African Research Review

An International *Multidisciplinary Journal, Ethiopia*
Vol. 5 (6), Serial No. 23, November, 2011
ISSN 1994-9057 (Print) ISSN 2070--0083 (Online)

DOI: http://dx.doi.org/10.4314/afrrev.v5i6.15

Networks, Micro Small Enterprises (MSE'S) and Performance: the Case of Kenya *(Pp. 172-187)*

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Abstract
This paper examines the role of informal personal networks in determining Micro Small Enterprises (MSE's) success in Kenya. It adopts the network perspective theoretical approach. Empirically, the paper finds that MSE's in Kenya get around market failures and lack of formal institutions through entrepreneurial personal network as a copying strategy in the process of global transformation to bridge the entrepreneurial global divide. General hypothesis predicting the 'likelihood of MSE's with better network performing better' is supported by performance models though pro-poor growth is evident with an average business performance. Network strategies to promote small enterprises are recommended to policy makers, donors and actors in the field against those of the failed traditional strategies. However, there are few empirical studies available in this area particularly in less developed countries; therefore further research is necessary in this direction.

Key words: Kenya, Networks, MSE's performance, Environment

Introduction

It is no doubt that the role of entrepreneurship in the emerging economies such like Kenya can not be undermined as a number of research in this field has pointed out (G.o.K 1999, McPherson 1996,ILO 1972). In Kenya, Micro

Small Enterprises (MSE's) plays a crucial role in the process of development as findings from the 1999 National MSE Baseline Survey show that MSE's activities are contributing to at least 18.4 percent of country's Gross Domestic Product (GDP) and 25 percent of non-agricultural GDP; employing approximately 17 percent of the total labour force from which 64 percent were in the urban employment in 2002 (Karekezi and Majoro 2002). In terms of income contribution, workers in the MSE sector earn an average income per month, which is two and a half times more than the minimum statutory wages in the formal sector. Employment creation in the formal private sector decelerated by 67.7 percent (- from 74.0 thousand new jobs in 2007 to 23.8 thousand new jobs in 2008-) but employment in the informal private sector is estimated to have expanded from 7.5 million in 2007 to 7.9 million in 2008. New jobs created generally in the whole country declined from 485.5 thousand in 2007 to 467.3 thousand in 2008 (G.o.K 2008).

Given the importance of this sector in areas of employment creation, growth and poverty alleviation, it is important that it is efficiently managed, but this has been lacking due to external factors that are beyond the owner-manager's control. These factors are inherent in the institutional environment of Kenya which favours larger firms.

Institutional gap left by the government of Kenya has proactively made the MSE's to circumvent the risks involved through informal institutional settings of social networks. Risks are as well inherent in such arrangements but it is the ideal mechanisms through which the MSE's can operate under such environment (Birley et al. 1991).

Theoretical framework

To understand network requires a deep understanding of dynamic pattern of networks given that they don't evolve overnight (Venkataraman 1989). With respect to the instrumental role of social capital, Marketing Network Model as developed by Hakansson and Johanson (1988) is adopted, which reconciles both Social network perspective (Aldrich, Zimmer 1986, Birley 1985, 1990, Birley, Cromie 1988, Granovetter 1976, 1985, Johannisson 1986, 1987a, 1988, 1995b, Uzzi 1996, 1999, Veciana, Clarke 1999) and Resource Dependency Theory (Butler and Sohod 1995; Pfeffer and Salancik 1978, 2003). The Marketing Network Model is an amalgamation of these two distinct theoretical perspectives. The study uses the integrated network theoretical approaches of Marketing Network Model on the argument that, small firms cannot perform better without direct or indirect network

relationships hence the hypotheses is formulated on this basis. Researchers have used different types of theoretical approaches in order to analyze and understand networking and small business performance as there is no single general theory of small business networks.

