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Inside Informality: The Links Between Poverty, Microenterprises, and Living Conditions in Nairobi's Slums

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Summary. — Using households rather than enterprises as the analytical unit, this study of 1,755 households in Nairobi's slums reveals that informal household microenterprises are indeed helping offset poverty. Microenterprises are helping households that are, *a priori*, more likely to be poor. Better microenterprise performance is associated with certain "business-related" factors, such as sales area, time in, and sector of operation. But "living conditions"—residential tenure and infrastructure access—also strongly influence both creation and success of microenterprises. Interventions that improve infrastructure and reduce tenure insecurity and rent-induced pressures to move may be crucial for incubating microenterprises and reinforcing their contribution to poverty alleviation in Nairobi's slums.

Key words — informal sector microenterprises, urban poverty, slums, housing tenure, infrastructure, Kenya, Africa

1. INTRODUCTION

Job creation and poverty alleviation are often seen as two sides of the same coin. Efforts in one area do not, however, necessarily lead to benefits in the other. Not all jobs filter down to the poor and, of those that do, not all successfully help offset poverty. The links between jobs and poverty are even murkier if we narrow the discussion to "informal" microenterprises—often seen demeaningly as "small-scale, semi-legal, frequently family-based, perhaps pre-capitalistic enterprise" (Maloney, 2004). Almost everyone concedes that informal microenterprises are ubiquitous in developing countries and employ a large proportion of the labor force (e.g., Daniels, 1999; Mead & Liedholm, 1998). There is little consensus, however, on the utility of such employment in poverty alleviation and national development.

Even supporters of informal microenterprises acknowledge that returns to such entrepreneurial activity vary tremendously and that their contribution in offsetting poverty remains unclear. For instance, a national study of micro and small enterprises in Kenya found a high poverty rate (72%) among urban households dependent on these businesses; it concludes that, in these cases, "[micro and small enterprises] may be seen as a last resort or the best of a number of poor options" (Daniels, 1999).

Similarly, a multi-country review of informal enterprises notes that informal sector entrepreneurs may well be living in poverty—the point, the author argues, is that they would not necessarily be better off in formal sector jobs for which they are qualified (Maloney, 2004). A burgeoning literature on microfinance finds mixed results, that is, microfinance facilitates exit from poverty in some cases, but not in others (e.g., Copestake, Bhalotra, & Johnson, 2001; Hulme & Mosley, 1996; Navajas, Schreiner, Meyer, Gonzalez-Vega, & Rodriguez-Meza, 2000; Shaw, 2004). The policy signals emerging from such studies are confusing. Should policy makers who are concerned about poverty alleviation support informal enterprises? If yes, what form should such assistance take?

One way to better understand the links between poverty and employment in informal sector microenterprises, we argue, is to start with the household (rather than enterprise) as the unit of analysis and examine whether these informal micro-businesses are helping their owners offset poverty. This approach can also shed light on the links between poverty and enterprise ownership and creation, because it allows for a comparison of households that do manage to start and operate an enterprise with those that do not. Enterprise studies, by contrast, have to limit themselves to *existing* businesses, and microfinance studies limit their samples even further because they focus only on the subset of existing enterprises that take a loan. In this paper, we take, as our illustrative case, slum residents in Nairobi—a subset of the population known to be poor and surviving largely on informal sector employment. We empirically examine the employment base of slum residents to better understand what employment "options" they actually have and the role that household microenterprises play. Analytically, we focus on the following questions: *Are household microenterprises helping relatively poor people—slum residents in Nairobi—in their own struggle against poverty? What factors facilitate creation and success of informal enterprises?*

It worth highlighting that by opting to focus on the very small and informal businesses in Nairobi's informal settlements (or slums), we are examining microenterprises that would be categorized by other authors—for example, House (1984), Mead and Liedholm (1998), and Shaw (2004)—as

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"survival" type activities rather than "entrepreneurial" activities.[1] According to these authors, survival activities can play a role in poverty alleviation, but it is the entrepreneurial activities that are more dynamic and can make a contribution to growth. In this paper, our task is to test whether these "survival-type" informal microenterprises in Nairobi's slums are delivering on their promise of poverty alleviation.

We find that informal household microenterprises are indeed helping Nairobi's slum residents in their fight against poverty. At first glance, the 75% poverty rate among microenterprise owners is very high in absolute terms, and relatively close to the 73% rate among slum residents as a group. However, after controlling simultaneously for various other poverty-influencing factors such as household composition and education, households with microenterprises are systematically less likely to be poor.

