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Unlocking potential: Tackling economic, institutional and social constraints of informal entrepreneurship in Sub-Saharan Africa: Main findings and policy conclusions

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Abstract

In the past two decades, research on the informal sector has emphasized the heterogeneity of this part of the economy, e.g. in terms of entry costs, firm size, access to credit, forward- and backward linkages as well as human and physical capital endowments. Yet, not much research has investigated the causes of this heterogeneity and the implied inefficiencies. This is true in particular for Sub-Saharan Africa, where informality dominates urban labor markets. Understanding these causes and the implied inefficiencies is however necessary to design policy interventions that are able to remove the most binding constraints for informal entrepreneurs. This note summarizes the main findings and policy conclusions from a research project that analyzes the quantitative importance of various constraints to informal enterprises in West Africa and Madagascar.

Keywords: Informality, Entrepreneurship, Informal Sector Policies, West-Africa.

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This is work in progress. Its dissemination should encourage the exchange of ideas about issues related to entrepreneurship and informality. The findings, interpretations and conclusions expressed in this paper are entirely those of the authors. They do not necessarily represent the views of the World Bank, the donors supporting the Trust Fund or those of the institutions that are part of the research consortium.

Scope of research

Decades of research on urban informal entrepreneurs in developing countries have at least provided us with one rather consistent observation: next to a rather small group of successful entrepreneurs, we find a much larger group of entrepreneurs that struggle to survive (House, 1984; Fields, 1990; Mead and Liedholm, 1998; ILO, 2002; World Bank, 2007; Nichter and Goldmark, 2009). A focus on this bifurcation has proven useful to avoid one-size-fits-all thinking, but it also has inhibited progress in identifying possible other segments of informal entrepreneurs. Moreover, progress in producing more rigorous and generalisable findings on informal entrepreneurs has been hampered because representative samples hardly exist.

A major finding of our research is that we find next to the well-known top-performers and survivalists a substantial group of entrepreneurs that operate micro and small enterprises (MSEs) with very small or no capital endowments but produce at a very high productivity because they share a large number of managerial skills with top-performers (Grimm, Knorringa and Lay, 2011). This is in line with a number of recent studies (for example, Faijnzilber *et al.*, 2006; McKenzie and Woodruff, 2006; De Mel, McKenzie and Woodruff, 2008; Kremer, Lee andRobinson, 2008). These studies indicate that the proposed distinction between an upper entrepreneurial and a lower subsistence may be too simple to capture the informal sector's often noted heterogeneity. In particular, these studies consistently find high returns to capital at low levels of capital suggesting that many entrepreneurs in the lower tier are more entrepreneurial and have better growth prospects than previously assumed. Understanding this more differentiated heterogeneity of the informal sector is the core of our research as it mirrors the inefficiencies that arise from the constraints informal enterprises face. We distinguish between (i) economic constraints, such as capital market imperfections, the lack of insurance and the lack of demand for informal sector products, (ii) institutional constraints, such as ill-managed government regulations and high exposure to corruption, and, (iii) social constraints, such as sharing obligations with the extended family that prevent potentially successful entrepreneurs from investing.

A major innovation of our project is that we analyze the different sources of inefficiencies in a unified framework and across a large set of West-African countries and Madagascar, for which we have comparable and detailed micro-data for informal micro and small enterprises. The data sets are representative for the entire urban non-farm informal sector. We even have similar data for Peru and Vietnam which allows undertaking - where useful - inter-regional comparisons. As we hope to show below, the integration of the results emanating from this research considerably enlarges the limited empirical basis for informed policy choices regarding the question how to unlock the potential of the informal sector.

In what follows we summarize the main results from our research along with the major policy implications. We organize this summary around the major questions we posed at the start of this research. Two disclaimers apply though. First, this note is on purpose very short and therefore does not do justice to the vast informal sector literature. We keep references to other papers at a minimum and refer to the research papers underlying this note, which offer in each case a detailed discussion of the state of the art and where and how our research contributes. Second, we are fairly cautious with spelling out concrete policy implications. Today, it is widely recognized that the design of any concrete targeted policy needs to be based on a rigorous impact assessment. Such assessments were not the scope of our research project; with the exception of the evaluation of a micro-credit program in Madagascar.

