Ordinary Least Squares (OLS) assumptions. Autocorrelation can be treated through manipulation of sample data.

The second step was to run the regression using stepwise regression. The individual t-values and p-values are significant though the explanatory power of each coefficient is very low.

Conclusion: OLS is not an appropriate method if one wants to assess the different elasticities of demand. The results are attached in the appendix.

The third step was then to convert the variables into log form and regress output on the log of disposable income, the log of price index, and the log of import index. The results were not good after changing the functional form. The variables were then tested for stationarity or unit root. Non-stationarity is a common problem with time series data. When the time series is not stationary, the resulting regression results are spurious, i.e. results may appear good but with close scrutiny they are suspicious.

On the basis of a visual plot of data on individual variables, the data are not stationary. This is indicated by the upward trend exhibited by each graph. Below, figure 5.1 exhibits the case of non-stationarity. The output variable is plotted against time.

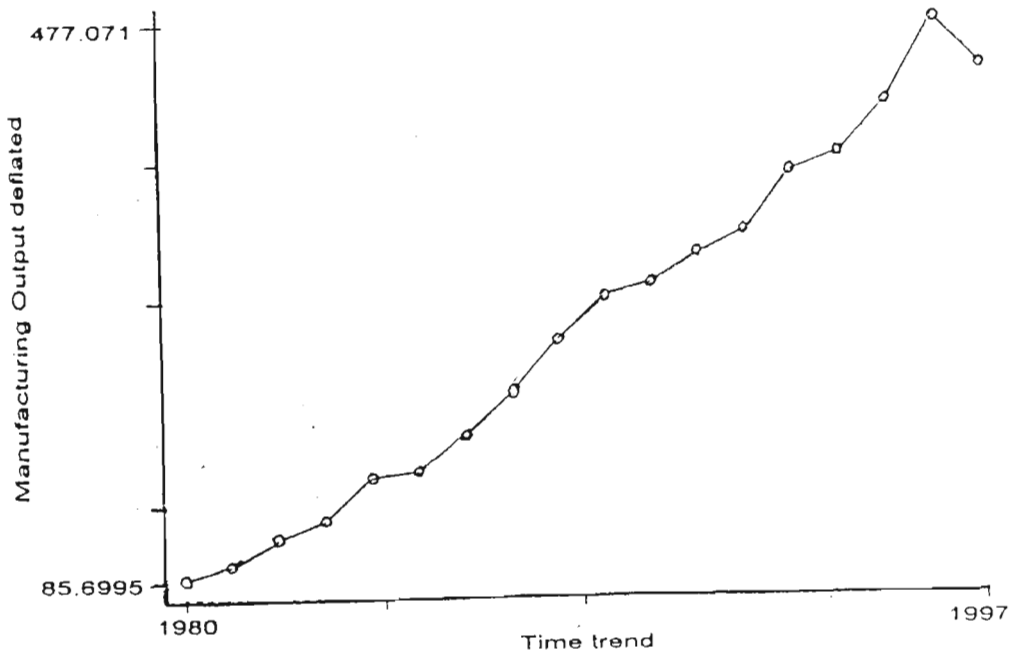


Figure 5.1: Graphical Representation of Non-Stationarity

Since the plot of data is not sufficient to conclude that unit root exists in the time series concerned, the Augmented Dickey-Fuller (ADF) tests for unit root are performed for each variable. With the manufacturing output variable, the series becomes stationary when the DF regression includes a linear trend. This means a trend variable is needed in the model. However the regressors (i.e. Disposable Income, Price Index and Import Index) are still not stationary even after the inclusion of an intercept term and linear trend.

The model was tested for misspecification i.e. whether there are variables that should be added or deleted from the model. The trend variable (INTP), economic performance (Ei) and location (Li) variables were deleted from the model. The model becomes significant though the signs are wrong.

More modifications were done to the model. The dependent variable (output) was also converted into a logarithm and was then regressed on the log of all independent variables. The results are presented in table 5.1 below.

**Table 5.1: Demand Estimates for Major Determinants of SMME's Products  
1980-1997**

Variable	Coefficient	T-value	R <sup>2</sup> -adj	F-value
Lndispin	0.8912	0.050	0.9835	339.51
Lnindex	-0.1047	0.387	0.9835	339.51
Lnimport	0.6742	0.002	0.9835	339.51
constant	-4.4926	0.158	0.9835	339.51

\*Significant at 5 percent level of significance

\*DW Statistic: .998601=inconclusive

\*Source: Estimated

The coefficient of Lndispin (log of disposable income) indicates that a 1 percent change in disposable income will result in 89.1 percent increase in output of SMMEs. This coefficient is significant at 5 percent level of significance and the sign is positive as was expected.

The coefficient of Lnindex (log of price index of SMMEs products), which measures price elasticity of demand, shows that as price level increases by 1 percent, output decreases by 10.5 percent. Though the sign on this coefficient is correct, the p-value is not compatible with the overall level of significance. The problem is suspected to be due to the deficiency in the data and errors in sample collection.

The coefficient on the Lnimport (log of imports index) is also significant at 5 percent level. This coefficient measures the cross price elasticity (as assumed) and the elasticity is high and positive. Moreover the sign is as expected.

## 5.4 Supply-Side Factors

Supply side factors are also important when analysing the demand for SMMEs products. What are the major factors influencing the sales of small-scale industrial commodities? These factors include among others; labour size, price level, type of production processes (machines, equipment), factor productivity, sales, size of firm, location, economic profit/returns, and external factors such as availability of finance, support institutions, market size, infrastructure, etc.

### Size of employed labour

It is argued that size of the employed labour has an effect on output of a firm. Having five people working in an enterprise is better than having one person. However this depends on the firm size and the type of activity engaged in. Duplication of activities is not allowed (i.e. a job that can be performed by one person within the required time framework is not supposed to be shared). More labour employed means output is increasing especially if the labour is productive. The sign on the coefficient of labour size is supposed to be positive.

