



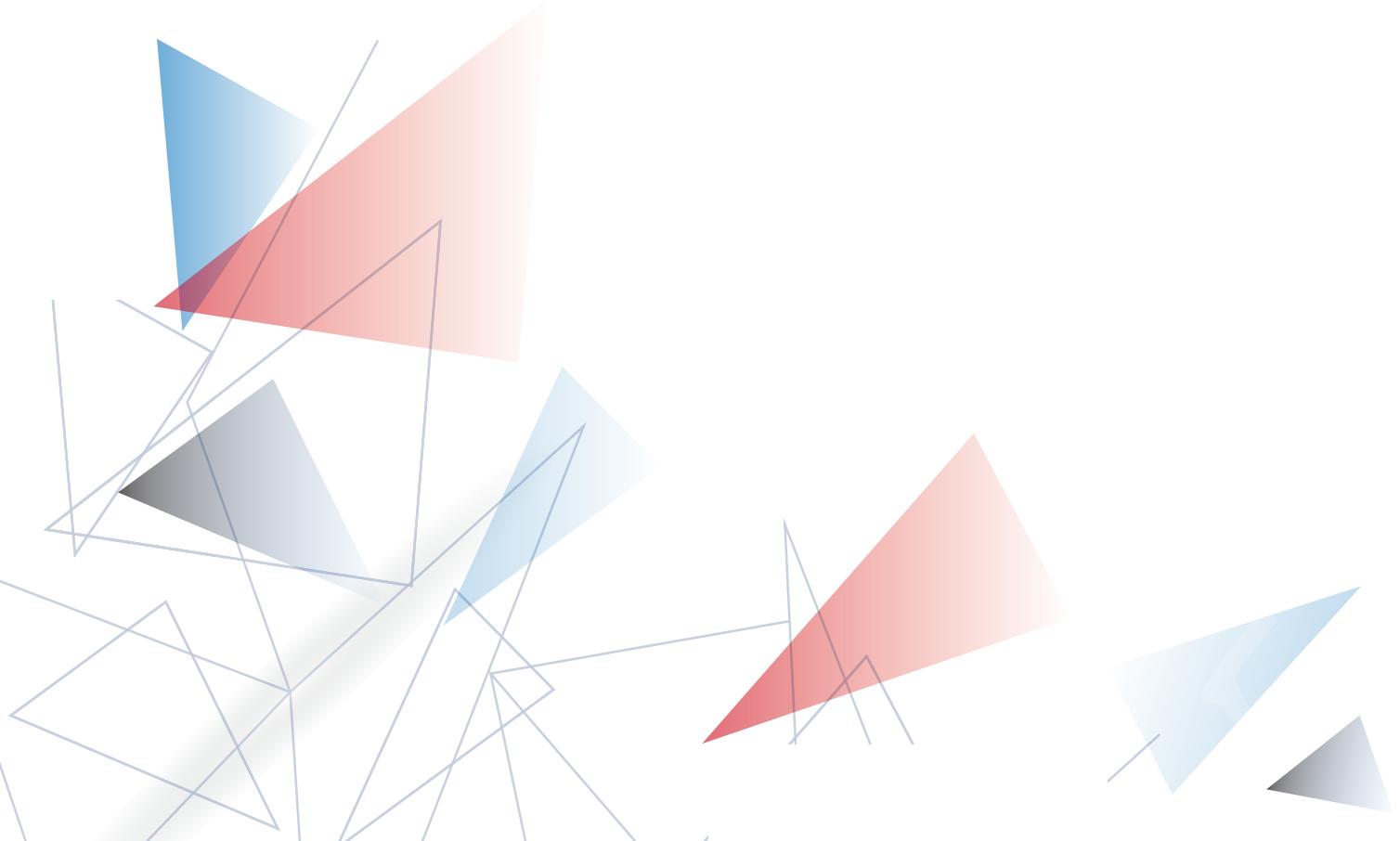
> The Informal Economy in Kenya



March 2021



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Preface

The Federation of Kenyan Employers (FKE) with its partners the International Labour Organization (ILO) has commissioned this assessment of the informal economy in Kenya to better understand its characteristics and to provide a clear policy pathway.

Currently, there are limited specific policy interventions targeting the informal economy. Policies in place do not provide for an effective development framework for informal sector businesses, thus leaving loopholes in the informal sector development agenda.

This Report was the result of multiple surveys, working group assessments and interviews that were conducted over the last 18 months. FKE feels that this report offers clear guidance on how we can move forward progressively in terms of the policy and enabling environment for the informal economy.

Arising from the findings it is clear that the complexity of the issue is wide-ranging. It will take a concerted effort by multiple actors to help lead informal economy enterprises onto a pathway to formality. Specifically FKE will look to partner with informal economy operators to advocate and lobby for improved formalization procedures at national and county levels. FKE will seek to strengthen vertical linkages between formal and informal enterprises and improve access to finance, skills and technology.

FKE is committed to working with our government partners and other stakeholders to drive solutions to the issue of informality in our country.

We feel this report provides an excellent basis to move that agenda constructively forward.

Jacqueline Mugo

Executive Director



Federation of Kenyan Employers



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► Abbreviations and Acronyms

AGPO	Access to Government Procurement Opportunities
APF	Advancement Possible Finance
BDS	Business Development Services
CBK	Central Bank of Kenya
CBR	Commercial Bank Rate
COTU-K	Central Organization of Trade Unions (Kenya)
COVID-19	Coronavirus Diseases 2019
CRB	Credit Reference Bureau
CRR	Cash Reserve Ratio
EAC	East African Community
EBMOs	Employer and Business Membership Organizations
ELRC	Employment and Labour Relations Court
EOs	Employer Organizations
ERS	Economic Recovery Strategy
FGD	Focus Group Discussion
FKE	Federation of Kenya Employers
FSD Kenya	Financial Sector Deepening Kenya
GDP	Gross Domestic Product
ICT	Information and Communications Technology
ILO	International Labour Organization
KEBS	Kenya Bureau of Standards
KIHBs	Kenya Integrated Household Budget Survey
KII	Key Informant Interview
KIRDI	Kenya Industrial Research Development Institute

KNBS	Kenya National Bureau of Statistics
KNCCI	Kenya National Chamber of Commerce and Industry
KNFJKA	Kenya National Federation of Jua Kali Association
KRA	Kenya Revenue Authority
KSh.	Kenya Shillings
KUCFAW	Kenya Union of Commercial Food and Allied Workers
MDAs	Ministries, Departments and Agencies
MFIs	Micro Finance Institutions
MSEA	Micro and Small Enterprises Authority
MSEs	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
MTPs	Medium Term Plans
NASSEP	National Sample Survey and Evaluation Programme
NHIF	National Hospital Insurance Fund
NISCOF	Nairobi Informal Sector Confederation
NITA	National Industrial Training Authority
NLB	National Labour Board
NSE	Non Standard Employment
NSSF	National Social Security Fund
OSH	Occupational Safety and Health
PAYE	Pay As You Earn
PIN	Personal Identification Number
PPE	Personal Protective Equipment
REF	Rural Enterprise Fund
ROSCAs	Rotating Savings and Credit Associations
SACCOS	Savings and Credit Co-operative Societies
SME	Small and Medium Enterprises
SPF	Social Protection Fund
TIFA	Trends and Insights for Africa

► Executive Summary

Kenya has a large informal economy that makes significant contribution to employment creation, income generation, poverty reduction and economic growth. The Federation of Kenya Employers with the support of the International Labour Organisation implemented a project aimed at increasing the knowledge base and understanding of informal enterprises from perspectives of policy and membership development services. It commissioned an assessment of the informal economy in Kenya to better understand the characteristics of the informal economy, employment and remuneration of workers in the informal economy, market conduct of informal enterprises, the potential for formalization among informal enterprises, employer organizations and informality, constraints experienced by informal enterprises and their perceived solutions, and the effects of COVID-19 on the informal economy. The key findings of the assessment are as follows:

Characteristics of informal enterprises:

- 1.** There were 6,987,090 informal enterprises in 2016, majority (99.4%) of whom were unlicensed micro enterprises with an average age of seven years and engage workers with at most certificate level of education.
- 2.** The informal microenterprises are mainly run by females (58.5%) who have primary level of education while the informal small and medium enterprises are mainly run by males (55.6% and 51.2%, respectively) with college level of educationLes UPI des secteurs étudiés sont à plus de 95 % dirigées par des hommes. Il faut encourager l'entrepreneuriat des femmes dans ces secteurs ;
- 3.** Informal enterprises have low levels of innovation and competitiveness as represented by 96 per cent of microenterprises, 92 per cent of medium enterprises and 89 per cent of small enterprises. They are also exposed to customer concentration and supplier risks.

