

**FORMALIZATION OF THE INFORMAL
SECTOR IN KENYA: *A Critical Review of the
Kenyan Law on Investments.***

L.MM THESIS

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DECLARATION

I, Onesmus Ndumbuthi Makau, do hereby declare that this Thesis is my original work and has not been submitted and it is not currently being submitted in any other University.

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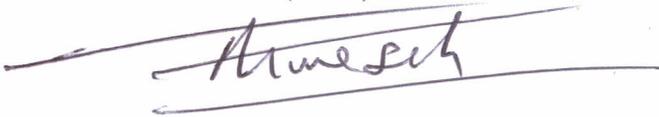


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This Thesis has been submitted for examination with my approval as University Supervisor.

Signed

MR. TIM MWESELI (UON)



Nairobi, November 2006.

DEDICATION

This dissertation is dedicated to my beloved children Benjamin Vinya and Mercy Ndunge.

ACKNOWLEDGEMENT

I salute my Supervisor Mr. Tim Mweseli for his kind effort in marking my work on time and guiding me to compile this dissertation. I am thankful to my wife Jane and my son Vinya who were very supportive through out my LL.M course. I am most grateful to the Institute of Development Studies and KIPPRA Library Staff for their support during my data collection in their respective Libraries. Finally I appreciate the effort and contribution of all those who helped or challenged me during my research including my classmates and the staff of Onesmus N.Makau & Associates.

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ACRONYMS

CAP	Chapter
CBS	Central Bureau of Statistics
GOK	Government of Kenya
ICDC	Industrial and Commercial Development Credit
ICEG	International Centre for Economic Growth
ILO	International Labor Organization
IMSE	Informal Micro and Small Enterprise
KIE	Kenya Industrial Estates
KIPPRA	Kenya Institute of Public Policy Research and Analysis
MFI	Micro Finance Institution
MSE	Micro and Small Enterprise
OECD	Organization for Economic Co-operation and Development

ABSTRACT

Micro and Small enterprises (MSEs) sector in Kenya is an old economic sector dating back to the pre- colonial era. Over the years the sector has rapidly grown to contribute a lot to the country's economic development through provision of employment to the ever increasing army of job seekers. The sector has however largely continued to operate informally.

Little interest, to exploit the sector's potential, was shown by either colonial or independence governments until 1972, when ILO published a report on employment in Kenya. Since then, the government of Kenya has taken a bold step in formulation of various policy and strategy papers aimed at creating an enabling environment for the growth and development of the sector. None of these government papers has however advocated for the formalization of all the Micro and Small Enterprises (MSEs). The process of formalizing MSEs has therefore been left at the mercy of the existing investment laws which are irrelevant to the Micro and Small investors.

Consequently, the sector has continued to experience a rapid increase of the informal MSEs, resulting in poor planning, poor allocation of resource and poor provision of essential services due to lack of accurate statistics. There is also no mechanism to guarantee protection of workers, consumers and the environment. Likewise the government is not able to efficiently tax all the MSEs because the majority is unknown to it and there is no possibility of catching the evaders. An economic sector which cannot contribute to the civilization of the country is not sound. It is parasitic to government resources and services.

This paper traces the evolution of the MSE sector and its policy in Kenya generally but more particularly regarding Artisans and Crafts people. The paper then catalogues and critically reviews the investment laws in Kenya and makes recommendations towards creation of a conducive legal and institutional framework for the formalization of the informal MSEs. To this end the paper recommends for enactment of MSEs Act to regulate all the MSEs' activities.

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background to the Research Problem

Investment in whatever magnitude is very central to the development of every country, Kenya included. Investment means, an expenditure on capital goods or acquisition of capital goods incurred in the understanding that these capital goods shall be deployed to produce income.¹ For developing countries like Kenya investment in the Micro and Small Enterprises (MSEs) sector has been viewed as the main vehicle to propel the said countries to industrialization. Developing countries are therefore supposed to put in place an enabling legal and regulatory framework founded on clear and firm government policy on the MSEs sector if at all this dream of industrialization is to be realized.

Kenya is recognized as the country where the study of Micro and Small Enterprises (MSEs) was first born under the rubric of the informal sector some 34 years ago.² The term “informal sector” was first coined by the International Labor Organization (ILO) in 1972 when it did a pilot study in Kenya and published a report called, *Employment, Incomes and Equality: A strategy for Increasing Productive Employment in Kenya*.³ Although studies of limited scope and objectives were done it was only from the 1990s that nation-wide studies started with a focus on generating baseline surveys on the Informal MSEs.⁴

The first national baseline survey in Kenya was done in 1993 followed by the 1995 survey then the last one in 1999. The 1993 survey approximated the number of the

¹ Livingstone I. and Goodall A.S. (1970) *Economics and Development: An introduction* Nairobi, Oxford University Press, 9

² Central Bureau of Statistics (CBS), International Centre for Economic Growth (ICEG), and K-Rep Holdings Ltd, (1999) *National Micro and Small Enterprise Baseline Survey 1*. There is evidence however that the term was first coined in Ghana in 1970 by Hart – see Cross, C.J.(1998) *The informal sector* London, Routledge 1 in <http://www.openair.org/cross/infdef2.html> accessed on 27.6.2006 at 4.30 pm

³ Kenneth King, *Jua Kali Kenya: Chabge & development in an Informal Econom 1970-1995* London EAEP 7.

⁴ Note 2 1

MSEs to be 910000 employing up to 2 million people. The 1995 survey estimated the size MSEs at 708000 employing up to 1.2 million people. The 1999 survey found that there were about 1.3 MSEs in the country employing about 2.3 million people. These figures reflect some discrepancies and in my view the figures cannot be conclusive because they were based on estimates rather documented register of formal MSEs since most MSEs are not registered. It is therefore very necessary to formalize all the MSEs if at all proper statistics are to be kept and effectively utilized. An example of areas where proper MSEs statistics are required is when the government is challenged to prove that it has helped create 500000 jobs. Despite the said discrepancies, the Baseline Surveys reports above mentioned, remain the only main and authoritative sources of data of its kind.⁵

As already stated above, the greater majority of the MSEs in Kenya are either not registered, or if at all registered they do not fully comply with all regulations provided for under the relevant investment legislations. Indeed Kenya did not have any policy on the MSEs until 1992 and todate the country has no specific legislation to regulate investment in MSEs. The sector is therefore required to comply with the same investment law that regulates the macro enterprises which is complex and with minimum standards high above the capacity of the MSEs.

In addition the investment law in Kenya is not contained in single legislation but a mosaic of numerous pieces of legislations each with its own procedures and obligations some of which conflict. These legislations regulate entry to formality, through registration and licensing on the one hand; and remaining formal through compliance with the operating regulations on the other hand.

Consequently, the sector has faced serious challenges directed to all entrepreneurs, their laborers and consumers including:

- lack of proper legal recognition and protection from harassment by local authorities and the rich private developers who grab and evict the poor entrepreneurs usually forcefully and without notice;

⁵ *Ibid*

- Strict and rigid bureaucratic procedures of registration and licensing coupled with corruption often constrain the expansion of the sectors;
- Policing on business location as the sector is normally located in remote parts of the urban centers where there is no security and other social services. This discourages customers' access to the market due to insecurity and environmental pollution;
- Lack of financial credit has denied the sector capital for starting up or expansion and this has led to financial form of informal sector called the Micro-finance Institutions to provide credit to the informal sector;
- High operating costs due to licensing demands, cost of fuel and electricity, and transport have had a heavy toll on the sector.⁶

Despite the foregoing lapses, Kenya is committed to the provision of an enabling environment for both local and foreign investors, MSEs included.⁷ This commitment has been demonstrated through the formulation of various Sessional Papers, Strategic Development plans and Legal Notices on the development of the MSEs. An important element of such an environment is the legal and institutional framework that regulates the phenomenon of investment. A rational legal system backed by an efficient bureaucracy acts as an incentive to formal investments and improves productivity and competitiveness.

The implementation of the said government policies, however, remains a puzzle due to various reasons the key one being that the policies are not stakeholders-driven but government –driven. It is therefore necessary to involve all the stake holders in the formulation of any policies on the sector if proper results are to be realized in the growth and development of formal MSEs in Kenya.

⁶ Masai, W. Mbithi M, and Otieno B.O. (2005) *Development of Micro and Small Enterprises in Kenya: Renewed Policy and Strategy Framework*, Nairobi ,ACEG 5-9.

⁷ Moyi E. and Njiraini P. (2005) *Misallocation of Workplaces for MSEs in Kenya: Some Lessons and Models*, Kenya Institute of Public Policy Research and Analysis (KIPPRA) 8.

1.2 The Research Problem

The MSE Sector in Kenya is largely informal. The enterprises are not registered with government regulatory Authorities for recognition, taxation, regulation and protection. As a result the exact number of all the MSEs in the country cannot be ascertained and their full benefits like job creation and revenue generation cannot be properly documented and verified.

The above state of affairs puts into focus the regulatory framework that deals with the investments in MSEs sector. The focus of this study is therefore on the legal and the bureaucratic framework that regulate investments in the MSE Sector with a view to identifying the cause of the extensive informality in the sector in order to prescribe remedies that would enhance the formalization of the informal MSEs in the sector.

It is surprising to note that the cause of informality is largely attributable to the legal and bureaucratic framework that currently regulate investments in Kenya. The said laws and bureaucracies are rigid and only designed to suit macro investments. The regime is largely a legacy of the colonial era which spilled over to the independent Kenya. The laws regulating registration, licensing and operation of businesses did not contemplate and it is not suitable to investments in the MSE Sector.

It is that inflexibility of the investment law and its inability to address the special and unique needs of the MSEs that leads to massive informality. Setting up a Micro and Small Enterprise like any other investment requires compliance with certain minimum legal procedures. For an informal enterprise to become and stay formal it must comply with various legal requirements, which involve costs in the form of finance as well as time. Financial costs include a series of initial registration fees, as well as payment of tax and labour obligations during the operation of the enterprise. Time costs depend on the degree of intricacy of the registration procedure and degree of efficiency of the state institution involved in the registration process.

The study is founded on the belief that the MSEs Sector is very important to the economic development of Kenya and other developing countries. As such the legal and bureaucratic framework that regulates investments should be reformed to

recognize the MSE Sector as a cadre of investors *Sui generis*. This study makes a case for the investment laws and bureaucracies there under to be made flexible to address the unique needs of the sectors investors that deter the formalization process.

This study closely examines the Kenya's investment law to see if it is relevant, beneficial and applicable to the formalization of the MSE sector. The main areas of consideration by the study include registration, licencing, land allocation, labour, taxation, intellectual property among others. All these aspects of formalities have the effect of benefiting both the investor and the national economy. The investor benefits from recognition and protection, while the state benefits from the tax revenue. The investment law currently in force does not address the special needs of the SMEs. Consequently there is need to develop a Micro and Small Enterprises law founded on a firm government policy if at all the informal Micro and Small investments are to be formalized and developed to attain macro status.

1.3 Objectives of the research

This study seeks to explore the legal needs raised by the proliferation of the informal enterprises in Kenya. The intention here is to fortify the view that the existing legal and bureaucratic framework in Kenya did not contemplate investment through MSEs and as such the said laws and bureaucracies act as barriers to growth, and also to the process of formalization of the IMSEs in the country.

More specifically the study:

- Considers definitional issues and a brief conceptual/ theoretical framework surrounding the sector with a view to settling the issue that MSEs constitute a cadre of investors *sui generis* having special qualities and faced with special challenges which require a special law to regulate it separate from the orthodox macro investment sector.
- Traces the evolution of the informal sector and its policy in Kenya to settle the issue that the government has positively responded to the sector as a vital contributor to the development of the national economy.

- Provides an overview of the sector and explores the characteristics of the MSEs and the challenges they face which inhibit growth and development.
- Critically discusses the existing investment laws in Kenya with a view to exposing the legal barriers to the process of formalization of the IMSEs. Makes recommendations for review of the investment laws with a view to developing an MSEs law to regulate micro and small investments in the country.

1.4 Research Questions

In view of the aforesaid research problem and the objectives, the questions to be answered by this study are:

- What are the MSEs and what leads to their informality?
- What laws regulate investments in Kenya and what is their suitability to the growth and formalization of MSEs?
- What legal, institutional and/ or policy recommendations should be made to catalyse the process of formalization of the MSEs sector in Kenya?

1.5 Hypotheses

- Formalization of the informal MSEs is necessary for economic growth in Kenya.
- The investment laws in Kenya did not contemplate the emergence of the MSEs as a form of investment.

1.6 Justification of the Study

The 1999 National Micro and Small Enterprises Baseline Survey estimated that 68 % of the non- agricultural employment in Africa is found in the informal sector.⁸ Although not contemplated in global economy, the sector has been growing at a rapid speed and has been able to absorb an ever-increasing large number of job seekers,

⁸ The National Baseline Survey of 1999 as quoted in ⁸ Ronge E. *et al*,(2002) *Review of the Government policies for the promotion of Micro and Small scale Enterprises in Kenya*, Nairobi, KIPPRA 1

increase income and contribute to the national account. The sector is therefore an important driver of economic development and should be explored in order to give its definition, highlight its size, its characteristics, make observations from past experiences and put forward a few innovative legal as well as policy proposals on formalization of the sector in Kenya.

The study is a novel one among the Kenyan legal scholars and will add to the existing knowledge about the importance of having a special legal regime for regulation of the informal sector micro enterprises in the country. The study will explore the relevance of formalization of the informal micro and small enterprises in economic growth and overall poverty reduction Kenya. The study explores the investment regime in Kenya with a view to exposing all the legal constraints which inhibit the growth and development of the MSEs generally, and formalization of the informal MSEs in particular.

The legal scholars have not taken a leading role in studying and theorizing on the phenomenon that was born in our land over 34 years ago. The matter has been left to other social scientists and policy makers to study and theorize thereby causing a legal vacuum to remain unattended for over three decades now. The study is intended to provoke legal scholars to do more research on the informal sector. The study also intends to challenge policy makers and planners to treat the sector as a special cadre of investors that every developing country should not sideline.

1.7 Conceptual Framework

The informal sector has been defined in many ways internationally making it impossible to have a clear and universally acceptable definition. According to McLaughlin,⁹ informal sector is the shadow economy comprising those small enterprises which utilize the most rudimentary and traditional technology and business practices; and the businesses are unlicensed, unregulated and unknown to the government. Much of the labour is supplied by the family and the skill is acquired by working. Sethoraman on the hand defines informal sector as small-scale units engaged

⁹ McLaughlin S. Characteristics of the Informal Sector, in OECD, (Turnham, D. Benard, S. and Antoine, S , eds,1990) Paris,157

in the production and distribution of goods and services whose primary objective is to generate employment for the participants rather than to maximize profits.¹⁰ This study defines and considers the informal sector as comprising those MSEs which are not registered and do not comply with the legal obligations concerning safety, taxes and labour laws.

The informal sector enterprises are characterized by; ease of entry; small scale of activity; self employment with a high proportion of family labour; little capital and equipment; labour intensive technologies; low skills; low level of organization with little access to organized market; informal credit; education and training or services and amenities; cheap provision of goods and services or provision of goods and services otherwise unavailable; low productivity and low incomes.¹¹ The informal sector activities are rarely in compliance with administrative requirements.

According to Ronge,¹² the informal sector is roughly divisible into two: the small productive sector and the main survivalist activities. The informal productive sectors are those elements of the informal sector, which are sustainable or entrepreneurial. They have significantly high incomes than the survivalist. Such enterprises are vital for poverty alleviation and production of goods, services and employment. Survivalist activities on the other hand are those primarily engaged in commerce and deal with basic and low quality product with the intention of earning income to meet subsistence needs.

On the other hand, Micro and Small Enterprises as an economic concept has been defined using the following three criteria:

- Those enterprises employing less than 50 workers.
- Those enterprises that are not registered and do not comply with the legal obligations concerning safety, taxes and labour laws.
- Those with low amount of capital and skill per worker.