Economic functions can be performed either within the boundaries of hierarchical firms (within the organization) or by market processes that cut across these hierarchical boundaries; either hierarchies or markets. Both the hierarchy and market governance mechanisms represent trade-off between production and transaction costs. Hierarchical governance imposes production costs on the firm and minimizes transaction costs. In contrast, market governance causes transaction costs on the firm and it does not create productions costs (Williamson 1985). For small firms, the economic functions and transactions within the boundaries of hierarchical firms are either impossible or extremely difficult because small firms, being small and alone, are inherently lacking in resources thereby causing higher production costs. Market mechanism is also not a better solution because perfect competition is far from reality especially in developing countries like Kenya. Perfect competition causes higher transaction costs. Hence, it is clear those small firms find it difficult to perform their economic activities either at the level of hierarchical firm (or bureaucracy) or market. Given this, small firms in developing countries need support to compete and survive in their businesses. Networking is one of the best solutions given in the literature for the development of small firms in LDCs because networking lies between the hierarchy (or bureaucracy) and the market (Borg 1991; Jarillo 1988; Thorelli 1986). Hierarchies and markets are regarded as being the polar ends of a variety of governance options (Butler 1991; Williamson 1985).

In the network, the logic of exchange differs from the economic logic of market and hierarchy. The logic of exchange of networks considered in this study is that of 'social embededness' because ongoing social ties shape actors expectations and opportunities in ways that differ from the economic logic of market behavior (Granovetter 1985, Uzzi 1996). A small firm without networking with its external actors is bound to fail. Networking is the best solution for small firm development (Borg 1991, Donckels and Lambrecht 1995, Gibb, 1993; Johannisson, 1990b; Szarka 1990). At one hand of firm's hierarchy level, firms are too small and thus growth may be hindered by lack of resources. At the market level, on the other hand, transaction costs to obtain necessary resources are extremely high. Therefore small firms have to obtain resources and support from 'outsiders' or external actors. Thus, small

firms are dependent on other external actor, which is called 'interdependence'. Hence, to study small firms and entrepreneurship, this research views focal firms within their external environment. Within this integrated model, Resource Dependency Approach examines the behavior of a firm within its environment on the basis of resource dependence meanwhile Social Network Approach looks at how network relationships influence small business performance and its application to the economic phenomena. In addition, Social Network Approach views entrepreneurship as an act of creation and small business as a way of life that is different from the rational economic behavior. As with Social Network Approach, actors and their exchange relationships are very important for small firm development. In this framework, entrepreneurship is seen as an ongoing process of venturing forth through personal networking in which actors, resources, exchange relations and activities are the major network elements. On the whole, there are two major arguments behind the concept of networking. It is very common for small entrepreneurs in Kenya to follow evolutionary network model to meet different needs of different phases of entrepreneurship as other writers suggest.

Development of the hypothesis

The study seeks to test the following hypotheses:

Hypothesis 1: Small firms engage in local, homogeneous networks among themselves to cope with uncertainty and risk.

Hypothesis 2: Heterogeneous networks which include non-local partners stabilize performance outcomes.

Hypothesis 3: Networking with interest groups influences their agenda and actions and therefore benefits small businesses.

Methodology

The population of this study is Micro small enterprises in Kenya estimated to be 1.3 Million based on the MSEs Baseline Survey carried out by the government of Kenya in 1999 once and has not been carried out again (CBS, K-Rep/ICEG 1999 pp. 17,105). The population frame which targets those small enterprises in the big towns, peri-urban, urban and rural areas was selected on the basis of this research framework and comprised the micro small enterprises in four districts of Kenya based on their location, size and region. Then the research sample was selected from the population frame by using a standard sampling method.