Employment and remuneration

- 4.** Nine in every ten of informal economy workers are in informal microenterprises
- 5.** Social security coverage is generally low in the informal economy with 75.7 percent of the enterprises not paying monthly National Social Security Fund and National Hospital Insurance Fund contributions for their workers.
- 6.** There exist low levels of unionization among informal enterprises estimated at 0.5 per cent, 3 per cent and 6.5 per cent for micro enterprises, medium enterprises and small enterprises, respectively. Up to 99 per cent of the informal workers 99 percent did not belong to any trade union.
- 7.** Micro, small and medium enterprises pay an estimated monthly wage of KSh. 3,525, KSh. 4,975 and KSh. 2,082 per worker, respectively. These wage rates are below the 2020 statutory minimum wages of KSh. 13,572.88, KSh. 12,522.72 and KSh. 7,240.96 for a labourer in cities, former municipalities and other areas, respectively.

Access to credit and finance

8. About one-half of informal enterprises are financially constrained owing to inadequate collateral, lending ceilings and high interest rates.
9. While formality (possession of formal business documents) is a requirement for access to formal credit, firm owners circumvent this by borrowing money in their individual capacities then channel it into their businesses.

Market conduct

10. About 80 per cent of informal firms neither advertises nor market their products compared to 46 per cent for formal firms.
11. There are weak contractual agreements between informal enterprises and other input providers or output buyers with only one in ten informal enterprises having any agreement.
12. While there exist some linkages between the formal and informal sector, there is no policy framework and/or guidelines to anchor and strengthen the linkages between formal and informal enterprises.
13. The main training and capacity needs for informal enterprises include customer service (54%), marketing (44%) and communication skills (27%).

Formalization

14. Formalization of informal sector enterprises in Kenya has a pyramidal shape with majority (73.3%) of informal enterprises yet to start their formalization journey, a few (19.1%) are a step away from informality, another minimal proportion (5.4%) are midway the journey. A paltry 1.4 per cent of informal enterprises are ready to formalize while slightly less than one per cent are fully formalized.
15. The costs of formalization which include high cost of compliance with tax regulations, existence of too many procedures and delays, high cost of compliance with social security regulations and labour laws, lack of information and informal costs incurred through corruption appear to outweigh the gains from formalization. These gains include reduced cost of inspection, better access to credit, access to strategic business location, expansion of clientele base and eligibility for business development services and other support programs.
16. A major factor that drives informality in Kenya is lack of opportunities to do business with the government and failure to export goods and services. The micro, small and medium enterprises that trade with the government and export their goods and services are 38.3 percentage points more likely to be formal than those who do not.

Employer and Business Membership Organizations and informality

17. There exists low level of knowledge and awareness of existence and role of Employer and Business Membership Organizations. Only one percent of the surveyed informal enterprises had knowledge and understanding of the role of these organizations, while nine in every ten of the informal enterprises surveyed neither knew nor heard of the employer and business membership organizations.
18. Although majority (57%) of informal enterprises perceived employer and business membership organizations to be important in helping the growth and development of micro, small and medium enterprises, informal entrepreneurs do not consider themselves to be employers. This perception may be due to existence of weak employment relationship and structure of informal enterprises that make many informal entrepreneurs to view themselves as non-employers.

- 19.** On average, 66 per cent of owners of informal enterprises do not belong to any organization such as industry associations, chamber of commerce, *merry go rounds*, women/men associations or any other form of business association.

Constraints and perceived solutions

- 20.** Lack of markets, difficulties in getting licenses, poor infrastructure and stiff local competition are some of the major and severest constraints faced by informal enterprises
- 21.** Informal enterprises consider relaxation of licensing requirements, support towards access to markets, and provision of an enabling business environment to be priority solutions to their most pressing challenges.
- 22.** Enhancing access to information and services on compliance to taxes, easing of social security requirements, and access to credit and skills training are viewed as important elements in enhancing growth of informal enterprises and their progress towards formalization.

COVID-19 and the informal economy

- 23.** The informal economy has lost more than 1.1 million jobs due to COVID-19 with wholesale, retail trade, hotels and restaurants bearing the greatest brunt and accounting for 59.8 per cent of the jobs lost
- 24.** Majority of informal economy workers have a higher exposure to occupational safety and health risks that have been heightened by the risk of COVID-19.
- 25.** There is low level of unionization and social dialogue in the informal economy, which contributes to their exclusion in COVID-19 pandemic response and management interventions including stimulus packages by government.

Recommendations

Arising from the study findings, the following agents can contribute to growth of the informal economy and its eventual formalization through the following ways.

National Government and State Agencies

1. In view of the informal economy being supported by a complex structure of diverse stakeholders, the Micro and Small Enterprises Authority should step up its coordination role as mandated by the Micro and Small Enterprises Act (2012). The strengthening of multi-stakeholder coordination framework will enhance synergy, address duplicity of roles and overlapping mandates among the players. The coordination mechanism should undertake regular audit of the effectiveness of informal economy policy, legal and regulatory framework; drive change of attitude towards the sector; and enhance monitoring and evaluation of the policies and programmes targeting the informal economy.
2. In light of informal enterprises being financially excluded from the formal financial system, the Ministry of Industry, Trade and Cooperatives in conjunction with the Registrar of Companies, Kenya Revenue Authority, National Social Security Fund, National Hospital Insurance Fund and the National Treasury should review their procedures and flex regulations around acquisition of relevant documents for formalization.
3. The informal economy suffers low social security coverage. The National Social Security Fund and National Hospital Insurance Fund should develop, implement and promote hybrid social security and health insurance schemes with centralized management, oversight and risk-pooling. This should be combined with informal economy association-based membership mobilization, collection and remission of premiums towards the social security and health insurance schemes.

4. To enhance access to credit, the National Treasury should increase the allocation to the Small and Medium Enterprises Credit Guarantee Scheme and provide guidelines to allow promising informal or semi-formal enterprises to access the funds through registered formal associations or groups.
5. To further address financial exclusion of the informal economy, the Central Bank of Kenya in conjunction with the National Treasury and other financial institutions should establish a low risk weighting for informal enterprise' loans. The credit to the informal economy operators should be embedded with specific business development services, which addresses identified informal economy growth and competitiveness gaps.
6. Laws and regulations have a direct bearing on formation, growth, competitiveness and sustainability of enterprises. To strike a balance between promotion of compliance with labour laws and labour-related regulations, and competitiveness of the informal enterprises, the Ministry of Labour and Social Protection in consultation with the social partners and informal economy associations should establish a responsive labour and labour-related code that balances low cost of doing business with incentives for compliance. The differentiated code, which should be implemented gradually, should prioritize compliance with fundamental principles and rights at work. This would include freedom of association and effective recognition of the right to collective bargaining, effective abolition of child labour, adherence to basic occupational safety and health regulations and promotion of access to social protection.
7. To strengthen the linkages between the informal economy and the formal sector, the Ministry of Industry, Trade and Cooperatives in consultation with the informal economy actors and industry players should finalize and implement the subcontracting policy.
8. The National Government in conjunction with the County governments and other key stakeholders should support formalization of informal enterprises through short and medium to long term measures:

a) Short term measures

- ▶ Enhance productivity through multi-stakeholder training and capacity building in marketing, technology adoption, pricing and customer service and other needs
- ▶ Provide decent spaces, sanitation and infrastructure where the informal economy operates
- ▶ Enhance provision of targeted credit and financial services in form of grants, loans and revolving funds both at national and county levels
- ▶ Reduce unnecessary level of inspections in the informal economy.

b) Medium to long term measures

- ▶ Promote participation of the informal economy in public procurement through special channels such as use of registered informal sector groups than individual groups who are not registered
- ▶ Reduce the number of procedures and delays associated with the formalization processes of registration, taxation and licensing
- ▶ Integrate the informal economy's space and infrastructure needs in national and county physical planning activities. This will ensure a sustainable supply of adequate infrastructure in the long run
- ▶ Create a sound multi-stakeholder monitoring and evaluation system that will ensure tracking of formalisation policies and programmes, and enhance coordination of the formalization process
- ▶ Enforce existing laws and regulations relating to employment contracts and promotion of creation of full and productive employment and decent work for all

- ▶ Increase awareness about the potential benefits of compliance with
 - ▶ the legal and regulatory framework including penalties for non-compliance through a sustained communication and media campaign strategy. This would enable the informal economy operators to view formalization as a means to sustained growth and competitiveness
 - ▶ Simplify tax administration by having a single or fewer tax obligations depending on the size of informal enterprise. In addition, leverage on technology to further simplify tax returns processes
- 9.** The COVID-19 pandemic may decimate the informal economy if not moderated. The national and county governments should, therefore, ensure timely implementation of the 8-point economic stimulus package unveiled by the government to protect the informal enterprises from the adverse effects of COVID-19.
- 10.** The Directorate of Occupational Safety and Health Services in collaboration with the social partners and the informal economy associations should develop and implement mechanisms to promote occupational safety and health within the informal economy.