¹⁰ Sethoraman, 1981 quoted by Lubell H.(1991) the Informal Sector in the 1980s and 1990s, OECD

¹¹ . Charmes, 1997 and National baseline survey, 1999 as quoted in Ronge E. *et al*,(2002) *Review of the Government policies for the promotion of Micro and Small scale Enterprises in Kenya*, Nairobi, KIPPRA 3

¹² Ronge E. *et al*,(2002) 2

For the purpose of this study we will adopt the criterion of number of employees which is also the definition used in the MSEs National Baseline Survey of 1999. Thus MSEs are those small-scale enterprises (excluding agricultural production, animal husbandry, fishing, hunting, gathering and forestry), which employs upto fifty employees whether in the formal or informal sector. An enterprise employing up to a maximum 10 workers is called a micro- enterprise while the one employing between 11- 50 employees is called a small- enterprise.

The terms MSEs sector and Informal sector have normally been used interchangeably because most MSEs are informal. That is however a misconception which fails to notice that the informal sector is actually a sub-sector of the MSEs sector. Thus the correct position and which is adopted by this study is that, the MSEs sector is a conglomeration of both formal and informal micro and small enterprises.¹³

Formalization of the informal sector simply means the legalization of informal MSEs. This consists of two related but different aspects: (a) entry to legality and (b) staying legal. Each of these aspects of formalization has got its barriers and costs which we have highlighted as hereunder.

1.7.1 Entry to legality

Entry to legality for MSEs simply means becoming part of the regulated or formal economy. This is achieved through a series of registration in public offices at both local and national levels. The purpose of registration is to gain legal existence and operate as: (a) an economic unit in determined activities for example trade, production or services; (b) an economic unit subject to tax obligation, (c) an economic unit that ensures that certain minimum standard are met in terms of health, products quality and labour, and (d) an economic unit that belongs to certain associations of producers, traders and so forth.¹⁴

¹³ Ronge E. *et al*, (2002) *Review of the Government policies for the promotion of Micro and Small scale Enterprises in Kenya*, Nairobi, KIPPRA 2

¹⁴ Ricardo, A. L. Barriers to Legality and their costs for the Informal Sector, in BEYOND REGULATION : THE INFORMAL ECONOMY IN LATIN AMERICA (Tokman, V.E. ed, 1992) 88

Barriers to becoming formal.

According to case studies done in Latin American countries, it was found that the procedure for establishing a formal MSE involves complying with the following sets of requirements:¹⁵ (a) initial registration, (b) procedure concerning the location of the MSE, (c) procedures related to health and safety standards, (d) regulations concerning taxes, and rules related to labour. These requirements for formalization pose as costly challenges to any informal MSE wishing to formalize.

Costs of becoming formal

In the aforesaid study of Latin America, the cost of fulfilling the different legal requirements mentioned above were measured in terms of the number of procedures or steps needed, the time (in days) involved and the financial resources required.

On the procedural aspect, it was found that in most cases steps between 20 and 30 were required to register an economic activity – with some extreme cases extending to 59 steps. The steps involved initial registration and procedure related to tax registration. The number of procedural steps involved and their complexity have a direct relationship with the time and financial costs.

Regarding time costs, the study found that the duration required for registration process ranged between 15 – 30 working days, but in some countries the process could take up to two years. The study found that the time taken to legalize an economic activity is directly proportional to the number of bureaucratic steps required for registration. The obstacle presented by the bureaucracy was found to vary with degree in centralization/ decentralization, the administrative organization and the complexity of the required procedures of a particular country. Thus the intricacy of some requirements affects the registration process on the side of the informal units as well as on the side of the public administrators of low skills.

¹⁵ Ibid 88-89

The financial costs involved in the formalization process included the registration fees, licence fees and costs of preparing or modifying the locale. The modification costs depend on labour laws requirements, public health and the nature of the economic activity. The locale modification costs is more for legalizing MSEs doing manufacturing because they are required to overhaul their shoddy premises to comply with all the statutory requirements for a manufacturing enterprise.

Once an enterprise overcomes all these barriers and costs of entering into formality the other main challenge becomes that of remaining formal. Many just get the registration for purposes of starting business but still operate illegally risking dire consequences.

1.7.2 Staying legal

As already mentioned above formality involves not only the aspect of entry to legality but also this implies the fulfillment of legal requirements during the actual operation of the enterprise. These requirements are mandatory as long as the enterprise remains operational and they involve costs.

Barriers to remaining formal

The main requirement for an enterprise to remain formal is that it should fulfill the obligations that accrue automatically upon entry to legality. The main ones from the study of the Latin American countries are tax and labour obligations.

As regards obligation, the formalized MSE is required to pay two main taxes: income tax and the Value –Added tax. That calls for proper records of accounts and accurate returns on incomes.

Labour obligations on the other hand, only apply to the MSEs which employ workers other than the proprietor or family members. The main issue for regulation is the contract terms of employment: minimum wages and non- wage benefits including leaves, benefits and social security obligations. The labour law requirements are not

flexible in favour of the MSEs but apply equally to all formal enterprises whether micro or macro.

Like entry to formality there also costs for remaining formal. These emerge in relation to tax payments and labour obligations – including social securities, minimum wages and so on and so forth.

The study on the Latin American countries established that law and especially labour law was the main barrier to formalization. This proposition compares so well with Kenya's informal sector scenario and it forms our thesis in this research paper. We submit that the rigidity in Kenya's out-dated investment legal regime has driven many would- be formal MSEs to informality due to the barriers and costs involved in the formalization of the informal MSEs. It is my recommendation therefore that the said legal regime should be reviewed to make it MSEs – friendly if the dream to formalize all IMSE investments is to be realized.

1.8 Theoretical Framework

Legal scholars have shied away from the discourse on the informal sector leaving it to other social scientists. Ronge,¹⁶ among other authors, has discussed in detail the following theories of the informal sector:

- The dual economy theory
- Rural-urban migration theory
- Structural Adjustments theory
- Institutional failure theory
- Micro-enterprise theory

The dual economy model believes that there are two economic sectors running parallel, namely; the informal sector (traditional and subsistence) and the formal sector, which is a capital intensive and productive modern sector. It argues that the informal sector is a temporary disequilibrium experienced by the economy and it is

¹⁶ Ronge E. *et al*, (2002) *Review of the Government policies for the promotion of Micro and Small scale Enterprises in Kenya*, Nairobi, KIPPRA, 5-6

expected to disappear as the economy modernizes and industrial sector absorbs surplus Labour.¹⁷

This model has been rejected by international labour organization (ILO) and World Bank on the ground that informal sector is a permanent feature with significant benefits to the economy and which needs to be promoted and government intervention reduced. The World Bank argued that much government intervention was haphazard and characterized by unsustainable policies. It argued that successful development strategies for the informal sector should have three key elements: Creating a level playing field, carefully targeting public expenditure to use scarce public resources effectively, and encouraging private provision of a wide array of financial and non-financial services. A level playing field is possible through reviews of regulations, which are burdensome to the informal sector to make the regulations flexible and convenient to the sector.

Rural-urban migration is another model explaining the rise of the informal sector.¹⁸ The migration is from the unproductive rural agriculture (where the majority live) to the urban areas where there is the formal industrial sector and where there are prospects of better and higher wages due to government minimum wage legislations. This is however not always positive and many immigrants find no jobs and end up in the informal sector for survival. As a result the informal sector's existence is perceived as dependent on the existence of the formal sector.

The structuralist approach views the informal sector as a product of either contractions of exaggerated demand, which is stagnant while there is sustained increase in labour supply. The theory argues that informal sector arises due to reaction to a need or crises like capitalist low salaries where formal employee invests informally to earn another income, or due to structural adjustments in the formal sector, which lead to retrenchments.

¹⁷ Lewis, 1954 quoted in Ronge *et al*, 2002,5

¹⁸ Todaro, 1969 and Harris and Todaro, 1970 as quoted in Ronge *et al* , 2002,7

The institutional failure theory argues that when the state or its institutions fails, the central planners and leaders neglect certain sectors of the economy to emergence of the informal economy due to market demands. As argued by Loayza,¹⁹ the state bureaucracy is in charge of regulation and enforcement systems and if it fails to efficiently protect and promote market economy, the informal sector grows. In my view this seems to be a mere academic argument rather than a serious theory. If one argues that informality is due to institutional failure alone, then it means a macro enterprise can become part of the informal sector, an argument which would fail because the informal sector enterprises are small investments.

The micro enterprise view considers the informal economy as a rational choice.²⁰ It is argued that the micro-entrepreneurs rationally evaluate the costs and benefits of formalizing in view of their institutional and resources configuration. The costs of formality consist of taxes, registry and license payments errand and waiting time, higher labour costs and urban planning regulations, property rights, environment protection, allocation of imported inputs, consumer protection and quality control, workers' welfare and so on.

The costs of informality include penalties when the informal activity is detected and the inability to take advantage of government provided goods. The benefits of formality include working in safe areas, more access to credit, more access to public and private services, and more access to technology and markets. By comparing the costs and the benefits, and establishing a net loss, the micro- entrepreneur chooses to operate in the informal sector.²¹

According to De Soto,²² the state sanctioned legal and regulatory hurdles have excluded the majority of the population access to resources thereby forcing the poor to resort to the informal economy. He concludes therefore that the legal system has been designed to serve the interest of the formal sector to the exclusion of the poor majority.

¹⁹ Quoted in Moyi E. and Njiraini P. (2005) *Misallocation of Workplaces for MSEs in Kenya: Some Lessons and Models*, Kenya Institute of Public Policy Research and Analysis (KIPPRA) 8.

²⁰ Orlando, 2001 as quoted in Moyi *et al*, 2005,20

²¹ Moyi *et al*, 2005, *supra*

²² Quoted in Moyi *et al*, 2005 *ibid*

In spite of different interpretations the above approaches share the belief that informal activities are performed beyond regulations because of functional requirements alone or mixed with survival strategies or simply because of inadequate regulatory system. The existing regulations prevent growth of the sector because access to resources and more dynamic markets can only be gained through the existing legal and institutional machinery.²³ Hence the definition of the informal sector as all the activities performed beyond government regulation has become a universal feature in both developing and developed countries.

In this study I adopt the micro enterprise theory of informal sector and reject the other theories discussed above. Thus the sector is informal because it operates beyond the law or without full compliance with all the requirements of the law. Informality cannot be the result of size of the enterprise or amount of capital or number of personnel or the investor's education. Indeed an investor nowadays can be sole proprietor, poor, illiterate yet operate a formal enterprise. This paper therefore rejects the Dual- economy, structural adjustments, and rural- urban migration theories because they cannot stand independently to define informal sector without reference to law unlike the Micro Enterprise theory. The said three theories are therefore mere desperate concepts of doom trying to explain the true theory of informal sector which is best defined in legal terms.

In the Kenyan case, the existing laws and the bureaucratic procedures on investment are too complex and costly for the Informal MSEs. These costs which are seen in terms of procedure, time and finance have led to informality as contextualized in this study. The existing legal structure is too general and contemplates investments only in the Formal Macro-Enterprises and as such the Informal MSEs, which lack enough starting capital are put at a disadvantage in the globalizing free market from the start. For the formalization to be successful the legal regime should be rational in the Weberian capitalistic terms, and flexible to accommodate IMSEs as a category of investment *sui generis*.

²³De Soto: 1986 as quoted in Tokman V. E. The Informal Sector in Latin America: From Underground to Legality, in BEYOND REGULATION : THE INFORMAL ECONOMY IN LATIN AMERICA (Tokma V.E. ed, 1992)

1.9 Methodology

Lawyers in Kenya have not written much on this area, therefore this study, is largely exploratory. It is meant to be descriptive, comparative and analytical. The study will use theoretical and historical available data much of which will be from other disciplines like economics. Literature survey of primary and secondary data such as statutes, case law and available articles and textbooks shall be used to: -

- a) Comprehend the underlying rationale behind informal sector.
- b) Analyzing and cataloguing relevant investment laws in Kenya.
- c) Examine the problems with the existing legal framework in Kenya to see its effectiveness or otherwise in the formalization of the informal sector.
- d) Evaluating the legal frameworks from other select countries in order to form a basis for conceptual/ theoretical framework for the study and also for the recommendations towards law reform.

Other sources shall be the Internet, newspaper articles and journals. These will be helpful especially in highlighting issues not yet captured in textbooks, as well as highlighting current affairs and emerging issues. Particularly, the Internet is expected to ease access to data that would only be available with a lot of effort and expense.

1.10 Limitation/ Assumptions

The study assumes that there is need to formalize the informal sector MSEs in order to achieve sustainable development, benefiting both the entrepreneurs and the nation generally. Due to lack of time and resources constraints, all the required information might not be gathered and the study will only be a review of the current policy, institutional and legal framework in Kenya which deals with the MSEs sector investment. The study will merely identify the existing legal gaps that need to be addressed. The study may not get enough data since there is little legal research work written about Kenyan informal sector. Funding is another limitation because the research is not funded.

1.11 LITERATURE REVIEW

A lot of writing has been done on the Micro and Small Enterprises sector in Kenya. Much of it has however not been written by Lawyers but by other Social Scientists. As such most of the literature was obtained from the Institute of Development Studies (IDS) Library of the University of Nairobi and the Kenya Institute for Public Research and Analysis (KIPRA). This paper is therefore pioneer study from a legal perspective.

Masai, Mbithi & Otieno,²⁴ is very vital source of literature to this study. They define the informal and the MSE sector, give a highlight of challenges to the development of MSES and detail the historical background of MSES Policy. They appreciate the efforts taken by the government to address the issue of MSES but fault that effort in two ways: -

- (a) Lack of clear implementation framework and guidelines and government's commitment and co-ordination mechanism for the stakeholders.
- (b) Failure to involve stakeholders in the policymaking and implementation.

They recognize the importance of creating an enabling legal and institutional framework without which the MSE sector cannot attain the desired impact and play an effective role as an engine for economic growth, generation of income, and reduction of poverty. This book does not however address the question why most MSES operating informally – outside legal regulations, and how they can be formalized. The book is therefore a mere synthesis of the Sessional Paper number 2 of 2005.²⁵

Ronge, Ndirangu & Nyagito,²⁶ have also written a relevant literature on this project. They have given a very current conceptual and theoretical framework of the MSES

²⁴ Development of micro and small enterprises in Kenya: renewed policy and strategy frame work - (2005) NAIROBI - ACEG

²⁵ *On Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 22- 24

²⁶ *Review of Government Policies for the Promotion of Micro and Small scale Enterprises in Kenya* (2002) Nairobi, KIPRA.

sector that is very relevant to the research paper. It defines the MSEs sector and gives a detailed historical background of the government policies on the sector. The book however does not deal with the legal issues affecting the formalization of the informal sector. It deals with policies, which almost borders on political issues.

Moyi & Njiraini,²⁷ is also another very relevant text to this study with respect to the conceptual and theoretical approach to the MSEs sector. The text blames the law and state institutions for the emergence and growth of the sector. This is very much in line with the thesis of study. The book however deals more with physical planning policy and not the formalization law – registration and legal regulation of the sector. It is obvious that the physical planning will not succeed unless statistics of registered enterprises are provided to the planners to enable them allocate resources.

Tokman, V.E.²⁸ has written a wonderful text and which is very vital to this study. He deals with the conceptual and theoretical framework of the informal sector generally. He has discussed the causes of the informality in the sector and the costs thereof. His study is based on case studies done on various countries in the Latin America, which are comparable to Kenyan scenario and therefore relevant to my study.

Mc McCormick, D.²⁹ gives the conceptual and theoretical framework of informal sector in Nairobi, Kenya. He also traces the history of the development of the sector in the country and more so the recognition of the sector as an economic sector by the government. He does not however address the issue of the law and formalization of the informal enterprises.