### Type of Production processes

In the literature the type of production processes identified are traditional and modern. For example, in the tailoring industry, the distinction arises between the traditional proprietors that engage in only ordinary sewing and tailoring, producing such products as common shirts and dresses, (Chuta & Liedholm, 1985, 58). Those in the modern proprietors sew embroidery designs on fabric. It is important to note that these tailors even though they all sew, tailors that embroider require more sophisticated machines (electrical machines) and more expensive type of machines than those that engage in ordinary sewing. In the carpentry industry, the distinction between the type of processes centers on the type of tool and equipment as well. The traditional proprietors use only simple hand tools such as hammers and saws whereas the more modern ones use electric saws, sanders and planes. The type of machine therefore, affects quantity supplied if we



assume that more sophisticated equipment is reliable, quicker and hence efficient. Production must increase as a more modern machine is employed.

### Factor productivity

Factor proportions are generally applied and are measured in terms of the average ratios that relate to capital, labour and output. The determination of factor proportions provide useful insights firstly, in factor intensity, relative productivities of factors of production, and finally they provide a clue as to the amount of output and employment generated per unit of scarce capital input<sup>9</sup>. Chuta and Liedholm (1985, 64) in their study of small-scale industry in Sierra Leone used these factor proportions. The mean values of output-capital, output-labour, and labour capital ratios of both the traditional and modern processes were computed. The output variable has been measured in terms of value added.

In their study, Chuta and Liedholm found that factor combinations do appear to vary depending on the production process utilised. The output-capital ratio did not only provide a useful measure of average capital productivity but it also gave an indication of capital intensity of production. The study discovered that output was higher for the more traditional processes that used scarce factor, capital. Productivity of capital was higher within the carpentry, blacksmithing and baking industries, (at least three times that of more modern processes).

The output-labour ratio or average labour productivity was found to be generally higher for the more modern processes within each industry. The labour-capital ratio, which provides a useful measure of labour intensity and amount of employment generated per unit of capital, appeared to be always highest for the more traditional process within each industry. The labour-capital ratio also was found to vary widely by industry.

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<sup>9</sup> Note that it was pointed out in the previous chapters that capital is scarce in most African developing countries.

### Sales /turnover

Sales or turnover of a firm is a useful measure as it sheds a light on the gross income a firm makes. It gives an indication of the firm's capacity to grow and distribute its output. As sales of a firm increase, more products must be produced, therefore supply increases.

### Size of the firm

Firm size is also another important measure of firm's ability to grow and thus contribute to gross domestic product. Size of the firm in this study is measured by size of employed labour and total assets though the latter is very difficult to determine. Studies have found that size of the firm is positively related to growth of the firm. Therefore as the enterprise grows, productivity is expected to increase thereby resulting in increased output. As output rises, more goods will be supplied.

### Location

Location of an enterprise is a very crucial determinant of firm's operations. Volume of output as well as sales to a certain extent is determined by firm's location. Enterprises located in the urban areas and near shopping centres (or at places where there is lot of activity) sell more and are able to market their products than those located in hidden and away from activity centres. It is stated in the World Bank staff working paper (1979), that rural small enterprises appear to be less market oriented in sale of output. Intuitively it can be understood that if products sell, sales will increase and more will be produced, hence supply will increase.

### Economic profit/return

It is pointed out that the return to the proprietor is important because it provides not only a measure of the real income earned by the proprietor but also the extent to which the proprietor himself may be a scarce factor of production, (Chuta & Liedholm, 1985, 66). Moreover, economic profit provides an additional measure of the relative economic viability of small-scale industry.

### External factors

External factors such as availability of finance or credit affect the production of small-scale enterprises. Lack of access to credit is often cited as one of the major impediment to development of SMME's. In many instances, an entrepreneur would want to produce so much quantity, but is hindered to attain that amount due to lack of funds to buy material/stock. In many developing countries, as already pointed out in the previous chapters, financial institutions available do not cater for the needs of small-scale enterprises. Improved access to credit (other things constant) is expected to lead to increased production and thereby stimulate sales provided there is market.

### Support Institutions

Availability of institutions that give technical support and even financial support is crucial for efficient production of SMME's. Technical support includes provision of training and information transfer to small-scale, medium and micro enterprise owners as well as workers. The shortage of managerial skills seems to be an important constraint to effective growth and development of SMMEs. In many instances, owners of enterprises, particularly the more traditional small-scale activities such as craftsmen, are technically proficient in the manufacturing process but lack extensive training in marketing, financial management or business organisation. Increased managerial abilities therefore, are expected to lead to increased productivity. Support institutions are also supposed to convey information about market opportunities of SMMEs products so that their sales can increase. With increased sales therefore supply is induced.

### Market Size

It is clear that market size affects production and sales of an enterprise. Increase in market size is supposed to lead to a rise in sales of a product. In most cases, one finds that small-scale enterprises sell to individual consumers mostly. If we assume that enterprises are able to produce intermediate products, then they can sell to wholesalers and supermarkets as well. They also have an opportunity to expand their market to the external markets. Attainment of subcontracts or public contracts would enhance their sales and profit.

### Infrastructure

The type of premises that the enterprise operates from matters as well. In most African developing countries including Lesotho, industrial estates (well organised and developed in terms of provision of electricity, water and the buildings themselves) are often made available for large-scale enterprises. Even where these estates exist, they are not in proper form and are often not adequate. In terms of roads, transport etc, small and large firms share the infrastructure, depending on where the firm is located. Lack of infrastructure increases firm's costs. This will have a negative effect on supply.

### **5.5 Summary**

The hypothesis that demand for SMMEs products will decline as households income increases is disputed and the results confirm that SMMEs products are not necessarily inferior goods. Even though there is a general consensus that market for SMMEs products is consumer demand and that these goods serve mainly low-income population, demand for them will increase as households' income increases, whether rural or urban.

Further, observing the behaviour of the different elasticities, for example, the price elasticity of a substitute good, is positive. This means that an increase in the price of a substitute good will lead to an increase in the demand for the good in question, (in our case, the variable output will rise by 67%).

