REGULATORY FRAMEWORK OF MICRO AND SMALL ENTERPRISES IN THE INFORMAL SECTOR IN KENYA: A CRITICAL ANALYSIS

Submitted in Partial Fulfilment of the Requirements of the Bachelor of Laws Degree, Strathmore University Law School

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A special thanks goes to my siblings for putting up with my outbursts during this period.
DECLARATION

I, ROSARIO MUTHONI KAMUTI, DO HEREBY DECLARE THAT THIS RESEARCH IS MY ORIGINAL WORK AND THAT TO THE BEST OF MY KNOWLEDGE AND BELIEF, IT HAS NOT BEEN PREVIOUSLY, IN ITS ENTIRETY OR IN PART, BEEN SUBMITTED TO ANY OTHER UNIVERSITY FOR A DEGREE OR DIPLOMA.

OTHER WORKS CITED OR REFERRED TO ARE ACCORDINGLY ACKNOWLEDGED.

SIGNED: .............................................................

DATE: 30th Nov, 2018

THIS DISSERTATION HAS BEEN SUBMITTED FOR EXAMINATION WITH MY APPROVAL AS UNIVERSITY SUPERVISOR.

SIGNED: .............................................................

EMMAH SENGE
ABSTRACT
The enactment of the Micro and Small Enterprises Act in 2012 in Kenya was a major step forward in the regulation of Micro and Small Enterprises, and especially those in the informal sector. The Act provides for registration procedures, account keeping requirements and it establishes the MSE Authority and the MSE tribunal.

Regrettably, the implementation of this Act has however been poor. Although the Act established the MSE Authority which has the mandate of formulating policies for MSEs, there has been no policy formulation to date. There has also been no evidence of the use of the tribunal.

Therefore, the Objective of this study is to analyse the regulatory framework of MSEs and find out the loopholes and the challenges faced so as to formulate recommendations that would strengthen the capacity and role of the Kenyan government in enhancing performance, access to resources and economic efficiency in the MSE industry in the informal sector.

Major recommendations drawn in this study include making the registration process cheaper and accessible through online portals, and development of incubation hubs for micro and small enterprises to make it easier for entrepreneurs to access resources.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>GOK</td>
<td>Government of Kenya</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>ILO</td>
<td>International Labour Organisation</td>
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<td>KNBS</td>
<td>Kenya National Bureau of Statistics</td>
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<td>LED</td>
<td>Local Economic Development</td>
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<td>LLPs</td>
<td>Limited Liability Partnerships</td>
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<td>MSEs</td>
<td>Micro and Small Enterprises</td>
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<td>SACCO</td>
<td>Savings and Credit Cooperative Organization</td>
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<td>SMEs</td>
<td>Small and Micro Enterprises</td>
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CHAPTER 1
INTRODUCTION

1.1 Background to the study
Micro and small enterprises have been a huge contributor to development in Kenya's economy.\(^1\) The aim of this paper is to establish whether there is effective regulation of micro and small enterprises in the informal sector in Kenya. Thereafter, an analysis will be conducted to determine how effective these laws and policies are.

1.1.1 What is the Informal Sector?
The informal sector may be defined as a group of production units which are unincorporated enterprises owned by households.\(^2\) This is the sector which encompasses all jobs which are not recognized as normal income sources, and on which taxes are not paid.\(^3\)

The informal sector includes work that takes place in unincorporated enterprises that are unregistered or small. However, there are additional types of informal employment outside informal enterprises: for example, persons working in formal enterprises who are not covered by social protection through their work, as well as domestic workers, casual day labourers, and contributing family workers who are not covered by social protection through their work.\(^4\)

Therefore, the informal sector may include: small farmers, street vendors, hawkers, small traders, micro-entrepreneurs, home-based workers, cobblers, rag-pickers, porters, labourers, artisans. In Kenya this sector is called the Jua Kali sector. This paper will focus on Micro and Small Enterprises which includes businesses in the informal sector in Kenya.

1.2 Problem Statement
The problem to be addressed in the study is the lack of proper laws and policies that regulate the micro and small enterprise sector which are implemented in the formal sector.

Despite the fact that the micro and small enterprise sector is important to the economy of the country as many citizens are employed in this sector, there is little implementation of MSE legislation which has led to improper working conditions and a lack of opportunity for development making these people more prone to living and dying in poverty.

1.3 Research Questions

The main research question of this study is: “To what extent is the existing regulatory framework on micro and small enterprises effective in regulating the informal sector in Kenya?”.

From this, the following secondary questions may be derived:

a) What does the informal sector in Kenya comprise of?

b) What laws govern MSEs in Kenya?

1.4 Objectives of the study

The general objective of this study is to investigate how MSEs in the informal sector are regulated. This will be done through identifying and examining the attempts made by the Kenyan government and other international instruments to regulate MSEs. This includes establishing the laws have been put in place, if any and whether there are regulating authorities that govern this sector. The study will also entail a comparison study of MSEs in Malaysia. This will provide an insight into how an effective regulatory regime for MSEs would look like. I will then use the findings from Malaysia’s regulatory framework as recommendations in the last chapter.

1.5 Theoretical Framework

This study will be guided by the dualist theory of development.

The dualist approach explains the informal sector as a set of subsidiary activities that provide incomes for the deprived, that is, those who are incapable of accessing employment in the formal sector. These people who are not absorbed into the formal

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sector then venture into the informal sector. The dual labour market assumes two sectors with two different labour markets: formal and informal.

In the formal sector workers enjoy higher earnings, better employment security and often the protection of unions. The informal sector however, represents a different situation comprising a large portion of the unemployed with low wage, lack of employment security and no protection from unions. This school of thought views the informal sector as comprising marginal activities, one that provides income for the poor and acts as a safety net in times of crisis. The informal sector is viewed as an employment creating institution. In this dualist theory, the informal sector is filled with individual who have gone through education and training while the informal sector has very few individuals who have accessed education and training. It is mainly unskilled labour. The quality of jobs they can therefore access is that of a lower calibre than that of the individuals in the formal sector.

This theory therefore suggests that the informal sector exists due to a number of factors including lack of proper education, lack of skills, strict regulations and the need for a flexible market.

The importance of this theory to the study is to provide an explanation of the inception of the sector, its composition and its regulation. The study of this theory will provide a clear picture as to why this sector exists and how it can be regulated to ensure development for the individuals working in this sector and the development of the country as well.

1.6 Literature Review

The literature review in this study shall include books, articles and journals. There are various articles by the ILO that have been instrumental in legislation for the labour market. In ‘ILO World Employment Mission Kenya 1972, the ILO and the Informal Sector: An Institutional History’, the author states the need for growth of employment in Kenya and the need to implement the informal sector in the country. The book states the various ways unemployment can be reduced. It also states that the informal sector can absorb many workers locked out of the formal sector.

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7 Theories Of The Informal Sector Growth And International Monetary Fund And World bank Police Approaches To Incorporate The Informal Sector Into The formal Sector Economy In South Africa 25 / 136<
This study is also informed by several treatises. First among them is The Informal Economy: Studies in Advanced and Less Developed Countries. The authors of this book study the informal market and dispel a number of misconceptions about the informal economy for instance that it is not only for the poor and they study the regulatory framework of the sector. This book is relevant to this study because it will provide an insight into how the informal economy works.

I will also look at Informality: Exit and Exclusion, World Bank. This is a book published by the World Bank. The authors in this book analyse informality in Latin America, exploring reasons for and implications of its growth. The authors state that informality is either driven by exclusion from state benefits or, driven by voluntary exit decisions resulting from private cost-benefit calculations that lead workers and firms to opt out of formal institutions. The authors state that the solution to informality will be to improve productivity in the economy by establishing proper regulations and social policies.