King, K.³⁰ is one of the first to write on the MSEs sector in Kenya and his book is very helpful to this study. It gives a historical background of the informal sector in Kenya and vividly relates the growth of the sector after it received political support

²⁷ *Misallocation of Workspace for MSEs in Kenya: Some Lessons and Models*. (2005) Nairobi, KIPPRA.

²⁸ *Beyond Regulation* (1992)

²⁹ *Small Enterprises in Nairobi: Golden Opportunity or Dead End*. 1998. John Hopkins, University, Michigan.

³⁰ *Jua Kali Kenya change and development in an Informal economy 1970-1995*, Nairobi, EAEP

from the highest office in the country. The book however does not address the question why the sector arose and how it can be formalized.

Morrison C.³¹ is also a vital literature to my study problem. He has given definition, conceptual and theoretical framework of the informal sector. It does not however give a strong case on the process of formalization process.

National micro & small enterprises baseline survey, 1999³² report is a wonderful piece of work. It gives the definition of MSE and informal sector /activities. It also draws boundaries between the said concepts. It also appreciates institutional and legal function in encouraging the registration (formalization) of sector. It does not however explain the failure by most MSEs to formalize. The failure to be registered and be regulated leaves the various planners and policy makers struggling with estimates. In deed one cannot tell the number of new entrants to the sector or even the leavers.

The gaps left out by the above literature are what my study will seek to fill up. The said gaps are mainly due to failure by lawyers to research and write on the unique legal and institutional challenges facing the sector and which inhibits both its growth and formalization. In Kenya, the laws on investment contemplate Macro-Entrepreneurs (MEs) and the procedure of incorporating companies or other business organizations and names apply equally to all magnitudes of business. In fact any special treatment or privileges available in law is always in favour of the MEs who benefit from the best sites allocations, tax benefits and export compensation not to forget formal credit facilities. As we will demonstrate herein below, the relevant Statutes on investment in Kenya do not provide for the MSEs sector.

Our thesis in this study is that formalization of all the Informal MSEs will provide statistics which can help planners and policy makers to deal with the sector better.

³¹ *Micro-Enterprises and the Institutional Framework* (1994) Paris OECD.

³² (1999) - NAIROBI, CBS, ICEG & K-Rep.

1.12 Structure of the Dissertation/ Chapter Breakdown

This Chapter is basically my Research proposal with slight improvement dealing with background of the study problem, statement of the study problem, objective of the study, and the conceptual/ theoretical framework surrounding it. Chapter two traces the evolution of the Informal sector and the government policy in Kenya from its tender age, when little was known about it, to the present age when it enjoys national and international recognition. Chapter three gives an overview of the sector in Kenya, closely examines the characteristics of IMSEs and concludes with a discussion on the challenge which are faced by the IMSEs and which stifle growth and formalization of the IMSEs. Chapter four starts by giving a detailed catalogue of the laws that regulate the establishment and operation of all formal investments in the sector, and ends with a critique on the said regime. Chapter five is the conclusion and it provides a summary of the study findings and presents the recommendations on law and policy which are not only relevant to Kenya, but also to other developing countries.

CHAPTER TWO

2.0 EVOLUTION OF THE INFORMAL SECTOR AND ITS POLICY IN KENYA

The emergence and growth of the informal sector in Kenya has called for a clear and positive government policy. One way of understanding how the sector has evolved in the country is by tracing the evolution of the government policy on the Informal Micro and Small Enterprises (IMSEs). Although the concern of this research paper is on the artisans, we will nevertheless consider the evolution of Kenya's informal sector generally.

2.1 Pre- independence era

The history of the Informal sector in Kenya can be traced to the pre- colonial age of the blacksmithing, pottery, weaving and carving, which was exclusively for a few communities. These artisans were great innovators who produced wonderful goods and services for trade both local and international. These were mostly small scale producers for barter trade but, today the sector has undergone a tremendous development both in magnitude and quality. Today all urban centres have numerous artisans, craftspeople and small assemblers in markets, vacant yards and side street worksites, using simple tools and manufacturing techniques, women and men alike making clothing, furniture, cooking utensils, charcoal stoves, shoes, baskets, bags, jewelry, wood and metal building parts, souvenirs for tourists trade, and a host of other items.³³ Their hard work and ingenious improvisation of the simplest resources are striking. The conditions and the environment of the work for the sector are however shocking, earning the sector a unique name, *Jua kali*.³⁴

³³ McCormick, D. (1988), *Small enterprises in Nairobi: Golden opportunity or dead end?* Baltimore, University Microfilms International, 1

³⁴ Swahili word meaning hot sun. in this paper we have preferred a more wider meaning to include all weather condition , hence jua kali should be taken to mean cold blooded enterprises –to use the analogy of reptiles.

The first clear evidence of recognition of the sector was the East African Royal Commission (EARC) of 1953-55.³⁵ The Report by the EARC recognized and addressed the obstacles to the informal sector development namely the restrictions and regulations that affected marketing, provision of credit, licences, and the use and sale of land. All these were grievances common among the colonized Kenyan entrepreneurs but which have spilled over to the independent Kenya. The report argued that, the African traders' activities were very small in scale, lacking security of tenure, and having no incentive for growth and development. Yet these small enterprises were very crucial for the economic development of Africans in the urban centres. The report therefore recommended private land tenure system as one way of facilitating growth of the informal sector. The spirit in this report was later echoed by the International Labour Organization (ILO) report of 1972. The report did not however achieve much because obviously the colonial government gave little or no political support for the report during its era.

2.2 Development from 1964-1972

The aforesaid weak policy by the colonial government continued until independence after which the Kenyan government released Sessional paper No. 10 of 1965,³⁶ which advocated the indigenization of the Kenyan economy by encouraging private enterprise. Although the government policy in the said Paper was clear with respect to Africanization of commerce and industry, the policy did not initially contemplate IMSEs.³⁷ The main goal of the policy framework was to replace white owned large scale enterprises with African owned enterprises of the same size. The government soon realized that the target was too high for her indigenous citizens and chose to turn to 'modern' small industries mainly owned by indigenous Kenyans.³⁸

One of the ways of intervention by the government towards the new economic policy was in the form of legal and regulatory support to the sector.³⁹ The other form of

³⁵ King, K.(1996), *Jua Kali Kenya: Change and Development in an Informal Economy 19970-1995*, London, James Currey,4

³⁶ Quoted in Ronge E. *et al*,(2002) *Review of the Government policies for the promotion of Micro and Small scale Enterprises in Kenya*, Nairobi, KIPPRA 11

³⁷ *Ibid*

³⁸ *Ibid*

³⁹ *Ibid*

intervention included financial and infrastructure but this policy initiative did not also succeed because very few small enterprises actually got established.⁴⁰

Another milestone in the development of the informal sector in Kenya was the 1966 Kericho Conference which was a reaction to the increasing number of primary school leaver crisis and the increase in the rate of unemployment among the youth.⁴¹ The report recognized that the informal sector was the solution to the said problem of unemployment.

As a result of the failed policy as contemplated in the Sessional paper number 10 aforesaid, the informal sector emerged and grew parallel to the government version of modern small enterprises without being noticed.⁴² The official recognition of the informal sector came only after the ILO report of 1972 which applauded the sectors potential in generation of employment and low-cost goods and services.⁴³ The report was the result of the work of the ILO Comprehensive Employment Strategy Mission that came to Kenya in 1971. The report noted the official harassment of the sector by the government and urged the government instead to have a positive attitude towards the sector. In that regard the report recommended the following measures:⁴⁴

- Stop the demolition of informal sector housing, except in cases where land is genuinely required for positive housing development and town planning.
- Review of trade and commercial licensing with a view to eliminating unnecessary licences, substituting health and safety inspection for licensing.
- Issuing of licences to applicants who are able to pay the licence fee.
- Intensification of technical research and development work on products suitable for production or use in the informal sector , priority being given to capital and intermediate products, repairs and construction.
- Induction of large firms to train sub-contractors and use industrial estates to promote sub-contractors.

⁴⁰ *Ibid* 12

⁴¹ King, 1996 5

⁴² *Ibid* 13

⁴³ The report was titled, *Employment, Income and equality: A Strategy for Increasing Productive Employment in Kenya*. Refer to ILO, 1972.

⁴⁴ Masai *et al*, 2005 11- 12

- Government Tender Board to purchase the required goods and services if they were available in the informal sector.
- Reviewing of the systems of government construction contracts.
- Substitution of the direct payment for the government's purchasing order system, and increase the preference to local suppliers in government's contracts above the current level of 5%.

Noting, however, that the sector had grown without any government policy, but rather government harassment, the report recommended that all future government policies take account of their impact on the informal sector.⁴⁵ Critics of this policy, like King, have downplayed the impact of the policy on the sector arguing that government intervention would destroy the creativity of the sector, which had made it a unique feature of the Kenya's economy.⁴⁶ The views on the sector have therefore polarized between intervention and *laissez faire*.⁴⁷ Subsequent government documents have reflected on this tension and leading to only few tangible proposals for assisting in the development of the sector.

2.3 Development from 1973-1985

The Sessional Paper on Employment of 1973 accepted the ILO report of 1972 but fell short of a clear policy on the informal sector and it did not indeed translate into any programmed support for the sector. Similarly in the 1974-78 Development Plan, the government did not mention the term informal sector and instead used the term small scale industries which were only a small part of the informal sector. This terminology showed the confusion inherent in official circles over the definition of MSEs.⁴⁸

Under this development plan the government proposed to make intervention to assist in the small scale enterprises. An organization would be formed to provide extension services, and a sub sector of manufacturing sector would be left for the small-scale enterprises. There was however confusion as to whether the sector referred to by the

⁴⁵ *Ibid* 13

⁴⁶ *Ibid* 13, quoting King, K. (1993), 'Training for self-employment through experience'. A paper presented to the expert meeting on training or self-employment through VTIs, Nov-Dec, 1993, Turin.

⁴⁷ *Ibid* 14

⁴⁸ *Ibid* 14

ILO report was the same as the one targeted by new government interventionist development plan, which contemplated assistance to modern small scale industries that were already enjoying a lot of government support through Kenya Industrial Estates (KIE) and Industrial and Commercial Development Credit (ICDC).⁴⁹

The 1979-1983 Development Plan was more comprehensive for both the modern small industries and informal enterprises. The government proposed to undertake comprehensive support of modern small-scale enterprises including modern small industries and informal small industries. Unnecessarily punitive building and health regulations were to be removed from the Local Authority statutes and the government was to offer training programmes to small business entrepreneurs through village polytechnics and other relevant institutions. The proposal addressed the issue of credit and marketing in line with the ILO report of 1972 but on a weaker note.

In the Development Plan of 1984-1988 the government emphasized more on the small modern industries. The plan distinguished between small and cottage industries. The former had higher investment and employees than the latter which typically had less than Kenya shillings 50,000 of investment and less than six employees.⁵⁰

The period between the publication of the ILO report and the release of the 1986 Sessional Paper witnessed a gradual adoption of the recommendations of the ILO report in different government policy documents. That however was without much implementation. The implementation was affected by the ambiguity over the nature of the industries targeted- whether small modern industries or the informal sector. This can be deduced from the fact that the term 'informal sector' was hardly used in the development plans during these years and save the 1984-1988 plan which attempted to define the term.⁵¹ It was however, obvious that during that period the government favoured modern small industries over the informal sector.

⁴⁹ *Ibid* 15

⁵⁰ *Ibid* 16

⁵¹ *Ibid* 17

2.4.0 The period between 1986-todate

One of the key recommendations during this period was the review of legal and regulatory framework to facilitate the growth and development of MSEs and relaxation of restrictions on the informal sector activities.⁵² Through the Sessional Paper number 1 of 1986 on Economic and Management for Renewed Growth, the government underscored the value of the informal sector in terms of its potential to reduce rural- urban migration and in creation of non- agricultural employment based on its unique characteristics. The paper recognized the challenges faced by the sector and proposed measures to overcome them and encourage investments in the sector. Some of the policy measures included the need to:⁵³

- Develop agriculture and the rural economy in order to boost MSEs, seventy five of which are in the rural areas.
- Raise agricultural productivity and generate rural employment and incomes.
- Review by-laws and regulations to facilitate the growth of MSEs.
- Pursue a balanced rural- urban development with a view to improving agricultural technology and initiating arrangements that provide rewarding commodity prices to farmers.
- Lower tariffs on raw materials, semi- processed goods and intermediate inputs.
- Use labour-intensive means of production instead of machinery to boost small-scale activities.
- Expand access to credit for the MSE sector.
- Disseminate information on market and marketing opportunities and appropriate production methods.
- Expand youth polytechnics training and focus it on appropriate skills and management techniques.
- Relax restrictions on informal sector activities.

Similarly, the 1989 policy document on the Strategy for Small Enterprises Development in Kenya set out mechanisms for the removal of constraints to the

⁵² Sessional paper number 1 of 1986 on Economic Management for Renewed Growth and number 2 of 1992 on Small Enterprise and Jua Kali Development in Kenya .

⁵³ Paper number 1 of 1986 on Economic and Management for Renewed Growth, quoted in masai, W. et al (2005), 13

growth and development of the MSE sector and stressed the need for adoption and implementation of policies that improve MSEs access to credit and finance, marketing of goods and services and the environment in which MSEs operate.⁵⁴

The Sessional Paper number 2 of 1992 on Small enterprise and Jua Kali Development in Kenya is a landmark policy document and remains to date a cornerstone of the government policy on the development of MSEs Sector,⁵⁵ The Paper stressed the following measures among others:

- Review laws and regulations that slowed down the growth of MSEs
- Strengthen the implementation of policies by removing duplication of effort in coordination of the activities of MSEs.
- Develop appropriate policies for the MSE sector and evaluate their effectiveness on the ground.
- Create and nurture an enabling environment that encourages the MSE sector to grow and prosper.
- Review licencing arrangement and building codes for small enterprises with a view to relaxing any that hinder MSE businesses.
- Review the employment Act to remove those provisions which discriminate against women other than for medical or environmental reasons.

The Sessional paper number 2 of 1996 on Industrial Transformation to the Year 2020 provides a framework of government policies to stimulate economic growth and employment through the expansion of the industrial sector. It advocated for:

- Building links among MSEs and between MSEs and large firms.
- Enhancing the access of MSEs to credit, finance, and modern technology.
- Increasing the ability of the MSEs to create sustainable employment and income generating opportunities that will have greater impact on poverty.
- Providing training for MSEs operators.

The next document on the sector was, the Economic Recovery Strategy for Wealth and Employment Creation, 2003 – 2007. This paper recognized the need to establish and maintain a conducive environment for the graduation of MSEs into medium sized

⁵⁴ Karigithi, W. 'Legal and Regulatory Framework' Mullei A. and Bokea C.(1999) Micro and Small Enterprises in Kenya, Eds ,Nairobi,ICEG,9 . See also Masai, W. et al (2005) ,13

⁵⁵ . Masai *et al*, 2005, 13

enterprises with more capacity to produce high quality products and create sustainable employment opportunities.⁵⁶ The paper targets to create 500000 jobs annually.⁵⁷ The paper however acknowledges that there are many constraints to achieving the said target of job creation and especially the lack of market for the MSEs products. It identifies two areas of priority: rural-based enterprises and establishment of conducive environment for the growth of MSEs to medium enterprises that have capacity to produce high-quality employment. It details the measures to be undertaken to enhance the growth of trade and industry of MSEs including identifying suitable zones to serve as MSE incubators, reviewing of the Sessional paper number 2 of 1996 and completing the proposed Sessional paper on MSEs.

The paper on economic recovery strategy for the creation of wealth and employment acknowledges the existing regulatory framework hinders the development of the informal sector. To reduce the cost of the regulation, the government has proposed the following measures:

- Establish a commission to review all business-related regulations, covering both legal and institutional aspects.
- Formulate a strategy and action plan to address impediments caused by the regulation.
- Develop institutional capacity to ensure a level-playing field.