Main findings and policy implications

(i) Economic constraints

What are the returns to capital investment, what is the role of capital market constraints and risk and how do returns compare with those found in other regions? Are there important entry barriers?

Our findings for the seven West-African countries lend support to the view of informal activities as being very heterogeneous. Our assessment of initial investment of MSEs suggests that notable entry barriers exist, in particular when current costs are taken into account (Grimm, Krüger and Lay, 2011). While there is also a segment with very low entry costs, some informal activities require substantial initial investment in particular if also costs for inventory, labour and other intermediary inputs are taken into account. In addition, we find very heterogeneous patterns of capital returns in informal MSEs. At very low levels of capital, marginal returns are high, but rapidly decreasing. A detailed examination of the entrepreneurs at the lower end of the capital distribution shows that the entrepreneurs that realize high marginal returns to capital are more often men, have on average a higher education level, speak French, show substantial managerial skills and motivation and are less risk averse (Grimm, Knorringa and Lay, 2010).

In a medium range of capital between 150 and 1,000 international dollars (2001 Int. $), we (Grimm, Krueger and Lay, 2011) find marginal returns to be low and unstable leaving the entrepreneur with little incentive to build up a capital stock of more than 100 to 200 Int. $. This implies that informal entrepreneurs may be stuck at these fairly low levels of capital. Only when capital exceeds a threshold of at least (about) 500 Int. $, entrepreneurs seem to be able to earn a significant positive marginal return. For this segment we find monthly marginal returns of five to six percent. The annualized return would thus be around 60 to 70 percent, which is much higher what typical micro-credit providers effectively charge in interest (between 15 and 25 percent) and within the range of informal money lenders' rates (60 percent and more). Our results are consistent with a few other recent studies that have used panel data and experimental approaches for the cases of Sri Lanka, Mexico and Ghana (De Mel *et al.*, 2008; McKenzie and Woodruff, 2008; Fafchamps *et al.*, 2011). Many of the MSEs earn a profit of around 200 Int. $. With a marginal return of 60 percent annually, an increment of an entrepreneur's capital stock from 100 to 140 Int. $ would translate into a 12 percent increase in profits (24 Int. $).

This finding may reflect that MSEs are severely capital constrained. Yet, re-investment rates have also been found to be low in small-scale activities. High business risks may explain this observation and hence why capital stocks remain low and returns high. When we study the determinants of capital stocks of MSEs (Grimm, Lange and Lay, 2011), we find that capital market imperfections indeed seem to explain a large part of the variation in capital stocks in the early lifetime of MSEs. Credit constrained firms on average accumulate capital when they become older. Furthermore, our analyses show that risk plays a key role for capital accumulation. Risk-averse individuals seem to adjust their initially low capital stocks upwards when enterprises grow older. The importance of both risk and credit constraints is reflected in the strong influence of non-business wealth on capital stocks. Even in the capital scarce West-African economies, we find MSEs in risky activities owned by wealthy individuals that seem to over-invest when they start their business and adjust capital stocks downwards subsequently. As other firms simultaneously suffer from capital shortages, such behaviour may imply large inefficiencies.

Our analysis of the patterns of returns to capital in Peru yields surprisingly similar results (Goebel, Grimm and Lay, 2011). We also find very high returns at low levels of capital, close to zero returns at medium and relatively high returns at higher levels of capital. This is particularly comforting since for the case of Peru we can rely on panel data and thus can better deal with a potential bias due to unobserved factors. This panel dimension also allows us to study capital accumulation and the results suggest that MSEs accumulate capital through retained earnings. This reflects that they are indeed credit constrained and all the key determinants of returns to capital – the level of capital, total factor productivity, and risk – all exert the expected effect on accumulation. These observations are consistent with high estimated returns to capital at low levels of capital and, indeed, a repeated estimation of marginal returns to capital by sub-groups shows that the high returns at low levels of capital are strongly driven by firms that are credit constrained and/or exposed to high risks.