County Governments

The county governments in collaboration with other stakeholders may undertake the following:

- 11.** Since informal enterprises experience cyclical variations in their businesses, the county governments should review and tailor payments of levies, fees and taxes by the informal enterprises to fit in the cyclical business cycles experienced by the enterprises. This can be achieved by tying the levies to a variable such as sales turnover that correspond to the changes in business prospects
- 12.** To provide an enabling environment for informal economy, county governments should create package of solutions that respond to area-specific needs of the informal economy. These packages can be in form of legislation or executive actions, and may include:
- ▶ Provision of decent spaces and infrastructure where the informal economy operate
 - ▶ Training and capacity building in areas such as marketing, technology adoption, pricing and customer service
 - ▶ Provision of credit and finance services in form of grants, loans and revolving funds
 - ▶ Implementation of occupational safety and health measures, and improvement of sanitation services in informal economy workplaces.

Federation of Kenya Employers and Other Employer and Business Membership Organizations

- 13.** To effectively support the informal economy in lobbying, policy advocacy and social dialogue, the Federation of Kenya Employers and other Employer and Business Membership Organizations should work with informal economy associations to undertake large scale membership organization and recruitment of the informal enterprises into their membership. This may promote joint initiation and activation of bottom-up measures that promote growth and competitiveness of the informal economy.
- 14.** There is low knowledge and awareness of existence and role of Federation of Kenya Employers and other Employer and Business Membership Organizations among informal enterprises in Kenya. This provides opportunity for the Federation of Kenya Employers to popularize itself among the informal enterprises based on their perceived needs. A package of these needs and aspirations could include linkages to formal enterprises for markets and business opportunities, training and capacity building on

management skills, pricing and production, access to finance and credit, access to space for business, access to technology and tools, and mitigation of the negative effects of COVID-19.

- 15.** Another entry and intervention point is for the Federation of Kenya Employers to partner with the informal economy operators to advocate and lobby for convenient formalization procedures, voice concerns against harassment of informal enterprises by authorities at national and county levels, and promotion of social dialogue through establishment of collective bargaining and other policy dialogue platforms that informal economy operators and associations can use to voice their concerns and engage with the government and other partners.
- 16.** To strengthen vertical linkages between formal and informal enterprises, the Federation of Kenya Employers and other Employer and Business Membership Organizations should develop guidelines and support systems that encourage their members to source and sub-contract in input supply, production, distribution, marketing and other services with the informal economy enterprises. Informal enterprises who are willing to participate in these linkages can use existing formal groups or associations as a vehicle for trading.
- 17.** The Federation of Kenya Employers has a strategic niche in promotion of occupational safety and health. The Federation could, therefore, utilize its internal capacity including mobilization of its members to work with the informal economy operators to improve safety and health in the informal economy. This intervention is critical at this time of COVID-19 and post COVID-19 and would target provision of personal protective equipment, safety masks, hand sanitizers, and handwashing facilities. The formal-based members of the Federation could also partner with relevant informal economy enterprises to produce the relevant COVID-19 products. In designing the intervention package, the Federation of Kenya Employers should have clarity of the needs of the informal economy and what other partnering organizations are offering to the informal economy. This would enable the Federation to design and implement targeted and more competitive informal economy support interventions thereby endearing the partnership as value adding.
- 18.** The fact that most COVID-19 response package circumvent the informal economy is largely because there are no informal economy actors participating in the discussions regarding the design of such packages. Informal actors must themselves be central to all policies, legislations and institutions including COVID-19 responses that affect them. Social dialogue can provide the principle vehicle to bringing about informal economy participation and involvement. This calls on the Federation of Kenya Employers and the Central Organization of Trade Unions together with their constituents to work with the informal economy operators and promote social dialogue. The social partners can also work with the informal economy associations and workers to disseminate information about COVID-19; assess the impact of COVID-19 on specific professional groups within the informal economy; and propagate, supervise and enforce social distancing and hygiene protocols within the informal economy workplaces.

Technical and Vocational Training Institutions

- 19.** In view of the weak levels of competitiveness of the informal enterprises, Technical and Vocational Education and Training institutions, Micro and Small Enterprises Authority, National Industrial Training Authority, Federation of Kenya Employers, Central Organization of Trade Unions, Kenya National Chamber of Commerce and Industry and county governments in partnership with informal economy associations should establish mechanisms to build the capacities of the enterprises. Areas of training needs would include marketing, innovation, contracting and price determination. This may be done in the format of targeted tailor-made skills training through workplace-based training programmes. The skills training should incorporate assessment that would culminate in recognition of prior learning and certification for attainment of industry recognized skills within the Kenya National Qualification Framework.

► Section 1: Introduction

1.1 Study Context

Kenya has a large and dynamic informal economy, which plays an important role in employment creation, income generation, poverty reduction and economic growth (Republic of Kenya, 2013a). Informal economy accounted for 83 percent of total employment in 2019 up from 82.6 percent in 2018¹. It also accounted for 90.7 percent of new jobs in 2019, rising from 90.2 per cent in 2018 (Republic of Kenya, 2020). Informal economy's contribution to national income increased from 18.9 percent in 1999 to 33.8 percent in 2015 (KNBS, 2016). A sector which emerged originally as a response to problems of economic survival associated with rapid urbanization and urban poverty, is now being recognized as an important, autonomous and self-propelling sector for development (Potts, 2007; Hope, 2012).

The role of the informal economy as a driver of economic growth, employment creation and poverty reduction is well recognized in *Kenya Vision 2030* and Sessional Paper No.4 of 2013 on *Employment Policy and Strategy for Kenya* (Republic of Kenya, 2007; 2013a). In addition, the Sessional Paper No. 2 of 2005 on *Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction* identifies supporting growth and development of informal businesses as a catalyst for industrialization, economic growth and national development (Republic of Kenya, 2005).

Kenya's policy landscape recognizes a number of measures necessary for growth, development and ultimate formalization of the informal economy. These include, the need for capacity building, provision of appropriate financial and other business development services (BDS), and stimulation of economic opportunities and growth through removal of inhibiting regulations and licensing regimes. In addition, the policy landscape recognizes the need for enhancing linkages between various sizes of businesses, increasing efficiency and productivity of the enterprises and its labour force, enhancing competition and expanding markets for informal economy's products and services as key elements (Republic of Kenya, 2005; 2007a; 2013a).

In line with this overarching policy view, the need for effective support for business enterprises and promoting a business environment in which these enterprises can flourish is now a pressing priority for both policy makers and stakeholders. This is especially important given the myriad challenges that the informal economy faces leading to high rates of business closures. The Micro, Small and Medium Establishments (MSME) Survey of 2016 estimated, for example, that more than one-third (2.2 million) of informal and formal MSMEs closed between 2011 and 2015. About one-half (46%) of the businesses closed within the first year of operation with the proportion rising to 61 percent by the end of the second year of establishment (KNBS, 2016).

In light of this situation, debates have emerged on rethinking about growing and sustaining the informal economy. Formalization, which is the process of transforming informal businesses into formal enterprises, and informal jobs into formal jobs, is fronted as a possible solution (ILO, 2015; World Bank, 2016). The process, however, requires looking at the barriers to formalization including compliance with laws and regulations, the support and incentives to formalize and efforts to increase productivity at the enterprise level. Most certainly, laws and regulations have a direct bearing on the formation, growth, competitiveness and sustainability of enterprises (ILO, 2011). Therefore, the main policy concern would be the balance between offering incentives for legality and enforcing legal compliance through the courts or government repression (Kluge and Libman, 2018). The longer-term aim would be to minimize the cost of the regulatory burden on the informal economy for enhanced competitiveness and growth, without compromising the laws and regulations designed to protect its workers.

¹ Kenya's proportion compares well with the 2018 ILO estimates for Africa (86%) and Sub-Saharan Africa (89%)
https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_627189/lang--en/index.htm#:~:text=More%20than%2060%20per%20cent%20of%20the%20world's%20employed%20population,in%20emerging%20and%20developing%20countries.

In response to these concerns, the Federation of Kenya Employers (FKE) in partnership with the International Labour Organization (ILO) are implementing a project aimed at increasing the knowledge base and understanding of informal enterprises from perspectives of policy, membership development and services. The project commissioned three studies: (i) to profile the informal economy enterprises in Kenya a mapping exercise was carried out in 2019 and used as the initial basis for the project, (ii) assessment of current available data using 2016 MSME Survey and the 2015/2016 Kenya Integrated Household Budget Survey (KIHBS) datasets and reports, and (iii) two national surveys carried by TIFA in 2019/2020. The outcome of this project will form the basis for supporting the economy through policy and advocacy initiatives by the FKE.