I will include insights from Linking the Formal and Informal Economy: Concepts and Policies by London Oxford University Press. This book studies the formal and informal economy in developing countries. It will provide an insight as to how the two economies can exist and lead to development in a country.

Women in the Informal Economy in Urban Africa by Kinyanjui, Mary Njeri will also form part of the literature review. As the title suggests, this is a book on the contribution of women to the informal economy. The author urges the need to investigate the diversity and creativity within the African city in terms of inclusion of women in urban planning and collective organization as a method of organizing business, and including gender in the construction of urban planning. The author emphasises on the promise of innovations as a result of economic informality and from women in this sector.

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Insights from Africa's Informal Workers: Collective Agency, Alliances and Transnational Organizing in Urban Africa\textsuperscript{12}. This book aims to examine the role of collective agencies and organisation of informal workers in development of the informal economy.

I will also look at Africa’s information revolution: technical regimes and production networks in South Africa and Tanzania\textsuperscript{13}. This book studies the effect of ICT on economic growth in Africa. It is essential for this dissertation as it will provide insight into the role of ICT in a country’s productivity and growth.

1.7 Hypothesis/ Assumptions
This study shall be guided by the following hypotheses:

- That the working hypothesis is that there has been poor regulation and implementation of laws regulating the micro and small enterprises sector therefore making it challenging for the development of the informal sector;
- That the informal sector plays a huge role in the GDP of the Country and is important for the development of the country;
- That many traders in the informal sector are unaware of laws that could regulate the sector;
- That the implementation of the laws regulating micro and small enterprises in the informal sector has been poorly done.

1.8 Limitations
The main limitation is the reliance on secondary research which may be outdated and not tailored to this study.

1.9 Chapter Breakdown
This dissertation contains five chapters.


CHAPTER 1: INTRODUCTION

This is a background to the study stating the problem, the research question, and the objectives to the study, the theoretical framework, the literature review and the hypothesis.

CHAPTER 2: A BACKGROUND OF THE STUDY (A STUDY ON THE SECTOR)

This will be an in depth study of the micro and small enterprises sector, including its definition, its composition and the challenges that face this sector.

CHAPTER 3: LAW ON MSES AND THE INFORMAL SECTOR IN KENYA

This chapter will be a study on the regulatory framework of MSES in respect of the informal sector in Kenya.

CHAPTER 4: A COMPARATIVE STUDY WITH MALAYSIA

This chapter will aim to compare the micro and small enterprise sector in Kenya with Malaysia. This is to provide an insight as to how Malaysia have managed to have a flourishing Micro and small Enterprise sector, especially in respect of the informal sector.

CHAPTER 5: RECOMMENDATIONS

This last chapter will summarise the findings and form conclusions and recommendations.
CHAPTER 2
UNDERSTANDING THE MICRO AND SMALL ENTERPRISE SECTOR

2.1. Introduction
The previous chapter gave a general introduction to the paper. In the said chapter, the statement of the problem was given as the lack of proper laws and policies that regulate the micro and small enterprise sector in the informal sector in Kenya. The objectives of the study are to identify what the informal sector Kenya comprises of and what laws govern the MSE sector, the barriers to the development of the sector and to analyse whether the development and regulation of the MSE sector would improve the economic, legal and social situation in Kenya.

In this chapter, the author shall set out the background of the study by discussing the Micro and Small Enterprise Sector. This chapter will state the structure of MSEs in the informal sector and the challenges faced as a result. Recommendations drawn in the last chapter will be based on the challenges identified in this chapter. This chapter will first have a section conceptualizing the terms, it will then move into explaining the structure of MSEs and finally the challenges faced in MSEs in the informal sector.

2.2. Conceptualizing the Terms
2.2.1 Micro and Small Enterprises
The Micro and Small Enterprises Act was enacted in 2012 in a bid to regulate the MSE sector so as to lead to its development and growth. Section 2 of the Act defines MSEs as a firm, trade, service, industry or a business activity whose annual turnover does not exceed five hundred thousand shillings, which employs less than ten people, and where the assets in a manufacturing industry total to less than ten million or less than five million in the service industry.\(^\text{14}\) The law classifies MSEs based on the number of employees and the annual turnover.

MSEs may also be classified as enterprises which lack legal obligations concerning safety, taxes and labour laws. The MSEs in the informal sector lack the protection that employees in the formal sector enjoy including labour laws. I will address this in the next chapter as I am addressing regulation and institutional framework of MSEs. These enterprises are

\(^{14}\) Section 2, Micro and Small Enterprises Act (Act No 55 of 2012).
divided into four categories namely agriculture, trade, manufacturing and service provision.\textsuperscript{15}

There are 1.56 million licensed MSMEs and 5.85 million unlicensed businesses. These establishments were both in the formal and informal sectors. Most MSMEs are owned by individuals who run retail businesses of buying and selling goods. Wholesale and retail trade, repair of motor vehicles and motorcycles accounted for more than half of licensed (57.1\%) and unlicensed (62.9\%) businesses.\textsuperscript{16}

\textbf{2.2.2. The Informal Sector}

The informal sector is composed of activities generating income and profits, though on a small scale, uses simple skills, and is dynamic and not tied to regulation of the activities. There is no precise definition of the Informal sector. There are a number of attempts to define the informal sector which I will address. The International Labour Organisation describes the informal sector as a business which fulfils the following criteria.\textsuperscript{17} One is that it is an unincorporated enterprise meaning the business is not a separate legal entity from its owners. Two is that it’s a market enterprise meaning it is involved in the buying and selling of goods. Three is that it is an unregistered business and four is that the number of employees are below what is stipulated in a country’s law.

Kenya has two employment sectors. There is the formal sector and the informal sector. The formal sector is the regulated sector while the informal sector is the unregulated sector.\textsuperscript{18} The formal sector includes all jobs with normal hours and regular wages, and are recognized as income sources on which income taxes must be paid.\textsuperscript{19} The informal sector includes work that takes place in unincorporated enterprises that are unregistered or small.

\textsuperscript{15} Ong’olo D, Awino S, Small and medium enterprises and devolved government system: an assessment of the regulatory and institutional challenges affecting the SMEs development in Kenya, CUTS Centre for International Trade Economics and Environment, Nairobi Kenya.


\textsuperscript{17} Informal sector http://www.ilo.org/lostat-files/Documents/description_IFL_EN.pdf on 1 September 2017.


However, there are additional types of informal employment outside informal enterprises: for example, persons working in formal enterprises who are not covered by social protection through their work, as well as domestic workers, casual day labourers, and contributing family workers who are not covered by social protection through their work. This includes small farmers, street vendors, hawkers, small traders, micro-entrepreneurs, home-based workers, cobblers, rag-pickers, porters, labourers, artisans. In Kenya it is called the Jua Kali sector. The informal sector represents 82.7% of employment in the country. The focus of the paper will be the MSEs classified under the informal sector.

The Kenya National Bureau of statistics released an economic report in 2017. The report states that in 2016, the economy generated a total of 832,900 new jobs of which 85,600 were in the modern sector while 747,300 thousand were in the informal sector. Employment increased by 5.3 per cent to 16 million persons. Informal sector employment increased by 5.9 per cent to 13,300,000 persons. Employment in the modern sector grew by 3.3 per cent from 2,601,200 thousand persons in 2015 to 2,686,800 persons in 2016. This comprises of 2,554,300 wage employees and 132,500 self-employed and contributing family workers. According to the report, those Employed in the informal sector accounted for 13.3 million persons. The informal sector recorded an additional 747,300 jobs. This constituted 89.7 per cent of all new jobs in 2016. The report also states that Employment in the informal sector grew by 5.9 per cent from 12,562,500 persons in 2015 to 13,309,700 persons in 2016. The manufacturing industry had a share of 20.4 per cent in informal sector employment. From the statistics above, it is evident that MSEs in the informal sector employ quite a number and are a huge contributor to the economy of the country.