## CHAPTER 6

### POLICY ENVIRONMENT, INSTITUTIONAL SUPPORT AND PROBLEMS OF SMMEs IN LESOTHO

In this chapter, the overall economic policies and SMMEs institutional support by government, non-government institutions will be reviewed. This is done in order to provide insights into the efficacy of the major policies and government programs that influence the functioning of SMMEs. In addition, the chapter will also analyse the socio-economic aspects and other problems facing the surveyed SMMEs. This will help us to realise the influence of institutional support to the existing enterprises. This chapter is therefore organised as follows. The first part deals with discussion of government policies such as economic and industrial policies. Further, this section provides insights into the action plan to assist SMMEs undertaken by the Ministry of Trade and Industry in collaboration with UNDP. The second part presents institutional support and services that are available to SMMEs' sector in Lesotho. The third part relates the problems of SMMEs in regards to government policy and institutional support. Lastly, the final part is the summary of issues raised in the chapter.

#### **6.1 Policy Environment**

##### **6.1.1 Economic Policies**

It is stated in the Lesotho's Sixth National Development Plan for 1996/97 that, the development of Micro and Small-Scale Enterprises (MSSEs) is a key strategy in the development of the economy. The government recognises that through small and informal sector enterprises, the promotion of employment opportunities in the country could be realised. The vital role that is played by SMMEs in the creation of employment especially for semi-skilled and unskilled cannot be ignored. The government therefore understands its obligation to provide incentives for the development of SMMEs. These

incentives could be in the form of providing managerial and technical skills, education in entrepreneurship and creation of an enabling environment for sustainable development.

### **6.1.2 Credit Policies**

Chuta and Liedholm (1985, 137), show that provision of capital or credit is the most commonly articulated and utilized method of affecting small-scale industries. Therefore, it is important to explore the need for such policy measures and their effectiveness. The Government of Lesotho (GOL), through the collaboration of Lesotho National Development Corporation (LNDC), BEDCO and Business Advisory and Promotion Services (BAPS), plans to identify local investors and secure funds for them from the donors (local and foreign), and from local financial institutions and NGOs.

It is stated in the plan that the government will increase institutional credit flow to the small-scale enterprises by advocating viable projects and intensifying the Ministry of Planning's capacity in evaluation of projects. Practically, what happens is that, small-scale entrepreneurs normally submit their project proposals to BEDCO or to BAPS when they want loans from the banks in the country. BEDCO or BAPS then prepares the projects in such a way that they meet the bank's criteria. Specifically, These institutions become the guarantor. In other words, they ensure the security that is usually required by banks from the borrowers. Hence why the government takes an obligation to extend its support in the sector by strengthening the capacity of these institutions in the preparation of project proposals for soliciting loans from financial institutions. Commercial banks are expected to modify the condition for debt equity ratio, which is currently (9:1), for small-scale projects.

According to the plan, the government is supposed to support initiative by organising sustainable and steady supply of raw materials, taking into account cost implications for procurement of inputs for SMMEs.

The government further recognises the need to train prospective entrepreneurs for the sustained development of the industrial sector. To achieve this goal the government plans to implement the following;

- (1) Introduction of entrepreneurship training at secondary school level
- (2) An entrepreneurially oriented internship designed to form part of training courses for maintenance contractors and manufacturing technicians
- (3) Availing the LNDC – managed Skills Training Grant Fund to small and medium manufacturing so as to develop technical and supervisory skills.
- (4) Diversifying Technical and Vocational Division (TVD) of the Ministry of Education.
- (5) Initiating establishment of marketing skills, and also undertake research and development (R&D), (Sixth five-year National Development Plan).

### **6.1.3 Industrial Policies**

There is a general consensus in the literature that policies designed to encourage development of large scale can also affect small-scale industries, (Chuta & Liedholm, 1985, 142). These policies can have negative or positive effects. Those policies that negatively affect small-scale industries are fiscal incentives such as credit subsidies, tax holidays, exemption from import duty accorded to large-scale industries. On the other hand, intermediate inputs that are imported by small-scale are levied substantially. Hence, large-scale industrial expansion is realised at the expense of small-scale firms.

### **6.1.4 Intended Programmes for SMMEs**

According to the plan, the Ministry of Trade and Industry (MTI), supported by UNDP and UNIDO has launched a programme intended to create employment specifically in the medium, small and informal sector. The programme will be carried through:

- Designing new policies and implementing existing policies for the enhancement of activities in the sector that will create an enabling environment for growth.
- Assisting support institutions and business oriented NGOs to improve their capacity to deliver credit and business skills to the sector.

- Providing direct technical assistance to the sector on such issues as product diversification, import substitution opportunities, marketing and product quality improvements to meet export requirement.

With the country being a member of SADC, a market has been opened for SMMEs sector and also in Europe and the Far East, as Lesotho has duty free access to the European Union (EU) market through the LOME convention. According to the plan the government supposedly has to assist indigenous investors to form joint ventures with foreign companies or be subcontracted to competitively service requirements of large-scale industries. The government through LNDC has connections with African Development Bank and the European Investment Bank (EIB). This helps in securing the investment funds or credit to support indigenous investors. In addition, the two international financial institutions together with the World Bank sponsor the Government of Lesotho (GOL) in programmes involving small-scale sector. The programmes are designed to supplement indigenous investors' limited capital or equity. The World Bank also finances other industrial and agro-industry development projects.

#### **6.1.5 Infrastructural Environment and Net working**

What is government position on these issues? It is pointed out in the literature that policies designed to expand the infrastructure of a developing economy, indirectly affects small business industries. Provision of electricity, water, roads and even industrial sites is very crucial for small-scale development.

In Lesotho, infrastructural provision is accorded mainly to large-scale industries. This includes services such as provision of sites that are well developed. LNDC takes active role in organisation of all these services. It has to make sure that a conducive environment for foreign investment prevails. Nonetheless, in terms of roads small-scale industries benefit in the process. The most needed infrastructure especially in terms of roads is in the rural areas and rural towns in the country. There are still many places in Lesotho that are unreachable by motor vehicles. Many small businesses involved in



sewing and knitting, traditional dressmaking handicrafts and weaving and farm enterprises such as poultry are located in the rural areas and small rural towns.

BEDCO provides rented working premises but they are small and few in number. They are found only in four districts situated in the lowlands. These are Leribe, Maseru, Mafeteng and Mohale's hoek. Most SMMEs surveyed who are renting BEDCO premises complained that they are too expensive and small, considering what their businesses earn. Many SMMEs in the area cannot even get space at BEDCO. They work in the town market place where there is lack of electricity. Some who have build stalls are not even in good shape to be able to run productively and efficiently. Therefore, there is still lack of well-developed sites for small-scale enterprises.