1.2 Objectives of the Study

The broad objective of the assignment is to develop a final consolidated report on the informal economy in Kenya to assist FKE in developing policy responses. The study also assesses the possible direct and indirect effects of the Coronavirus Disease 2019 (COVID-19) on the informal economy and the extent to which the government stimulus package and other COVID-19 response and management mechanisms have benefitted the informal economy.

1.3 Scope of Assessment

The assessment is based on three broad studies. The first study was a desk analysis of the characteristics, perception and needs for support services among informal economy enterprises conducted in early 2019. The second study undertaken in late 2019 focused on the same objective and employed primary data from a survey of 1,476 respondents and four focus group discussions (FGDs) in Nairobi, Nakuru, Mombasa, Machakos, Kajiado, Kiambu and Kisumu. The primary survey was supplemented with personal in-depth interviews administered on 429 respondents, and two FGDs with selected respondents in Kakuma and Kalobeyei refugee towns. The third study involved assessment of the informal economy using the 2016 MSME Survey and 2015/2016 KIHBs datasets. This was supplemented with additional qualitative data collected through 14 key informant interviews (KII) and two FGDs, and review of relevant data and reports produced in the last five years. The assessment sought to provide information on the characteristics of the informal economy enterprises, nature of employment in the informal economy, environment under which the informal economy operates, drivers of growth and obstacles to entry into the mainstream economy and compliance with relevant laws and regulations. It also described the potential for formalization and the role of Employer and Business Membership Organizations (EBMOs) in facilitating growth and development of the informal economy.



► Section 2: Introduction

2.1 Introduction

This section presents the definition of informal economy both in the ILO and Kenyan context. It also traces the evolution, growth and development of the informal economy in Kenya and examines the constraints to and opportunities for growth and formalization of the informal economy.

2.2 Definition of informal economy

There is no universally accepted definition of the informal economy. Existing literature and policies describe it using various criteria (Kenyon, 2007; Ngui, Muniu and Wawire, 2014 and Hope, 2014). In view of this, ILO provides a number of guidelines and standards for the definition of the informal sector and informal employment which form part of the informal economy.

Informal sector economic units are those that are engaged in the production of goods and services with the main aim of generating employment and incomes to the persons concerned. Thus, the informal sector is a subset of unincorporated enterprises not constituted as separate legal entities independently of their owners (ILO, 1993)². The enterprises operate on a small scale and with little or no separation between labour and capital as factors of production and have a low level of organization (ILO, 2018).

The informal sector can be described using various operational criteria such as registration, licensing, taxation, labour standards. Those are the recommended operational criteria that assess coverage and compliance with formal arrangements. Other features tend to characterize the informal sector such as firm size, income level and product standards (Kenyon, 2007; Ngui, Muniu and Wawire, 2014). The definition becomes more complex when firms have varying levels of coverage and compliance to existing laws and regulation, and possess heterogeneous business characteristics.

Informal employment is a broader concept which include in addition to employment in the informal sector, informal employment in the formal and households. Employment in the informal sector is an enterprise-based concept and it is defined in terms of the characteristics of the place of work of the worker. By contrast, informal employment is a job-based concept and is defined in terms of the employment relationship and protections associated with the job of the worker. The statistical definition of informal employment differentiates three categories of a worker: (i) employees, (ii) employers and own-account workers, and (iii) contributing family workers (ICLS, 2003)³. The different aspects may be described as

- ▶ **In the case of employees, informal employment is defined in terms of the employment relationship. According to international standards, “employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits such as advance notice of dismissal, severance pay, paid annual or sick leave. The underpinning reasons may be: non-declaration of jobs; casual jobs or jobs of a short duration; jobs with hours of work or wages below a specified threshold for statutory deductions such as social security contributions; or lack of application of law and regulation in statistical terms. The formal or informal nature of a job held by an employee is determined on the basis of operational criteria, such as social security contributions by the employer on behalf of the employee, and entitlement to paid sick leave and paid annual leave.**

1. Resolution concerning statistics of employment in the informal sector, (ICLS 1993). Available at: https://www.ilo.org/wcms5/groups/public/-/-dgreports/-/-stat/documents/normativeinstrument/wcms_087484.pdf

3. Guidelines concerning a statistical definition of informal employment (ICLS 2003). Available at : https://ilo.org/wcms5/groups/public/-/-dgreports/-/-stat/documents/normativeinstrument/wcms_087622.pdf

- ▶ Employers and own-account workers are considered to be in informal employment when their economic units belong to the informal sector. The operational definition considers an informal economic unit or informal sector as one that is (i) unincorporated, (ii) produces goods and services for sale (iii) is not registered under required national legislation and (iv) does not maintain a set of accounts as required by law. In absence of adequate data, the criteria may be extended to cover units whose employees do not contribute to social security, have no more than five workers and do not operate from fixed visible premises (ILO, 2018).
- ▶ Informal employment may also cover contributing family workers who are by definition, informally employed, regardless of whether they work in formal or informal sector enterprises.

The ILO (2015) defines informal economy as all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements. This definition does not cover illicit or economic activities that are forbidden by law as defined in the relevant international treaties.

In Kenya, there is no clear definition of what informal employment and/or informal economy is. Various policy papers and reports refer to the informal economy ⁴ as *jua kali*, a term that alludes to those activities carried out in open worksites in which individuals are exposed to harsh conditions such as hot sun, dust and rain. The term *jua kali* has increasingly evolved and is even used to describe some activities carried out in permanent structures (Ngui, et al. 2014). More often than not, informal economy is defined by its generic characteristics such as use of vocational skills, use of low and simple technologies, low capital investment, limited job security, and, therefore, lacks a clear national statistical criterion (Republic of Kenya, 2019; 2020). Other terms that are commonly used to describe the informal sector are micro-enterprises (firms employing less than 10 workers) and small enterprises (firms employing between 10 and 49 workers) (Ngui, et al. 2014; KNBS, 2016).

Two recent surveys in Kenya have defined the informal sector differently. The 2016 MSME Survey defined the informal sector as one that comprises either all self-owned enterprises or only those which are not registered under specific forms of national legislation such as Factories or Companies Act, Partnership Act, tax or social security laws, professional groups regulatory or similar acts, and laws or regulations established by national legislative bodies (KNBS, 2016). The World Bank report on the informal economy defined informal firms as those not registered with the Kenya Revenue Authority (World Bank, 2016). This demonstrates that these definitions depend on the data being analysed and the issues of interest being studied.

Based on the definitions and criteria by ICLS (1993), ICLS (2003), ILO (2018) and KNBS (2016), in addition to the data used for this study, operational definition of the informal economy consists of:

- ▶ a) **Informal enterprises: all self-owned enterprises or those that engage in income generating activities but are not registered at the national level under the forms of either a company, partnership, sole proprietorship, or a group. This may take several ownership forms including family, sole proprietorship, group and partnership.**
- ▶ b) **Informal worker or employee: any person who was active in employment in the past 7 days before survey, had no contract (excludes implied or verbal contract), the employer did not make monthly National Social Security Fund (NSSF) and National Hospital Insurance Fund (NHIF) contributions, did not receive paid annual leave and has no employer provided medical benefits. This definition is relaxed at some point in the report to remove the requirement for contract.**

4. Most policies refer to the informal sector yet the policies to cover both aspects of the informal sector as well as the informal employment.

2.3 Dichotomy between formality and informality

The dichotomy between the formal and informal economy as described in Section 2.2 may sometimes not be distinct in practice. Some economic units may possess both the formal and informal properties due to partial compliance with the required laws (Nogueira, Carvalho, Santiago and Van Doorn, 2019). Since a dichotomous view ignores other aspects of formalization, it makes a continuum consideration of formality more practical and stricter than the dichotomous consideration. This is largely because developing economies have characteristics such as partial registration and licencing of businesses, under-declaration of turnover and labour by businesses, and formal actors engaging in the informal economy and vice versa (Nogueira et al., 2019). Therefore, semi-formality manifests itself when a registered enterprise (formal enterprise with respect to the dichotomous consideration) behaves informally, while semi-informality occurs when an informal enterprise (with respect to the dichotomous consideration) behaves formally. The following approach envisages that firms move from partial to full compliance as shown in Figure 1.