Finally we investigate the case of Madagascar. The interesting feature is here that we can draw on a set of four repeated cross-sections of data. Hence, besides the focus on returns to capital, with this data at hand it is also possible to analyze the dynamics of the informal sector during a period of fragile growth (Vaillant, Grimm, Lay and Roubaud and, 2011). We find that overall, the behavior of informal firms in terms of earnings, employment and capital accumulation points to a degree of heterogeneity which goes beyond a simple dualistic model and even a more refined model that would distinguish between an upper entrepreneurial and a lower subsistence tier within the informal sector. However, in line with the dualistic model, the informal sector indeed fulfils a labor absorbing function in times of crisis. During the growth period we see capital accumulation in most of the sectors and lots of evidence that households expand their activities. However, this happens mainly through the creation of new firms instead of the expansion of existing ones, which is consistent with much higher returns at very low levels of capital. More rapid expansion can be observed in sectors that operate with lower capital intensity, which is also consistent with risk or credit constraints as major deterrents to expansion. While there is some indication that total factor productivity increased over time, returns to capital and labor where not higher at the end of the observation period than at the beginning. Returns are also rather low at high levels of capital. These findings point to a limited growth potential of the informal sector as a whole. The heterogeneity in capital returns hints at large inefficiencies in allocating capital across informal firms.

All these studies suggest that policies towards the informal sector should also target entrepreneurs with very low levels of capital that have often mistakenly been considered subsistence-oriented entrepreneurs. In particular credit constrained and risk leave the potential of many small-scale entrepreneurs unexploited, thus providing a rationale for policy interventions addressing these causes, such as micro-credit programs and, at least, the protection against basic household-related risks through the provision of health and life-insurances. Our findings may also be taken as an argument for providing households with savings devices. Households would be better off if they were able to invest in the enterprises of others. Finally, the important role of risk obviously hints at a reliable and stable business environment as being conducive to capital accumulation.

Relaxing capital market constraints – a case study: What are the short and medium term effects of microcredit in Madagascar?

We assess the impact of a microfinance institution (ADéFI) serving micro-entrepreneurs in Antananarivo (Madagascar) (Gubert and Roubaud, 2011). The methodology consists of

comparing the situation of a representative sample of micro-enterprise ADéFI clients with a control group through a standard matching technique. Overall, the results indicate a positive impact of the microfinance services. Taken as a snapshot, the studies conducted in 2001 and 2004 indicate that the microenterprises financed recorded better average performance than informal production units without funding. With a dynamic perspective however, the results were more nuanced. If the positive effect of the project is clear during growth phases, its effect during contractions is mixed. Thus the provision of micro credit did not succeed in accelerating the growth process of clients. This case study also highlights that developing credit organisations for informal production units is not an easy task, since the survey data also shows that while almost half of for informal production units have ever heard of the existence of some microcredit programmes, only 3.1% of them have had direct contact with an MFI. Moreover, among those IPU's that asked for a loan, less than 40% actually obtained it. When asked about how they would use their loans, 42% say they would create another small informal enterprise, among which more than 50% would do it in another sector of activity (extensive growth). This latter result is fully in line with what we observed when following the development of the entire informal sector in Madagascar over a longer period of time (see above). In sum, these findings suggest that easing access to credit, which is called for by most micro-entrepreneurs, is a necessary but not sufficient condition to boost the performance of informal production units. In other terms, as our research project shows credit market imperfections are not the only constraints faced by these enterprises.

To what extend are informal entrepreneurs also constrained from the demand side?

Our research on the demand for informal products and services yields three main insights (Böhme and Thiele, 2011). First, there are substantial demand linkages between the channels through which goods are distributed in the formal and informal sector. More than half of formal goods (incl. imports) and services are marketed through informal distribution channels. However informal products are almost exclusively distributed informally. In the food and beverages sector, for instance, formal outlets such as supermarkets appear to be virtually non-existent for informal goods. The clear predominance of the informal distribution channel suggests that measures to improve its efficiency should figure more prominently on the policy agenda.