Networking:

Networking is defined as the establishment of contacts, exchange of information and experiences with various businesses, establishment of institutions that provide business information, and establishment of advertising and marketing agents. Provision of credit /financial institutions, working premises, counseling or consultancy agents and workshops or seminars also form part of the network, (UNIDO, Les/004/94).

In Lesotho, there is still lack of networking and the few support services available need to be improved, especially in terms of computerisation so that information can be exchanged easily and quickly. Credit or financial institutions specifically directed at small business, information and advertising are non-existent.

## **6.2 Institutional Support**

There are government agencies, private agencies, education and training centers, non-government organisations that offer support to SMMEs sector. Government agencies

include the Ministry of Trade and industry, BEDCO, Lesotho Chamber of commerce and Industry and Business Advisory and Promotions Services (BAPS).<sup>1</sup>

#### Ministry of Trade and Industry (MTI)

The MTI through its industry section is concerned with overall industrial policy and registration of small business enterprises. It is supposed to co-ordinate and articulate government agencies assigned with the role of promoting small-scale enterprises. It is reported in the Government of Lesotho Budget Speech (1998/99), that MTI has now established Standards and Quality Assurance section. This section will design a programme of quality awareness, aimed at assisting local industry to establish systems, based on the ISO 9000 series of standards.

#### Lesotho Chamber of Commerce and Industry (LCCI)

LCCI is supposed to represent government on any subject relating to commerce and industry. Its objectives as stated in the business brochure are:

- To foster and enhance the role of the private sector in conjunction with the business community including parastatals, banking institutions, association and organisations.
- To promote co-operation among businessmen and women in Lesotho in matters affecting them.
- To take active steps to secure the removal of all acknowledged grievances affecting the commercial community or mercantile interests.
- To scrutinise carefully all proposed legislation especially on fiscal topics
- To collect information and statistics on all matters of general mercantile interest
- To communicate with the public authorities and similar associations elsewhere, on all matters of mercantile interest.

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<sup>1</sup> BAPS was a project initiated by GOL and World Bank in 1991. It is now dissolved but such services have been integrated into BEDCO's policies and services.

Many Basotho business people are members of LCCI as it provides a forum for information and exchange of ideas. Moreover the chamber has taken several positive steps towards the co-ordination of the private sector. For example, it has procured funds from BP Lesotho to establish an association of street vendors. In this association, members receive short-term loans with which they can acquire necessary merchandise (Lesotho Review of Commerce and Industry, 1999, 20). The chamber also provides scholarships to deserving applicants, mainly students from the National University of Lesotho and the Lesotho Agricultural College who want to acquaint themselves in various business ventures.

#### Basotho Enterprise Development Corporation (BEDCO)

BEDCO's main objective is promotion of growth, development and sustenance of indigenous entrepreneurial activities<sup>2</sup>. This is implemented through training, consultancy and counseling, technical assistance, provision of working premises, machine hire for cutting, bending, rolling, chiseling, swaging, welding and sheet metal. The machines benefit small-scale carpenters and metal works entrepreneurs who do not have capital to buy this big and high costly equipment.

Business training courses cover areas such as management, marketing, stock control and costing and pricing. Training is also offered in pattern drafting, designing and sewing as well as in advanced product development in garments.

#### Business Advisory and Promotion Services (BAPS)

BAPS is supposed to offer business information and advice on such matters as when a person wants to start a business. BAPS advises on the viability of that business, checking the amount of capital one has and on formulation of business plans. It also advises on marketing issues. Counseling services are also provided to entrepreneurs.

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<sup>2</sup> When BEDCO started in 1975, promotion of indigenous entrepreneurs was the main objective, but with BEDCO's ACT of 1980, foreign small businesses are also included (whose owners have acquired Lesotho citizenship).

Besides these government institutions, there are non-government organisations that provide non-financial services like BAPS. However these NGO's also provide training courses such as those offered by BEDCO, and some of them organise financial assistance for SMME's which are members. The currently active NGOs known are Lesotho Manufactures Association (LMA), Women in Business under the umbrella of Lesotho National Council of Women (LNCW), Lesotho Council of Credit Union League (LCCUL).

LMA provides financial and technical assistance. It is sponsored by the British Government with the purpose of developing modern export-oriented small-scale enterprises. In his presentation of the Budget Speech (1998/99), the minister of Finance and Development Planning stated that about forty-five small-scale entrepreneurs would be provided with training by LMA. This training will enable them to undertake subcontracting work from large garment-making industries. In addition, the trainees will then be in a position to each employ twenty-five people or so, thus create 1125 jobs.

Lesotho National Council of Women and Women-in-Business, as the titles indicate, are concerned with all issues pertaining to women and businesswomen respectively. Women-in-Business operates in the same manner as LMA, though the former is still new in its operations. Women in business extends support services to all businesswomen regardless of the kind of activity and size of business, for instance, street vendors and hawkers are free to join.

LCCUL when it started in 1968 was primarily assigned to cooperate lending and organise credit union societies. Its main objectives were provision of savings and loan facilities, training, accounting and audit facilities. Lesotho Co-operative College used to offer courses. Currently, the credit unions are not functioning.

There exists educational and vocational training institutions as well, directed at promoting entrepreneurship and business management studies in the country. These

include among others, the Institute of Extra Mural Studies (IEMS)<sup>3</sup>, Lesotho Opportunities Industrialisation Center (LOIC), Lesotho Distance Teaching Center (LDTC), Institute of Development Management (IDM), Mary Mazarello Vocational Center, and Lerotholi Politechnic School.

### **6.3 Problems of SMMEs**

#### **Finance and working capital:**

The major problem that has been found to be facing small, micro and medium enterprises in Lesotho is finance. This problem is not new. It is a well-known constraint to all the entrepreneurs. Without finance, a firm cannot grow. People have tried to come up with suggestions and advice but it seems there is no change. Availability of financial markets is a first necessity, then access to these financial markets is next.

In Lesotho, there is lack of financial markets or rather this is non-existent. Unlike in other countries where there will be for instance, credit schemes as it is in South Africa and Kenya, in Lesotho none of these exist. Past efforts have been made but all ended in vain.

