Barriers of entry and capital returns in informal activities: Evidence from Sub-Saharan Africa

Michael Grimm
Institute for Social Studies, The Hague, Netherlands

Jann Lay
German Institute for Global and Area Studies, Hamburg, and University of Goettingen, Germany

Abstract

While microeconomic empirical evidence on the patterns of entry barriers into different economic activities in poor economies is relatively scarce, quite some evidence has been accumulated in favor of very high rates of return to capital (e.g. Banerjee and Duflo, 2004; de Mel *et al.*, 2008). Despite high returns, McKenzie and Woodruff (2006) find little evidence for the existence of high entry costs for the case of informal Mexican enterprises. For Sub-Saharan Africa, one of the few contributions on capital entry barriers and returns is the paper by Udry and Anagol (2006) who find extremely high returns to investment into pineapple cultivation, which, however, exhibits considerable entry barriers.

The proposed paper intends to contribute to this literature by investigating the patterns of capital entry barriers into different informal activities and capital returns in a number of Sub-Saharan African economies using a unique micro data set on informality covering seven West-African countries, Madagascar, Peru and Vietnam.1 In a first step, we plan to assess investment patterns across informal activities (and countries). Although our datasets are cross-sectional, they allow us to identify investment paths. Since we know when (and why) an enterprise has been started, we can compare the patterns of start-up costs and subsequent investments across different sizes of initial investment, different sectors, motivation of creating the enterprise and even different sources of finance (family, microcredit, formal loans etc.). In a second step, we estimate the returns to capital and examine how these vary with the size of the capital stock – based on profit or production function estimations. We attempt to deal with the typical problems of such cross-sectional estimates by including ability proxies and/or estimating individual-, family- or household-fixed effect models on a sub-sample comprising entrepreneurs and households with more than one enterprise. In assessing the heterogeneity of returns conditional on the size of the capital stock we intend to follow McKenzie and Woodruff (2006) who apply semi-parametric techniques.