Figure 1: Possible steps to formalize Source: Nogueira, et. al. (2019)

In Kenya, an enterprise is required to adhere to laws relating to registration, licensing, taxation and social security. These requirements yield a four-point continuum that considers an enterprise as being formal on one end, and informal on the other. A firm that is not fully covered or fully compliant with the law may be registered by the registrar of companies but misses either one or all of the other three aspects. The firm may also be registered with the tax office but not with the business registry and social security office. In practice, the steps to formalization may not be chronological, and compliance may take different routes for different enterprises. Given the various formalization requirements, different degrees of coverage and compliance emerge. The levels provide lessons and insights on how quickly the firms can formalize or remain informal. In the later section 4.6 of this report arguments are made to suggest that future definitions of the formal or informal economy may follow a continuum rather than a dichotomous view. Further, following the complexity of the continuum view and the limitations of secondary data sets used, the report adopts the dichotomous view in distinguishing between the formal and informal enterprises unless otherwise stated such as in section 4.6.

2.4 Evolution, growth and development of informal economy in Kenya

The informal economy in Kenya is where majority of individuals who are not employed, partially employed, street children, street subsistence workers, workers on casual contracts of service, and members of the underworld derive their livelihoods (Kinyanjui, 2014). It is characterized by ease of entry, enterprises mainly owned by family, reliance on indigenous resources, labour intensiveness, small-scale operations, unregulated but competitive markets, skills acquired outside the formal school system and use of low and simple technologies (Kinyanjui, 2014; Ngui, et al., 2014).

Kenya's public policy orientation has, since attaining political independence in 1963, favoured local ownership of economic enterprises (Republic of Kenya, 1965). Soon after independence, the government aimed at liberating her citizens from subordination in workplaces and other productive spaces. To achieve this, the government targeted expanding education, which would then enable Kenyans to enter into the world of modern commerce or rather the formal economy and not in the informal economy (Republic of Kenya, 1965; Kinyanjui, 2014). As Mwatha (1990) notes, the country experienced influx of job seekers in urban formal economy after independence. However, the formal economy, which majorly relied on capital intensive rather than labour intensive operations could not accommodate the large number of job seekers. This meant that those who could

not secure jobs in the formal economy had to look for alternative means of survival, which was easily found in the informal economy (Republic of Kenya, 1969).

Kenya also pursued growth-oriented employment strategy (Omolo, 2010). This meant that employment was seen as an offshoot of economic growth, which required the country to achieve high and sustained levels of economic growth. However, the country's economic performance since independence has been mixed. In the 1960s, the country experienced high economic growth rate, averaging 6.6 per cent in 1964-1972. However, this growth rate reduced to an average of 5.2 per cent in 1974-1979 and further declined to an average of 4 per cent in 1980-1989. The country continued to experience poor economic growth over 1990-2002 period recording an average growth rate of 2.4 per cent (Omolo, 2010). The implication is that the low and un-sustained economic growth could not generate the jobs required to match the growing labour force.

Following the election of a new regime in 2002 and implementation of policies aimed at revolutionizing the economy, the country registered 1.8 per cent growth rate in 2003, which increased gradually to reach 7.1 per cent in 2007 (see Table A1). However, these gains were reversed following post-election violence in 2007/2008, which dipped the country's economic growth to 1.7 per cent in 2008 before a slight rebound to 2.9 percent in 2009. Kenya's economic growth rate averaged 5.8 per cent in 2010-2019 with the highest growth rate being 6.3 per cent attained in 2018 and a low of 4.6 per cent recorded in 2012. Kenya's economy was projected to grow by 6.2 per cent in 2020. However, the growth prospect is undermined by the supply and demand shocks arising from the COVID-19 crisis. It is estimated that the growth rate could decelerate to 1.5 per cent in 2020 or contract by one per cent should it take longer than expected to bring COVID-19 pandemic under control⁵. Overall, the country's rate of growth has been cyclical, affirming the World Bank's assertion that it has always been difficult for Kenya to attain and sustain a high economic growth rate of at least 7 per cent per annum, which is required for meaningful job creation (World Bank, 2008). The low, non-inclusive and un-sustained economic growth has led to declining formal employment and increasing informal employment as depicted in Figure 2.

As illustrated in Figure 2, formal employment has been decreasing while informal employment has been increasing. Increasing employment in the informal economy is an indication of a shrinking capacity of the formal economy to create adequate jobs to absorb the growing labour force. The employment gap paves way for a flourishing informal economy, which offers the much needed solace for the job seekers. As observed by Obare (2015), failure by the state and the private sector to support the formal labour market enabled the informal economy to step in to fill the employment gap.

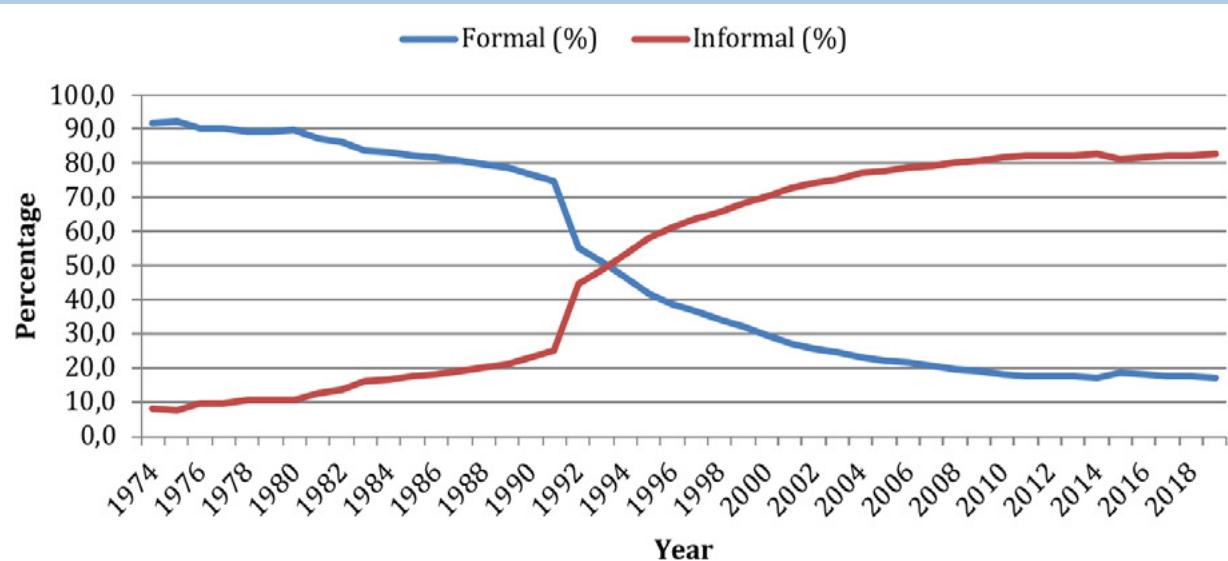


Figure 2: Proportion of formal and informal employment in Kenya, 1974-2019

Source of Data: Republic of Kenya, Economic Survey (various)

5. <https://www.worldbank.org/en/country/kenya/overview>

Employment in the informal economy has increased from less than 10 per cent of total employment in 1974 to about 83 per cent in 2019. The greatest jump in the growth of employment in the informal economy was from 1992 (Figure 2). This period is associated with factors such as liberalization and privatization policies, strategies for promotion of growth and development of the informal economy and broadening of the definition and more consistent capturing of informal economy data in the national statistics (Omolo, 2010). Overall, the rate of growth of employment in the informal economy has for most of the years surpassed rate of growth in formal employment and expansion of the economy (Figure 3).

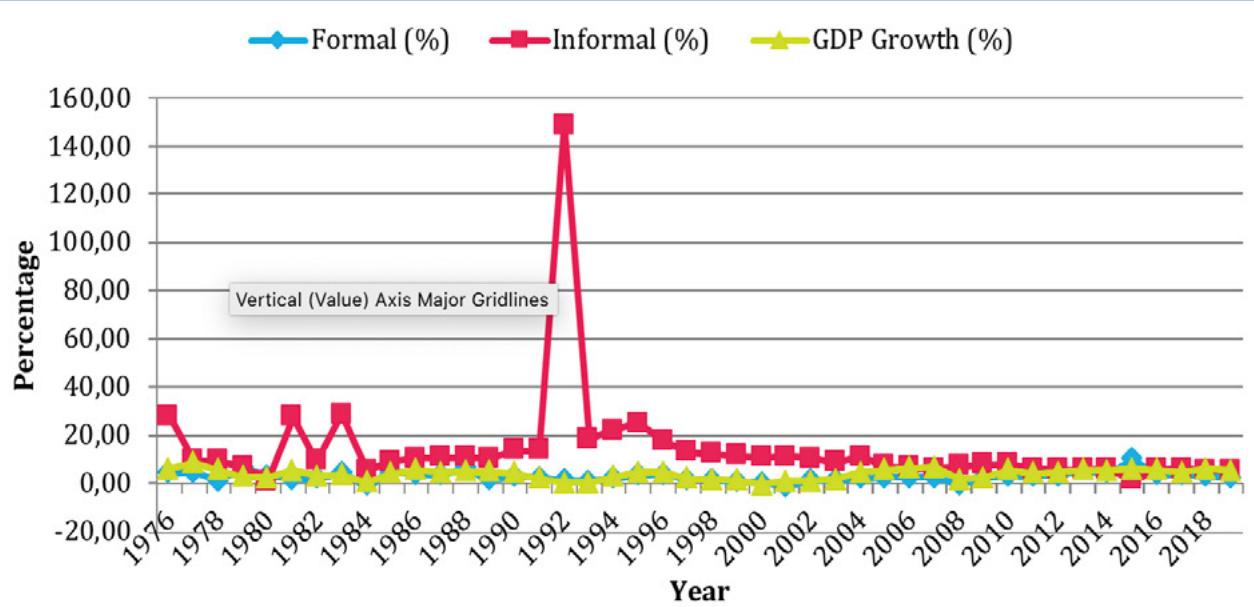


Figure 3: Trends in growth rates of employment and GDP

Source of Data: Republic of Kenya, Economic Survey (various)

