Private Enterprise Development in Low-Income Countries

Differentiation, Property Rights, and Performance Among Micro-entrepreneurs

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In contexts where ownership as a mode of access to productive assets is limited, research shows that leasing has a strong positive impact on micro-entrepreneur performance and differentiation from competitors.

Introduction

Most micro-entrepreneurs (owners of businesses with fewer than five employees) in developing countries barely eke out a living: their businesses are informal, unprofitable, and often short-lived. One reason for their poor performance is that few micro-entrepreneurs seem to differentiate themselves from their competitors. Since most micro-entrepreneurs within a particular market context face similar demand and supply environments, why then do some differentiate themselves more from competitors (and therefore perform better) than others?

This study examines differentiation among micro-entrepreneurs operating retail stores in a slum neighbourhood in Egypt. We highlight a hitherto unexplored factor that might explain differential rates of differentiation among micro-businesses: the mode of access to major productive assets. We distinguish between three modes of access to productive assets: 1) 'ownership', namely the legal right to use, earn an income from and transfer a productive asset, and the ability to legally enforce that right, 2) 'possession', namely holding on to, using and earning an income from a productive asset, without having the legal right to it, nor paying for the use of the asset (usually, the productive asset is 'owned' by a third party, such as the government), and 3) 'lease', specifically using and earning an income from a productive asset for a period of time against a regular lease payment. This study focuses on lease and possession as modes of access to productive assets, since they are the most common forms of access in urban slums.

We argue that both the leasing and the possession of the productive asset cause the micro-entrepreneur to fear the potential loss of their primary productive asset (the retail store in this study). However, the nature of this fear is different in the two cases. In the case of leasing, we argue that the fear of losing the store is actionable in nature. Specifically, the actions needed to alleviate the fear lie within the micro-entrepreneur's control. For instance, the micro-entrepreneur can take specific steps to differentiate the business and attract more customers, thereby generating the additional income needed to meet their lease payments and maintain continued access to their productive asset. Conversely, in the case of possession, the fear of losing the productive asset is non-actionable in nature, as actions needed to alleviate this fear lie beyond the micro-entrepreneur's control. Thus, micro-entrepreneurs who lease their productive assets are more likely to take actions to improve and differentiate themselves from competitors than micro-entrepreneurs who possess their productive assets.

Picture 1 – Micro-entrepreneur who possesses her store

Any empirical approach that seeks to test the impact of leasing versus possession of a major productive asset on micro-enterprise innovation in marketing practices (i.e., differentiation from competitors) should ideally address the endogeneity of the decision to lease or possess the productive asset. It is possible that an unobserved and difficult-to-measure factor such as entrepreneurial ability could influence our independent variables (i.e., access to the productive asset through leasing vs. possession) as well as the dependent variable (differentiation). Any empirical approach that does not account for this issue of unobservable factors in access to productive assets will likely yield biased estimates.

Empirical Context

We address the issue of endogeneity by choosing an empirical context that witnessed an external and unexpected policy shock. We make use of this shock to rule out the most obvious sources of endogeneity, and estimate our results using instrumental variables.

A suitable empirical context for testing our theory would be a subsistence market with a high percentage of micro-entrepreneurs. Ideally, the context would also offer an exogenous unexpected change in property right laws. Further, it would involve a community that is representative of urban slums worldwide, where ownership is limited, possession and leasing are prevalent, and micro-entrepreneurs who possess their productive assets face the threat of expropriation. We chose to conduct our study in Egypt for the following reasons. First, the percentage of self-employed people in Egypt was 48% in 2013 (CAPMAS 2013). Second, in the 1950s, Egypt saw a sudden change in property rights laws, which we show had an impact on micro-entrepreneurs' decision to lease versus possess their productive asset. The most important productive assets of micro-entrepreneurs in our sample are their stores. Ownership as a mode of access to a productive asset (i.e., their retail store) is almost non-existent. Up to 48.26% of micro-marketers possess their stores and 45.65% lease them, but only 6.09% own them (see Table 2).