Second, informal households account for a considerable share of overall expenditures on formal goods and goods sold via formal distribution channels. Regulations pertaining to the formal sector such as pricing or competition policies are thus likely to affect equally the welfare of those working in the informal sector. Likewise, formal households consume a considerable amount of informal products and products distributed informally. A thriving formal economy might indirectly benefit the informal sector through this demand linkage.

Third, rising household incomes lead to a lower propensity to consume informal sector goods and to use informal distribution channels. This implies that growing demand induced by higher incomes, even if all other factors remain the same, leads to a transition from informal to formal activities. At the same time, demand elasticities for informal goods and distribution channels are generally not too far below and in some cases even above unity, which points to a slow and uneven transition process. Support for those staying behind in the informal sector is thus likely to be needed for a long time to come.

Overall, the main message is that strong linkages rather than a formal-informal dichotomy characterize the demand structure in the studied West-African economic centers.

Consequently, a comprehensive policy strategy should not treat the informal sector in isolation.

Similar evidence comes from the study by Böhme and Thiele (2011) who examine production linkages between informal MSEs and the formal sector. Their study also shows that formal-informal linkages exist with backward linkages to the formal sector being more prevalent than forward linkages. These linkages vary with the degree of informality, occurring less frequently if firms are unregistered or have low capital stocks. The study also examines the correlation of the existence of linkages with firm performance. Using various measures of firm performances Böhme and Thiele (2011) show that the existence of formal backward linkages is strongly correlated with performance. This suggests an important role of formal linkages for firm performance although it is difficult to establish causality here with the cross-sectional data at hand.

(ii) Institutional constraints

What are the costs of going formal? How do these costs relate to propensity to formalize?

Our research points to three groups of institutional constraints for the registration of informal production units (Ouedraogo, Koriko, Coulibaly et al., 2011). (i) *Cost and delays to obtain permits:* All West-African countries offer the possibility to register through a special service (the so-called "*guichet unique*"). However, procedures are not yet harmonized; required formalities, costs and duration differ a lot by country. In Burkina Faso, Mali and Senegal costs are moderate, formalities limited and the duration acceptable. In Benin and Côte d'Ivoire costs are also moderate, but there are lots of formalities to follow and procedures are slow. In Niger the costs are particularly high, while formalities are limited and the duration is acceptable. Finally in Togo, costs are high; there are many formalities and the procedure takes a long time. These differences are well reflected in the general acceptance of the procedure (and the *guichet unique*) and the propensity to formalize, which is for instance relatively high in Burkina Faso and low in Togo, although, clearly, other factors matter in this decision too. (ii.) *Lack of information:* We find a correlation between the fact that informal production units were not willing to register their enterprise and the fact of being unaware of the procedures necessary for registration. (iii.) *Inefficient provision of public services:* The often poor quality of public services (see also below), such as water and electricity but also support for business development seems to be a further deterrent for informal production units to formalize. In other words the returns associated with formalisation are perceived as low compared to the costs.

Are informal entrepreneurs affected by corruption, and if so, how?

Our research shows that in West African capital cities, contrary to the common belief, informal production units are not massively victim of corruption by public officials *(*Lavalée and Roubaud, 2011*).* Indeed, only 4.2% of these enterprises declare that they had to pay bribes the year before the survey. Such a figure does of course not mean that corruption is an anecdotal phenomenon. Moreover, if we take into account only production units that had contact with the State in the year before the survey, the proportion of being bribed rises to 37%, which makes bribery a significant mean of settling disputes with public agents. There is also large variety between countries, ranging from 47% in Lomé (Togo) to 8% in Cotonou (Benin). Our analysis of the determinants of experiencing corruption among informal

production units, shows furthermore that the mechanisms of bribing are not substantially different from those prevailing in the formal sector. Moreover, our findings strongly suggest that experience with corruption drastically reduces firms' performance, stressing that the 'greasing wheel' hypothesis is not valid, at least in the informal sector. Conversely, taxation does have a significant positive effect on economic outputs. This is not surprising as the taxes paid in the informal sector usually refer to fees that have to be paid to get for instance access to a local market or another well exposed selling point. In conclusion, policies designed to fight against corruption are definitely necessary, but they do not need to be targeted exclusively to the informal sector.