The proposed commission is supposed to address among other things: simplification of the rules and regulations, a rationalization to remove the rules and regulations that are not necessary, and an introduction of rules and regulations that are required. The number of Sessional Papers, Development Plans and Legal Notices establishing procedures for the management of the sector from pre-independence to year 2004 is great and cannot be discussed in full.

The aforesaid numerous government policies notwithstanding, the MSE sector continued to stagnate in its development.⁵⁸ There was therefore need for new policy orientations which would facilitate the development of a vibrant MSE sector that would in turn contribute to the creation of wealth and employment, to the reduction of

⁵⁶ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 19

⁵⁷ (Masai *et al*, 2005), 14

⁵⁸ *Ibid*

poverty and to eventual economic growth. Thus the Sessional Paper number 2 of 2005 on development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction. The purpose of the new policy is to facilitate the creation of an enabling policy and regulatory environment that will increase competitiveness of MSEs in Kenya.⁵⁹ In the process, the following, among others outcomes are expected to be realized:

- Enabling policies that support MSE growth and development,
- Favourable institutional framework for effective implementation of policies; and
- An MSE sector that is vibrant and integrated into the mainstream national economy. This integration in our considered view has to involve formalization of the MSEs.

The success of this policy is pegged on the following guiding principles:⁶⁰

- The government's involvement in the MSE sector to create an enabling environment to increase the competitiveness of MSE in Kenya, employment creation and poverty reduction;
- The government to play a facilitative and catalytic role rather than engage in direct intervention in the market, and to only intervene when there is clear market failure;
- The recognition of the future importance of the MSE sector in creating decent and sustainable employment and income-generating opportunities, promoting creativity and innovation and generating quality output, hence the need to integrate MSEs into the broader formal economy;
- Giving priority to interventions that remove barriers to open up markets for MSEs;
- The government to welcome all forms of support from development partners and channel it through appropriate instruments, where such support does not create market distortions especially in areas where the private sector is unable to invest;

⁵⁹ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 22- 24

⁶⁰ Ibid 20 - 21

- In full consultation with all stakeholders in the sector, the government to pursue an implementation framework that is specific and sustainable through capacity building of the Department of Micro and Small Enterprise Development (DMSED), the establishment of an MSE Act to give legal force to the implementation framework and its underlying principles;
- The government to continue pursuing macro-economic policies that will facilitate the generation of high and sustainable aggregate demand while keeping inflation and interest rates low;
- Commitment by all stakeholders to promote gender equality in the MSE sector.

The policy provides for specific targets in legal and regulatory environment, markets and marketing, business linkages, financial services, production skills and technology, infrastructure development, business management and entrepreneurial skills acquisition, gender equity, information management and dissemination, tax regime, formal and informal entry barriers, health and safety in workplaces and HIV/AIDS pandemic. Most of these targets touch on and/or depend on the legal and regulatory environment which is our main concern in this dissertation.

2.4.1 Legal and regulatory environment

An enabling legal and regulatory environment is imperative if the MSE sector is to create the desired impact and play an effective role as an engine for economic growth, the generation of income, and the reduction of poverty.⁶¹ In this regard, the government of Kenya through this new policy paper is committed to continue with legislative reforms, which encompass reviewing, and updating the existing legislation and enacting new laws. The intended laws and regulations are those which are dynamic, responsive to the needs of the MSEs, supportive to the growth and development of the sector. More of these legal and regulatory aspects will be discussed in the chapter four below. Some of the key areas for reform include:⁶²

⁶¹ Masai , W, Mbithi,M and Otieno,B.O, (2005) *Development of Micro and Small Enterprises in Kenya: A Renewed Policy and Strategy Framework*, Nairobi, African Centre for Economic Growth (ACEG) 16

⁶² *Ibid* 16 -17 commenting on Sessional Paper No. 2 of 2005 *supra*.

- **Licensing and Regulations:** Favourable legal and regulatory environment will be achieved through the consolidation and harmonization of trade licensing and regulation services. Licensing requirements, as well as their rationale, will be reviewed to make them more effective and user friendly. Single Business Permit guidelines will also be operationalized in all the local authorities.
- **Business Registration:** The government will decentralize the registration of business, initially to provincial, and eventually to district, levels. Computerizing and networking activities in all relevant offices will be undertaken.
- **Local Government Reforms:** The Local Authority Act⁶³ will be amended to reflect limited and essential regulatory powers by local authorities to ensure their compliance with required standards. Local Authority by laws will be reviewed and standardized to make them more flexible and supportive to promote business and to be consistent with the changing socio-economic environment.
- **Land Laws:** Laws governing land ownership will continue to be reviewed for simplification and harmonization with the relevant pieces of legislation. The Physical Planning Act, 1996, will be effected to encourage local authorities to earmark land for MSE development. MSE associations will be assisted through targeted capacity building to become strong legal entities capable of effectively managing the affairs of MSE associations.
- **Labour Laws:** A review of labour laws will continue to make them more dynamic, supportive and responsive to the needs of both employers and employees.
- **Arbitration and Dispute Resolution:** The government recognizes the need for MSEs to access justice and have their disputes resolved conveniently and at reasonable cost. An MSE court will be established to dispense justice and deal with small but non-trivial claims emanating from the MSE sector.
- **Micro and small Enterprise (MSE) Act:** In consultation with stakeholders, the government will formulate and enact MSE-specific legislation, the Micro and Small Enterprises Act. The act will provide the legal and institutional

⁶³ Cap 265 laws of Kenya

framework for the implementation of MSE policies. In this respect, the act will make provisions for the establishment of an NCSE to advise and follow up on the implementation of MSE-specific policies and programmes.

2.4.2 Markets and marketing

The new policy recognizes that the growth and development of MSEs sector depends on existence of a vibrant market for its products and services.⁶⁴ To expand marketing frontiers of MSE products, the government will allocate at least 25% of its of its procurement requirements to the sector. Further, the Ministry of Finance will adjust public tendering procedures as appropriate and make them more flexible to promote the participation of MSEs in the procurement process. For large tenders, the government will encourage the formation of MSE consortia capable of registering group bids.

Through the public-private sector partnership and in consultation with MSE operators and stakeholders, the government will encourage sub-contracting arrangements between large and medium firms and the MSEs. This will be achieved through a provision of incentives such as tax rebates and duty waivers to encourage the large firms to participate in the arrangement.

The government will restrict the dumping of goods and will facilitate the expansion and the promotion of marketing of MSE products in local and international markets.

2.4.3 Business linkages

The government will provide incentives to the private sector to invest in areas that enhance the development of business linkages between MSEs and large enterprises, to enhance the graduation of MSEs into medium enterprises, the government will identify suitable zones to serve as incubators; this will improve the image and the

⁶⁴ Masai *et al* 2005 , supra 17

feasibility of MSEs.⁶⁵ The government will also put in place mechanisms that promote linkages between MSEs and the agricultural sector.

2.4.4 Financial services

Access to credit and financial services is vital to the growth and development of any enterprise including MSEs. The government of Kenya has undertaken to promote the development of the financial services sector by providing incentives to attract savings and investment and the development of venture capital.⁶⁶ It will establish a Micro Finance Trust from which MFIs can borrow in order to lend to MSEs at affordable interest rates. Insurance schemes will be established to underwrite risks of MFIs.

The government will enact the Micro-finance Bill, which will provide a legal framework for the operations of MFIs. The sustainability of MFIs and other MSE financial service providers will be enhanced through legal and regulatory reforms including institutional oversight through the CBK.

The government will amend specific laws that inhibit organizations that mobilize savings in the country to offer credit. Hence, the Kenya Post Office savings Bank Act will be reviewed to allow the Post Bank to lend to MSEs. SACCOs and co-operatives, which provide financial service to MSEs, will be encouraged to participate more effectively in these endeavours. At the same time, the Co-operative Act will also be reviewed to provide effective supervision to SACCOs.

The government will strengthen and restructure the capital base of Development Finance Institution so as to improve their ability to offer affordable credit to MSEs. Today, larger enterprises than MSEs are able to access finance through the Nairobi Stock Exchange; as a result, similar mechanisms will be put in place for MSEs.⁶⁷

Leasing is firmly established in many countries and is potentially able to expand access to credit by MSEs in ways that overcome traditional collateral requirements

⁶⁵ *Ibid* 18

⁶⁶ *Ibid* 18-19

⁶⁷ This has come true with listing in the Nairobi Stock Exchange of MSEs like Faulu Kenya and K-Rep Bank

and that contribute to capital formation. Accordingly, the ministry of Finance will review existing laws and regulations so as to incorporate special requirements for micro leasing.

2.4.5 Production skills and technology

The policy framework for the development of production skills and technological capacity of the MSEs seeks to enhance their ability to adopt and adapt new production skills and technology, improve the capacity of institutions that support technological development, and increase overall access to information on available technologies and production skills.⁶⁸

Through relevant institutions like Kenya Industrial Research development Institute (KIRDI), National Council of Science and Technology (NCST), Kenya Industrial Estates (KIE), Kenya Bureau of Standards (KEBS), and the Productivity Centre of Kenya (PCK), the government will review the current modes of the acquisition and the transfer of technology into the country, define laws and provide legislation that would:

- Regulate and promote local and international technology transfer.
- Encourage partnerships through sub-contracting, franchising and licensing.
- Vet and register imported technologies. This will discourage dumping of obsolete or dangerous technology that hinders innovation.

The government will collaborate and strengthen links with private sector research institutions to identify MSE-specific technology needs, and enhance appropriate technology research and technology information flow to MSEs. Measures will be put in place to diversify technological innovations, as well as research and development, to cater for the needs of all MSEs. In addition, the government will endeavour to encourage the commercialization of technology and viable innovations. Further, the government will provide steady alternative sources of information through the importation of relevant technology from countries such as India, south Korea, Pakistan, and China.

⁶⁸ Masai *et al* , 2005, supra 19

Through the Kenya Industrial property Institute (KIPI), the government will provide assistance to MSEs by improving their access to and making effective use of the existing intellectual property system aimed at enhancing their creativity and capacity to innovate and to derive the full benefits of their innovations in the market place. The government will also encourage creativity and innovation in the MSE sector through establishment of award schemes that recognize innovations and technology development within the sector.

The government will also put in place measures to design and implement programs for capacity building aimed at promoting business incubators so as to support new businesses during start-ups and early growth phase. To this end special emphasis will be given to improve the technical skills of women entrepreneurs.

The government will also promote skills acquisition and development within the MSE sector through special programs that will woo the private sector to participate in the skills up- grading within the MSE sector. For example, the government will encourage university-industrial, technical and business attachments and also encourage enhancement of the capacity of the Technical Training Institutes and other technical training centres.

2.4.6 Infrastructure development

In collaboration with relevant stake holders, the government has undertaken to encourage more private sector participation in the development and management of market stalls and worksites for MSEs.⁶⁹ This will be done through leasing land to developers at concessionary rates and granting tax incentives to the developers. Privatization of existing sheds will be introduced to facilitate their efficient management and utilization.

In collaboration with Local Authorities, the central government will promote the issue of Temporary Occupancy Licence for longer and specified periods to overcome

⁶⁹ *Ibid* 20

insecurity of tenure of land allocated to MSEs. MSE associations will be encouraged to adopt a Community Land Trust Management for the benefit of their members to promote the development of investment and infrastructure.

2.4.6 Business management and entrepreneurial skills acquisition

The government has promised to encourage universities, polytechnics, technical institutions and MSE support organizations to develop certified demand-driven courses on entrepreneurship and business management.⁷⁰ An introduction of entrepreneurial development programmes in school and other training institutions will spread enterprise culture.

The new policy framework will promote cost-effective Business Development Service programmes and tailor them to specific needs of a range of MSE entrepreneurs and business sector. It will promote the formation of an umbrella of Business Development establishments within the district to promote the accessibility of MSEs to these services.

2.4.7 Gender equity

The government has undertaken to pursue-responsive policies that increase participation, equal opportunities and equal access to, among others, land, education and training, financial credit, and services to both men and women. Particular efforts will be made to empower women to take advantage of technology development, market opportunities, and credit facilities.⁷¹

2.4.8 Information management and dissemination

In line with the needs of specific MSEs, policies on information management for MSEs seek to improve gathering, processing and packaging of information. The government will encourage private sector investment in information centres for MSEs support stakeholders' initiatives targeting the dissemination of information generated

⁷⁰ *Ibid* 20

⁷¹ *Ibid*

within the sector. Additionally, it will support periodic baseline surveys of the sector and enhance the role of sectoral organizations in the dissemination of the information gathered. At the same time, the government will encourage and provide incentives on the private sector initiatives towards the establishment of an information-clearing house to ensure that relevant information about the MSE sector is collected, organized, processed and disseminated according to the needs of its different stakeholders.

2.4.9 Tax regime

Taxation being an important ingredient determining the nature and growth of any economy, the government will continue with tax reforms that are aimed at improving transparency and efficiency of taxation, strengthening tax collection and harmonizing the tax system.⁷² The government will put mechanisms in place to ensure that MSEs pay tax that allows them to thrive.

2.4.10 Formal and informal entry barriers

To ensure promotion of good governance, ethical trading and rule of law, the government-in collaboration with the private sector and stakeholders will address both informal barriers such as cartels and informal trade practices that hinder the growth and the development of the MSE sector. At the same time, the capacity of MSE associations will also be strengthened to enable play a self-regulatory role more effectively.

2.4.11 Health and safety in workplaces

Measures will be put in place to ensure that all operations observe order, occupational safety, health, hygiene and environmental management principles, thereby improving the quality of jobs in the MSE sector.

⁷² *Ibid* 21

2.4.12 HIV/AIDS

A holistic approach will be developed to address HIV/AIDS in the MSE sector. MSE operators will be facilitated to take advantage of all the prevention, care and control programmes under the National AIDS Control Council Strategic plan. Besides MSE associations will spearhead HIV/AIDS campaigns among their members.

As a consequence of the above policy evolution in the country the sector has been supported to develop from survivalist crude craftsmen and blacksmiths to semi-modern micro and small enterprises producing goods for domestic use and export. The sector is also growing steadily and it is a wonderful source of employment and national income. It is no longer seen as an enemy of development always being harassed by the Local Authorities and the government agents but a central player in the development of the national economy. As such the sector deserves the foregoing clear government policy in order to create an enabling environment and enhance its capacity.

In concluding this chapter, however we opine that all the policy papers discussed above have not adequately addressed the need for the formalization of the informal MSEs. As a result of that failure the sector will continue to face perennial challenges some of which could have been overcome by mere planning if there were current statistics for all the MSEs in Kenya. The statistics will only be authoritative if all the MSEs were formalized through registration and regulation. In the following chapter we will give an overview of the informal sector in Kenya as a form of investment and the barriers to the formalization of informal enterprises. We will also do a critical review of the existing investment law in Kenya by considering its relevance to the sector.

CHAPTER THREE

3.0 THE INFORMAL SECTOR IN KENYA

3.1.0 OVERVIEW OF THE INFORMAL SECTOR IN KENYA

3.1.1 Introduction

The informal sector in Kenya is generally composed of MSEs- Enterprises employing between one and fifty workers per enterprise. Micro enterprises employ up to ten workers while small enterprises employ up to fifty workers.⁷³ On average there are more micro enterprises than the small enterprises of which 70% of the MSEs in Kenya employ one person.⁷⁴ The latter MSEs are survivalist entrepreneurs mainly for subsistence purposes. Only a few MSEs grow to employ six or more workers.⁷⁵ It is however worth noting that the sector is fast growing. In 1993 there were 910000 MSEs which increased to 1.3 million in 1999 representing 42.9 percentage points in six years.⁷⁶ This average growth rate is over 7% per year.

A healthy informal sector is a reflection of a vibrant economy as a whole. Hence when the economy as whole is healthy the informal sector reaches the peak of its growth. The exact statistics about the sector are, however not available because most enterprises are not registered. Some are very short lived being operated for the interim survival while the entrepreneurs wait to join other engagements. Hence this lack of proper statistics justifies our call for the formalization of the informal sector.