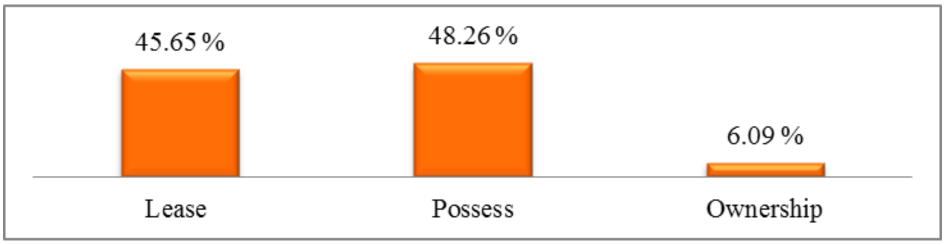

Table 2. Percentage of lease versus possession among micro-entrepreneurs

Research Findings

In the paper, we demonstrate that, in contexts where ownership as a mode of access to productive assets is limited, leasing has a strong positive impact on differentiation. Furthermore, we show that micro-entrepreneurs are more likely to use less costly differentiation strategies, such as promotion, pricing and place (i.e., location), while avoiding more costly differentiation strategies such as product assortment. We also show that loose products allow for more price differentiation than sachet products (i.e., products that come in small affordable sizes and volumes). It is worth noting that sachet products are the second most common type of products in the slum after packaged products. Finally, we show that changes in property rights laws have a strong impact on the possession and leasing of productive assets. We show that changes in property right laws affect more than one generation over a period of more than 60 years.

Potential Policy Impact

Our results suggest that possession without ownership is harmful for micro-entrepreneurs. We show that, through fear of expropriation, possession limits the micro-entrepreneur's ability to differentiate and perform. Yet, despite the well-known importance of establishing and implementing property rights laws, developing countries have seen little tangible progress, especially in the context of urban slums. From the government's perspective, bringing the informal economy into the formal economy requires government commitment and investment. If the informal sector remains outside the formal economy, then governments can justify a lack of investment in infrastructure for informal communities by the fact that they live on illegal land. But once the informal settlements become formal and legal, governments are then held responsible for investing in and providing infrastructure such as roads, electricity, healthcare, water and sanitation and security for these informal settlements. This is expensive and often very difficult as informal settlements are built haphazardly without prior urban planning.

This background suggests the following policy implications of our research. First, we suggest that governments in developing countries explore the role of leasing programmes as a feasible intermediate solution until issues linked to implementing property rights are resolved. Second, we suggest that governments properly examine the long-term impact of their property rights policies. In this study, we argue that micro-entrepreneurs in Ezbet Khairallah, whose parents were born outside Cairo and Alexandria and were affected by the 1952 land reform, tend to possess, not lease their stores. We also demonstrate that the fear of expropriation linked to possession results in less differentiation, and therefore poorer performance of these businesses. We thus highlight an example of a property rights law that was originally intended to alleviate poverty and provide social justice, but which instead had the long-term impact of compounding poverty and social injustice over one or more generations. Finally, in our conceptual framework we argue that micro-entrepreneurs face two types of fears, fear that is actionable in nature and fear that is non-actionable in nature and therefore lies beyond the micro-entrepreneurs control. This distinction between fears that micro-entrepreneurs can act on and manage versus those that require clear government policy and action can be a good guide for policy makers in prioritizing issues to focus on.

Moving Forward…

One of our research findings that we would like to follow up on is that there are often only two to three main suppliers in the slum that form a market oligopoly and therefore exert great power over microentrepreneurs. Hence, the majority of micro-entrepreneurs are dependent on one supplier who often dictates prices as well as product assortment and many are left with very little discretion in their decision-making. We are now working on identifying a feasible, effective and scalable intervention that can test for the role of reduced supplier power in creating more discretion in micro-entrepreneur decision-making and marketing innovation.