The World Bank also attempts to define the informal sector as follows. It starts by stating that the informal sector is viewed as the sector that has unprotected workers, lack of regulation, low productivity, unfair competition, evasion of the rule of law and underpayment or non-payment of taxes.

It continues on to give the criteria to be used to determine the informal sector. This includes labourers who have been locked out of the formal sector and those who have left the formal sector to be micro entrepreneurs, and firms and micro firms avoiding the regulation of the formal sector. Activities done in the informal sector include Selling fruits and vegetables, food operation, sale and processing, selling clothes and shoes, Kiosk selling various items, water kiosks, small retailers or hawkers who sell cereals, home suppliers, fuels and other goods, small manufacturing, production, construction and repair of goods. Most of these activities are done by Micro and Small Enterprises.

2.2.3. The Formal Sector
The formal sector comprises of people with recognized income sources, who work specific hours a week and earn regular wages. This sector has an organised system of employment with clear written rules of recruitment, agreement and job responsibilities. The relationship between the employer and the employee is maintained through a formal contract. The employee is expected to work for fixed hours and receives fixed salaries in addition to incentives and perks. Employees have an organised association or union where their grievances are addressed. Employees in this sector are covered under social protection benefits such as life insurance, health insurance, pension, and gratuity. The formal sector is regulated with rules governing the sector. This differs from the informal sector which lacks the governance and regulation provided in the formal sector.

2.3. Challenges faced by MSEs in the Informal sector
Several problems plague the MSEs in the informal sector as follows.

The job quality in MSEs is often very poor. It also stated that many MSEs are unstable or short-lived, and many operate in a state of semi formality. This has repercussions for job quality, and for broader economic development and growth.

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There is lack of access to financial institutions which are essential in capital generation. Many businesses therefore remain small and in many cases inefficient and unproductive. Many entrepreneurs in micro and small enterprises raise capital through family and friends. This means the amount will be limited and therefore limit the capital investment which hinders growth. Most businesses will therefore not be as productive and efficient as they could be if they could access finance.

Technological changes are a major drawback for MSEs. Due to the rapid changes in technology, small enterprises which cannot adopt to the changes due to lack of know-how and finance, will be left behind. This normally leads to their businesses either collapsing.

There is improper implementation of laws and policies. Although there are laws regulating the sector including the micro and small enterprises act, the microfinance act and the SACCOS societies Act, there is lack of coordination in which bodies govern this sector. There are various departments in different Ministries handling MSE’s Issues. The ministry of labour social security and services and Ministry of Industrialisation and enterprise development, each deal with MSEs. Other institutions which are directly involved in the MSEs include the Kenya Industrial Estates, Kenya Industrial Research and Development Institute (KIRDI); Kenya Bureau of Standards (KBS), and Kenya Industrial Property Institute (KIPI).

The registration process can be tedious. Section 5 and 6 of the micro and small enterprises act state the registration procedure. The process can take up to sixty days before an application is considered. This is a long time making room for people to operate illegally without a license due to the long waiting period.

There are lack of proper training programmes for entrepreneurs who wish to enter the sector. The courses offered are expensive, the procedures for applying for a start-up are costly and time consuming. This is a problem because it stops many from starting their businesses due to the various impediments. As many are unable to access training, many lack the skills to run MSEs. Many businesses therefore end up failing or not growing.

There are lack of proper institutions that protect employees in the informal sector. This comprises of institutions that govern employment contracts, wages, working time, benefits.

and occupational safety and health. It should be noted that there are laws governing contracts, i.e. the employment act and the Occupational Health and Safety Act which governs health and safety in the work place. There is however a lack of institutions and policies that govern these laws therefore making implementation of these laws difficult. Therefore, payment to social security schemes like National Social Security Fund and the National Hospital Insurance Fund are not adhered to by workers in the informal sector as there is nobody to follow up on them unlike in the formal sector where it would be a requirement for all employers to deduct their employees’ payment to the scheme before paying them. As it is not compulsorily being done by an employer, workers in this sector may avoid paying up and so lack any social protection. This makes them more vulnerable to risks where their businesses will suffer if there is a need for a visit to the hospital as the worker will simply use money for the business, something that could have been avoided if they had paid money to the fund.

These challenges pose a hindrance to the growth and development of MSEs. The aim of this paper is to be able to identify the challenges faced with implementation of laws governing MSEs so as to be able recommend solutions to these challenges. These solutions will ensure the growth of MSEs, which are a huge contributor to the economy and employment in Kenya.

2.4 Conclusion
It has been stated that the MSE sector is a huge contributor to employment in the country. There have been challenges identified which pose as a barrier to the flourishing of this sector.

Prior to the 2010 Constitution, and now the MSE Act, there was minimal regulation of MSEs. This had led to lack of registration of businesses, improper taxing, limited financial access and lack of policies guiding this sector.

It is therefore important to establish whether this sector has the protection the law gives to the formal sector and if there is inadequate implementation of such laws, what recommendations can be drawn to be able to ensure that there is development of this sector. MSEs, should be accorded with the protection of the law so as to give them an opportunity to grow into bigger and efficient businesses.
CHAPTER 3
THE REGULATION OF MSEs IN THE INFORMAL SECTOR

3.1. Introduction

Chapter 2 introduced the concepts of Micro and small enterprises and the informal sector. It also discussed the statistics of employment and the contribution of MSEs in the country before concluding with the challenges faced by MSEs in the informal sector. This includes lack of capital, lack of access to finance and lack of skills. These challenges posed are a threat to the growth of these enterprises.

The aim of this chapter is to identify the legal challenges that MSEs face. I will first identify the historical background of MSE regulation in Kenya and then look at the existing regulatory body of MSEs in the informal sector in Kenya. This is so as to be able to identify any gaps in regulations so as to be able to form proper regulations and policies that would enable the growth and success of this sector. It will then focus on an in depth analysis of the Micro and Small Enterprises Act.

3.2. History of Regulation of MSEs in Kenya

The first Government strategy on MSEs can be traced back to the ILO report of 1972 on Employment, income and equity in Kenya which recognised MSEs as an important sector for creating income and employment for the Kenyan population. Due to increasing unemployment the International Labour Organization (ILO) came to implement employment initiatives in Kenya in 1972, following a paper by Hart in 1973. The Kenya Employment Mission, through its fieldwork and in its official report, recognised that the traditional sector had not just persisted but expanded to include profitable and efficient enterprises as well as marginal activities. This traditional sector is known as the informal sector.

The problem of employment in developing countries is not one of unemployment but rather of employed workers who do not earn enough money to make a living. The people

who work in the informal sector are known as the ‘working poor’ as they are living below the poverty line.\textsuperscript{32} Earning money that cannot sustain their basic needs. This conceptual interpretation was based on the opposition to formality and their lack of access to the market and productive resources.\textsuperscript{33}

Sessional Paper No.1 of 1986, Economic Management for Renewed Growth (GOK, 1986),\textsuperscript{34} was also instrumental in the recognition of the importance of MSEs. It set out mechanisms for enhancing an enabling environment for MSEs. Another effort by the government was formulation of a policy framework on MSEs in Sessional Paper No.2 of 1992, on Small and Medium Enterprises and Jua kali Development in Kenya.\textsuperscript{35} The Sessional paper recommended that the legal and regulatory framework to support the creation of an enabling business environment for MSEs should be implemented. This included the need to look into the registration procedures of MSEs. The paper also advocated for the formation of an association to provide for easy access to information to various enterprises in the country.