The Lesotho Bank in collaboration with GOL, created a projects division to undertake lending to the small-scale industrial sector, (SSI). The projects division is entrusted with the approval of projects for bank financing and monitoring of borrowers' progress, (Lesotho Bank, 1994). However, because of conventional criteria concerning collateral, high interest rate charges etc., small-scale borrowers have lost faith in Lesotho Bank. Only a minority gained recognition in this fund.

Most businesses suffer because they lack working capital. Businesses start but do not grow. Entrepreneurs are very reluctant to borrow because they say that terms of repayment of loans are high. Commercial banks on the other hand are unwilling to lend to the SMME's because they feel that;

- There are limited number of solid local entrepreneurs,

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<sup>3</sup> IEMS is a subsidiary of the University of Lesotho, and it is situated in Maseru ( capital town).

- The high risk, costly nature of small-scale enterprises in servicing loans discourages them,
- Difficulty in guaranteeing money lend and fear that it will not be spent on declared purposes,
- Lack of demonstrated experience among Basotho entrepreneurs in taking responsibility for planning and running a business, and
- Lack of guarantee (collateral) facility.

From the interviews that were conducted, it was discovered that lack of working capital and finance has led to redundancy in most businesses despite the fact that they were established 10 or 15 years back. Many businesses were started but did not last. It is henceforth concluded that growth of business is not necessarily linked to how old it is. There is a lot of literature on births and deaths of enterprises and the relationship of the two issues with growth of business. When analysing the problems of SMMEs, the study has observed the age of business enterprise in relation to what it has achieved since it started, for example, expanded activities or added wage-paid labour. Ages of businesses and frequencies are recorded below.

Table 6.1: How old is the business

Age	Frequency	Percentage	Cumulative %
> 1	4	6.6	6.6
1-2	6	9.8	16.4
3-5	7	11.5	27.9
6-10	14	23.0	50.9
11-20	19	31.1	82.0
20 <sup>+</sup>	9	14.8	
Total	59	100	100

Source: Field Survey, 1999.

The oldest business was the 1968 one. However, this business does not show signs of growing/growth. Monthly sales range between 800 to 1000 maluti (equivalent to rand). It

is self-employed business. The respondent cited capital as the major problem why the business does not grow. Respondent was member of LMA in 1991/92, but she quit because she has never been assisted with borrowing.

Lack of education could also be one of the factors that lead to business redundancy. Respondent has never been to school (even primary). Several studies provide evidence that 'human capital' does significantly affect small and medium enterprise (MSE) expansion. McPherson (1992) in Leidholm and Mead (1998, 137), found that in Southern Africa entrepreneurs with vocational training expanded their MSEs 9 percent faster than those without such training. Further, other researchers discovered that entrepreneurs who had completed secondary school were likely to expand, (based on the study of Kenya and Zimbabwe). On the other hand, completion of primary school by an entrepreneur had no significant effect on MSE expansion in any of these countries.

#### **Market:**

Every business whether small or large, its major concern is market. Every business-oriented person, when starting business, wonders first whether his/her product will sell. If product does not sell, business closes. Many attempts have been made to expand market for SMME's in Lesotho. Support institutions organise trade fairs in the country and outside. However, entrepreneurs complain that not everybody's products are promoted during trade fairs, even those organised in the country. A few entrepreneurs (well known by the organisers) are chosen to attend the trade fairs and show what their activities are.

Besides trade fairs, the foreign donor institutions try to help indigenous manufactures by providing financial and technical support. However, they do not link them with their markets (donor countries). Establishing market networks with the foreign countries is very necessary.

The study has discovered that some entrepreneurs do produce for export. Their export market is mainly in South Africa. There are a few entrepreneurs who have found market in Botswana, in some special shops. These entrepreneurs (who are able to export) are

well established and their businesses seem to be performing well. The average income business earns is around 95,000 maluti per year (approximately 8,000 per month), which is high by Lesotho's economy standards.

Other characteristics of these entrepreneurs (exporters) are that; (1) most of them are well educated. They at least have vocational training. The advantage with vocational training is that it is relevant to the type of work the entrepreneur is involved in. One of these entrepreneurs was previously a production manager in a clothing firm in Lesotho. Therefore he had relevant experience in business management. (2) These entrepreneurs are LMA members and they regularly enter international trade fairs and therefore, they are fairly exposed to the business world. Exposure is very important because that is how the entrepreneur acquires marketing skills. (3) Most of these entrepreneurs are in sewing and knitting (garment industry) and in traditional wear and handicrafts production. (4) These businesses are the most employer, employing between 10 to 20 people.

### **Transport problem**

The entrepreneurs cited transport problem as one of major impediments to smooth running of their businesses. Most businesses use imported raw materials or inputs. The main source of these inputs is South Africa. Entrepreneurs have to travel to major cities of South Africa, such as Durban, Johannesburg and Bloemfontein. It is thus very costly and time consuming to get inputs.

### **High costly rental charges**

The entrepreneurs who have hired BEDCO's premises complain that the rent is too high. Their complaint is honestly justified because the rent is 650 maluti for some one whose business is making 800 to 1,000 maluti per month. The business has hired 2 to 3 persons to help, has to buy stock, and in most cases people make orders without deposit. The entrepreneurs have pointed out that they run into difficulties of meeting their financial obligations such as payment of rent because of delays when an order has been made. Delays take place especially when the entrepreneur has no working capital to buy material and has therefore applied for a loan financing at the commercial banks.



Entrepreneurs end up making endless debts trying to meet the order and by the time the loan is approved, debt has accumulated and interest charges have increased. Moreover customers do not pay enough deposit to purchase material and even when the order has been finished they do not pay on time.

In addition, the entrepreneurs are not satisfied with the way government and its agencies work. Small business owners indicate that they are not given a chance to tender for government projects. One of the respondents shows that BEDCO and other support institutions are not helpful in this matter. Instead, BEDCO competes with the small businesses. The respondent reasons that BEDCO makes wooden products and supplies the government. However, the study has observed that most of the small businesses are not aware of the government tender board procedures. Moreover the government does not really have tendering guidance for small-scale, micro and medium enterprises.