A national survey of Micro and Small Enterprises (MSEs) conducted in Kenya in 1999 showed that the number of MSEs increased from 910,000 enterprises in 1993 to 1.3 million enterprises in 1999 (CBS, ICEG & K-Rep, 1999). A similar survey covering MSMEs conducted in 2016 found that there were 5.9 million unlicensed establishments countrywide, an indication of a growing informal economy (KNBS, 2016). More than one-third (36.3%) of the enterprises in the informal economy were located in places with no structures while about half of the establishments either operated in temporary or semi-permanent structures (KNBS, 2016). The location of these enterprises could be due to the nature of economic activities they engage in such as shoe-shining, hawking, blacksmithing, grocery, tailoring, meat and maize roasting on road sides, repair of footwear among others. This is in addition to failure to incorporate informal economy activities in urban planning (Ouma, 2010).

Though most of the observations made by ILO in its 1972 report on the informal economy in Kenya (ILO, 1972) remain valid, the recommendations in the report have mainly been unattended. The report observed in page 226 that "the sector can be a source of future growth as an integral part of an employment strategy". It observed further that government policy towards the urban informal economy contained too few elements of positive support and promotion, and too many elements of inaction, restriction and harassment. This situation seems not to have changed much since workers and entrepreneurs in the informal economy have continued to experience harassment by authorities at national and county levels. Observation of the 1972 ILO report that informal economy activities are primarily those of petty traders, street hawkers, shoeshine boys and other groups of 'under employed' on the streets and big towns remain valid.

2.5 Informal economy policy environment

Based on the role that the informal economy plays in Kenya as well the ILO's observations (ILO, 1972), the Government of Kenya has introduced policy prescriptions aimed at promoting growth and development of the informal economy, in particular the informal sector (KNBS, 2016). In this section, the key policy documents supporting the informal economy and its transition to formality are discussed.

2.5.1 Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth

Sessional Paper No. 1 of 1986 was prepared in the backdrop of declining economic growth. The policy blueprint recognized the importance of MSEs as a driver of Kenya's economic development. It underscored the potential of the MSEs in being a hub for technological innovation, aggressive entrepreneurship and a cornerstone for promoting latent growth amongst informal economy enterprises. The Sessional Paper advocated for special consideration of informal economy entrepreneurs in manufacturing, construction, transport, and housing given their greater potential to transition to medium and large enterprises.

As part of implementation of the Sessional Paper No. 1 of 1986, the government established a Special Task Force in 1987 to review all policies, laws and regulations relating to MSEs. This culminated in the development of a paper entitled '*A Strategy for Small Enterprises Development in Kenya: Towards the Year 2000*' (Republic of Kenya, 1989), which largely decried the inhibitive legal and regulatory environment in which MSEs operate. The strategy paper also identified other constraints facing the MSEs as investment and finance, inadequate markets and product promotion, ineffective programmes and weak entrepreneurship culture. This further formed the basis for publication of Sessional Paper No.2 of 1992 on *Small Enterprises and Jua Kali Development in Kenya*. The implication is that no concrete action was taken by the government to implement programmatic actions to promote growth and development of the informal economy or the formalization of informal economic units and jobs between 1986 and 1992. Instead, the government focused on design of informal economy policies, with a particular focus on informal sector economic units.

2.5.2 Sessional Paper No 2 of 1992 on Small Enterprises and Jua Kali Development

Sessional Paper No. 2 of 1992 was the first government policy document to exclusively address small enterprises, defining them as those enterprises employing between 1 and 50 workers. The paper set out measures geared towards development of legal and regulatory framework, addressing gender issues in enterprise development, policy to improve access to credit and non-financial services, and the government's role in creating an enabling business environment for sustainable growth and development of the MSEs. The paper recommended that relevant government Ministries, Departments and Agencies (MDAs) in consultation with the Attorney General's office should address the legal and regulatory framework that inhibits growth and development of the MSEs. The MDAs were required to carry out comprehensive review and analysis of laws and licenses relevant to MSEs, especially those which had impacted negatively on their growth and development.

It also recommended the formation of informal economy associations to facilitate access to information regarding taxation, licensing and legal requirements. The government committed to improve infrastructure at the local levels by establishing Rural Enterprise Fund (REF) to finance informal economy entrepreneurs, and to re-orientate Kenya Industrial Research Development Institute (KIRDI) to modify, adopt and promote research and dissemination of research information to the sector (Republic of Kenya, 1992).

A review by Mwami and Matwere (2019), indicates that, studies, taskforces and policy responses based on Sessional Paper No. 2 of 1992 led to the transfer of MSE functions to the Ministry of Labour and Human Resource Development, which commissioned a task force that recommended the establishment of Jua Kali Authority and Jua Kali Council. Further, through the policy, legal and regulatory frameworks that had impacted negatively on the growth and development of the informal economy were addressed by the government. However, there was further call for a review and analysis of the tight controls and laws to create an enabling business environment (Mwami & Matwere, 2019). Overall, effectiveness of the Sessional Paper No. 2 of 1992 were undermined by weak implementation and inappropriate policy design (Republic of Kenya, 2017; Mwami & Matwere, 2019).

2.5.3 Economic Recovery Strategy for Wealth and Employment Creation (ERS, 2003-2007)

The Economic Recovery Strategy for Wealth and Employment Creation [ERS (2003-2007)] was formulated at a time when Kenya's economy was depressed. It recognised that the country had experienced slow economic growth rate for more than a decade and purposed to put the country on a growth trajectory. The ERS (2003-2007)

identified MSEs as one of the productive sectors that could support the envisaged growth. The government also acknowledged the constraints with which the MSEs operate, which included inadequate market for their products; insecurity and harassment by local authorities; lack of access to affordable credit; and dearth of serviced commercial worksites. The government also identified existing regulatory framework to be a hindrance to growth and development of the MSEs as it imposed significant costs on the businesses thereby limiting their development and formalization.

To address the regulatory challenges, the government proposed to establish a Commission to review all business-related regulations, covering legal and institutional aspects. The findings and recommendations of the Commission were expected to be used to formulate a strategy to address challenges caused by such regulations. Thus, based on the recommendations, and in order to promote MSEs, the government aimed at finalizing and implementing a Sessional Paper on the sector focusing on job creation and formalization of informal activities. The government also proposed to identify zones with basic infrastructure to serve as incubators for MSEs. It was expected that such zones will improve the image of MSEs, their visibility and facilitate linkages between them and medium and large-scale enterprises. The government also proposed to transform the MSE sector through linkages with external markets (Republic of Kenya, 2003).

A number of legal, policy and institutional reforms were undertaken during the ERS (2003-2007) period. These included elimination of 11 licenses in trade, and simplification of others making business environment more friendly. Sessional Paper No.2 of 2005 on *Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction* was formulated. Institutionally, a total of 204 *jua kali* worksites were also rehabilitated, 381 parcels of land were secured in different parts of the country for MSE activities, and 373 *jua kali* exhibitions conducted at local and regional levels to promote marketing of MSE products and services (Republic of Kenya, 2009).