The National Development Plan, 1989-1993 formulated a strategy for Enterprise Development in Kenya towards the Year 2000 and a National Action Programme for Small-Scale Enterprises and the Jua Kali Sector. This paper was a strategy by the Government proposed for accomplishing the national goals of renewing economic growth. This was to be through provision of jobs for the growing labour force, prosperity for the

\textsuperscript{32} M Chen, Progress of the World’s Women 2005: Women, Work, & Poverty, United Nations Development https://books.google.co.ke/books?id=X2WYApDG6YwC&pg=RA1-PA22&lpg=RA1-PA22&dq=The+people+who+work+in+the+informal+sector+are+known+as+the+%E2%80%98working+poor%E2%80%99+as+they+are+living+below+the+poverty+line&source=bl&ots=HScb2P6Uvn&sig=Oklw1T8CbtWFrWh8EUmFBzWYtg&hl=en&sa=X&ved=0ahUKEwjnysfe7qZAhU8RQKHc6IAWyYQ6AEIXgAv#v=onepage&q=The%20people%20who%20work%20in%20the%20informal%20sector%20are%20living%20below%20the%20poverty%20line&f=false on 10 September 2017.

\textsuperscript{33} Tokman V, Modernizing the informal sector, June 2007. - <https://pdfs.semanticscholar.org/8e08/beb5a26756845a55f0ee6f4817c731f5a8ce8.pdf> on 10 September 2017.


mass of people in the rural areas, and equitable sharing of benefits of growth and provision of basic needs for all.\textsuperscript{36}

The Small Enterprise Policy Implementation Programme Mission Report of 1994 also identified the failure to address some key issues such as legislative reform, land allocation and poor infrastructure as the main weakness inhibiting the development of the MSEs. Sessional paper No.2 on the development of SMEs for wealth and employment creation for poverty reduction was formulated and published in 2005. The Sessional paper spelt out some of the key measures to address business registration, business licensing and the tax regime.\textsuperscript{37}

3.3 Relevant Laws on MSEs in Kenya

3.3.1 Constitution of Kenya

The enactment of the Constitution of Kenya in 2010 was a major step towards improving the regulation of MSEs in Kenya, where devolution has been embedded as a key instrument in fostering LED initiatives. The enactment of the 2010 constitution incorporated devolution. One of the objectives of devolution is to encourage local economic development in counties. Article 174 of the constitution of Kenya states the objects of devolution, one of the objects being to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya.\textsuperscript{38} This includes creating institutions and legislation that enhance development in a country.

3.3.2 The Micro and Small Enterprises Act

The Micro and Small Enterprises Act was enacted in 2012. This act is meant to regulate micro and small enterprises. Micro and Small Enterprises are a subset of the informal sector which is not only the major source of jobs but whose growth rate is much higher than any other the wage sector. If this rate of growth is maintained through the provision of a better environment for MSEs, it is clear that their contribution to the Gross Domestic

\textsuperscript{36} Sessional paper no. 1 of 1986 on economic management for renewed growth in Kenya 1986

\textsuperscript{37} Ong’olo D, Awino S, Small and medium enterprises and devolved government system: an assessment of the regulatory and institutional challenges affecting the SMEs development in Kenya.

\textsuperscript{38} Article 174, Constitution of Kenya (2010).
product in Kenya will be higher. The purpose of this law is to provide for the promotion, development and regulation of Micro and Small Enterprises and to establish the Micro and Small Enterprises Authority which the body mandated to oversee the implementation of this act and the development of MSEs.

Section 3 elaborates on the objectives to include the provision of an enabling business environment, inspiring an entrepreneurial culture and facilitate formalization, promotion of representative organizations and upgrading of the informal Micro and Small Enterprises. It is evident that the government has taken steps towards regulating Micro and small enterprises and providing a conducive space for the flourishing of this sector.

The Micro and Small Enterprises Act was enacted on 31st December 2012 and commenced on the 4th of January 2013. The aim of this Act is to provide for the promotion, development, and regulation of micro and small enterprises and to provide for the establishment of the Micro and Small Enterprises Authority, which is an authority with the mandate of overseeing implementation of the Act.

Section 3 states the object and purpose of the Act which includes the provision of an enabling business environment, inspiring an entrepreneurial culture and facilitate formalization, promotion of representative organizations and upgrading of the informal MSEs. This act aims to improve MSEs in the informal sector.

Part 2 of the Act provides for regulation of MSEs. Section 4 sets up an office for the registrar and section 5 states the application for registration process. Section 21 states that every treasurer of a registered association shall render accounts. This will ensure that businesses are transparent. Section 22 also provides for the inspection of the accounts of the registered business. Section 24 states that annual returns shall be furnished to the registrar annually. This will ensure there is transparency and the registrar can be able to

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40 Section 3, Micro and Small Enterprises Act (Act No. 55 of 2012).
41 Section 3, Micro and Small Enterprises Act (Act No. 55 of 2012).
42 Section 4, Micro and Small Enterprises Act (Act No. 55 of 2012).
43 Section 5, Micro and Small Enterprises Act (Act No. 55 of 2012).
44 Section 21, Micro and Small Enterprises Act (Act No. 55 of 2012).
45 Section 22, Micro and Small Enterprises Act (Act No. 55 of 2012).
46 Section 24, Micro and Small Enterprises Act (Act No. 55 of 2012).
know when a business is liable to pay taxes. Many unregistered businesses in the informal sector don’t pay taxes as there is no mechanism to know whether they are to pay taxes and how much. This Act will solve that challenge.

3.4. Institutions Governing MSEs in Kenya

The Micro and Small Enterprises Act has provided for a number of mechanisms to ensure there is implementation of this Act

3.4.1 Micro and Small Enterprises Authority

This is established under section 29 of the MSE Act\[47\] and is currently under the Ministry of Industry, Trade and Co-operatives. Its mandate is to formulate and Coordinate policies that will facilitate the integration and harmonization of various public and private sector initiatives, for the promotion, development and regulation of the Micro and Small Enterprises to become key Industries of Tomorrow.\[48\]

The Micro and Small Enterprises Authority has sought to have offices in counties to ensure that its officers are accessible to individual organizations that represent collectives of Micro and Small enterprises throughout Kenya. There is however no policy available yet by the authority.

3.4.2 Micro and Small Enterprises Fund

Section 51 of the Micro and Small Enterprises Act requires the formation of a fund to be known as the Micro and Small Enterprises (MSE) Development Fund. The function of this fund is to finance the promotion and development of micro and small enterprises in accordance with this Act, provide affordable and accessible credit to micro and small enterprises, finance capacity building of micro and small enterprises and finance research, development, innovation and transfer of technology.\[49\]

One of the challenges stated in chapter 2 was the lack of access to finances. This fund therefore aims to solve this problem. Another challenge was the rapid technological changes where many cannot afford to keep up. Funding research and providing for innovation and transfer of technology would be of great assistance to many MSEs in the informal sector. According to the state of implementation of the MSE Act document, an

\[47\] Section 29, Micro and Small Enterprises Act (Act No. 55 of 2012).


\[49\] Section 51, Micro and Small Enterprises Act (Act No. 55 of 2012).
examination of the budget estimates for the financial year that commenced on July 1, 2015 confirms that for the third consecutive year, parliament has not allocated funding for the MSE development fund as required by law.\textsuperscript{50} This means that this fund only exists on paper and there have been no efforts to enforce availability of this fund as required by law.

3.5. \textbf{Legal challenges facing Micro and Small Enterprises}

As stated above, there is a legal framework regulating Micro and small enterprises. There are however issues facing the sector which I will address.

There is a lack of a legal structure for the enterprises. According to a survey by the Kenya National Bureau of Statistics, the total number of persons engaged in MSEs was approximately 14.9 million with the unlicensed enterprises contributing 57.8 per cent.\textsuperscript{51} These unlicensed businesses are not registered. This means they are operating illegally. It creates a problem as there is no way to collect taxes from an unregistered business. It is also difficult to establish where there is production or selling of prohibited goods and services. Lack of a legal structure is therefore an issue for the country. The Micro and Small Enterprises Act has tries to address this problem by providing for registration of businesses in the sector. It is however not established how well this provision has been implemented.