We do not find a relation between non-registration and escaping corruption. Non-registration is rather an issue of weak law enforcement and not the result of a fear for corruption once registered. Moreover the surveys suggest that public authorities do not force informal production units to comply with the law. It is rather the case that no one really knows who should register and pay taxes, thus creating a grey zone prone to informal arrangements and negotiation, including corruption. Enacting clear rules would help reducing discretionary decisions and harassment by public officials, as well as allowing them to enforce legal regulations. In addition, it is of primary importance for public authorities to advertise registration procedures and to make clear that these procedures are compulsory. This should be bolstered by regular campaigns.

Do informal entrepreneurs benefit from public services such as water, electricity and telecommunication? Do these services matter?

We hardly find any systematic evidence for a significant contribution of access to public services to the productivity of MSEs (Grimm, Hartwig and Lay, 2011). We argue that this finding is rooted in the heterogeneity of the informal sector in which the need of public services and the type of binding constraints vary considerably. Although the data indicates that larger and more productive firms have more frequently access to electricity, water and telecommunication and at least electricity and telecommunication seems to increase the potential productivity of a firm, it does not seem to be indispensable for the surveyed firms. In fact, the full potential of access to electricity can only be exploited if firms have a need and also access to machines using electricity. The latter seems generally not to be case; many machines are difficult to obtain and if so only at a very high cost (as they are usually imported) and are thus out of reach for most informal production units. But even if machines are more easily available, the purchase would often require some form of credit, to which many of the entrepreneurs do not have access.

However, considering the more specific situation of a sample of tailors in Ouagadougou, we do find that access to electricity exerts a positive and statistically significant influence on their performance. This is due to both, allowing for longer working hours but also for the use of more sophisticated machinery. In conclusion, improving access to public services and in particular electricity may make a significant contribution in some sectors and for some types of firms but is not a magic bullet for the informal sector at large. Hence, as so often, a 'one-size-fits-all' approach is of little help. This finding should not be interpreted as an excuse for not increasing electrical capacity and other infrastructure, as this would certainly retard the necessary industrial development, which is badly needed in Africa; it rather indicates that for informal production units the lack of infrastructure is not the most binding constraint and that the potential benefits of infrastructure depend on many other factors too.

(iii) Social constraints

Do family and kinship ties help or hinder the development of micro and small businesses?

As mentioned above it is puzzling to observe among informal production units with very small capital stocks relative high marginal returns but only very low re-investment rates. In our research project we evoke a couple of possible explanation for this observation, one of which is the role of sharing obligations or 'forced redistribution' which prevents entrepreneurs from saving and investing. Forced redistribution is in the anthropological and sociological literature prominently discussed and often presented as a typical feature of Sub-Saharan African societies. However, there is only little empirical analysis that would allow judging whether forced redistribution is really widespread and indeed constitutes an obstacle to economic activities in that region.

In a first paper we analyse how the intensity of family networks influences firms' use of labour and capital in general (Grimm, Gubert, Koriko et al., 2011). The underlying hypothesis is that if entrepreneurs feel obliged to share a fixed proportion of their profits, they will use less resources for their firm and use more for alternative activities that are more difficult to 'tax' by the family. Using the 123 data and focusing on a sub-sample of migrant entrepreneurs, we find that local family and kinship-ties within the city enhance the use of labour inputs maybe because local ties help to overcome labour market imperfections. As a proxy for the potential intensity of the links with the family and kin who remained in the village of origin we use the distance to the area of origin of the migrant Our results suggests throughout that looser ties are correlated with a higher capital and labour inputs, in particular for women. Although we are not in a position to make any causal claims, this finding is at least consistent with the hypothesis that redistributive pressure tied to the village leads to adverse incentive effects and that these adverse incentive effects seem to get diluted with distance. Greater distance from home may hence make it easier to protect savings from abusive demands. We can rule out that this result is driven by unobservables that would determine both the willingness and ability to migrate far and the ability to run an enterprise. We also find weak evidence that the migration duration – controlling for the enterprise age – is positively correlated with the use of capital and labour. Most of our results also hold if we use predicted 'excess transfers' as a measure of redistributive pressure.