A higher density of Kenya's MSEs is found in the urban centres and trade sector dominates close to two-thirds of all the enterprises.⁷⁷ On aggregate however a larger

⁷³ Masai , W, Mbithi,M and Otieno,B.O, (2005) *Development of Micro and Small Enterprises in Kenya: A Renewed Policy and Strategy Framework*, Nairobi, African Centre for Economic Growth (ACEG) 1

⁷⁴ *Ibid*

⁷⁵ *Ibid*

⁷⁶ *Ibid* . see also the National Baseline Survey 1999,*supra* 12

⁷⁷ *Ibid* 19

share of these enterprises are found in the rural areas except for service sector which is divided almost equally between rural and urban locations.⁷⁸

3.1.2 Contribution of the Sector to the Country's Economy

The Informal Sector in Kenya is generally growing fast and as such it is major contributor to the countries economy. The sector is a creator of employment and helps to solve the problem of unemployment in Kenya. In 1999, the sector employed 2.4 million people, while in 2002 it employed 5.1 million people representing 74.2% of the Kenyan labour force.⁷⁹ In 2003 the figure stood at 5.5 million people employed in the sector suggesting that, with a good and enabling environment the sector could hit the government's target of creating 500,000 jobs a year.⁸⁰ The enabling environment here is in terms of legal and institutional framework that recognizes MSE and investors *Sui generis* requiring flexibility in formalization.

The sector has played the role of increasing income and reducing poverty. One of the reasons for starting an informal enterprise is lack of formal employment.⁸¹ The sector therefore helps in providing an alternative source of income, and especially for women. The sector therefore gives an opportunity to the poor and untrained citizens to participate in the economic development of their country as they eke a living. On average informal sector workers earn Ksh.6000 per month, which is indeed twice higher than the minimum statutory wage level in the formal sector.⁸²

The sector contributes to the Gross Domestic Product (GDP) in an encouraging magnitude. In 1993 the sector contribution to the GDP stood at 13.8% which increased to 18% in 1999. This represents 4.2% increase in GDP contribution which in turn translates to 0.7% annual increase per year.⁸³ Overall the contribution by non-

⁷⁸ Ibid 20

⁷⁹ Masai, et al 2 quoting the 1999 National Baseline MSE survey 1, 25

⁸⁰ *Ibid*

⁸¹ CBS, ICEG and K-Rep,(1999) *National Baseline MSE survey 1999*, Nairobi, CBS, ICEG & K-Rep 49

⁸² Masai, et al 2

⁸³ Note 3 *ibid* 38

agricultural informal sector to the country's GDP is 25%.⁸⁴ In 2003 the sector contributed 18.4% of the country's GDP.⁸⁵ There is potential for higher contribution.

The sector acts in supporting the growth of local industry.⁸⁶ It provides inputs and also outputs to the other informal and formal firms. It is therefore a source of both market and also materials through symbiosis with the formal sector firms.

The sector provides opportunities for skills training, as many are trained while on the job. This is a great opportunity to learn skills especially for the poor majority who cannot afford formal training. This provides a basis for industrial take off and in the words of De Soto, the sector is vehicle for industrialization for many developing countries.

The sector also produces goods and services local consumption and also export. These include baskets, wood carvings among other tourist attractions which earn foreign exchange for the country.

The sector has helped to reduce rural-urban migration and therefore congestion in the cities where population would have been high as school leavers would have gone there to look for jobs. The informal sector has therefore helped to create a balance in development as many jobs are being created by the sector in the rural areas where cost of living and production is low.

The sector has exploited the local resources and technologies to make cheaper goods and thereby saved the country's foreign exchange which could have been used to import goods made using foreign technologies and raw materials. To this end also the sector has been able to recycle or even recondition old products from the formal sector to become useful through the innovative hand of the '*jua kali*' artisans. It has become possible almost in cases to find solution or repair or spare parts in '*jua kali*' sector – for all products whether made from obsolete to the most sophisticated technologies.

⁸⁴ *Ibid*

⁸⁵ Note 4 *ibid* 2

⁸⁶ Note 1 *ibid* 3

From the above contribution, we conclude that the sector is very crucial to the economy of Kenya and it should be helped to grow and develop both in quality and quantity. The actual contribution to the economy cannot be assessed unless, and until proper statistics are made available through the process of formalization of the informal MSEs.

3.2. Characteristics of the Informal Enterprises in Kenya

Ondiege has analyzed the characteristics of the informal sector in Kenya by classifying them into two, the entrepreneur and the enterprise characteristics.⁸⁷ We now discuss each of the two in details in order to lay a foundation for a further discussion on the multiple challenges that are faced by the informal sector generally in Kenya.

3.2.1 Entrepreneur Characteristics

These refer to the special qualities of the entrepreneur by considering the enterprises' ownership, management and personnel.

Ownership of the enterprise

According to Ondiege, ownership of the informal sector enterprises was dominated by males. Over all male enjoyed 75% ownership but in some sub-sectors like knitting females dominated with 98% while in others like shoe making, carpentry metal work and electric repairs were the dominion of males with over 93% ownership.⁸⁸ This situation, in my view can be explained in terms of legal and social biases which favour male domination.

⁸⁷ Ondiege ,P.O. (1995) Informal Sector Development Models and Assistance Programmes in Kenya (Project Report) University of Nairobi, Nairobi, Housing & building Research Institute(HABRI) 38

⁸⁸ *Ibid*

Age of the entrepreneur

The age of the entrepreneurs, according to Ondiege, varies with sub sector of individual enterprise. For example in the sub sectors of metal and motor vehicle repairs, which are dominated by male entrepreneurs, the age of majority of the entrepreneurs was found to be 35 years.⁸⁹ On average in all sub sectors the age of entrepreneurs was found to be 33years. This in my view has something to do with the age of the informal sector vis a vis the ILO report of 1972. It is after 1972, about 34 years now, when a clear national interest in the sector was established that means that many young people born after the report were socialized to seek employment in the sector.

Marital status of the entrepreneurs

Most of the investors in the sector are married representing 80% while only 17.8% are single.⁹⁰ In deed about 92% of the entrepreneurs have dependants a fact which was found to be very important in explaining the amount of capital invested.⁹¹ The more the dependants the heavier the burden and hence the lower the amount of capital invested. The marital status however can be taken also to explain the rapid growth in numbers of the people working in the sector in that the pressure to earn a living for the dependants pushes them to *jua kali*.

Level of education of the entrepreneurs

This is a very vital factor in investment and it affects the overall performance of the sector in terms of management, productivity and sustainable development of the enterprises.⁹² The majority of the enterprises are managed by the owners representing 92.8% while only 7.2% have employed managers.⁹³ According to Ondiege, 10.95% of the entrepreneurs were of lower primary education level, 46.7% upper primary education level, 1.8% secondary and/or college education while only 0.5 % were

⁸⁹ *ibid*

⁹⁰ *Ibid* 55

⁹¹ *Ibid*

⁹² *ibid*

⁹³ *ibid*

university graduates.⁹⁴ Over 50% of entrepreneurs in metal furniture and fixtures, electric and motor vehicle repairs sub sectors had secondary education but overall about 80% of the investors in the sector fall within the bracket of primary and secondary level of education. Ironically, in my view it is the lack of higher education due to poverty that has compelled a large number to join the informal sector to eke a living.

3.2.2 Enterprise Characteristics

Here the centre of focus is the enterprise itself and not the special qualities of the entrepreneur.

Location of the enterprises

Location of any enterprise is very vital in that it affects: access to market for competition; security factors for the enterprise and stakeholders; access to credit; availability of infrastructure and services. The informal sector finds itself a victim of the law and planners when it comes to the issue of location of these enterprises in urban areas in Kenya. In my view, the law on allocation of work spaces only favours the formal Macro enterprises and discriminate against the would be formal MSEs.

Ondiege,⁹⁵ found that at the infant stages the enterprises are usually located where there is demand for their products and services. These tend to be near main or minor roads especially within residential areas. They squat on road reserves and open spaces close to areas of high level of commercial activities thereby provoking conflicts with the Local Authorities' planning by-laws. Overall 45.3% are located in established commercial areas, 47.6% in residential areas while 2.1% are in industrial areas.

In Nairobi however 20% of the enterprises are located in established commercial areas, 73% are in residential areas and only 2% are in industrial areas while the rest are spread along the road reserves and other open spaces.⁹⁶ In smaller towns the

⁹⁴ *Ibid*

⁹⁵ *ibid*

⁹⁶ *Ibid* 58

distribution is balanced between commercial and residential areas because there is space and reduced harassment in commercial zones and the sector's activities are thriving because there is room for its products and services to compete with those of the formal sector.⁹⁷ The position is opposite in the major towns because IMSEs lack space in the commercial areas and even if the space existed the by-laws of the local Authorities would bar them and that leads to harassment.⁹⁸ Hence the lack of planning regulation conducive to accommodate IMSEs in commercial zones has forced them to concentrate in the residential areas in the major towns and cities.⁹⁹

In my view, because of the nature of their work, which is manufacturing, the artisans and craft people rarely access the commercial zones. Ironically, unlike their counterparts in hawking sub sector, the artisans and craft people would require a fixed work site which in my opinion, they cannot afford to either own or lease even if they were allowed in the said commercial zone due to financial constraints.

Business premise type

According to Ondiege, the type and site of the enterprise depends on the city and the sub sector. 18.7% of the activities are done in the open air, 29.5% on road pavements 11.6% in temporary sheds and 15.6% in fixed sheds including *Nyayo* sheds, and shops or houses (either inside or verandas).¹⁰⁰ Metal fixtures and furniture activities are usually done in the open air or temporary sheds because they require more space, infrastructure and equipment.¹⁰¹ In my view there are legal reasons for this. The first is that the existing law and by- laws have not granted the IMSEs title to the work site. The investors are squatters on the public land. Secondly the investor cannot access credit. That explains the lack of motivation to develop the site.

⁹⁷ *Ibid*

⁹⁸ *Ibid*

⁹⁹ *Ibid*

¹⁰⁰ *Ibid*

¹⁰¹ *Ibid* 59

Ownership of the enterprise premises

Most of the premises are privately owned mainly but in some towns the local authorities provide premises in form of markets or planned areas. In Nairobi, central government provides 3% of the premises while in other towns it provides between 1.2 -0.9%.¹⁰² The said premises take the form of *Nyayo* sheds or Kenya Industrial Estates (KIE) sheds. These sheds benefit mainly metal and manufacturing sub sectors leaving the vast majority of other enterprises squatting in the open air. Non governmental Organizations (NGOs) have reacted to that shortage of premises for enterprises but this has provided only 2% of the needed amount.¹⁰³ As already stated above, the land policy generally and the land laws specifically are to blame for poor allocations of the work sites to the MSEs sector entrepreneurs most of whom are poor.

Life span of the enterprises

The life spans of the enterprises vary greatly depending on the sub sectors but overall they last for 7.25 years.¹⁰⁴ Structure metal product activities however last for the longest time compared to the rest of the sub sectors. In my view, the reason for this short span is because most MSEs are taken as interim engagement pending entry to formal sector, or undertaken after retirement from the formal sector.

Enterprise ownership status

The majority of the enterprises are owned by single individuals representing 93.3%.¹⁰⁵ In a few cases like fixtures and structural metal products some enterprises are owned by Partnerships or groups of people although the latter case represents a negligible minority.¹⁰⁶ In my view this is another reason why the MSES do not own their worksite or get easy licencing. If they were united into large groups, they could easily

¹⁰² *ibid*

¹⁰³ The lack of premises to shelter the entrepreneurs has earned the name 'Jua Kali' to Kenyan informal sector. The right name should have been cold blooded enterprises because it is all whether phenomenon.

¹⁰⁴ Ondiege, P.O. (1995) *Informal Sector Development Models and Assistance Programmes in Kenya* (Project Report) University of Nairobi, Nairobi, Housing & building Research Institute(HABRI) 59

¹⁰⁵ *Ibid*

¹⁰⁶ *Ibid* 61

afford the sites they operate in any they could also get easily licensed as a group. This view however is subject to the law and by-laws regulating entry to formality and licensing to operate in the commercial zones of the urban centres.

3.3.0 Challenges to the Development of the Informal Sector in Kenya

The positive contribution of the informal sector to the economy of Kenya notwithstanding, the sector's development generally is faced with many challenges and constraints which are highlighted below.¹⁰⁷ Most of these challenges are related legal and institutional framework in the country which is catalogued and discussed later in chapter four.

3.3.1 Unfavourable Policy Environment

The Policies for the development of the informal sector discussed in chapter two above have been poorly formulated and designed by the government alone without involving wider consultations with the stakeholders.¹⁰⁸ As a result the said government driven policies have not been embraced by the stakeholders as they also do not address the investors' specific needs of the target groups.

The policy implementation and monitoring have also been weak and not effective and the stakeholders have not been given any role to play or any responsibilities with respect to implementation and monitoring. The time and modalities as to when and how the implementation and monitoring is to be done have not been specified. This has led to duplication of and sub optimal utilization of scarce resources. There has been no institutional mechanism within the government for identifying and resolving policy conflicts and for overseeing implementation of policies and programmes. Therefore there has not been proper follow up on policy implementation to identify lacunae and assess impact. The policies have not yet been reduced into laws that are relevant to the sector.

¹⁰⁷ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 7-18

¹⁰⁸ Ibid 7

3.3.2 Inhibiting Legal and Regulatory Environment

An enabling legal and regulatory environment is imperative for the sector to thrive and effectively contribute to the economic growth, poverty eradication and employment creation.¹⁰⁹ There has been some progress in reforming the legal and regulatory framework in Kenya, but some archaic laws and regulations still exist which impede the growth of the sector.¹¹⁰ They are cumbersome, out of step with current realities and hostile to the growth of the sector. By-laws of most Local Authorities are punitive and more criminal oriented instead of being facilitative.¹¹¹

As a result of the foregoing attitude in the law the sector activities have been viewed as public nuisance and denied licences in best commercial zones of respective cities and towns. The sectors entrepreneurs also face constant harassment from Local Authorities and Central Government officials over the use of the undeveloped open land, and also through daily licence fees which may at times be multiple because there is no clear policy for managing the informal sector.¹¹²

As already mentioned earlier, most informal sector entrepreneurs are squatters along roads and railways or on private but undeveloped parcels for which they lack title deeds to warrant them investment in the worksites as per the building standards. This lack of security of tenure denies them access to credit for both development of the site and enterprises.¹¹³ This problem is compounded by the strict policies regulating essential services such as electric power, roads, water, and sanitation thereby enhancing their insecurity.¹¹⁴

The role of the Provincial Administration in the enforcement of regulation, and in jurisdiction over land and utilities tends to overlap and conflict with those of Local

¹⁰⁹ *ibid*

¹¹⁰ Masai, W, Mbithi, M and Otieno, B.O, (2005) *Development of Micro and Small Enterprises in Kenya: A Renewed Policy and Strategy Framework*, Nairobi, African Centre for Economic Growth (ACEG) 5

¹¹¹ *Ibid* discussing Sessional Paper No 2 of 2005 and Moyi *et al*, (2005) 68

¹¹² *Ibid* 6

¹¹³ *Ibid*

¹¹⁴ *Ibid*

Authorities.¹¹⁵ The bureaucracy and lengthy process of transacting with the government agencies puts the informal sector to a disadvantage compared with the formal sector which can afford all the formalities for such transactions.¹¹⁶

The centralization of the registration of Business Names in Nairobi is serious draw back to formalization for the informal enterprises situated outside the capital city.¹¹⁷ The requirements for the details of physical and postal address as a condition for registration is another draw back to formalization as the majority of the entrepreneurs lack permanent physical locations.¹¹⁸ All these translate to increased cost of formalization which forces many enterprises remaining informal.