### **Unsuitable working premises**

Maseru City Council has some buildings as well which are comparatively cheaper than BEDCO's. However they are not enough for every one and they are only in Maseru. On top of that they do not have all the facilities such as water and electricity.

### **Security problems**

This security problem is related to the above problem of unsuitable working conditions. Some of the small-scale entrepreneurs trying to avoid high rental fees, have erected their own buildings along the streets and the market place. However, because they lack capital, these buildings are shabby and unsecured. Theft then becomes major problem.

### **Financial Assistance and other Support Services**

The business owners were asked as to whether they have received any financial assistance since the start of the business. Three possible sources of finance were explored; that is government, non-government, private or foreign donor. The form of finance, whether grant or loan financing had to be specified. The study has discovered that the most common method of financing is self-financing from personal savings. This

is due to the fact that loan financing is very difficult to secure for a new and small business, which has no collateral or security. Loan financing from government through BEDCO and non-government organisation such as LMA is the second popular method of finance. There are other newly established private associations such as Mine-Workers Association and Daram Link, which help in financing. However, a business must be registered member to be able to borrow. These associations though, have different requirements for one to become member and the terms of borrowing differ.

The study has revealed that out of the 62 businesses covered, 20 got loans from BEDCO, LMA, Mine- Workers Association and Daram Link. Only 3 (three) businesses got financial assistance in the form of grants. These grants were from U.S.A and Canada. Around 6 (six) businesses got loans from Lesotho commercial banks. Usually the most common one is Lesotho Bank, as BEDCO and the Ministry of Trade and Industry help organise these loans for those SMMEs that have made proposals. Some entrepreneurs explained that they prefer to use South African banks in the nearby border towns because their regulations and services are more reasonable. About 30 SMMEs have not received any financial support, in any form. They relied on personal savings, especially when starting their businesses. Others simply do not have confidence in the financial institutions available in the country.

UNDP has also tried to reach out and extend its support to small-scale industrial sector through strengthening of MTI. This was done through provision of technical support for women entrepreneurs and assistance in the establishment of an export finance scheme. It is still currently trying to perform this role through UNIDO, though most of the interviewed entrepreneurs are not aware of the latter's work. Those who are aware are members of the support institutions, especially LMA and BEDCO. However the entrepreneurs' comments among others are that, there should be price control of small-scale production. There is a general agreement that BEDCO and foreign businesses sell at lower prices and this undermines indigenous entrepreneurs' businesses. They also want MTI to establish quantity and quality control measures, (quantity of imports).

## 6.4 Summary

The major problem in Lesotho is that there is no policy document designed specifically for SMMEs' sector. In other countries such as South Africa, there is a 'White Paper', i.e. a policy document that stipulates clearly government objectives and strategies to assist SMMEs' sector. In this way it is easy to follow implementation plan and to assess the achievements. Without policy guidelines, there will never be any proper execution, rather we will always see the rosy picture drawn in national development plans. These are only empty words because no implementation takes place.

It is argued that measures must be taken to correct market imperfections such as extending bank facilities, support services, training and technology centers to both rural and urban areas especially the former where shortage is still immense. Well-serviced industrial estates are provided to large-scale industries and incentives in the form of tax holidays, investment funds and credit opportunities. The only service that is available to SMMEs' sector is institutional support, though it is pointed out that support institutions may be insensitive to the requirements of SMMEs or rather they simply do not have the capacity to respond to these needs. However, the available institutions still have to be restructured and improved for efficient delivery of services. Therefore, there is need for;

- Creation of well-functioning information centres
- Assistance in acquisition of imports, as at present it is very costly and time consuming
- Infrastructural provision
- Liaison and co-ordination with government departments as most SMMEs are not aware of the work or use of these departments.

All these should be done for the purpose of creating an enabling environment both socially and economically, for SMMEs.

## CHAPTER 7

### SUMMARY, CONCLUSIONS AND POLICY IMPLICATIONS

#### 7.1 Summary of Major Findings

How much does the manufacturing sector contribute to the SMMEs sector, in terms of its share to GDP through value addition, employment creation and income generation hence poverty reduction? It is the purpose of this chapter, therefore, to re-emphasise the major findings of this study in regard to the aforementioned issues. In this section (i.e. section 7.1), we summarise over all the important issues that were raised in the study. In section 7.2, the concluding remark and major policy implications are provided.

Sub-sectors or category of manufacturing enterprises covered by the study revealed very interesting characteristics. Sewing and knitting, woodwork and metal work constitutes a large part of small-scale manufacturing activities. As we saw previously, sewing and knitting comprise 46.8 per cent of all the sub-sectors surveyed, while woodwork comprise 22.6 per cent. Metal work is the third largest sub-sector comprising 14.5 per cent of the sub-sectors covered by the study. Food processing and production of toiletries such as candle making, soap making and vaseline seems to have a lot of potential and hence it poses a challenge in SMMEs promotion and development.

Notably, 51 per cent of the manufacturing enterprises (i.e. half of the manufacturing entities interviewed) were making an income of between 1000 to 5000 Maluti a month. 18.2 per cent earned between 5000 to 10000 Maluti a month. A minority number of enterprises make income between 10000 and 20000 Maluti a month and these are mainly cooperatives (ownership of more than 3 persons). Analyses have also shown that there are those who make more than 20000 Maluti a month. M.M Leather Works and Shoe

Repairs factory sometimes makes 75,000 Maluti per month when the business is running smoothly.

Employment in these manufacturing entities is also significant. Out of 62 enterprises interviewed, 39 (over half) of them had hired labour. This figure excludes apprenticeship, which also contributes to training people to become independent. These enterprises employ between 2 to 3 and 6 to 10 persons per enterprise. This is a significant contribution because there are numerous manufacturing enterprises and when put together they absorb a lot of unemployed labour. Though they are few, businesses employing 11 to 20 persons make a major contribution simply because they employ a lot of people at once. If such businesses expand in such a way that they establish branches in other districts, even more people would be absorbed. These businesses have contributed to the economy by securing jobs for people who would otherwise remain unemployed and poor. At least these people earn some cash income. Wage income earned by salaried labour in this sector ranges between 300 and 1000 Maluti a month.