A total of 400 firms were sampled through a multi-stage cluster sampling method. Four stratums were chosen from eight clusters covering areas; for example, **cities;** of which Nairobi was chosen to be representative of all the major cities in Kenya, **towns;** of which Kisumu town was chosen to be representative of all the major town in Kenya having a population above 10,000 people, **urban;** of which Eldoret was chosen to be representative of all urban areas in Kenya with a population of between 2000 people to 10,000 people, and lastly **rural;** of which Kakamega was chosen to be representative of all the rural areas in Kenya and the choice of Kakamega was made purposively based on the BIOTA4C; A project funded by the German government under EU in Africa to deal with conservation of the bio-diversity of Kakamega rain-fed Forests undergoing deforestation . From these stratified clusters, 400 MSE's were chosen based on their demographic and economic characteristics with each stratum producing 100 MSE's. A bigger percentage of the total MSE populations of the small enterprises (61 per cent) are concentrated in the rural areas and the type of industry in which most of them are involved in are Service industry (40 per cent) followed by Manufacturing (23.2 per cent). The response rate of the MSE's owner or Managers was impressive with 99 per cent response rate. Due to practical difficulties *(money, time and transport),* the study restricted to this particular number of the sample size despite the immense cooperation received among the entrepreneurs.

Table I. Type of enterprise and sampling area *(Clusters)* p.p 19

Data set analysis: empirical evidence

The empirical results of the regression models for the dependant, independent and control variables are presented here as empirical evidence. Their relationships are traced on how they relate with each other on building the networks for MSE's in Kenya. This is followed by a detailed discussion and conclusions of these findings as to whether the relations exhibited consequently has an impact on the performance, growth and sustainability of the MSE's in Kenya. As mentioned before, the dependent variable was identified as firm growth and performance (in terms of profitability and in terms of sales) and market expansion (National, regional and local). The firms were divided into three groups (growth, neutral and decline firms) on the basis of the respondents' answers and data availability as Table II show. From the table, 58.8 per cent of firms report growth category, while 9.8 per cent of them are reported 'not growth'. 31.5 per cent of them are in neutral in terms of profits. In sales term, 40.5 per cent are in the neutral growth

category as sales increase in 57.0 per cent of firms. 2.5 per cent recorded sales declining during the two season's periods of high and low.

Table II. Performance of Small Enterprises pp. 20

In the major market location, 20.8 per cent of the small business represented growth and 33.5 per cent represented a decline with a higher percentage of 45.8 stagnating at a neutral state (A case of a pro-poor growth). The situation can further be understood by considering the market segment in which these enterprises operate be it at the local, regional or National Level. The models of growth in financial terms (Model 1), in sale terms (Model 2) and market expansion (Model 3) are presented in Table III. Entrepreneur-related and enterprise-related factors were used as control variables in all models.

Table III. Ordered *Logit* Regression Analysis of Business Performance pp. 21

The dependent variable of model 1 and 2 are binary choice as 1 for growth, and 0 for otherwise (decline). Model 1 is statistically significant with a moderate goodness of fit as indicated by the value of chi-square (p-value < 0.01, Pseudo $\mathbf{R^2}$ = 0.1296). The model tests the impact of network elements on growth. In this model, growth is defined in financial terms of profits (1 = if growth, 0 = otherwise). Model 2 also tests the same impact, but in terms of sales. The second model is also significant at 0.01 levels (p-value < 0.01, Pseudo $\mathbf{R^2}$ = 0.0692). Positive relationship between network formation and market expansion of small businesses has been identified by international business and marketing scholars (Johanson and Mattsson 1993). Consequently, in addition to the growth measures (profit and sale); market expansion was used within the seasonal periods as a dependent variable to test the hypothesis. Most of the small enterprises mainly serve the local market. In the multinomial logistic model, model 3, therefore regional market is used as the baseline (comparison category). The multinomial logistic model is also statistically significant (p-value <0.01, Pseudo $\mathbf{R^2}$ = 0.2014).