MSEs lack employee protection. There are various laws protecting employees including the Employment Act, the Labour Institutions Act, the labour relations Act, the Occupational Health and Safety Act, The Domestic Workers' Act and the National Social Security Fund Act. All these are established to protect the employee by giving him rights and protecting those rights. Employees in the informal sector however may not be aware of these laws and so employers will take advantage and not give the employee the rights they deserve. This includes provision of contracts and payment of retirement and health schemes. Employees in the sector therefore don't benefit from the laws put in place. Due to lack of registration of many of these business, it is hard to follow up on how some of these business treat their employees.


Enterprises in this sector are prone to tax avoidance. Many of those operating MSEs will avoid tax as they will not declare their profits and thus will not remit their taxes. As stated above, there is a lot of money exchange in this sector but a huge amount of that money will not be taxed as it is not declared. In as much as the sector is a huge contributor to employment, lack of payment of taxes is detrimental to the country. The country needs taxes to provide for public goods among others. The more money collected, the more development that can be done.

Entrepreneurs in this sector are unaware of Intellectual property rights. There is little to no protection of IP rights in MSEs. This leads to the small enterprises being exploited by other businesses who copy or enforce their ideas. This roots from the fact that these small enterprises have little capital. They therefore come up with ideas and will produce in small quantities. An entrepreneur with more capital will see the idea and produce in large scale. There is also little awareness on IP protection. Those in this sector need to be educated on the benefits of protecting their IP.

3.6. Conclusion
The enactment of the Micro and Small Enterprises Act has been a major step forward in the regulation of Micro and Small Enterprises, and especially those in the informal sector. Economic reports have shown that this sector is a huge contributor to employment in the country. It has also shown that this sector has been a major contributor in the production of goods and services in the country. Promoting this sector is therefore essential. There are legal issues that face MSEs which need to be addressed so as to improve the sector.
CHAPTER 4

A COMPARATIVE STUDY OF MICRO AND SMALL ENTERPRISES IN KENYA AND MALAYSIA

4.1 Introduction
The previous chapter discussed the regulation of MSEs. It stated the laws and policies that govern MSEs and the institutions mandated to govern MSEs. It also highlighted the legal challenges faced with the regulation of MSEs. This chapter aims to do a comparative study of MSEs in Malaysia and Kenya.

This chapter will discuss the regulation of MSEs in Malaysia as compared to Kenya. The purpose of comparing regulation of MSEs in the two countries is so as to identify policies that Kenya can implement. The findings will be used to formulate recommendations in the next chapter.

4.2 Malaysia as a Point of Comparison
Malaysia has a population of 31.7 million people. The Gross Domestic Product per capita 9,420 US Dollars and the Gross Domestic Product is 298 billion US Dollars. The Economic Growth is recorded at 4.2 %.52 The unemployment rate is at 3.5.53 According to the SME annual report, SMEs contribute to 36.6% of the country’s GDP.54

In May 1996, a specialized agency known as the Small and Medium Industries Development Corporation (SMIDEC) was established to increase the development of small and medium enterprises in Malaysia. SMIDEC is an agency under the Ministry of International Trade & Industry and was established with the aim of further promoting the development of small and medium industries in the manufacturing, manufacturing related services and services sector.55 SMIDEC provided assistance in building and strengthening capacity and capability of SMEs, through the provision of development programmes

including financial assistance, advisory services, infrastructure facilities, market access and other support programs.\textsuperscript{56}

The National SME Development Council (NSDC) is the highest policy-making body for the development of SMEs in Malaysia.\textsuperscript{57} It was established in 2004, with the aim of ensuring the comprehensive and coordinated development of SMEs. The Council members comprises of 13 Ministers as well as the Chief Secretary to the Government, the Director-General of Economic Planning Unit and the Governor of Bank Negara Malaysia.\textsuperscript{58} The functions of the council are to formulate policies and strategies to facilitate development of SMEs, to review the roles and responsibilities of those with SME development, to enhance cooperation and coordination of programmes to ensure effective implementation of SME development policies and action plans and to encourage and strengthen the role of the private sector in supporting the development of SMEs.\textsuperscript{59}

The reason for choosing Malaysia as a comparison study to Kenya is attributed to the contribution of SMEs in the economic growth of Malaysia. Ninety-seven percent of business establishments in Malaysia are SMEs. These businesses contribute to 36\% of the country’s GDP, 65\% of the country’s employment, and nearly 18\% of Malaysia’s exports.\textsuperscript{60} SMEs in Malaysia have been instrumental to the economic growth of the country. Malaysia is therefore a good example for a country that has been able to have an effective regime for MSEs.

4.3 Comparing the MSE Sector, Law And Policy Of Malaysia And Kenya

I will compare regulation of SMEs in Kenya and Malaysia. The comparison will be based on legislation and policies that have been implemented, agencies building MSEs, the registration process of MSEs and various programmes that have been implemented.


4.3.1 Definition of MSEs in the law

In Kenya, MSEs are described in section 2 of the Micro and Small Enterprises Act as a firm, trade, service, industry or a business activity whose annual turnover does not exceed five hundred thousand shillings, which employs less than ten people, and where the assets in a manufacturing industry total to less than ten million or less than five million in the service industry.\(^6\)

The definition of an MSE in Malaysia is measured using sales turnover or number of employees. The criteria is different for businesses in the manufacturing industry and the service industry. In the Manufacturing industry, a small business is one whose Sales turnover is between RM 300,000 (kshs 7,838,746.89) and RM15 million (kshs 391,937,344.50) or, full-time employees are between 5 and 75. A medium business is one whose Sales turnover is between RM15 million (kshs 391,937,344.50) and RM50 million (kshs 1,306,457,815) or, full-time employees are between 75 and 200. In the service industry and other sectors, a small business is one whose Sales turnover is between RM 300,000 (kshs 7,838,746.89) and RM3 million (kshs 78,387,468.90) or, full-time employees are between 5 and 30. A medium business in the service sector is one whose Sales turnover is between RM3 million (kshs 78,387,468.90) and RM20 million (kshs 522,583,126) or, full-time employees are between 30 and 75.

Micro enterprises are defined as those whose Sales turnover is less than RM 300,000 (kshs 7,838,746.89) or, enterprises who have less than 5 full-time employees.\(^6\) A business will need to meet either of the requirements based on which requirement is lower to qualify as a micro, small or medium enterprise. The SME guideline states that there are 653,000 SMEs which make up 98.5% of total businesses.\(^6\) In Malaysia, MSEs are part of SMEs. They do not have a separate definition from SMEs. Regulation and policies are therefore made for SMEs unlike in Kenya where MSEs have a separate definition and different regulation.

The threshold for MSEs in Kenya and Malaysia are different with Malaysia having a higher cap for what constitutes a medium and small enterprise. A small enterprise in

\(^6\) Section 2, Micro and Small Enterprises Act (Act No. 55 of 2012).


Malaysia is one that makes an annual return of kshs 7 million while in Kenya a small enterprise is one that makes an annual return of kshs 500,000 to kshs 5 million. This could be attributed to the economic status of both countries. Malaysia is more developed and so will have a higher cap than Kenya which is less developed. The Gross Domestic Product (GDP) in Malaysia was worth 296.54 billion US dollars in 2016 while The Gross Domestic Product (GDP) in Kenya was worth 70.53 billion US dollars in 2016. Businesses in Malaysia will therefore have higher sales turnovers that those in Kenya.

4.3.2 Policies for MSEs in Kenya and Malaysia

The main policy maker of MSEs in Malaysia is the National SME Development Council. It is chaired by YAB Prime Minister. It was established in 2004 with the main goal of ensuring the development of SMEs across all sectors. The Council members comprise 13 Ministers as well as the Chief Secretary to the Government, the Director-General of Economic Planning Unit (EPU) and the Governor of Bank Negara Malaysia (BNM). The functions of the council include: formulating policies and strategies to facilitate the overall development of SMEs, enhancing cooperation and coordination of programmes to ensure effective implementation of SME development policies and action plans and encouraging and strengthening the role of the private sector in supporting the overall development of SMEs.