Dispute resolution is another serious problem area for the informal sector entrepreneurs.¹¹⁹ They need a simple alternative dispute resolution method which can address the special nature of business transactions and disputes at a cheaper and faster rate. This is the opposite of the judicial system which is complex, expensive, time consuming and sometimes unfair. The above legal lacunae and biases, which militate against the MSEs should be removed through reform process if formalization of the MSEs is to succeed.

3.3.3 Limited Access to Markets

This is a severe constraint to development of the sector due to lack ready market and marketing information. Overall, there is market saturation due to overproduction, dumping and low aggregate demand.¹²⁰ Some products face unfair competition from imports which enter our country without payment of the statutory duties, and many entrepreneurs are also not well equipped to compete in liberalized markets.¹²¹ Very few are able to venture in export markets and even fewer are able to reach new markets through electronic commerce.¹²² This situation of confining to very narrow

¹¹⁵ Ibid

¹¹⁶ Ibid

¹¹⁷ Ibid

¹¹⁸ Ibid

¹¹⁹ Ibid

¹²⁰ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 9

¹²¹ Ibid 10

¹²² Ibid

local markets with stiff competition pushes prices down leading to low profit margins and low development.

The sector is disadvantaged in that it is normally excluded from the large public sector market whose prequalification standards demand assurance of large supplies and proof of adequate financial resources to produce the required amounts.¹²³ This operates as a barrier to accessing certain markets notwithstanding the effort of government to liberalize the financial and product market.

Despite slight improvement, the sector generally lacks marketing information regarding where and how to get existing and relevant marketing information. As a result most entrepreneurs rely on informal feedback from customers. At the same time the competitiveness of the sector remains weak due to poor product quality, packaging, advertising and distribution.¹²⁴

3.3.4 Limited access to financial services

According to 2005 policy paper, limited access to credit inhibits the growth of the MSE sector, especially the growth of women entrepreneurs. Two main reasons have been advanced for this state of affairs including: lack of tangible security coupled with an inappropriate legal and regulatory framework, and insufficient capacity to deliver financial services to MSEs.¹²⁵ There is no structured institutional mechanism in the country to facilitate the flow of financial resources from the formal financial sector through micro-finance institutions (MFIs) to the IMSEs.¹²⁶ MFIs offer credit service to formally registered businesses, a criterion that IMSEs cannot meet. This justifies my call for the formalization of the IMSEs in order to access credit.

MSEs lack collateral due to lack of title deeds for their worksites, but even where collateral exists, commercial banks are not confident that the legal system will allow them to realize it in case of default on loans.¹²⁷ The legal and policy framework for

¹²³ Ibid

¹²⁴ Ibid

¹²⁵ Ibid 11

¹²⁶ Ibid

¹²⁷ Ibid

financial services is less supportive of the small borrower generally and the IMSEs in particular. In this connection, the Banking Act¹²⁸ prohibits MFIs from mobilizing savings and taking deposits for re-investment, hence they are unable to build a sustainable base for MSEs; the Post Office Act¹²⁹ prohibits that Post Bank from lending; and the Co-operative societies Act¹³⁰ does not provide effective supervision of savings and credit co-operative societies (SACCOs). This has led to increased cost on vetting credit worthy MSEs. Over all the policies and strategies designed to boost credit and finance to the sector has been formulated without reliable information on reliable methodologies, data on magnitude of MSE sector, characteristics of MSE investor and factor influencing growth and dynamics of the sector.

3.3.5 Inadequate access to production skills and technology

As already mentioned Kenya's MSEs are characterized by low level of technology. There is indeed no adequate institutional capacity to support adaptation and absorption of modern technological skills.¹³¹ MSEs in the country operate in a weak environment that hampers co-ordination and transfer of appropriate technology.¹³² There is general lack of production skills in industry, but MSEs lack capacity to identify, seek and use appropriate technology.

At the same time, there is general low investment in research and development, and institutions expected to provide technical services to MSEs are weak and have poor links with the MSEs.¹³³ In addition, inadequate production skills contribute to low productivity, poor quality and limited product diversity, which lead to low competitiveness, in local and international markets if at all they reach there.¹³⁴ Although the government has encouraged polytechnic and technical institutes, most of the informal sector investors have never trained there or are drop outs.

¹²⁸ Cap 488 laws of Kenya

¹²⁹ Cap 493B of 1990

¹³⁰ Act number 12 of 1997

¹³¹ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 11

¹³² Ibid

¹³³ Ibid 13

¹³⁴ Ibid 12

3.3.6 Limited access to infrastructure

Limited access to infrastructure limits the level of investment and performance of MSEs, thereby adversely affecting the competitiveness of their products and services.¹³⁵ The physical infrastructure that is of concern includes both the poor state of the country's road network as well as feeder roads and inaccessibility to land, work-space, electricity, water and sanitation, and other utilities. Of major concern, however, has been the conflict between the local authorities and Provincial Administration on their jurisdiction over land for worksites.¹³⁶ Rural areas have been the main victims of poor roads and lack of electricity.

3.3.7 Inadequate business skills

Business management is very crucial for growth. As already mentioned earlier MSE sector lack basic skills in business management and entrepreneurship and this is a major drawback to the growth and development of the sector.¹³⁷ The integration of the business studies in the schools curricula and technical training institutions have not provided the state-of-the art training on business start-up, survival, and growth.¹³⁸ Consequently, the potential investors enter the sector without the capacity to contribute to its success, while the existing ones remain dwarfs.

3.3.8 Limited linkages with large enterprises

Linkages between MSEs and large formal enterprises in Kenya are weak or non-existent.¹³⁹ This leads to inadequate technological transfer and development, poor information flow, weak sub-contracting arrangements, and inadequate marketing opportunities to promote expansion and, especially, vertical growth of MSEs. Some of the reasons given for this state of affairs are the poor quality products and standard of contracts which require large scale production.

¹³⁵ Ibid 13

¹³⁶ Ibid

¹³⁷ Ibid 14

¹³⁸ Ibid

¹³⁹ Ibid 15

3.3.9 Gender inequality

Though women's participation in MSEs is increasing, accounting for 48 % of all MSE owners in 1999, gender inequalities still persist.¹⁴⁰ In this regard, the 1999 MSE baseline survey shows that 13.7% of women had no formal education as compared to 6.8% of men entrepreneurs. As a consequence, women were concentrated in unskilled and semi-skilled activities in the labour market, and in trade and service categories of MSEs.¹⁴¹ Besides, women spend less time in running business because they have other multiple family responsibilities.

Further, disparities between male and female entrepreneurs are evident in business size, product mix, business age, technological development, finance and location. There is discrimination in law when it comes to ownership of land, access to credit where women are called upon to provide male approval as a condition prior to credit. Some laws like the Factories and other Places of Work Act¹⁴² provide for special working condition for women and deny them some jobs.

3.3.10 Limited access to information

MSEs have limitations in acquiring, interpreting and effectively utilizing and disseminating information.¹⁴³ Dissemination of information on legal and regulatory issues to the public and MSEs is particularly poor. No major efforts have been made to sensitize key players on their roles in the formulation and implementation of policies, and MSEs have not been adequately sensitized on their obligations and rights. It has therefore been the MSE to factor in policy and legal issues in their decision making; as a result, law-enforcement agencies have continued to harass them.¹⁴⁴ There is also lack of an information network between MSE operators and experts on technology; this contributes to inadequate access to skills and technology in the MSE sector. The overall lack of timely simplified, reliable and relevant

¹⁴⁰ *Ibid* 15 quoting CBS, ICEG and K-Rep,(1999) *National Baseline MSE survey 1999*, Nairobi, CBS, ICEG & K-Rep

¹⁴¹ *ibid*

¹⁴² Cap 514 laws Kenya

¹⁴³ ¹⁴³ GOK, (2005) *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation For Poverty Reduction*, Nairobi, Government Printer 16

¹⁴⁴ *Ibid*

information on market opportunities, production technology and government regulations inhibit MSEs from surviving and competing effectively in the ever changing and globalizing economy.¹⁴⁵

3.3.11 Unfavourable taxation regime

The tax regime is cumbersome and is a formidable barrier to the growth and formalization of informal enterprises into formal ones.¹⁴⁶ What is more, it does not encourage IMSEs to either become formal, or register to pay taxes. At the same time, it increases compliance costs and restricts the upward mobility of MSEs; thus, the Value Added Tax,¹⁴⁷ which is applicable to most products and services, is costly for businesses to administer, increases transaction costs due to increased cost of raw materials, and inhibits cash flow for all categories of enterprises but particularly for MSEs.¹⁴⁸ In addition, customs administrators are not vigilant against the dumping of subsidized imported goods that pose unfair competition to MSE products. Costs and delay in clearing imports and exports deter productivity and marketing of the MSEs and generally deter domestic investment.¹⁴⁹

3.3.12 Formal and informal entry barriers

Formal and informal barriers inhibit the growth of the MSE sector.¹⁵⁰ Formal barriers include also the inefficient and irrational bureaucracy that is biased against MSEs and, especially for the locals unless they pay bribes as a condition for approving licences. The multiplicity of licences required in order to operate an enterprise and requirement needed before granting such licences translate to increased cost of formalization which forces many enterprises remaining informal.

¹⁴⁵ Ibid 16

¹⁴⁶ Ibid 17

¹⁴⁷ Cap 476

¹⁴⁸ Ibid

¹⁴⁹ Ibid

¹⁵⁰ Masai , W, Mbithi,M and Otieno,B.O, (2005) *Development of Micro and Small Enterprises in Kenya: A Renewed Policy and Strategy Framework*, Nairobi, African Centre for Economic Growth (ACEG) 5

Examples of informal barriers include cartels that control certain businesses and insecurity. Whereas, the legal framework can effectively deal with the formal barriers, it may not effectively deal with cartels and informal trade practices that are not clearly visible and documented. The formal entry barriers, which are mainly legal, are discussed in the next chapter.

3.3.13 Health and safety in workplaces

Occupational health and safety is critical for enhanced productivity enterprise growth and expansion.¹⁵¹ Depending on the nature of their work, sites, equipment and materials used, MSE operators are exposed to occupational hazards and workplace-related accidents.¹⁵² They are however limited in accessing and adhering to health and safety regulations, which are critical for enhancing productivity, growth and expansion of enterprises. Ironically the Factories Work Act does not cover the MSE sector, despite the fact that this sector stands out as the most hazardous.¹⁵³ This clearly shows that the law did not contemplate the informal sector.

3.3.14 HIV/AIDS

The HIV/AIDS (Human Immunodeficiency Virus Acquired Immune Deficiency syndrome) pandemic has greatly affected the potential growth of the MSE sector, particularly in relation to productivity, skilled manpower, social and economic performance and concentration of resources to productive activities.¹⁵⁴ This has resulted into high mortality rates of entrepreneur, increased labour costs due to absenteeism from work and inability of affected enterprises to meet their business obligations.

In an attempt to address these challenges the government of Kenya has, although with little success, come up with positive policies aimed at strengthening the sector. This has already been discussed in chapter two above in which I demonstrated latest the endeavour by the government through Sessional paper number 2 of 2005.

¹⁵¹ Ibid 18

¹⁵² Ibid

¹⁵³ Ibid

¹⁵⁴ Ibid

It is my conclusion therefore that, this chapter has demonstrated by comprehensive reference to literature that the informal sector is vibrant in Kenya. As such its constitution to the development of the country's economy cannot be over emphasized. The much contribution to the economy notwithstanding, the sector continues to face serious challenges most of which are legal in nature. Some of these legal challenges inhibit growth and development of the MSEs sector generally while others inhibit the process of formalizing the sector. As indicated in chapter one, formalization of the informal sector opens up the IMSEs to many benefits which are not accessible if IMSEs continue in their informality.

In the following chapter we catalogue and critically analyze the investment laws in Kenya.

CHAPTER FOUR:

4.0 CRITICAL REVIEW KENYA'S INVESTMENT LAW

4.1.0 The Investment Law in Kenya

One of Kenya's development goals is to provide an enabling environment for both local and foreign investors. The best way of providing such an environment is through an efficient and rational legal and regulatory framework. The Kenyan laws that regulate investments are found in various statutes and where possible in the English common law and international law. These laws deal with registration of investment enterprises, acquisition of workspaces, licensing and taxation, access to credit, labour, intellectual property rights and globalization.

We now discuss the respective laws briefly.

4.1.1 Laws affecting registration of investment enterprises.

Investment enterprises in Kenya are normally registered either as Business Names, Partnerships and Companies. The procedure involved in registering any of these is rigid and not considerate to the MSEs investors who are mostly jobless school drop-outs due to poverty, or retrenched and retirees whose capital is low and who consider time to be of essence.

Business Names

Business Names are the easiest way of registering an investment enterprise if it is a business owned solely or by a group of partners. These are registered under the Business names Act.¹⁵⁵ The registration office is centralized at the AG's chambers at Nairobi only, unlike the other types of enterprises. The investors are required to apply for reservation of the Business name a process which takes a minimum of 7-days. After the name is reserved the investor is required to apply for registration through

¹⁵⁵ Cap 499 laws of Kenya

filling of a standard form in which the investor must indicate his permanent physical as well as postal address in order to qualify for registration. This requirement is a drawback for the sector because most investors here have no such permanent addresses. The registration fee is a lot for the informal investors and the process has no time limit within which to complete. It can take years and at times bribes are demanded. This tedious and expensive procedure discourages many investors from registering their enterprises, especially those outside Nairobi or who cannot afford to wait for long or pay bribes.

Partnerships

These are established under the Partnerships Act.¹⁵⁶ There are no formalities under the Act for a partnership to be registered but the Act sets out criteria for discerning partnerships. The procedure is just like that of Business name registration save for limits in number of partners and in cases like those of limited liability partnerships. The cost in this category of firms is higher than registering a Business Name. The cost in time taken and the complexity of drafting the formal deeds for partnerships is also higher. The registration office is centralized in Nairobi. The registration process involves hiring of lawyers and the process is also infested with corruption. This as in the case Business names has caused many MSEs investors to go the informal way in order to save time, avoid corruption and make quick income for survival.

Company

A Company is the most modern and sophisticated business organization for investment and in Kenya the relevant law applicable thereto is the Companies Act.¹⁵⁷ The company has however a long history of evolution stretching to the medieval ages. The precursor of the company included the guilds of merchants, which roughly resembled the modern company but based on ceremonial and mutual fellowship almost like the present day Freemasons and Livery Companies.¹⁵⁸ The guilds obtained charters from the crown in order to gain monopoly over certain a commodity or

¹⁵⁶ Cap 29 laws of kenya

¹⁵⁷ Cap 486 “

¹⁵⁸ Davies L.P. (1997) *Gower's Principles of Modern Company Law* 6th Ed, London, Sweet & Maxwell 19

branch of trade. Incorporation as a method of distinguishing the rights and liabilities of the association from those of the members was not necessary because each guild member traded on his own account subject only to obedience to regulations of the guild.¹⁵⁹

The first English organization to be referred to as 'company' was that of Merchant adventurers trading overseas. Royal charters for such companies stretch back to the fourteenth century but became more common in the sixteenth century. These companies were just an extension of the guild principle into the foreign sphere which retained much of the ceremonial and freemasonry of the domestic guilds. The charters were needed to acquire monopoly of trade for members of the company and governmental powers over the territory for the company itself.¹⁶⁰ The companies operated on the partnership principle as we know by applying stock for a common profit of the members.

In mid seventeenth century a clear distinction was discernible between unincorporated partnerships and incorporated companies. Originally the said joint stock companies formed as partnerships allowed only a limited freedom to members to transfer shares. There was no limit of the number of members, though it remained small, and additional capital was raised by levitation or calls from the existing members rather than by public invitation.¹⁶¹

On the other hand, incorporation had certain clear advantages in that a corporation: existed in perpetuity, it could sue both its members and non-members. The current company is a body corporate with full juristic personality separate from its share holders. The procedure of incorporating a company is very technical, lengthy, and costly and requires the aid of legal experts. In Kenya the companies' registry is situated at Nairobi in the Attorney General Chambers.