2.5.4 Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction

Sessional Paper No. 2 of 2005 was based on six guiding principles. These were stimulation of economic opportunities and growth through removal of inhibitive regulations; integrated perspective on MSMEs and large enterprise development; promotion of linkages between various sizes of businesses; increased efficiency and productivity of the enterprises and its labour force; enhanced competition amongst enterprises; and expanded markets for MSE products and services (Republic of Kenya, 2005). The principles were developed on the backdrop of the constraints faced by MSEs, which were identified as inappropriate policy design, weak implementation framework and failure to institute and effectively monitor the policies. The Sessional Paper focused on creating an enabling policy and regulatory environment to increase competitiveness of MSEs and for the enterprises to sustainably contribute to economic growth, creation of employment and poverty reduction. It further recommended institutional reforms to enhance coordination and implementation of sector activities. It also called for preferential allocation and ring-fencing of at least 25 per cent of all public procurement to MSEs (KNBS, 2016).

Sessional Paper No. 2 of 2005 continued to advocate for improvement of the legal and regulatory framework for effective growth and development of the informal economy, which had been identified in the Sessional Paper No. 2 of 1992. The policy further advocated for consolidation and harmonization of trade licensing, local government reforms, security of tenure, capacity building, compliance to labour law and promotion of access to justice for MSEs, and decentralization of business registration. The MSEs are, however, yet to benefit from preferential treatment in public procurement due to its inconsistency with other complementary regulations and laws. Furthermore, there is either weak or non-existent linkages between informal entrepreneurs and firms in the formal economy (Republic of Kenya, 2017).

2.5.5 The Kenya Vision 2030

The *Kenya Vision 2030* identifies MSE sector as being among the key segments of the economy expected to drive achievement of the country's aspirations. The blueprint emphasizes the importance of the informal economy

and stresses on measures that are aimed at increasing productivity, creating employment, and increasing entrepreneurs' incomes and public revenues. It recognizes the need for capacity building and provision of targeted financial services to the informal economy. It also prioritizes establishment of industrial parks to promote growth and development of the informal economy and strengthen the country's industrial base.

The *Kenya Vision 2030* is implemented through five-year rolling Medium Term Plans (MTPs). The First Medium Term Plan (MTP I, 2008-2012) acknowledged the role of the MSMEs in employment creation and economic growth (Republic of Kenya, 2008). It identified the challenges facing the informal economy as low productivity, limited technological transfer, poor occupational safety and health measures, inadequate access to markets and marketing channels, and information asymmetry.

To capitalize on the country's potential competitive advantage particularly in the manufacturing sector, the MTP I emphasized on the need to strengthen the MSMEs to grow vertically and become large industries. This was to be achieved through addressing constraints that inhibit the enterprises from growing; securing property rights and security of tenure; addressing costs associated with entry, expansion and exit; and reviewing legal and regulatory framework related to licensing, taxation and labour. The MTP I also prioritized establishment of centres of excellence at regional levels to promote technological transfer, capacity building, product design and development and marketing of MSME products. It also proposed establishment of at least five SME industrial parks, and MSME research and development, risk and venture capital fund. To give the informal economy the required impetus, the government planned to fast track implementation of Sessional Paper No. 2 of 2005.

A total of 157 MSE worksites were established and/or rehabilitated during the MTP I period against a target of 545. Only phase I of construction of the MSE centre of excellence at the Kariobangi *Jua Kali* Demonstration Centre was completed during the period, implying non-conformance to the MTP I target of establishing eight centres of excellence. Two key legal and institutional reforms were undertaken during the MTP I period. These are enactment of the MSE Act (2012) and establishment of the MSE Authority (MSEA) and MSE Tribunal for dispute resolution. Other programmatic interventions implemented included productivity improvement programmes in 72 companies and identification of land in Eldoret and Taita Taveta for construction of SME parks (Republic of Kenya, 2013b)

The Second Medium Term Plan (MTP II, 2013-2017) built on MTP I. The MTP II acknowledged that Kenya's manufacturing sector comprise MSMEs and large industries mainly classified based on employment levels and capital investment (Republic of Kenya, 2013b). The MTP II prioritized establishment of a legal framework that would ensure existence of a vibrant MSE sector for employment and wealth creation. It also targeted establishment of centres of excellence in all counties for promotion of product development and marketing of informal economy products.

A MSME baseline survey was conducted during the MTP II period. A total of 13 MSE worksites were also rehabilitated and operationalised, and a curriculum that integrates entrepreneurship was introduced in primary and secondary schools, and in tertiary institutions. A total of 128,943 entrepreneurs in the informal economy went through a short-term tailor-made training on entrepreneurship. Other achievements included finalization of master plans and structural designs for establishment of small and medium enterprises (SME) industrial parks, equipping of Kariakor Common Footwear Centre for SMEs, provision of incubation services by KIRDI to 1,000 SMEs, certification of 2,333 SMEs products by Kenya Bureau of Standards (KEBs) and completion of upgrading of Kariobangi MSE Demonstration Centre (Republic of Kenya, 2018). Implementation of MTP II coincided with introduction of the Kenya National Trade Policy of 2016, which is discussed in section 2.5.6.

Kenya is on her third medium term planning phase (2018-2022) of the *Kenya Vision 2030*. The MTP III (2018-2022) builds on the lessons learnt during implementation of MTP II. It acknowledges existence of a number of challenges facing the informal economy, which include unreliable and high cost of energy, labour and transport; insufficient access to affordable long-term financing; high cost of land for establishment of SME industrial parks; weak linkages between MSMEs and large enterprises; and high initial infrastructure investments required to attract investors in SME industrial parks.

Priority intervention areas identified in the MTP III include identification of land for establishment of SME industrial parks, development of infrastructure, and management of SMEs to promote industrial dispersion and balanced economic development. The MTP III also proposes establishment of SME support programmes in every constituency and SME centres of excellence per county. It also plans to roll-out MSME development programmes, which will include inculcation of entrepreneurial culture and skills development; registration of intellectual property rights; provision of financing; branding and market access to MSME products; provision of worksites; incubation, innovation and transfer of technology; and promotion of productivity and improvement of quality improvement of MSME products. The MTP III also contain measures aimed at formalizing and supporting informal enterprises so that they can grow and eventually graduate from micro and small to medium enterprises, and finally into large firms. It is envisaged that such action will enable the informal economy to contribute to creation of at least 1 million jobs and contribute to tax revenue (Republic of Kenya, 2018). Challenges identified under the MTP III are not any different from those identified in previous government policy documents, implying persistence of constrained growth and development of the informal economy.

2.5.6 Kenya National Trade Policy (2016)

The Kenya National Trade Policy (2016) was formulated within the framework of the *Kenya Vision 2030*. The Policy aims at making Kenya an efficient domestic market and globally competitive export-led economy. It appreciates the role MSEs plays in labour market and cross-border trade. The blueprint identifies lack of access to affordable credit, inadequate business skills, and inadequate business premises and work sites as some of the challenges facing the MSEs. Others are inadequate market access and low-quality products, inhibitive regulatory framework, and informal and cumbersome trade facilitation procedures. It advocates for creation of an enabling and business friendly legal and regulatory framework, establishment of fully serviced markets and workspaces, and provision of single business permits to all MSEs operating in designated markets and work spaces. The policy also roots for protection of MSEs against harassment from any arm of government, strengthening of MSE associations and cross border trade committees, establishing county credit and loans schemes through legislation, undertaking capacity building programmes, and establishing trade finance facility (Republic of Kenya, 2017).

2.6 Overview of the policy environment related to the informal economy

A review of the informal economy landscape reveals some level of achievement in the spheres of policy, legal and institutional frameworks besides consistent development of new policy and institutional approaches. Institutions established and/or dedicated to support growth and development of the informal economy include MSEA, KIRDI, and a host of informal economy associations including a number of informal economy federations such as the Kenya National Federation of Jua Kali Associations (KNFJKA). Other interventions include establishment of MSE centres of excellence; worksites for informal economy entrepreneurs; trade fairs and exhibitions for product marketing; capacity building of the informal economy operators through tailor-made trainings; and enactment of laws and regulations meant to improve the business environment for informal economy operators.

Policy, legal, institutional and programmatic interventions notwithstanding, the informal economy continue to face recurring constraints/challenges that hinder their growth and undermines their movement towards formalization. Among the constraints that have consistently appeared in almost all the policy documents are inhibitive legal and regulatory environment; inadequate markets, marketing information and product promotion; weak entrepreneurship culture and skills; inadequate market space and worksites; cumbersome trade facilitation procedures; inadequate linkages between MSMEs and large enterprises; lack of affordable credit facilities; insecurity and harassment by various government arms; and unreliable cost of doing business related to energy, labour and transport.

Low levels of effectiveness of most policies could be blamed on weak implementation and use of inappropriate policy designs adopted at various levels. It may also be linked to lack of political will and overlapping mandates of the many MDAs involved in the implementation of informal economy policies and interventions.