Findings and discussion

Network relations are vital and important for small business, in particularly to the small firm as it does not have all resources such as raw materials, capital, machinery, etc. Therefore, small business network researches (Donckels and Lambrecht 1995, Ozcan 1995, Szarka 1990, Uzzi 1999) suggest networking as a necessary strategy in obtaining resources such as gathering information, technology, finance, etc. Besides, building contacts through networks are the fundamental factor in determining the success of

any firm (MacMillan, 1993) because through entrepreneurial networks, the entrepreneur can gather information, look for customers and suppliers, and obtain the other resources he needs. As regards contacts with entrepreneurs, network literature suggests that inter-firm linkages may span various levels of aggregation: Firms may be linked only locally, sometimes, interregional or globally (Stabber 1996a). Positive impact of network formation on business performance was predicted and logistic regression technique was used to analyze the data. The first hypothesis was tested by using three separate dependent variables. Entrepreneurs with only local contacts (LC) are significantly less likely to be in the growth group. But those who have national level connections are more likely to belong to the growth group. In the case of the market expansion, the formation of networks is positively related to the market expansion. The results conclude that when the market expands beyond the regional border, the influences of the network connections are vital and important for the small entrepreneurs. The second hypothesis is about the network elements and the network relations with regional and national entrepreneurs. It is expected that relations with other entrepreneurs to be promoted by the network elements and they are positively related with the formation of networks. However, the study fails to identify considerable network relations with international entrepreneurs. At the same time, it is found that the small entrepreneurs do not have direct export opportunities. They deal with export market through some link-agents or firms. Although it was expected in the second hypothesis that all of the network elements influence network formation, the contact with other entrepreneurs is not significantly influenced by external consultancy. One reason for the lack of significant relationship could be that the relationship between education and contact with other entrepreneurs is positive and significant. Meanwhile, it was found that small entrepreneurs who attend seminars and training and participate in trade fairs have a higher chance of developing relations with other entrepreneurs .Consultation with relatives is also very critical as family ties occupy an important role in entrepreneurial networks in Kenya in which social relations are largely built around the family. In such a society, Family members work together in their businesses as well as at home. The family relationship is stronger in rural areas. It was found that the rural-entrepreneurs consult and discuss their business matters with relatives more than the entrepreneurs in urban areas do. However, the study defined consultation and discussion with relatives by excluding very close family members if they were partners of their business. In most cases, the close family members are also a part of the businesses. Future research

should be conducted in this direction. Tribal variables should also be included into the overall model.

It is also important to study how the other enterprise- and entrepreneur-related factors such as gender, education, firms' location etc. separately influence on each of the network formation elements. It was found that there are some significant relationships between the network formation elements and the enterprise-and entrepreneur -related factors, though they are not very strong relationships. The results show that educated entrepreneurs are more likely to attend seminars, training, advertise and attend trade fairs, join professional and other societies, and contact other entrepreneurs, while they are less likely to discuss their business matters with relatives and friends. Meanwhile, female entrepreneurs discuss their business matters with relatives and friends more than their male counterparts. By contrast, compared to female owners, male counter-partners are looking for more external consultants, attending more seminars, and training, advertise and attend trade fairs. The male entrepreneurs also have more contacts with other entrepreneurs as pointed out above. It was found that network formation is an essential aspect of small business development as postulated in the last hypothesis. Therefore, the policy makers, small entrepreneurs, donors and others, who deal with the development of small enterprises in developing countries, can use the network formation approach apart from their traditional supporting approach. For instance, supporting institutions should organize network activities for small businesses. Small business owners should also realize the importance of constructing Networks. However, there are few empirical studies available in this area particularly in less developed countries. Therefore, further research is necessary in this direction. Researchers should also deeply consider enterprise- and entrepreneur -related factors when studying networking and small businesses.

Significance and implication of the study

The purpose of the study has been to analyze the role and impact of networks on small business performance and sustainability in Kenya. However, the concept of networks and network analysis cannot easily be explained due to an array of different definitions of network found in the literature and on the other hand, network analysis has been used in different areas of studies by different researchers in different perspectives. In this study, networking has been seen as an effective vehicle for obtaining necessary resources for small enterprises from the outsiders or external environment. The study found that small entrepreneurs who maintain regular relationships with external actors

are more likely to be successful in their respective businesses because such relationships provide a constant and reliable source of resources and effective influence on firms. These external relationships are identified as entrepreneurial networks in this study.