The process starts with the reservation of the company name which takes a minimum of 7-days at a small fee. After reservation the investor engages legal experts to draw

¹⁵⁹ *ibid*

¹⁶⁰ *Ibid* 20

¹⁶¹ *Ibid* 21

Memorandum and Articles of Association. This is costly depending on the lawyer doing the job. The capital invested is higher for companies. The investor is required to indicate physical as well as postal address. The cost of the whole process is also higher and includes payment of stamp duty at the lands office situated at Nairobi, and then registration fees at the AG's Chambers. The registration office is only in Nairobi, Kisumu and Mombasa. The process is infested with corruption and it is known to take a long period of time. One is forced to lodge the documents with the Collector of Stamp Duty at Lands Office Nairobi before later presenting them for registration at the Companies registry.

The management skills and regulatory requirement is an art well above that of ordinary informal sector investor and therefore many have taken the option of informality.

4.1.2 Laws affecting entry to formal operations

These are laws that regulate the issuing of operating licences or permits. The Local Governments Act and local Authorities by-laws are the central regime in this area while the Local Authorities form the key institutional framework. The procedure for obtaining the requisite licence is complex and tedious repetition. The bureaucracies involved in obtaining relevant inspection reports and approvals are inefficient and a good recipe for demanding bribes. The seriousness of this constraint is worsened by imposition of informal hindrances like cartels and other improper business practices encouraged by the bureaucracy.

4.1.3 Laws regulating investments promotion

The legislation relevant in this area is the Investments Promotion Act 2004.¹⁶² Under Section 2 of the Act "investment" is defined as the contribution of local or foreign capital by an investor, including the creation or acquisition of business assets by or for a business enterprise and includes the expansion, restructuring improvement or rehabilitation of a business enterprises. It further defines a "local investor" as:-

¹⁶² Act No. 6 of 2004

- (a) A natural person who is a citizen of Kenya;*
- (b) A partnership in which the partnership controlling interest is owned by a person who is a citizen of Kenya;*
- (c) A company incorporated under the laws of Kenya, in which the majority of shares are held by a person who is a citizen of Kenya; or*
- (d) A trust or trust corporation established under the laws of Kenya, in which the majority of trustees and beneficiaries are citizens of Kenya;*

As we have already mentioned while discussing characteristics of MSEs, the sectors majority investors operate solely using unregistered business names. The reason is to avoid the legal and bureaucratic costs involved at the entry point of any business. In my considered view, the Act is not relevant to the MSEs.

The objective of the Act is to promote and encourage investment both local and foreign capital by providing incentives to qualify for such incentives, the investor must fulfil the following conditions under section 4 of the Act:

- (1) An applicant shall be entitled to an investment certificate if:-*
 - (a) The application is complete and satisfies the applicable requirements under this Act;*
 - (b) The amount to be invested by a foreign investor is at least five hundred thousand United State of America dollars or the equivalent in any currency;*
 - (c) The amount to be invested by a local investor is at least five million shillings or the equivalent in another currency; and*
 - (d) The investment and the activity related to the investment are lawful and beneficial of Kenya.*

- (2) In determining whether an investment and the activity related to the investment are beneficial to Kenya for the purposes of subsection (1)(d), the Authority shall consider the extent to which the investment or activity will contribute to the conditions specified in paragraphs (a),(b) and (c), and any or all of the conditions specified in paragraphs (d),(e),(f) (g) and (h):-*
 - (a) Creation of employment of Kenyans;*
 - (b) Acquisition of new skills or technology for Kenyans;*

- (c) *Contribution to tax revenues or other Government revenues;*
- (d) *A transfer of technology of Kenya;*
- (e) *An increase in foreign exchange, either through exports or import substitution;*
- (f) *Utilization of domestic raw materials, supplies and services;*
- (g) *Adoption of value addition in the processing of local, natural and agricultural recourses;*
- (h) *Utilization, promotion, development and implementation of information and communication technology.*
- (i) *Any other factors that the authority considers beneficial to Kenya.*

This Section spells doom to the MSEs and in my view it is self contradicting. The first drawback is manifested in its erroneous definition of the term investment. The definition connotes macro-enterprises in a legalistic context and thereby disregards MSEs with their micro- capitals. Livingstone *et al*,¹⁶³ argues that investment is not a legal term but one which lies in the province of economics. He defines it to mean, an expenditure on capital goods or acquisition of capital goods incurred in the understanding that these capital goods shall be deployed to produce income. This is more comprehensive and simple enough to cover MSEs.

Consequently, if the gist of the Act is to enhance investment in order to create job opportunities, enhance technology transfer and contribute to the national revenue through tax, it is hereby argued that the informal sector is able do all these. Never the less, from the amount of capital required to be invested in order to receive recognition under the Act, it is obvious that the MSEs are excluded.

4.1.4 Laws affecting the acquisition of workspaces

An effective and functional physical infrastructure is vital to investment. A dysfunctional infrastructure acts as a disincentive to investments and lowers the productivity and competitiveness of firms by imposing both direct and indirect costs

¹⁶³Livingstone I. and Goodall A.S. (1970) *Economics and Development: An introduction* Nairobi, Oxford University Press, 9

to business.¹⁶⁴ One of the key infrastructural services that are of concern to MSEs is the allocation of land workspaces. The problem of lack of worksites is ranked quite high by the MSEs based in urban areas according to the 1999 Baseline survey.¹⁶⁵

The lack of access to workspace in Kenya is complicated by the allocation and tenure issues, and aggravated by stringent building standards and regulations controlling the provision of utilities like power, water and roads.¹⁶⁶ The work of allocating land and workspaces for MSEs rests with Local Authorities, but this function has been weakened by lack of clear MSE policies at the Local Authorities and weak institutional frameworks that are dominated by conflicts with the provincial administration. The Local Authorities view the role of providing incentives to investors including MSEs as resting with the central Government. Further there is conflict between the roles of Provincial Administration and the Local Authorities of the enforcement of regulations, as well as on the jurisdiction over workspaces, land and utilities.

The inadequacy of physical infrastructure is a principal cause of low levels of investment and unsatisfactory performance of MSEs. Physical infrastructure has been defined to include land and business workspace (like industrial premises of MSEs), water supply and sewerage, roads, communication facilities and power.¹⁶⁷ Poor infrastructure is a constraint to profitable business in Kenya.

Most land-related problems faced by MSEs revolve around ownership, title deeds and encroachment onto their workspaces by private developers. The land allocated to MSEs in most urban and rural areas is a major impediment to their growth and development. The allocated land has been inaccessible, without title deeds or just temporary allocation leading to encroachment and/or grabbing by the rich private developers. In these circumstances we find that the Local Governments Act¹⁶⁸ and the

¹⁶⁴ Moyi E. and Njiraini P, (2005) *Msallocation of Workspaces in Kenya: Some lessons and Models*, Nairobi, KIPPRA, 8

¹⁶⁵ Quoted by Moyi *et al*, *ibid*.

¹⁶⁶ Karigithi, W. 'Legal and Regulatory Framework' Mullei A. and Bokea C. (1999) *Micro and Small Enterprises in Kenya*, Eds, Nairobi, ICEG, 20

¹⁶⁷ Bokea, (1999) quoted in Moyi *et al*, (2002) *supra*

¹⁶⁸ Cap.265

Physical Planning Act¹⁶⁹ have failed to provide and protect work space to the informal sector investors despite the role played by the sector in creating jobs, generating revenue, among other things.¹⁷⁰ This is surprising in that they are deprived of the facilitative aspects of the law – property rights – yet such rights are indispensable for growth and competitiveness of business.¹⁷¹

Even where land has been set aside for the sector the rich private developers exploit the ignorance or the poverty of the informal sector allottees to encroach and grab the land including sheds and obtain title deeds or leases from the Local Authorities and the commissioner of Lands. The rich developers once armed with title documents leases the premises back to the poor MSEs leading to high cost of operating the business due to rent burden. The land having become private property, the Local Authorities are no longer bound to provide utilities and that has led to working sites that are polluted, with poor toilet facilities and drainages. That has become hazardous to public health and environment. I observed this problem in Nairobi and Machakos town in all areas occupied by motor mechanics, carpenters and metals artisans.

4.1.5 Laws imposing and regulating taxation

Taxation is one of the most fundamental links between the population and the government in any country. It is the processes by which the state through the machinery of law determines, assesses, collects and quantifies a contribution from the private expenditure in favour of public expenditure, so as to allow it obtain funds to provide goods and services to all. On the other hand tax is defined as the exaction by the state through the instrumentality of law to dispose people of their financial resources as a contribution to the maintenance of civilization and welfare.

Any investor wishing to invest in Kenya must always be warned of the tax regimes in force and comply. The following are some of the legislations that impose taxes on the investors.

¹⁶⁹ Cap. 286

¹⁷⁰ Moyi *et al* note 117, 10

¹⁷¹ *Ibid*

Value Added Tax Act¹⁷²

This was introduced in 1990 to levy tax on goods and services whether produced locally abroad or merely improved. It is levied on the scheduled goods and services. This affects the management cost in that it calls for engagement of accountants to do the job and also the production costs increased due to taxation on raw materials and electricity.

Income Tax Act¹⁷³

This requires that tax be levied on all gains made from investments. The investor is supposed to register with KRA and given a PIN Certificate. Failure to register is an offence which carries severe penalties.

Stamp Duty Act¹⁷⁴

This imposes and regulates the collection of stamp duty on official documents securities, mortgages, agreement, memorandum and Articles of association, leases, insurances transfers and licences among others.

Public Fees Act¹⁷⁵

This imposes tax in form of fees, licences and charges for road use, court fees, and registration of documents in government registries among others. This affects MSEs when registering businesses with the Registrar General and also in form of service charge in respect of their workplace.

¹⁷² Cap. 476 laws Kenya

¹⁷³ CAP. 470 laws of Kenya

¹⁷⁴ CAP. 480 “

¹⁷⁵ Cap 424 “

Local Government Act ¹⁷⁶

This statute establishes Local authorities and gives them jurisdiction over a certain area. This jurisdiction includes the power to administer and provide services within their area. One such power is to provide licences to businesses operating in their area and to make necessary by-laws to prohibit, control and regulate various trades and businesses within their jurisdiction. The by-laws ordinarily lay emphasis on control. They incorporate harsh penalties and criminal sentences for non-compliance, and they give broad discretionary powers to the local authority official to impose numerous trading restrictions.¹⁷⁷

The by-laws are not uniformly modeled on how to regulate businesses but rather each local authority has its own model. The local authorities use their respective by-laws to charge various taxes which affect the starting and continuity of formal investments. These include licences, service charge and fees in markets and other operating zones, and which is done either daily or periodically.

Rating Act ¹⁷⁸ **and** **Valuation for Rating Act** ¹⁷⁹

These two statutes complement each other to levy rates on real property. They provide cadastral information which is needed for charging the tax on land. This tax is levied on municipalities and it is very crucial in that it affects the value of the rent for work sites for the investors.

From the above catalogue of taxes I find that the tax burden is a justifiable reason to compel MSEs to informality. The law imposing taxes is not considerate to the MSEs and is therefore to blame for increasing number informal MSEs.

¹⁷⁶ CAP 265 “

¹⁷⁷ Karigithi, W. ‘*Legal and Regulatory Framework*’ Mullei A. and Bokea C. (1999) *Micro and Small Enterprises in Kenya*, Eds, Nairobi, ICEG, 20

¹⁷⁸ CAP 267 laws of Kenya

¹⁷⁹ CAP 266 “

4.1.6 Laws regulating labour

The laws include the Employment Act,¹⁸⁰ Workmen Compensation Act,¹⁸¹ the Factories Act,¹⁸² Trade disputes Act,¹⁸³ Regulation of Wages Act,¹⁸⁴ NSSF Act,¹⁸⁵ NHIF Act,¹⁸⁶ and Public Health Act¹⁸⁷ to name but a few. These statutes are very crucial to the investors in that they set certain minimum standards which ordinarily would be above the reach of the informal sector. The requirements under such legislations are such that they serve only the formal rich investors who can meet the desired statutory minimum standards of wages, benefits, safety among others. These minimum standards are automatic to all formal enterprises and they are not flexible. They add to operating costs for the MSEs, hence another reason for informality.

Factories Act,¹⁸⁸ for example, deals with occupational health and safety at work place. This Act however does not refer to the informal sector and do provide discriminatory treatment to female workers.

My considered opinion is that these minimum standards are good for general welfare, public health and environmental development. They should be maintained but with flexibility in order to encourage formalization of the IMSEs. Failure to formalize in my view would lead to backstreet operation which exposes workers to risky working conditions, un-hygienic food and drinks manufacturing, and environmental degradation. At the same time the regulations should be flexible in order not to deter innovation and creativity.

4.1.7 Laws affecting access to credit

The Banking Act¹⁸⁹ is crucial here. It provides for standardized procedures by commercial banks. There is no clear provision for lending by Central Bank to MFIs in

¹⁸⁰ Cap.226 laws of Kenya

¹⁸¹ Cap.236 “

¹⁸² Cap. 514

¹⁸³ Cap. 234

¹⁸⁴ Cap. 229

¹⁸⁵ Cap 258

¹⁸⁶ Act number 9 of 1998 which repealed N.H.I.F Act Cap.255

¹⁸⁷ Cap. 242

¹⁸⁸ Cap. 514 laws of kenya

order to lend to the MSEs. This neglects the special circumstances of the sector's investors. The law contemplates the formal sector banking and credit through a rigid process.

The Co-operative Societies Act¹⁹⁰ is another relevant legislation which establishes SACCOs for informal credit. The procedure of accessing the credit is based on rigid procedures which are not regulated by the Act but by the by-laws of each individual SACCO. Poor management has led to huge losses to the sectors investors when the SACCOs collapse with all the contributions of members. The interest rates on SACCO loans can also be high at times thereby deterring borrowing.

4.1.8 Laws enhancing globalization

The concept of globalization is wide and its meaning depends on whether used in economic, political and social-cultural context. In this paper we refer to economic globalization meaning the liberalization and opening up barriers of domestic markets to international competitors. The main laws here are the international law and the national legislations of various states. International law in our context refers mainly to conventions and treaties on the one hand and customs on the other. These are normally domesticated through passing of national legislations of individual states to make them effective.

In Kenya, the IMSEs are affected at home by unfair competition caused by cheaper substitute goods imported duty free or produced through subsidized schemes abroad. The result is poor prices of locally produced goods and closed businesses. The explanation to this state of affairs in my opinion is the fact that negotiators of conventions and treaties at the international plane contemplate trade and production of goods and services in respect of formal Macro-Enterprises and pay little or no attention to the implications of such conventions and treaties on the MSEs investors enterprises at the national plane.

¹⁸⁹ Cap. 488

¹⁹⁰ Act number 12 of 1997

4.1.9 Intellectual Property law

The law applicable here is of international standard which is still unknown to the informal sector in Kenya. Many artisans and crafts people do not know their intellectual property rights. The problem is compounded by the fact that they operate outside the law and lack legal recognition leave alone protection. Although they are very innovative with many patentable ideals and marks, they rarely register them and as such they do not benefit from their innovations due to copying of their ideas by competitors who end up patenting the idea and exploit it.¹⁹¹ On the other hand the procedure for the registration to the patents and trade marks is complex and costly because it requires legal experts on the subject area.

4.1.10 Laws regulating Dispute resolution

The relevant laws here are legislations and rules regulating procedures for courts of law and tribunals. Both the laws and the institutions are not suitable to the MSEs sector because they are complex and technical. The cost involved in retaining legal experts and delay in determination of the cause of justice is high. The matter is worsened by corruption in the court system.