This policy making agency is run by the SME Corporation Malaysia which is under the Ministry of International Trade and Industry Malaysia that formulates overall policies and strategies for Small and Medium Enterprises and coordinates the implementation of SME development programmes across all related Ministries and Agencies.

Policies adopted in respect of MSEs include laws and any measures taken by the government and its agencies towards developing SMEs. One, The Companies Act of 2016, simplified the application procedures. The application process has been made easier. A

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template has been introduced to allow individuals to complete the incorporation process without requiring a company secretary to do so.68

4.3.3 Institutions Regulating MSEs
In Kenya, the organisation with the mandate of managing the development of MSEs is the MSE Authority. This is established under section 29 of the MSE Act69 and is currently under the Ministry of Industry, Trade and Co-operatives. The authority comprises of a non-executive chairperson appointed by the President, five principal secretaries in charge of development, finance, trade and industrialisation, and twelve nominated members each with a function.70

The purpose of the MSEA is to formulate and review policies and programs for MSEs, to monitor and evaluate the implementation of existing policies and programs related to or affecting micro and small enterprises, and advise the government on what policies to formulate, to raise resources for the development of MSE activities and to promote innovation and development of products by MSEs.71 There has not been any policy from the authority as yet. There is a strategic plan for 2013 to 201772 which is a document by the authority identifying the progress made and the various challenges faced.

Section 73 of the Act requires the authority to publish an annual report to the cabinet secretary providing information regarding the activities and plans of the Authority during the year to which it relates sufficient to impart an accurate understanding of the nature and scope of its activities and its plans and priorities.73 The Cabinet Secretary shall, within three months after receiving the annual report, transmit it to the Clerk of the National Assembly for tabling before the National Assembly. There has been no report that has been published to date.

Section 51 establishes an MSE Development Fund. The purpose of the fund is to finance the promotion and development of micro and small enterprises, to provide affordable and accessible credit to micro and small enterprises, to finance capacity building of micro and

small enterprises and to finance research, development, innovation and transfer of technology.\textsuperscript{74}

According to the state of implementation of the MSE Act document however, it is stated that parliament is yet to allocate funding for the MSE development fund as required by law.\textsuperscript{75} There has therefore been no implementation of the fund. Part VI of the MSE Act provides for settlement of disputes. A tribunal is set up under section 54 to settle disputes arising in Micro and Small Enterprises.\textsuperscript{76}

In Malaysia, there are various institutions involved in the regulation of MSEs. The ministries involved are the Ministry of Entrepreneur and Co-operative Development and the Ministry of Science, Technology and Innovation (MOSTI)\textsuperscript{77} who have both taken initiative in developing SMEs through initiation of various projects.

One of the steps that has been taken towards providing information about SMEs is the launch of the SME Information Portal.\textsuperscript{78} This is a platform that acts as an online information resource centre for SMEs. Information includes tips on managing your business, financing schemes and funds, business support & advisory services.\textsuperscript{79} The advisory services include providing access to SME business advisers and experts in various fields.

Another step that has been instrumental in the development of SMEs is the Launch of SME Bank. This is a bank with an aim to provide financial and business support services to SMEs.\textsuperscript{80} The bank has provided many programmes and financing options for SMEs. This makes it easier for these businesses to access capital. Other banks also have financing

\textsuperscript{74} Section 51, Micro and Small Enterprises Act (Act No. 55 of 2012).
\textsuperscript{76} Section 54, Micro and Small Enterprises Act (Act No. 55 of 2012).
\textsuperscript{78} <www.smeinfo.com.my on 16 December 2017.
options tailored for SMEs. CIMB has the option of an overdraft, credit and business friendly interest rates.\textsuperscript{81}

The Market Development Grant is another initiative by the government for SMEs. It is a financial support facility in the form of a reimbursable grant to assist Malaysian SMEs, Professional Service Providers, Trade & Industry Associations, Chambers of Commerce and Professional Bodies to assist them with export promotional activities. Its aim is to help SMEs penetrate overseas markets.\textsuperscript{82}

The SME Corporation has a number of Programmes geared towards skill development for SMEs. This includes programmes that improve the competitiveness of existing automotive workshops across the country, innovation and investment in training and education programmes and assisting youth entrepreneurs to promote and market products with their own brand name.\textsuperscript{83}

There is also an SME Experts Advisory Panel whose aim is to provide SMEs with necessary technical and advisory services in order to promote efficiency and productivity. It is known as SEAP and it comprises of retired experts from industries and Government agencies.\textsuperscript{84}

Another initiative by the Malaysia Government is the Enterprise 50 Award Program. This is an annual award programme organised by the SME Corporation Malaysia and Deloitte Malaysia, to celebrate and highlight the achievements of enterprising SMEs. This award programme started in 1996. Each year, 50 winners are selected from amongst the nominations received. Winners receive media coverage from Business Times, Media Prima, Malaysia SME and other printed media and an endorsement and mark of recognition and excellence.\textsuperscript{85} Kenya has a similar award program where KPMG and Nation


\textsuperscript{82} \texttt{<http://www.matrade.gov.my/en/malaysian-exporters/services-for-exporters/exporters-development/market-development-grant-mdg> on 20 December 2017.}


\textsuperscript{84} \texttt{<http://www.smecorp.gov.my/index.php/en/programmes/2015-12-21-09-53-14/sme-expert-advisory-panel-seap-programme> on 20 December 2017.}

\textsuperscript{85} \texttt{<https://www.e50.com.my/node/3> on 20 December 2017.}
Media Group recognise Kenya’s top a hundred mid-sized companies. These awards encourage business owners to work harder so as to get the recognition of excellence.

The Franchise Development Assistance Scheme is a fund by the government given to individual entrepreneurs keen on making a franchise out of their products or services as well as entering foreign markets.

All these initiatives taken by the Malaysian government have been instrumental in providing a conducive environment for SMEs to flourish. The various programmes have provided business individuals with an opportunity to develop themselves and their company. This has led to efficiency in the sector.

Both Kenya and Malaysia have similar structures where the authority and the council are run by government officials. The functions of both bodies are similar. It is however evident that Malaysia has been more successful in implementing the functions through the implementation of various programmes and policies.

4.3.4. Legislation

In Kenya there are various laws that govern MSEs. The first is the Constitution of Kenya. Article 174 of the constitution of Kenya states that there should be promotion of social and economic development and the provision of proximate, easily accessible services throughout Kenya. This includes creating institutions and legislation that enhance development in a country. The main law governing Micro and Small enterprises is the Micro and Small Enterprises Act. It sets out the meaning of an MSE, the registration process of MSEs, creates provision for an authority and a fund.

In Malaysia, the Companies Act provides for the registration of all companies including MSEs. The Main policy maker is the National SME Development Council. The council is in charge of making policies that are geared towards the development of MSEs through various programmes run by agencies.

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86 <https://eastafricatop100.com/> on 20 December 2017.
Kenya has a special Act for MSEs while Malaysia does not have a special Act for MSEs. Businesses in Malaysia are regulated by the companies act. Malaysia has the SME development council whose mandate is to formulate policies for MSEs. The implementation of policies has been more effective in Malaysia even if there is no specific legislation for MSEs. Although Kenya has a specific Act for MSEs, implementation of the Act has been ineffective.

According to the state of implantation of the MSE Act, the MSE fund and tribunal are yet to be implemented.\(^\text{90}\) Malaysia is therefore doing better than Kenya in terms of implementation of legislation and policies.