The beneficial influence of household microenterprises cannot be explained away as a "positive selection effect," where those who were already better off decided to establish a business. To the contrary, we find that poor households are *a priori* more likely to own a microenterprise, but that, all else being equal, these businesses help them do better than households without one. It is important to note that a parallel study in Dakar's slums found no such inverse relationship between enterprises and poverty (Gulyani, Talukdar, & Jack, 2009). In other words, microenterprises are helping in the fight against poverty in Nairobi's slums but not in the slums of Dakar, and some enterprise owners in Nairobi are doing better than others.

In analyzing creation and performance of informal enterprises, we not only examine some of the standard "business-related" factors but also introduce and study the effect, if any, of "housing-related" or "living conditions" variables. By business-related factors we mean variables that are, from a management perspective, considered important for understanding performance and are typically included in enterprise analyses; these include, for instance, access to credit, quantity and quality or skill-level of labor, entrepreneur characteristics, sector of operation, sales area, and age of the business. By housing-related factors we mean variables associated with the *residential living conditions* of the entrepreneur, including the quality or permanence of the housing structure, the security and duration of tenure, access to infrastructure such as electricity and water, and the neighborhood's location and features. We find that both business-related variables and living conditions matter—they influence not only the creation of enterprises but also their performance. While the importance of the living environment may be obvious to slum experts, few microenterprise studies or programs concern themselves with constraints imposed by *residential* tenure and infrastructure or, more broadly, the living conditions of entrepreneurs.

This study leads to a different understanding of the links between poverty and enterprises because it combines and builds on approaches in three different fields of inquiry: poverty analyses, microenterprise development, and slum studies. Methodologically, this is a quantitative and micro study, and we use the household as the unit of analysis. The data are from a specially commissioned, stratified random sample of 1,755 households in Nairobi's slums—this is a valuable data set both because it is one of the very few large-scale and carefully sampled surveys of urban slums in Africa,[2] and because the survey gathered information relevant not just to one narrowly defined theme (e.g., microenterprises) or even one sector (e.g., education) but on a multitude of variables that characterize life in the slums.[3] This allows us to examine linkages between various factors and their net effect on employment and poverty.

Overall, this study contributes to the literature in three ways. First, it makes an empirical contribution by providing a statistically robust estimate of—and rare insight into—the scale, nature, and role of entrepreneurial activity in Nairobi's slums. Second, it confirms the methodological value of using the household (and not only the enterprise) as the unit to analysis and then controlling for poverty-related variables to better understand the role of microenterprises in poverty alleviation. Third, it highlights that living conditions—especially, tenure and infrastructure—can affect both creation and performance of microenterprises and demonstrates how such factors can be incorporated into future analyses.

The paper is structured as follows. Section 2 delineates the methodology, data and profile of slum households. Section 3 presents descriptive data on enterprises, especially their scale and nature, and also discusses labor market constraints that are pushing households to start their own businesses. Section 4 empirically examines the links between ownership of household microenterprises and poverty in the slums. Section 5 focuses on factors that distinguish poor from non-poor entrepreneurs—to shed light on factors and conditions that may facilitate the poverty-alleviation impact of microenterprises. Section 6 reviews access to banking services and credit, and Section 7 concludes.

2. RESEARCH METHODOLOGY AND THE DATA

This study is based on data gathered, in February and March 2004, from an in-depth survey of 1,755 households residing in Nairobi's slum settlements. A population-weighted stratified random sample of households was created as follows. For census purposes, Kenya's Central Statistics Bureau (CBS) has divided Nairobi into about 4,700 Enumeration Areas (EAs), of which 1,263 as categorized as "EA5" or "informal settlements" that are characterized by poor quality sub-standard housing and poor infrastructure; for our purpose, all of the 1,263 EA5s are "slums." For this study, 88 slum EAs were randomly selected from the superset of 1,263. CBS then conducted a complete field-based re-listing of households in each of the 88 EAs to create an updated master list of current residents. About 20 households were selected randomly from the updated resident lists in each of the 88 EAs, and all households were assigned a weight adjusted to reflect their probability of selection.[4] In the results presented in this paper, all household-level data analyses are weighted but individual-level data analyses are not.

(a) *Slum residents account for at least 30% of the population*

In the 1999 national census, Nairobi's population was found to be 2.139 million and slums accounted for 0.64 million people or about 30% of the city's population. It is important to note that "30%" seems to be a conservative estimate and may reflect, in part, CBS's use of a relatively stringent definition of slums.[5] We use this number—0.64 million slum residents in 1999—as establishing a "floor" or minimum number of slum residents in the city. By the time of the survey in 2004, the population of slum residents is estimated to have grown from a base of 0.64 million to 0.81 million.[6] The sampling and results of this study, therefore, pertain to the total population of the 1,263 EAs in 2004, or an estimated 0.81 million people.