In this context we also show that migrants with several enterprises transfer less to their families than those with only one firm. This is consistent with the hypothesis and our findings for Madagascar above, that some entrepreneurs prefer to invest in several small activities instead of expanding an existing firm; an expansion that would probably send a signal of entrepreneurial success to the entrepreneur's kin. Such behaviour would also partly explain why we see so many micro firms. We also show, holding constant total income, that migrants that draw their income from several enterprises transfer less to their families than those that manage only one firm. This is consistent with the hypothesis that some entrepreneurs rather invest in several small activities that can easily be hidden, than in one single large firm that would then send a clear signal of entrepreneurial success to the entrepreneur's kin. It would also partly explain why we see so many small firms with less than two or three employees and only few larger firms (extensive growth).

Based on these insights, we then looked at this issue in more detail for the case of tailors in Burkina Faso's capital, Ouagadougou. First, we conducted a survey using a modified phase 2 questionnaire on which we included many questions regarding the interaction with other

members of the kin, via start-up help, transfers, hired labour and other services. Second, we conducted different variants of a field experiment to measure the short term impact on productivity of exogenous variations in the pressure for redistribution.

The field experiment shows that implicit and explicit solidarity obligations as well as the expectation of future demands for financial support lead to a significant reduction in work input and productivity alike (Hadnes, Vollan and Kosfeld, 2011). Using the survey data Grimm, Hartwig and Lay (2011) analyse then in more detail the underlying mechanisms, the heterogeneity in terms of compliance with such sharing norms and the implications via investment. The basic idea is that entrepreneurs have to decide whether they want to invest and rely on their own or whether they share their income with their family and kin, and hence forgo investment opportunities but are insured against business and household-related shocks. A sanction that is imposed in case of a refusal of sharing, may force entrepreneurs to comply even if from their individual perspective investing would be the better alternative. In other words, the informal insurance is in principle compulsory. Non-participation is costly. The model shows that the trade-off between sharing and investing is driven by the entrepreneur's risk aversion, the riskiness of the environment and the severeness of the sanction imposed by the kin in case of non-compliance. We then test this model using the data collected among the sample of tailors. Overall we find support for our model. More risk-averse tailors and tailors facing higher pressure for redistribution as measured by the number of siblings alive, the size of the village of origin and the number of visitors are more likely to remit and less likely to invest. We also find evidence in the data that remittances to the kin make it more likely to receive help in times of economic hardship suggesting that remittances fulfil indeed an insurance function. Finally, we find (weak) evidence that tailors with intense kinship ties are more likely to employ workers hired from the kin. We also show that these workers are on average less productive than workers that do not have a blood relationship with the tailor. However, we do not find empirical support for the hypothesis that hiring members of the kin is part of the insurance arrangement and thus substitutes for remittances. That family labour is less productive than other labour has been confirmed for Vietnam, a country where family networks are generally considered of having large benefits (Grimm, Nordman and Chi, 2011).

In sum, we conclude from this set of papers that policies intended to support small and micro enterprises in a context of strong sharing norms like in many parts of Sub-Saharan Africa should consider to provide insurance services not only to the entrepreneur to facilitate stepping out of traditional kinship network, but also to those that economically rely on them to reduce the pressure for redistribution. More broadly, the introduction of public health insurance may indirectly also enhance investment in small and micro-enterprises as it will crowd out inter-household remittances and hence allow entrepreneurs to save and to invest. Such policies should be the more effective the more such networks are motivated by insurance and not by pure egalitarian norms.

