Why do identical informal businesses set up side by side? It's a survival tactic: Kenya study

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The population on the African continent will have nearly doubled by 2050, according to UN projections. About 800 million more young Africans will enter the job market by then. Combine this forecast with the high youth unemployment rate in many African countries today, then the pressing question is: who will create stable jobs at mass scale?

Many policies to create new employment at scale focus on solution templates that have worked elsewhere, often outside Africa. These include enabling entrepreneurship to create high-growth start-up ventures, bringing in technological advances to potentially unlock new industries, or the establishment of outsourcing hubs for low-cost labor.

Few policies directly support homegrown solutions that already have a track record of creating large-scale stable employment.

Together with my co-authors, I looked for answers in a seemingly unlikely place. We studied how car repair businesses were organized. Specifically, we studied the neighborhood of Dagoretti Corner in Nairobi, Kenya.

Here, 105 largely identical car repair businesses set up shop close to one another. Imagine corrugated iron sheets as fences to demarcate businesses which offer exactly the same service in the same location.

This phenomenon is common in major African cities. Thousands of different traders—from fruit sellers to furniture makers—set up next door to each other and co-locate. This doesn't make sense as a competitive strategy, so why do it?

We found that these businesses do this in part because it generates an informal welfare system. In our study, the car repair businesses mutually supported each other in a variety of ways to ensure they survived and thrived.

Our findings make a case that policymakers should focus on supporting these informal welfare systems. They abound in urban areas and create employment at scale. Yet, policies tend to support individuals, as opposed to groups, in informal economies. This could risk eroding these welfare systems, putting livelihoods at risk.

Informal welfare system

Over the past two decades, car repair businesses in Dagoretti Corner grew from 11 to 105 identical businesses. As the satellite images in the video below show (car repair businesses shaded in yellow), they have massively expanded and are now fully integrated into the urban infrastructure.

The agglomeration of businesses in this way is often seen as a sign of failed economic and urban development policy by industry analysts, development practitioners and policy makers. They tend to believe that agglomerated businesses should reach higher levels of efficiency, competitiveness, specialization and innovation.

Yet, many businesses continue to operate the same way they did a decade ago with little change or upgrading. What benefit are these businesses reaping?

Through our fieldwork in Dagoretti Corner, visiting car repair businesses and conducting interviews with 45 owners, we identified five ways in which business owners create their own welfare system:

First, they save and invest money together. This is often done in small scale, informal rotating savings and investment associations. In Kenya these are known as chamas and Savings and Credit Cooperative Organisations (Saccos) and are akin to credit unions and cooperatives. Saving money together enables owners to get a loan and enables business owners to make investments together. Rather than being competitors, businesses are interdependent and trust each other to grow together.

Second, businesses offer apprenticeship opportunities, enabling the youth from rural Kenya to get trained and equipping them with the knowledge and resources to start their own car repair businesses. Through apprenticeships, mechanics become familiar with the welfare system and continue its upkeep into the future.

Third, trust is fragile and business owners come up with ways to self-police against free riding and theft. They address competitive behavior through self-organized committees. Poaching customers from a peer business is seen as theft and is policed. Repeated shoddy repair work and alcohol abuse among mechanics is also policed. Particularly exploitative customers are blacklisted. After all, the owners want to make sure that customers perceive Dagoretti Corner as a safe place for customers to entrust their valuable cars.

Fourth, businesses support each other in times of crisis when nearing bankruptcy to ensure survival. Chamas and Saccos make emergency money available to smooth over gaps. Businesses temporarily loan out their employees to other businesses to ease the financial burden of paying a wage. And businesses sub-contract repair work to distressed businesses, ensuring at least some cash flow until business picks up again.

Fifth, in times of personal crises when livelihoods are at stake, due to high medical bills or funeral costs, peer businesses step in and provide a type of insurance policy. Owners, employees and apprentices collectively contribute funds to support those in dire need and prevent them from slipping into destitution. This informal insurance scheme even extends to family members.

This informal social welfare system is critical because it provides stable employment, saving and investment opportunities and insurance at considerable scale.

Policies that support the growth of individual entrepreneurs in these areas—such as through training and cash infusions geared towards business differentiation—are likely to introduce competitive behaviors among identical businesses. This risks the collapse of welfare systems and thus also employment at scale.

Policies must strengthen informal welfare systems

We concluded from our research that policies need to further enable, strengthen and then leverage the existing welfare systems of co-locating businesses to engender firm and employment growth. These are strongholds of cooperative behavior that need to be protected rather than transformed or displaced.

One way this can be done is through the creation of transparent cooperative structures and exit pathways for individual businesses to grow. This would strengthen the welfare system and needs to be the starting point of policy discussions.

For example, targeted governance interventions could make chamas and Saccos more robust to safeguard them against fraud and enhance their self-organizing capacity. Digital technologies can play a role here to bring these saving and investment schemes into the modern age. Once made robust, cash infusions by the government to support firms in the informal economy can then happen through these rather than through separate, government-run entities.

We do not rule out the potential for policy interventions seeking to support individual firms. Yet, these need to be context-sensitive so that they can enable businesses to scale without eroding the social order.

This is just a starting point. In light of the pressing challenge to bring about labor-intensive growth in African societies, it is paramount to not only focus on importing solutions from elsewhere but to be intentional about enabling and supporting homegrown solutions that already work.

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