This study is different from the other studies in the field of small business networking in four ways. First, current studies largely focus on formal business networks such as alliance and joint ventures. In contrast, the focus of this study is on the entrepreneurial informal network relationships in a less developed country. Second, most current studies are largely focused on the experiences of developed countries (for example, Birley 1985 (USA), Bryson et al. 1993 (UK), Curran et al. 1993 (UK); Goodman and Bamford 1990, (Italy). Therefore, there was a gap in our understanding of small business networks in developing countries. In particular, small business networks in Kenya have not been studied and some studies which have been done focus on the possibilities of emerging clusters and subcontracting in the industrial estates (McCormick and Pedersen 1996). Thirdly, this approach also differs from others in respect of the unit of analysis. For example, the industrial estate (holistic approach) has been widely used in the field of small business development in developing countries. This study has employed an individualistic approach (the ego-centered firm) to study small business development within the context of entrepreneurial networks. Fourth, entrepreneurial networks are always regarded as advantageous for small business success.

Apart from various case studies, however, a critical approach was needed in the network analysis in order to assess the importance of networks for small business performance. This study has filled this gap. We believe that this approach is necessary for advancing research on the field of entrepreneurial informal networks beyond general descriptions of the advantages of networks of a single case study. In this regard, the study contributes to network studies in four ways. Firstly, the study analyzed entrepreneurial informal network relationships. Secondly, the recent studies in this area are largely focused on the experiences of developed countries. A very few or no such a study has been available in the field of entrepreneurial networks in developing countries, particularly in Africa. Thirdly, the study used survey research approach to test a number of hypotheses. Overall, this study contributes to the literature by showing how small firms use network relationships to overcome their business bottle-necks, identify new market opportunities and finally to perform their business successfully. The findings of this study will

without doubt be useful to the policymakers, business community, researchers, public institutions, financial organizations, donors and supporting organizations of small firms and social workers particularly in Kenya and the other countries as well. There are some conclusions from the study, but the major conclusion is that entrepreneurial networking can create a successful small firm sector by helping to overcome the lack of resources, the managerial and professional weakness of small firms within a broader supportive external environment. Owing to lack of resources, small enterprises always need to maintain contacts with their external actors to obtain necessary resources. The actors of social networks and supporting networks are very important for small enterprises particularly in developing countries such as Kenya. Before a new entrepreneur starts his venture, his social network relationships work as an opportunity set. Then gradually the entrepreneur develops his network relationships with supporting agencies and other firms as well. The study emphasizes the fact that, in order to really succeed in business, small business entrepreneurs must use their own personal networks as well as the inter-organizational networks. To reach the conclusion, we analyzed informal networks of small enterprises in Kenya. We also believe that the results have significant policy implications. This empirical study has further recommended the need for more in-depth comparative studies before generalizing the results.

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Table I. Type of enterprise and sampling area *(Clusters)*

	Sampling Area of the respondents									
	Town		**Urban**		**Peri-urban**		**Rural**		**Total**	
	n	%	n	%	n	%	n	%	n	%
Manufacturing	45	11.2	10	2.5	23	5.8	15	3.8	93	23.2
Service (Incl. Repair, health and Beauty ,I.T)	32	8.0	58	14.5	41	10.2	29	7.2	160	40.0
Trade	9	2.2	16	4.0	16	4.0	18	4.5	59	14.8
Agricultural Processing	3	0.8	1	0.2	2	0.5	4	1.0	10	2.5
Handicraft	10	2.5	8	2.0	3	0.8	25	6.2	46	11.5
Food and beverage/Restaurant.	1	0.2	7	1.8	15	3.8	9	2.2	32	8.0
Total	**100**	**25**	**100**	**25**	**100**	**25**	**100**	**25**	**400**	**100**
Source: Survey Data (2008-2009)										