### 4.3.5. Registration of MSEs

Part 2 of the MSE Act provides for the registration process. Section 5 states that within 28 days of forming an organisation, an application must be made to the registrar containing the copy of the constitution of the organisation, the names of the founders and the place of doing business.\(^\text{91}\) Registering for a business name requires application and payment for a name search on the online portal and then obtaining a business name reservation, paying for the registration of that name then obtaining a certificate of registration. This process costs Kshs 1000 and could take up to 13 days.\(^\text{92}\)

According to the business registration portal online, firms must obtain registration with National Social Security Fund (NSSF), National Hospital Insurance Fund (NHIF) and the Kenya Revenue Authority (KRA). A business permit should also be obtained from the County Government depending on the business type.\(^\text{93}\) A business permit costs ksh 23,900 according to the portal.\(^\text{94}\) To apply for the permit you are required to go to city hall with the following documents: an application form, identity card and a company pin certificate. The estimated time that this process could take is a day. It is also stated that all company and business registrations for sole proprietorships and partnerships are being done through the

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\(^{91}\) Section 5, Micro and Small Enterprises Act (Act No. 55 of 2012).


e-citizen online platform but limited liability partnerships (LLPs) registrations are being manually at the company registry.\textsuperscript{95}

In Malaysia, the Companies Act states the requirements for registration which include the name of the company, nature of the company, address of the proposed office and the name and address of each member of the company.\textsuperscript{96} The Companies Commission of Malaysia (SSM) established on 16 April 2002, serves as an agency to incorporate companies and register businesses in Malaysia.\textsuperscript{97} The portal provides for Guidelines for registration of businesses.\textsuperscript{98} Registration and renewal of a business name costs RM60 (kshs 1585.04) per year.\textsuperscript{99} The portal provides for an application form to be downloaded and filled in.\textsuperscript{100}

Both countries have registration mechanisms for MSEs that have been put in place. The registration procedures are similar with the aim of making the registration process faster and cheaper. Applications in of a business name in Kenya and Malaysia are affordable. Malaysia does not have a requirement for a permit like Kenya which is an expensive cost to be paying annually. The registration procedure in Kenya is an easy procedure though they need to consider doing away with the visit to city hall and make all processes available online to make the process efficient.

\textbf{4.4 Conclusion}

Malaysia has managed to implement policies geared towards the development of MSEs through implementation of various programmes including the SME information Portal\textsuperscript{101}, Grants like the market development Grant\textsuperscript{102}, the SME Bank\textsuperscript{103}, the SME Experts advisory panel\textsuperscript{104} and the enterprise 50 award\textsuperscript{105}. All these are geared towards the growth of the

\textsuperscript{95} \texttt{http://kenya.eregulations.org/menu/1?l=en} on 16 December 2017.
\textsuperscript{96} Section 14, Companies Act (Act 777 2016 Laws of Malaysia).
\textsuperscript{101} \texttt{www.smeinfo.com.my} on 10 January 2018.
\textsuperscript{105} \texttt{https://www.e50.com.my/node/3} on 10 January 2018.
sector through making information available, providing training that will improve skills and easing access to capital.

Kenya could borrow a leaf from the way Malaysia has initiated programmes for SME. This will solve many of the challenges that Kenya is currently facing. All the commendable steps that Malaysia has taken in developing the regulation of MSEs will form recommendations in the next chapter. I will also formulate recommendations for the challenges that the Authority has identified.
CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion
The general conclusion is that there are laws that regulate MSEs that exist but they are poorly implemented. There is also a lack of policy formulation by the MSE Authority. This has led to the inefficiency of the existing legislation.

Chapter 1 introduced the dissertation by stating the problem, the research questions and the objectives of the study. The research questions in chapter 1 were what the informal sector in Kenya comprises of and whether there are any laws governing the MSE sector, whether there are barriers to development of this sector and if so, what are the barriers, whether there have been any attempts by the government to enhance the development of the MSE sector in Kenya and whether the development and regulation of the MSE sector would improve the economic, legal and social situation in Kenya.

My working hypothesis for this paper was ‘there has been poor regulation and implementation of laws regulating the micro and small enterprises sector therefore making it challenging for the development of the informal sector’.

Chapter 2 established that MSEs contribute to the economic growth of the country. It also identified challenges faced in the sector which included improper registration procedures, improper taxing, limited financial access and a lack of policies guiding MSEs.

Chapter 3 discussed the regulatory framework of MSEs. This includes the MSE Act and the institutions that were to be established. That is the MSE Authority and the MSE Act. It then stated the legal issues facing MSEs.

Chapter 4 was a comparison study of MSEs in Kenya and Malaysia. Malaysia has an effective regulatory framework for MSEs.

The findings from chapter 4 will be used for the recommendations in this chapter.

5.2 Recommendations
This chapter aims to formulate recommendations for the regulation of MSEs based on the research carried out in the previous chapters. The recommendations will be based on legislation, the need for creation of decentralised public support institutions and business development services, the need for a tax regime for MSEs, employee protection and IP
protection. The Recommendations will be based on findings of the previous chapters and practices by Malaysia as discussed in the previous chapter.

5.2.1 Legislation

Recommendations on legislation will include improvement on Registration procedures, improvement on the access to information and improvement on access to finance.

5.2.1.1. Registration

The current legal structure providing for registration of micro and small enterprises is the Micro and Small Enterprises Act. The Micro and Small Enterprises Act was enacted in 2012 to regulate Micro and small enterprises. The Act provides for registration procedures of MSEs.\(^{106}\) It also establishes the MSE authority\(^ {107}\) and the MSE fund.\(^ {108}\)

Application for registration includes making an application to the registrar within 28 days of formation of the business with a document containing the company's constitution, names of the founders, physical address of the business and the prescribed fee. All businesses then require a license so as to operate.

Licensing in Kenya is established at the county level and national level. The Trade Licensing Act read together with the licensing laws (repeal and amendment) act regulates the issuing of trade licenses. All persons conducting businesses shall make application in the forms prescribed in the Schedule for a licence.\(^ {109}\) No person shall conduct business unless he is in the possession of a valid licence granted in the appropriate form in the Schedule. The procedure for acquiring a license can be found on online portals.\(^ {110} \)\(^ {111} \)

Registering for a business name requires application and payment for a name search on the online portal and then obtaining a business name reservation, paying for the registration of that name then obtaining a certificate of registration. This process costs KES1000 and could take up to 13 days.\(^ {112} \) 13 days is a long time for registration of a name. The law

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\(^{106}\) Section 5, Micro and Small Enterprises Act (Act No. 55 of 2012).

\(^{107}\) Section 29, Micro and Small Enterprises Act (Act No. 55 of 2012).

\(^{108}\) Section 51, Micro and Small Enterprises Act (Act No. 55 of 2012).

\(^{109}\) Section 28, Trade Licensing Act.


should strive for efficiency and therefore should look into cutting down the time it takes to register a business name.

A business permit costs KES 23,900 according to the portal. This figure is high considering these businesses are only making KES 500,000. This high figure may be the reason many businesses do not acquire business licences and are constantly trying to run away from the county council. It then opens up business for corrupt county officials who collect small fees from these businesses every day. The law should look into subsidising this figure as it may be too high for business owners.

It was identified in the previous chapter that not all companies can be registered on the online portal. Sole proprietorships and partnerships can be done on the e-citizen online platform but LLPs registrations are being manually at the company registry. The law should make it possible for all businesses to be able to register for their businesses online.

Applying for a permit also requires a visit to city hall. This portal should make it possible for all documents to be acquired online to avoid the inconvenience of going to city hall. The portal is an efficient way of registering business. It eliminates the bureaucracies that come with visiting a government organisation. The existence of the online portals in an excellent way to make registration fast and easy. There should be awareness campaigns on Registration procedures so that the public is aware of the various processes.