The typology of business owners has helped us to realise why most people in Lesotho start their own enterprises. Major reasons discovered by the study are:

- To earn a living
- Retrenchment reasons and joblessness
- To be independent

Problems of SMMEs, in order of importance are:

- Working capital
- Expensive BEDCO working premises
- Lack of market

Age of business (i.e. how old the business is) is not related to growth but education and training are. People who had minimum qualifications (i.e. secondary, vocational and basic management) were able to start their businesses at a higher level than those without any education. Most businesses used personal savings to start their businesses and others

were assisted by their relatives to acquire necessary capital such as sewing machines and welding equipment.

Value addition by the manufacturing sector is also recognisable. Using the qualitative definition of value-added, we realise for example, how fabric is turned into clothing, sheet metal into household utensils, wood into furniture and other wooden products, leather into shoes and bags, soya and dairy products, and basic handicrafts from grass. There is a potential to increase value-added in several small-scale manufacturing activities such as food processing and garment making especially traditional wear. These could be export-oriented firms.

Estimation of demand for SMMEs products has revealed important aspects about the nature of demand elasticities of these products. The elasticities are high (more than 50 percent) and positive. Income elasticity and import index elasticity are 0.89 and 0.67 respectively.

## **7.2 Conclusions and Major Policy Implications**

While the researcher encountered several problems, especially data constraints, the study has managed to reveal the nature and importance of SMMEs in the country. Firstly, the role played by SMMEs in employment creation and income generation is significant. Secondly, the study has established that there is a way of reducing poverty in the country, that is, through SMMEs. Thirdly, the value addition contribution of SMMEs is also significant. Therefore, promotion and development of this sector through better legislation, provision of services and strengthening of all various types of support institutions could yield even better results.

The study has revealed that small, medium and micro enterprises sector makes a significant contribution to Lesotho's economy. However, this sector still needs major restructuring and transformation for it to play a more significant role. For instance, there

is need for a policy document that is drafted specifically for SMMEs sector. This will induce their productivity and hence efficiency. The following issues are raised:

- While the government is in the process of formulating and drafting policies for the promotion and development of SMMEs sector, it needs to take into consideration the differences in the various needs of each type of SMMEs. For instance, an entrepreneur involved in handicrafts (tapestry), takes a longer period to produce a mat (rugs) or a woven shawl; but an entrepreneur in sewing and knitting takes less than a day to produce a dress or a school uniform. In formulating taxation policy or any fiscal policy towards SMMEs sector therefore, government must consider such factors as time span of production processes. Financial support must also take this factor into consideration.
- The Ministry of Trade and Industry must improve and strengthen its way of performing tasks. The section of industry that deals with small-scale sector is very weak. Regular surveys of SMMEs sector must be taken and reports on the performance of the sector must be produced so that the ministry is able to assess the policy objectives of economic development, employment recreation and poverty reduction in SMMEs sector. The ministry must also supervise the work of various support institutions. Drafting of laws, regulations, administration procedures and registration is not enough and flexibility must be allowed into these regulations. Regulation can lead to rigidities and hence suppress the potential of entrepreneurs to attain optimal use of resources in order to increase efficiency and productivity.
- Support institutions on the other hand must be sensitive to the varying needs of the SMMEs. Though each and every person needs to be assisted, support institution must be able to screen growth promising and outward oriented entrepreneurs. By outward oriented entrepreneurs, it is meant those entrepreneurs who aspire to expand their activities and produce for export as well. The objectives of the present support institutions in the country as we showed in chapter five are: to promote and train

SMMEs, to provide advisory services and provision of sites and services, to secure market opportunities, to provide information pertaining to SMMEs and sourcing SMMEs with raw materials. This is not enough. SMMEs in the country needs as the foremost, working capital to sustain their activities. Without this, training and advisory services are of limited use. The second aspect is to secure market by assisting SMMEs in tendering procedures and giving them the opportunity to tender. Support institutions must assist SMMEs in linking them directly with foreign suppliers of raw materials or inputs so that they develop contracting relationship with one another.

- The best way to reach out to each and every entrepreneur in the country is to hold annual meetings directly with the entrepreneurs and the venue of the meeting must circulate amongst the districts. It must be emphasized that networking is a very necessary tool to disseminate information and to educate people. Information is disseminated easily and faster to prospective individuals.
- Credit institution specifically directed to cater for the needs of SMMEs must be established and should work hand in hand with the NGOs and other private sector in the country. There is a single finance facility created by Lesotho Chamber of Commerce and Industry and the Lesotho Council of NGOs. However, this finance scheme is still young and its functions (i.e. terms of borrowing) are not clearly defined.
- Information centres are still in shortage or simply put, the service sector to SMMEs is underdeveloped. Tourism information centres have to be strengthened because tourism has a positive effect on the products of SMMEs especially traditional garments and handicrafts.
- On the side of entrepreneurs themselves, management and entrepreneurial skills must be instilled into them, specifically the latter. The training institutions especially vocational schools are quite available in the country. What is needed is to provide an



incentive to youngsters (school leaving) to join the entrepreneurial world, to adventure and bring change to the traditional inertia.

- Infrastructure in terms of roads still needs to be developed. Gravel constructed roads are better especially in the rural areas where construction of tarred roads and their maintenance is hard to come by. At least small-scale manufactures have to be accessed instead of waiting for tarred roads that we do not know when they will come. Industrial sites for SMMEs must be increased and should be available at reasonable fees.
- Exhibition and flea market stalls must be created not only in Maseru but in the other towns as well.
- Price control and quality control systems must be reinforced. This will enable the manufactures to sell at competitive prices and thus efficiency will be enhanced. Some imports especially where local producers have comparative advantage must be controlled. This can be achieved through limiting of quantity or raising taxes on such imports. Local producers are encouraged and the government policy of import substitution is enhanced. However, some people will take this as an act of protectionism in the face of free trade and globalisation. It must be emphasized though that some measures are necessary and they should be implemented carefully. For instance, time frame should be set in which a policy is implemented and modifications or flexibility should be allowed.
- Subcontracting by larger firms to SMMEs would allow division of labour and specialisation and would increase interaction between small and large firms. This would eliminate inefficiency in the economy as it is shown in the literature.