Table II. Performance of Small Enterprises

	in Profitability term %	in sales term %	Major Market location %
Growth	58.75	57.00	National 20.75
Neutral	31.50	40.50	Local 45.75
Decline	9.75	2.50	Regional 33.50
Source: Survey Data (2008-2009)			

Table III. Ordered *Logit* Regression Analysis of Business Performance

DEPENDENT VARIABLE► / **INDEPENDENT VARIABLE ▼**	Growth Models† *(Ordered Logit)* Financial		Market Expansion‡ **Model 3** *(Logit)*		
(a)Network Elements:	**Profit Model 1**	**Sale Model 2**	**Local**	**Regional**	**National**
(i) Membership of a support group **(Memb.)**	-0.5391474	-0.412117	-0.6257845	1.127626	-4.306764*
(ii) Consult with Relatives **(RltvC.)**	0.1768815	0.3213644	-0.0035988	0.2077015	4.688457
(iii) Consult with friends **(FrndC.)**	0.4204207	0.5413413	-0.7643241*	-2.67127***	2.188995*
(iv) Sponsor **(Spo.)**	-0.6301558*	0.4360656	-0.7658631*	1.562125	3.946916
(v) External Consultancy **(Excon.)**	-0.2912984	0.2297336	0.6087752**	-1.048016*	-0.620859*
(vi)Training Attendance **(Trainat.)**	1.062539***	-0.8131616**	0.900166**	-1.385168**	-4.237001***
(vii)Trade Fairs/exhibitions **(Exhb.)**	-0.8757981*	0.1488198	-0.5060612	0.7765897	-4.314818***
(viii) Advertisement linkages **(Advert.)**	0.876145**	-0.4422695	0.9287112**	-1.136924*	-4.018183***
Local Contacts **(LC)**	1.092227***	0.2776574	-	-	-
Regional contacts **(RC).**	0.0145981	0.4474843	-	-	-
National Contacts **(NC)**	-1.356309	0.5181947	-	-	-
(b)Entrepreneur-related:					
Age (Log form)	-0.2574903	-0.3141566	-0.8465496	0.4008095	5.111433**
Gender	0.4416784*	-0.0293623	-0.2337811	-0.1055492	-4.050044***
Location of the Respondent	-2.06825***	0.2434624	0.4514045	2.635399***	-4.077537

Educational level	0.0827355	0.0479231	0.1825082	0.5934178	0.5322168*
Owner's Period of experience (log form)	0.1612917	-0.1033626	-0.5007559**	-0.0989244	5.111433**
(c)Enterprise-related:					
Manufacturing Industry (S1)	0.1445633	0.6296169**	-0.2698701	0.1677356	0.8007031*
Service Sector (S2)	-0.077937	-0.4589423*	-0.4939045*	-1.022068*	1.368797
< 5 Employees (SE1)	0.544956	-0.8335374	-0.5937174	0.632742	0.674099
> 5 Employees (SE2)	0.2237928	-0.1952878	-0.1158605	0.3893944	-4.110874*
Firm's life time (Log form)	-0.0351872	0.3125358*	0.1420394	0.493515	-1.291059
Regular Employees (RE)	0.0521155	0.0197024	0.0444308	-0.0241193	0.056759
Seasonal Employees (SE)	-0.055761*	-0.0009008	0.0250711	0.0475733	0.6124792
Intercept	-	-	4.056091*	-8.055703*	-56.09511*
Pseudo R^2	0.1296***	0.0692***	0.1580***	0.2014***	0.4893***

Source: Survey Data (2008-2009) *Note: z-values are in parentheses; N = 386; †Baseline (comparison category) is non-growth group‡ Baseline (comparison category) is Regional market;*** P- value < 0.01-statistically significant at 1%** P- value < 0.05- statistically significant at 5%;*P -value < 0.10- statistically significant at 10%*