5.2.1.2 Access to Finance

It is important for MSEs to have access to finance so as to enable them to survive, expand and succeed. Types of financing include overdrafts, retained earnings, factoring, leasing, equity and bank loans. Kenya should ensure there is adequate regulation on micro finance institutions. The Micro-Finance Act was established to regulate and licence microfinance institutions. An application to carry out business as a micro finance institution must be made to Central bank who will issue the Institution with a license. The Central Bank has a directory stating the 13 licensed Micro Finance Banks. This list should be on an information resource portal for SMEs like the Micro Enterprises Support Programme Trust

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115 Section 5, Micro Finance Act (Act No 19 of 2006).

website. This will make it easier for MSE entrepreneurs to access information on which micro finance banks exist.

The SACCO Societies Act was established to regulate, licence and supervision of SACCOs.\textsuperscript{117} Section 33 states that any member who wishes to get credit facilities must apply to the SACCO.\textsuperscript{118} Micro finance institutions and SACCOS are important players in the financial sector that offer financial services to players in the sector. The two Acts were introduced to offer effective regulatory framework to both institutions hence enhancing governance for accessing finance for MSEs.

Banks in Kenya provide credit options but may not be favourable to small enterprises who may not be able to fulfill the requirements a bank needs like accounts that the business may not have. SACCOs are the easiest way to acquire money because they don’t have strict requirements but the money you can borrow from a SACCO may be limited and not adequate to finance the business. Malaysia has an SME bank which is tailored to finance Micro and small enterprises.\textsuperscript{119} Such an establishment would be beneficial to MSEs in Kenya as it will improve access to finance.

5.2.1.3 Access to Information

It is important for business owners to be able to access information on their enterprises sector easily. This includes information on registration procedures, ways to access finance and information on development and training programmes. The existence of online portals for registration is commendable. The government should look into creating an information resource centre portal for SMEs. The Micro Enterprises Support Programme Trust is an information portal however the site lacks adequate information.\textsuperscript{120} There is a resource centre for SMEs\textsuperscript{121} in Kenya however, it also has inadequate information.\textsuperscript{122} Kenya could implement an information resource centre portal like Malaysia’s.\textsuperscript{123} An information resource centre for MSEs should include Information on tips on managing your business, financing schemes and funds, business support & advisory services. This information

\textsuperscript{117} Sacco Societies Act (Act No. 14 of 2008).
\textsuperscript{118} Section 33 Sacco Societies Act (Act No. 14 of 2008).
\textsuperscript{120} - <https://www.mespt.org/# on 24 January 2018.
\textsuperscript{121} - <http://smeafrica.net/about-us/ on January 24 2018.
\textsuperscript{123} - <www.smeinfo.com.my on 24 January 2018.
centre will help businesses become efficient as they can now easily access information on how to improve their businesses.

5.2.2 Increase the Number of MSE Supporting Organisations
There are MSE supporting organisations that exist. However, they are few.

There are various existing support organisations. The Micro Enterprises Support Programme Trust was established in 2002 with the aim of supporting the growth of micro, small and medium enterprises by providing integrated business solutions for sustainable development. The government should look into creating MSE supporting organisations. This will help will policy making for MSEs.

The Assistance to Micro and Small Enterprises Programme (ASMEP) is an initiative under the Ministry of Industry, Trade and Cooperatives which is in support of MSEs in Kenya. The programme is funded by the European Commission. The Programme aims to improve the skills of Trade Development Officers on Business Development Services and Information and Communications Technology, so as to enable them to efficiently offer Business Development Services and manage Business Information Centres at the District Trade Offices. A workshop was also held in February 2012 for women entrepreneurs to improve their access to new markets and business development opportunities. Another support project that has been implemented is the Micro Small and Medium Enterprise Competitiveness Project which is a project that was initiated in 2011 through the Ministry of Trade and Industry, with the assistance of the World Bank, to support the development of the private sector, generate wealth and alleviate poverty in Kenya through public and private sector partnerships.

The existing supporting organisations are few. The law ought to look into increasing supporting organisations who will increase business development services, increase funds for MSEs and improve access to markets for MSEs.

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Malaysia has managed to implement MSE support organisations. These include the Market Development Grant which is an initiative by the government for SMEs. It is a financial support facility in the form of a reimbursable grant to assist Malaysian SMEs. Its aim is to help SMEs penetrate overseas markets.\(^{129}\)

Another initiative is programmes by the SME Corporation geared towards skill development for SMEs. This includes programmes that improve the competitiveness of existing automotive workshops across the country, innovation and investment in training and education programmes and assisting youth entrepreneurs to promote and market products with their own brand name.\(^ {130}\)

There is also an SME Experts Advisory Panel whose aim is to provide SMEs with necessary technical and advisory services in order to promote efficiency and productivity. It is known as SEAP and it comprises of retired experts from industries and Government agencies.\(^ {131}\) All these initiatives have been a step towards improving the environment for MSEs. Kenya should consider implementing programmes like this which will enhance the environment for MSEs in Kenya.

### 5.2.3 Improvement of SME Infrastructure

MSEs have limited resources. Costs for research and development and technology development are costly for small enterprises. The government should ensure that there are incubation hubs for micro and small enterprises. There are a number of incubation centres in Kenya.\(^ {132}\)

These centres should be advertised on MSE information portals so that MSE entrepreneurs can access information on the centres. This includes making entrepreneurs aware of IP rights protection so that there is no exploitation of these entrepreneurs. The Franchise Development Assistance Scheme is a fund by the government given to individual entrepreneurs keen on making a franchise out of their products or services as well as


entering foreign markets. Such a program would be beneficial to entrepreneurs in Kenya.

5.2.4 Employee Protection
All employers should ensure that they adhere to the requirements of the Employment Act, the Labour Institutions Act, the labour relations Act, the Occupational Health and Safety Act, The Domestic Workers' Act and the National Social Security Fund Act. All these are established to protect the employee by giving him rights and protecting those rights. This includes provision of contracts and payment of retirement and health schemes. Registration of the businesses can help ensure that businesses are held accountable.

5.2.5 Regulation and Collection of Taxes
According to the KNBS report, unlicensed businesses do not keep records. This makes it difficult to tax them. Section 20 of the MSE Act states that every enterprise should keep an account of it books. Section 21 states that every enterprise should render its accounts to its members. Section 22 also provides for inspection of accounts where a member or the registrar can inspect books.

Recording accounts will ensure that a business is held accountable and a tax collector can ensure that the expected tax is paid. The government will have to ensure that all businesses are registered so that it is easier to locate businesses when collecting taxes.

5.2.6 Affirmative Action Programmes to Reduce Gender Inequality in the Sector
Gender inequality in the MSE sector could be solved by supporting women entrepreneurs with business development services like training, business advisory and marketing services and opening various channels of accessing funds with low interest rates. This will give women the opportunity to start businesses and develop the essential skills that are required in running a business. A workshop was held in February 2012 for women entrepreneurs to improve their access to new markets and business development opportunities. There is a need for more of these programmes for women.

5.3 Conclusion

The implementation of these recommendations will result in growth of the economy as it will ensure that those involves in the sector have the opportunity to develop their ideas and businesses into productive enterprises. Implementation of the MSE fund will ensure entrepreneurs have access to capital which will be beneficial to entrepreneurs who will be able to start businesses. The MSE authority should formulate policies. This will be a step forward in ensuring that there is a regulatory body overseeing this sector. It is also important that information is made available to those in the sector. Many businesses fail due to lack of skills and therefore information centres and training workshops will be essential for the growth of this sector. Registration procedures should be fast, easy and reliable. The government should look into subsidizing the amount needed to register a business and acquire a license, so as to encourage more business owners to register their business. This will go a long way in ensuring that all businesses are registered. The government should also make the registration process efficient by ensuring that all processes can be done online.

Implementing these recommendations will ensure that MSEs have the opportunity to develop and continue contributing to the growth in the country.
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