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## APPENDIX A

### STRUCTURE OF THE QUESTIONNAIRE

1. Business name: \_\_\_\_\_  
Address: \_\_\_\_\_  
Telephone: \_\_\_\_\_
2. Type of Business:  
Individual Owner ( ) Partnership ( ) Cooperative ( )
3. Year of start of business: \_\_\_\_\_
4. What are the activities of business:  
kind of product/products business produces \_\_\_\_\_
5. State sources materials/inputs: \_\_\_\_\_
6. State main customer:  
Is the produce mainly for domestic consumption or export purposes? \_\_\_\_\_  
Average annual/monthly sales \_\_\_\_\_  
How many people does the business employ? \_\_\_\_\_
7. Education, Training and Experience  
What level of education has the owner received?  
  
Primary ( )      Secondary ( )      University/College ( )      Other ( )  
  
What kind of training has the respondent received and what kind of experience has been previously acquired in the operation of business?
8. Motivation and Age:  
Why did you start the business? \_\_\_\_\_  
Age of Owner \_\_\_\_\_
9. Occupation before owner started business e.g Student ( ) or retired civil ( )  
Or ex-miner ( ), other \_\_\_\_\_

10. Can you roughly indicate the initial capital you put into business or total capital invested to date?

Description of Capital Invested, Fixed Assets	Value/ how many	Purchase Costs
Initial Capital/stock		
Building		
Machines/fixed assets e.g. sewing or welding machine		
Equipment and Tools or Material		
Vehicles/transport mode		
Furniture e.g. desks, chairs, shelves		
Other		
<b>Total</b>		

11. Have you received any financial assistance since start of business? State source and specify type of finance.

Government ( ) Non-Government Organisation ( ) Private/Foreign donor ( )

In the form of Grant ( ) Loan ( )

12. Are you a member of any association or not? For example, LMA  
Yes ( ) No ( )

13. State problems that you come across in the business operation:

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

4. \_\_\_\_\_

5. \_\_\_\_\_

## APPENDIX B

Table B1: Description of Variables

obs:	18		
vars:	14		
size:	954	(99.8% of memory free)	

Variable	Type	Format	Description
1. year	int	%8.0g	
2. gdpr	int	%8.0g	Gross Domestic Product in Real
3. imports	float	%9.0g	Index of Imports
4. lnimport	float	%9.0g	log of Imports Index
5. manufac	float	%9.0g	Manufacturing Output (current)
6. dispinc	float	%9.0g	Disposable Income
7. gdpc	float	%9.0g	GDP in current terms
8. manufa	float	%9.0g	Manufacturing Output (real)
9. dispin	float	%9.0g	Disposable income (real)
10. index	float	%9.0g	Price Index of Small-scale Manu
11. lndispin	float	%9.0g	log of disposable income
12. lnindex	float	%9.0g	log of price index
13. trend	byte	%8.0g	
14. output	float	%9.0g	log of manufacturing output

Table B2: Summary of Observations

Variable	Obs	Mean	Std. Dev.	Min	Max
year	18	1988.5	5.338539	1980	1997
gdpr	18	2594.611	712.8391	1778	4036
imports	18	57.96111	32.78962	17.6	116
lnimport	18	3.887775	.6261514	2.867899	4.75359
manufac	18	187.7222	171.3875	16.2	520.1
dispinc	18	3022.967	2200.149	626.8	7686.9
gdpc	18	1703.111	1368.691	336.1	4740.6
manufa	18	262.0789	124.876	85.69949	477.0706
dispin	18	4785.799	952.256	3315.83	6544.388
index	18	9.755556	5.822393	3.3	21.2
lndispin	18	8.454142	.2038464	8.106463	8.786364
lnindex	18	2.106432	.610208	1.193922	3.054001
trend	18	9.5	5.338539	1	18
output	18	5.442115	.5432335	4.450847	6.167665

## Summary of observations continued

### Observation 1

year	1980	gdpr	1778	imports	17.6
lnimport	2.867899	manufac	16.2	dispinc	626.8
gdpc	336.1	manufa	85.69949	dispin	3315.83
index	3.5	lndispin	8.106463	lnindex	1.252763
trend	1	output	4.450847		

### Observation 2

year	1981	gdpr	1797	imports	19.9
lnimport	2.99072	manufac	20.3	dispinc	710.4
gdpc	381.1	manufa	95.72054	dispin	3349.748
index	4.5	lndispin	8.11664	lnindex	1.504077
trend	2	output	4.561433		

### Observation 3

year	1982	gdpr	1835	imports	22.6
lnimport	3.11795	manufac	27.4	dispinc	861.6
gdpc	436.4	manufa	115.2131	dispin	3622.906

### Observation 4

year	1983	gdpr	1792	imports	24.7
lnimport	3.206803	manufac	33.2	dispinc	981.9
gdpc	465.7	manufa	127.7526	dispin	3778.323
index	3.3	lndispin	8.237036	lnindex	1.193922
trend	4	output	4.850096		

### Observation 5

year	1984	gdpr	1978	imports	26.8
lnimport	3.288402	manufac	43.3	dispinc	1169.3
gdpc	539.1	manufa	158.8711	dispin	4290.253
index	4.2	lndispin	8.364101	lnindex	1.435084
trend	5	output	5.068093		

### Observation 6

year	1985	gdpr	2067	imports	31.3
lnimport	3.443618	manufac	50.8	dispinc	1340.4

## APPENDIX C

**Table C1: Estimation of the Model using Ordinary Least Squares**

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Dependent variable is MANUFA  
18 observations used for estimation from 1980 to 1997

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Regressor	Coefficient	Standard Error	T-Ratio[Prob]
DISPIN	.046326	.019256	2.4058[.031]
INDEX	.65132	3.0403	.21423[.833]
IMPORTS	2.3433	.75792	3.0917[.008]
INPT	-101.8011	61.2844	-1.6611[.119]

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R-Squared	.98339	R-Bar-Squared	.97984
S.E. of Regression	17.7321	F-stat. F(3, 14)	276.3731[.000]
Mean of Dependent Variable	262.0789	S.D. of Dependent Variable	124.8760
Residual Sum of Squares	4402.0	Equation Log-likelihood	-75.0358
Akaike Info. Criterion	-79.0358	Schwarz Bayesian Criterion	-80.8165
DW-statistic	1.5301		

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