Focusing on family traditions for a certain type of activity, we investigated another potentially *positive* effect related to the family (Pasquier-Doumer, 2011). We find that having family members involved in the same type of activity is per se important for informal businesses, although these effects are more pronounced for firms with a certain growth potential and less for survivalists. Firms with a family tradition generate higher earnings. This advantage is mostly explained by the transmission of enterprise-specific human capital, acquired thanks to higher opportunities to accumulate experiences in the same sector of activity, and by the transmission of social capital that guarantees a better clientele and reputation. However, a family tradition is not a guarantee for better access to physical capital and managerial skills per se. Physical capital investments rather respond to household wealth.

Concluding remarks

From a policy perspective, being able to isolate entrepreneurs with low capital but a high potential from true survivalists and top-performers may be an important step towards more differentiated informal sector policy menu and effective targeting. The high potential of a large share of what is often called the 'lower tier' makes them an attractive additional target for dedicated policy interventions. Our research highlights which constraints such interventions would need to address. While credit constraints have long been acknowledged as an important impediment to enterprise success, recent debates have sometimes cast doubts about the impact and sustainability of microcredit programmes that explicitly address these constraints. The presented evidence suggests that there is indeed an important number of financially constrained entrepreneurs who can make good and productive use of the resources of provided by such programmes. Yet, the results also indicate that it will be difficult to earn the high interest rates often charged by these microcredit institutions for entrepreneurs operating with an intermediate level of capital stock. Identifying entrepreneurs with a high potential is the challenge, microcredit providers are faced with.

In addition to capital constraints, risk-related factors can explain a major portion of differences in capital stocks and capital returns between firms. It would be wrong to advise government to try to curb business risk in general. Entrepreneurial activities always entail a certain degree of risk. First, governments should provide entrepreneurs with predictable business environments, for example in terms of legal frameworks and contract enforcement. We also emphasized the importance of idiosyncratic risks, which may also be rooted in non-business factors. While governments can do little to reduce business risks, they can engage in providing people with instruments to deal with non-business risks. More research, however, is needed to support this claim.

Particular attention needs also to be paid to female entrepreneurs who are clearly underrepresented among those with a high potential and even less represented in sectors with growth potential, such as construction and transport. However, those who are already among the top-performers are not less successful than men. Further research needs to find out whether the high concentration among survivalists is a deliberate choice by many women, for instance as they want to operate these firms on a small-scale to combine this activity with housework, or whether this is primarily the consequence of more severe constraints for women than for men. Recent studies that have examined this in more detail do not find evidence for gender discrimination or a lower inherent demand for finance. Rather performance differences can be explained by gender gaps in other dimensions related to the use of financial services and education (Aterido *et al.*, 2011). However, the fact to combine housework with the market activity seems to force many women to operate their business from home which often means to be far from input markets and clients.

While exploring the specific policy package for informal production units with a high potential – or constrained gazelles how we call them in one of our papers – is outside the scope of this project, it is clear that such a package should focus on unlocking the potential of these constrained gazelles. Therefore, it may differ from policies for top performers – focusing on consolidating growth and formalization – and those for survivalists –focusing on employability and poverty alleviation. We do not to argue in favour of giving preference to either target segment of the informal sector, but to add a special target group to the menu of informal sector policy makers.

Our research also shows that the relative size of the group of high potentials relative to survivalists depends among other aspects on structural characteristics of the respective economies, such as the urbanisation rate, the weight of agriculture in the economy and the size of the public and formal private sectors. Generally, we seem to find a higher share of high potentials in the more dynamic economies. In our basic partition, which - we think - provides an upper bound, the share of high potentials ranges from 30% to 60% of all informal entrepreneurs. It would be naïve to think that an exact threshold could be defined. We rather want to emphasize that a substantial share of those firms with very low capital stocks shows strong entrepreneurial dynamism. Arguably, the seven capital cities in West Africa belong to the less economically dynamic capitals in the developing world. Therefore, we expect to find at least similar shares of constrained gazelles in the informal sector of other developing but more advanced countries.

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