4.2 Critique of the Kenya's Investment Law

Most of the literature referred to in this research paper has attacked, though with varying degrees, the unsuitability of the existing legal system in the regulation of the MSEs sector investments. Indeed this paper deems the MSEs sector as a category of investors *Sui generis*, which does not fit in the existing legal system and the bureaucracy that regulate the investment in the formal Macro-economy.

The existing legal system is a colonial legacy. The system was intended to promote European settlers to invest in Kenya for exploitation. The law was therefore discriminative of the small and Micro-entrepreneurs of the African race. The colonial town planners and drafters of the law did not contemplate the MSEs and that has a

¹⁹¹ An example of such patents is the Kenyan *kyondo* in Japan.

bearing in today's status quo. The Town planning laws and by-laws have for years now since independence remained negative and discriminative against the informal MSE sector investments. The informal investors have been harassed by both central and local government agencies. The standard for becoming formal and remaining formal have remained rigid and inconsiderate to the special needs of the MSEs thereby forcing many into informality. As earlier discussed the informality is also very costly to the MSEs and leads to serious constraints to their growth and survival.

The registration of business enterprises is perceived by most MSEs as cumbersome, bureaucratic and costly process and consequently, a major hindrance to the start-up of a formal concern.¹⁹² The system of formalization of investments is mainly centralized in Nairobi's Attorney General's Chambers. Although some branch offices have been opened in Mombasa, and Kisumu, the registration of business names, which mainly deals with the poor majority, has remained conspicuously centralized in Nairobi. This is a serious drawback to the formalization process as regards the informal sector. The investors in the sector are victims of economic circumstances which relate to their dropping out of school or unemployment. The cost of registering the investment at Nairobi becomes a nightmare especially for those MSEs based in the upcountry setting. The congestion at the city's office calls for further cost of either waiting or payment of bribes or both.

The system is complex and the procedure demands the engagement of legal experts to assist in the drafting and attestation of the necessary documents. The cost of this can be forbidding. In addition to the foregoing cost, the procedure of formalization is not a single undertaking in one office. It involves a complex system of payments of fees and duties in various offices as a pre-condition for registration. At times it may require inspections and approvals to be done by government agencies. The sum total of all these has been a recipe for corruption which leads to the high costs of formalization.

¹⁹² Karigithi, W. 'Legal and Regulatory Framework' Muleli A. and Bokea C. (1999) Micro and Small Enterprises in Kenya, Eds, Nairobi, ICEG, 20

The tax regime on investments has been very rigid and inconsiderate of the MSEs. The procedure and requirements are the same for all investors. As already discussed earlier, one constraint to MSEs growth is lack of entrepreneurial capacity. The cost of complying with tax regime becomes quite high because the process requires experts in accounts and auditing. The compiling of returns and filing with the relevant tax agencies is an impossible task to many MSEs who disappear into informality. The multiplicity of the taxes required to be paid is also too much. . Although the government has attempted to reform the licensing process towards single Business permit, a lot needs to be done as the number of many other taxes operating indirectly against the sector continue to add burden of operating cost and hence encourage informality.

The licensing by-laws of all local authorities have no uniform tariff structure, although dealing with a common phenomenon of MSE. Licence has not been automatic upon payment of the specific fees and supply of the basic information such as may be required for statistics and information purposes. There have been conditions attached like acquisition of other licences like Occupiers licence given free of charge by the local authority. All these have the effect of increasing the cost formalization in form of time and money for fees and bribes.

Town planning laws and by-laws relegate the MSEs sector to the peripheral zones where there is no ideal physical infrastructure away from the central business areas. Licences are denied to the MSE artisans and crafts people who wish to venture into the central business areas forcing some to sneak into the prohibited zones informally. The result has been an endless hide-and-seek game between law enforcement and the informal entrepreneurs. In the process many entrepreneurs lose their stock and others are imprisoned, while even others are maimed or killed while fleeing from the law enforcers. Comprehensive law review is needed to repeal and or amend the obsolete provisions that inhibit formalization of the IMSES through denial of licensing to operate in the commercial zones of the major towns.

The laws regulating access to credit have also remained rigid and inconsiderate of the informal sector. They only favour and protect lending by commercial banks and institutions which demand collaterals but which the informal entrepreneurs lack. The

Micro-financial institutions are the most suitable to offer substitute credit facilities to the informal sector but they lack proper legal frame work to enable them operate savings accounts for accumulation of money to offer as credit. The result has been lack of growth and development in the sector.

Labour laws in the country are uniform to both formal Macro-enterprises and the MSEs in regulating recruitment, dismissal, terms of work for part-time and temporally workers and minimum pay rates. The law especially restricts redundancy by imposing strict requirements which would be in-applicable to the MSEs which would not be able to react positively to bad economic times in the same way as large enterprises. The requirements to contribute to social welfare for workers have forced many MSE to either use family labour or employ a number of staff below the minimum set by the labour law. Others have denied women employment in fear of maternity leave requirements among other statutory requirements which are unique for female workers. The aim of informality being geared to reduce operating costs.

The Employment Act, though good in protecting workers' wage payment, work hours and general welfare, the Act discriminates against women by denying them jobs in any industry undertaking mining or manual work.¹⁹³ This law has remained unchanged despite the recommendations for review of the legislation by Sessional paper No. 2 of 1992 that allowed such discrimination only for medical or environmental reasons. In addition, the Act among other legislations dealing with the labour issues, impose automatic minimum wage and non wage standards which add costs to MSEs leading to informality and operation in the backstreet. This as already stated opens up the workers to the risk of poor working conditions and endangers the consumers who eat and drink products made under unhygienic conditions.

Factory laws have also been too strict and rigid applying equal standards to small and big investors. The building layout, facilities required in factory setting and the public health requirements have been too much for the MSEs who prefer going informal. Hence the terms '*Jua Kali*' sector, meaning the informal investors who operate in the open air and using any public facilities available. . The law on factories excludes

¹⁹³ *Ibid* 23

MSEs because its requirements are irrelevant to MSEs who can even operate without the prescribed standard premises save for the risks mentioned above.

The safety requirements at the work places and consumer protection standards under the existing laws have also been too high for the MSEs forcing many to operate informally from the back street. That has made the situation worse because the workers are exposed to more risky jobs with electricity power connection being dangerously done, powered saws and other tools being used by desperate workers without the necessary precautions. On the other hand consumer protection is lost. The health conditions at workplace especially of food and drinks is such that makers prepare them at dirty and un- hygienic hidden places. The packing method used has also been poorly. These dangers would not have existed if the formalization process was cheap and efficient.

In conclusion to this chapter, we wish to state that the investment regime in Kenya is pro-formal macro- investments. It s a regime designed to promote formal macro- enterprises most of which are foreign. The regime sets certain minimum standards which are automatic once the investment enterprises are formalized. These minimum standards have been considered to be too high for ordinary MSEs. The procedure of formalization is itself an up hill task for the IMSES who have no big capital to spend on the registration process which is regulated by a lengthy, slow and corrupt bureaucratic frame work. All these factors of law and bureaucracy have inhibited the process of formalization of the informal MSEs.

As a result, we find that a serious law reform should be done to encourage formalization of the informal sector. In the next chapter we will propose both policy and legal reform as we wrap up this research paper.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATION

5.1 Summary of Findings

The informal sector, though known by different names, has a long history in Kenya. The sector however only received fame after the ILO report of 1972 which report claimed formal discovery of the sector. The sector is very vibrant and with much potential to propel Kenya to industrialization if only provided with an enabling environment.

Various theories have been advanced to conceptualize the sector. This paper has adopted the Micro-enterprise theory which considers the option of operating informality as a matter of a rational choice attributable to legal constraints. The choice is made rationally by evaluating the costs and benefits of formalizing in view of their resources. By finding costs for entry and remaining formal too high, the MSEs chose to operate informally. That means they rationally chose to operate beyond the government regulations, as opposed to finding themselves there unconsciously due to the circumstances advanced by the other theories of informality.

The MSEs are forced into this informality by legal and regulatory status quo introduced in the 18th and 19th century European mercantilism, which excluded the poor from the mainstream economy. The system is designed to serve the investments of the formal sector and condemn the majority poor population to informality and under development. This theory suggests reform in legal and institutional structures through simplification, decentralization, and deregulation. Simplification involves debureaucratization of rules by removing duplicative and insignificant parts of the law. Decentralization shifts legislative and administrative roles from the central government to the local governments and lower tiers of authority. Deregulation would ensure that legal framework and institutions create markets that work for every one.

The other theories discussed in this paper include the structural approach, Dual economy model and institutional failure view. In my view, these latter theories merely give a social and academic explanations which are not practical and cannot by themselves define informal sector without reference to legal and regulatory aspect. The lesson we learned from all these theories combined is that Informal Sector special is cadre of investors that has been neglected and relegated to the periphery of the economy.

This paper has found that the informal sector is a major player in the growth and development of Kenya's economy. It provides a larger number of job opportunities to school leavers and retrenchees. Above all the benefits discussed, the sector has the potential to propel Kenya to industrialization. It is however another finding of this study that the sector faces numerous challenges most of are attributable to the existing legal and the regulatory framework. The said challenges have threatened the growth and development of the sector. That fact has provoked the Kenya government to formulate various policy papers aimed at removing the said challenges and creating an enabling environment for MSEs investment. The latest of these policy documents is Sessional paper No. 2 of 2005 which has addressed very fundamental issues of MSEs investments.

The greatest challenge to the said government policies has been the failure in the implementation and monitoring of the various government policies. The reason for the failure as we found out is because the policies are not stakeholder-driven but government-driven. A finding that surprises us in this study, however, is that the sector has continued to grow in quality and quantity despite all the constraints discussed in this paper. This does not however justify that the status quo for the sector's legal neglect to continue.

There is a serious need for formalization process to take place in view of the size of the sector and the threats it faces due to globalization. To compete effectively in the fast globalizing economy the informal sector must formalize in order to: (a) access credit to finance quality investments, (b) protect and transact in technological innovations, and (c) access market and avoid all other costs of informality.

5.2 Recommendations

The main policy recommendation we are making in this paper is a review of all the previous government policies by a Task force consisting of government and other stakeholders' representatives. The aim should be to give the policy the spirit of the people otherwise jurisprudentially called the *Volksgist*. The recommended Task force should come up with policies on the following which would positively recognize Informal Sector as an integral part of the economy and not a welfare sector.

Registration of enterprises

As we have already highlighted, there are serious legal problems when micro and small enterprises seek to enter into formality. This has led to the rapid increase in the number of informal enterprises whose exact number is unknown. That state of affairs has further complicated the process of planning and provision of essential physical infrastructures and services. We therefore recommend a reformed legal and regulatory framework for registration of MSEs. To this end, we propose the development of a simple, transparent and cheaper mechanism of licensing and registration as a means of encouraging the formalization of the Informal Sector.

Lengthy, rigid, centralized and unclear procedure add to transaction costs and constrain formalization process. We therefore recommend simplification, decentralization and deregulation, in line with the Micro-enterprise concept discussed above and the empowerment of the local authorities and lower tiers of authority to regulate the sector.

To enhance faster registration of business names, we recommend that the exercise should be decentralized and computerized at all major towns and cities not necessarily district headquarters. The aim should be to reduce the congestion in the Nairobi centralized office and thereby quicken the process of formalization. Computerization will quicken the processing of applications and reservation of names. The ultimate benefit from decentralization and computerization will be to reduce costs of formalization in terms of money and time.

Regulation and Licensing

Licensing procedure at the local authorities should be simplified and the issuing of licences be made automatic upon payment of the requisite fees. The law and by-laws should be reviewed to remove unnecessary discretion on the part of the licencing authorities. We proposed and encourage group/association licensing in respective sub sectors of the MSEs. We propose that licencing by-laws should emphasize on incentives rather than penalties as this will encourage the process of formalizing the MSEs.

There should also be developed, an effective information management and dissemination mechanism to educate the public on their rights as small investors. It will also educate and train civil servants and enforcement agencies on how to carry out their duties in civilized society. The will help stop the ugly incidences which have now become a permanent feature in major cities and towns whenever law enforcement officers confront the informal entrepreneurs along the streets.

Allocation of worksites for MSEs

Land allocation and transfer system should be reformed to make it transparent. All public and Trust land held by the Local authorities of Ministries should be disposed of in an open manner and not secretly. All land ear-marked for *Jua Kali* activities should be registered in the name of individual informal sector investor or associations of them. This guarantees security of tenure and therefore ability to access credit to develop the work place and the enterprise.

Access to Credit

As discussed earlier MSEs face challenges which inhibit their access to credit. We recommend that an enabling legal framework be put in place by removing all legal constraints to enable MFI, SACCOs and other small financial institutions like Post Office Savings Bank to effectively provide credit to the informal sector. Special consideration on this issue should be made in respect of women entrepreneurs who continue to face both legal and social constraint in their attempt to acquire credit.

Regulation of Labour

Labour laws should be reviewed to make them flexible to accommodate SMEs. The social Security and other statutory obligation imposed upon the entrepreneurs are too much for the small enterprises. They discourage the process of entry to formality and remaining formal. The statutory requirement for certain minimum wages and non-wage benefits to be provided by the macro and micro enterprises equally are unreasonable and act as disincentive to the latter.

Tax regime

As earlier discussed, tax regime in Kenya is very stressing on the MSEs and a cause for informality in that its compliance adds the cost of production. We recommend therefore a review of the tax regime to give special treatment to the MSEs. This can be given through tax exemptions at registration and by consolidating the licence fees chargeable. The taxes should also be at affordable rates and the collection method should be made transparent to enable the enterprises to thrive.

Intellectual Property Rights

The Science and Technology Act¹⁹⁴ should be reviewed to accommodate informal sector skills. The Industrial property Act (IPA)¹⁹⁵ should also be reviewed in order to encourage development and innovation in the sector. In particular the IPA should prohibit dubbing of obsolete technologies from abroad. The law should be further reviewed to protect local innovations and traditional knowledge. These include knowledge in art and crafts, and in the herbal medicine.

The law should in particular protect the traditional knowledge from the pirating by the northern Multinational Pharmaceutical Corporations which send their agents to the developing countries to do “research,” which indeed is not lawful research but pirating on our traditional knowledge and stealing from our biodiversity. As such strict regulations should be put in place in order to check such illegality being done by

¹⁹⁴ Cap 250

¹⁹⁵ Act No. 3 of 2001

foreigners. The reason for such a move would be to reward the holders of such knowledge and the community in whose environment the biodiversity under research and exploitation is found.

Micro and Small Enterprises Act

Our thesis in this paper has been that MSEs are a cadre of investors *sui generis*, having special qualities and facing unique challenges which are not catered for by the current investment law. We recommend that a Micro and Small Enterprises Act should now be enacted. Despite earlier proposal by government policy papers, no law has so far been passed to deal with MSEs or MFI. That state of affairs has persisted for long and has left the sector open to a lot of legal and regulatory constraints from starting to winding up of the business. We feel that the MSE Act is now a matter of urgency if the sector is to compete well in the globalizing economy.

The aim of the Act should be to recognize MSEs as a unique category of investors and requiring special regulation on planning, licensing and enforcement of the regulations concerned. The new Act should establish a bureau for registration of the MSEs. The Act should also establish a tribunal to deal with all disputes touching on investments within the meaning of the proposed MSE Act. To this end we recommend that the government should borrow a leaf from the countries which have passed legislations to regulate the MSEs.

Review and repeal of obsolete investment laws

Consequent to the proposed MSEs Act, we recommend a comprehensive review and repeal of all absolute and out dated laws and by-laws to accommodate MSEs under the proposed MSEs Act. This will avoid the possibility conflict of jurisdiction over who should regulate the investment within the MSE-sector. To that end we propose that a model-by-laws be passed by special Task Force to apply to all Local Authorities. The Task Force should include government and all other stake holders' representatives. The proposed model by-laws should remove all the unnecessary requirements for full council resolutions in local Authorities in order to avoid politicizing investment matters.

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