2.7 Legal and regulatory framework in Kenya: a focus on what matters for the transition of economic units and workers to formality

2.7.1 Trade Licensing Act (Cap 497) of 1968

The Trade Licensing Act (1968) provides for licensing of certain trades and businesses. Most informal economy activities are regulated under this Act. The Act requires applicants of trade licenses to state space ownership, titles/lease or other evidence of permission to access and utilize the space for which the application is being sought and physical address of the space as a condition for licensing (Republic of Kenya, 1986). In addition, prior to issuance of trade license, the location of the business must be certified by the planning authority in collaboration with the health department.

Majority of business operators in the informal economy do not have a designated or permanent address from which they run their businesses. Further, most of them lack documents to prove ownership of space they occupy since they operate in public spaces such as pathways and roadsides. The problem is exacerbated by lack of employment, which leads to informal trading in a haphazard manner (Mitullah, 2003). Given the requirements for licensing and constraints faced by informal traders, the process of securing a trading license is burdensome and a major barrier to growth of the informal economy. In addition, there is incessant harassment from county authorities since majority of traders in the informal economy operate non-registered and/or unlicensed businesses and carry out their businesses in non-designated areas. This has made business operations more difficult for these traders. Creating incentives for increasing compliance while encouraging business growth is, therefore, necessary to cater for the informal traders.

2.7.2 Micro-Finance Act (2006) and SACCO Societies Act (2008)

In 2006, the government published the Microfinance Act Cap 493D to regulate microfinance institutions (MFIs) in the country. In 2008, the government established Savings and Credit Co-operative Societies (SACCOs) Act Cap 490B (No. 14 of 2008) aimed at regulating, licensing and supervising SACCOs. The MFIs and SACCOs Acts were established to regulate and enhance the governance of the institutions. The Acts were introduced to enable MFIs and SACCOs to mobilise savings and take deposits for re-investment, thus building a sustainable base for financial inclusion particularly to the majority of rural and urban poor, including MSEs. The two Acts of Parliament have been crucial in facilitating access to financial services by the informal economy players who may not access the required finances through commercials banks due to stringent requirements of collateral. The MFIs provides for group lending where members without collateral can co-guarantee each other while the SACCOs process loans on the basis of member's savings and individual members can guarantee one another. These relaxes the stringent requirements of security imposed by the commercial banks for one to access credit.

2.7.3 Labour Institutions Act, 2007

The Labour Institutions Act (2007) establishes labour institutions, provides for their functions, powers and duties and provide for other matters connected to the institutions. Labour institutions established under the Act include the National Labour Board (NLB), Labour Administration and Inspection; Employment and Labour Relations Court (ELRC); Committee of Inquiry; and Wages Council (WC) (Republic of Kenya, 2007b). Ordinarily, the WC advices on statutory wages and minimum terms and conditions of employment for all workers in the economy, including those in the informal economy. However, most workers in the informal economy do not benefit from the set minimum wages and terms and conditions of employment. This gap is mainly due to weak compliance and low enforcement services.

2.7.4 The Employment Act, 2007

The Employment Act (2007) establishes the basic minimum terms and conditions of employment, and the fundamental principles and rights at work. The fundamental principles and rights at work include paid annual leave, three months' maternity leave for female workers and two weeks' paternity leave for male workers, sick leave, provision of reasonable housing at the cost of the employer, provision of clean and wholesome water at places of work, and medical attention where necessary. The Act also legislates

on employment contracts including modalities for termination of employment. According to the Act, employment contracts of at least three months should be in writing, otherwise it can be oral. The Act also recognizes that employment contracts may be express or implied (Republic of Kenya, 2007c).

The Employment Act (2007) prohibits forced labour, discrimination and sexual harassment in employment. The Act requires employers with at least 20 employees to have sexual harassment policies at the workplace, implying that all micro enterprises and small enterprises with up to 19 workers are exempted from the requirement of having a sexual harassment policy in the workplace. This does not, however, mean that the enterprises are exempt from ensuring a sexual harassment free workplace.

2.7.5 The Labour Relations Act, 2007

The Labour Relations Act (2007) consolidates the law relating to trade unions and trade disputes. It provides for registration, regulation, management and democratisation of trade unions and employers organisations or federations; and promotion of sound labour relations through protection and promotion of freedom of association, encouragement of effective collective bargaining, and promotion of orderly and expeditious dispute settlement, conducive to social justice and economic development (Republic of Kenya, 2007d). The Act accords workers and employers the right to form and/or join a trade union and to undertake collective bargaining regardless of whether they are in formal or informal economy. However, most workers in the informal economy are not organized by trade unions. Similarly, majority of informal economy entrepreneurs are not members of employer organizations such as FKE. Both trade unions and employers' organizations have not developed effective strategies to organize and recruit informal economy workers and employers for purposes of collective bargaining and negotiations.

2.7.6 Occupational Safety and Health Act, 2007

The Occupational Safety and Health Act (2007) provides for the safety, health and welfare of employees and all persons lawfully present at places of work. All enterprises, including the informal enterprises are subject to this Act (Republic of Kenya, 2007e). However, the Act suffers weak compliance and enforcement, especially in the informal economy.

2.7.7 The Constitution of Kenya, 2010

The Kenya Constitution (2010) entrenches fundamental rights and freedoms of an individual. Article 41 of the Constitution advocate for decent work, where freely chosen productive employment is promoted simultaneously with fundamental principles and rights at work, adequate income from work, representation and security of social protection. Specifically, Article 41 of the Constitution accords fundamental principles and rights at work to all workers and employers. These include the right to fair labour practices (Article 41(1)); fair remuneration (Article 41(2a)); reasonable working conditions (Article 41(2b)); and freedom of association (Article 41(2c)). Article 41(5) of the Constitution grants trade unions and employers the right to engage in collective bargaining while Article 43 confers social and economic rights, which include the right to social security (Republic of Kenya, 2010). Article 30 of the Constitution also accords protection from slavery, servitude and forced labour. The Constitution, therefore, accords all workers whether in the formal or informal economy, a right to a fair remuneration and the right to form, join and/or participate in the activities of a trade union of choice.

2.7.8 Micro and Small Enterprises Act No. 55 of 2012

The Micro and Small Enterprises Act (2012) was put in place to provide legal and institutional framework to the informal economy and to address issues of promotion, development and regulation of the sector. The Act establishes MSEA whose mandate is to formulate and review policies and programs for MSEs; monitor and evaluate the implementation of existing policies and programmes related to MSEs and advise the government on appropriate policies; and facilitate the integration of various public and private sector activities, programmes and development plans relating to MSEs. The MSE Act also establishes an MSE Registrar to register and regulate all MSE associations and MSE Tribunal to settle MSE disputes. It also

establishes MSE Development Fund to provide affordable and accessible finance to MSEs, while at the same time financing promotion and development of the enterprises. The Act facilitates MSEs to comply with environmental standards and public health, in addition to business development outreach initiatives (Republic of Kenya, 2017). However, appointment of Registrar of MSEs, establishment of the MSE Tribunal and the MSE Fund are yet to be actualized (Mwami & Matwere, 2019).

2.7.9 County Government Act, 2017

Promulgation of the Constitution of Kenya (2010) led to creation of devolved governments hence abolition of the by-laws that were previously applied by the defunct Local Authorities (Republic of Kenya, 2017). The County Government Act (2017) mandates the county governments to develop county integrated development plans, which integrate economic, social, environmental, physical and spatial planning. Section 48 of the Act require decentralized units within the counties to develop and implement policies and plans; undertake service delivery; implement developmental activities to empower communities; and provide and maintain infrastructure. The Act also mandates the counties to undertake spatial planning and identify areas where strategic interventions can be taken.

The proliferation of informal economy activities in residential areas can, therefore, be handled under the framework of the county government and zoning plans of towns. The devolution of planning activities to the county governments provides a suitable environment for county-wide development of policies that promote growth and development of the informal economy. Overall, the County Government Act (2017) gives an implied right to the entrepreneurs in the informal economy to demand to be provided with conducive environment for conducting their business, including construction of decent marketplaces.

Most county governments collect revenue (mostly daily market fees and business permits charges) from small traders who are mostly in the informal economy. The county governments are also majorly involved in improvement of infrastructure, especially construction of markets and provision of other infrastructure services such as lighting of markets. This is an indication that the Act has had a positive institutional change that can be felt. However, the challenge is for the county governments to put in place laws that promote the growth and development of informal economy in a conducive legal and regulatory framework while also ensuring that the environment, security and social and economic activities are safeguarded.

2.8 Informal economy and COVID-19

The Coronavirus Disease 2019 (COVID-19) was first reported in Kenya on 13th March 2020 and continues to ravage the economy. The government has since decreed two types of interventions with implications on the informal economy. The first set of measures aim to contain the spread of the virus while the second set are aimed at cushioning the economy, inclusive of citizens from the negative effects of COVID-19.

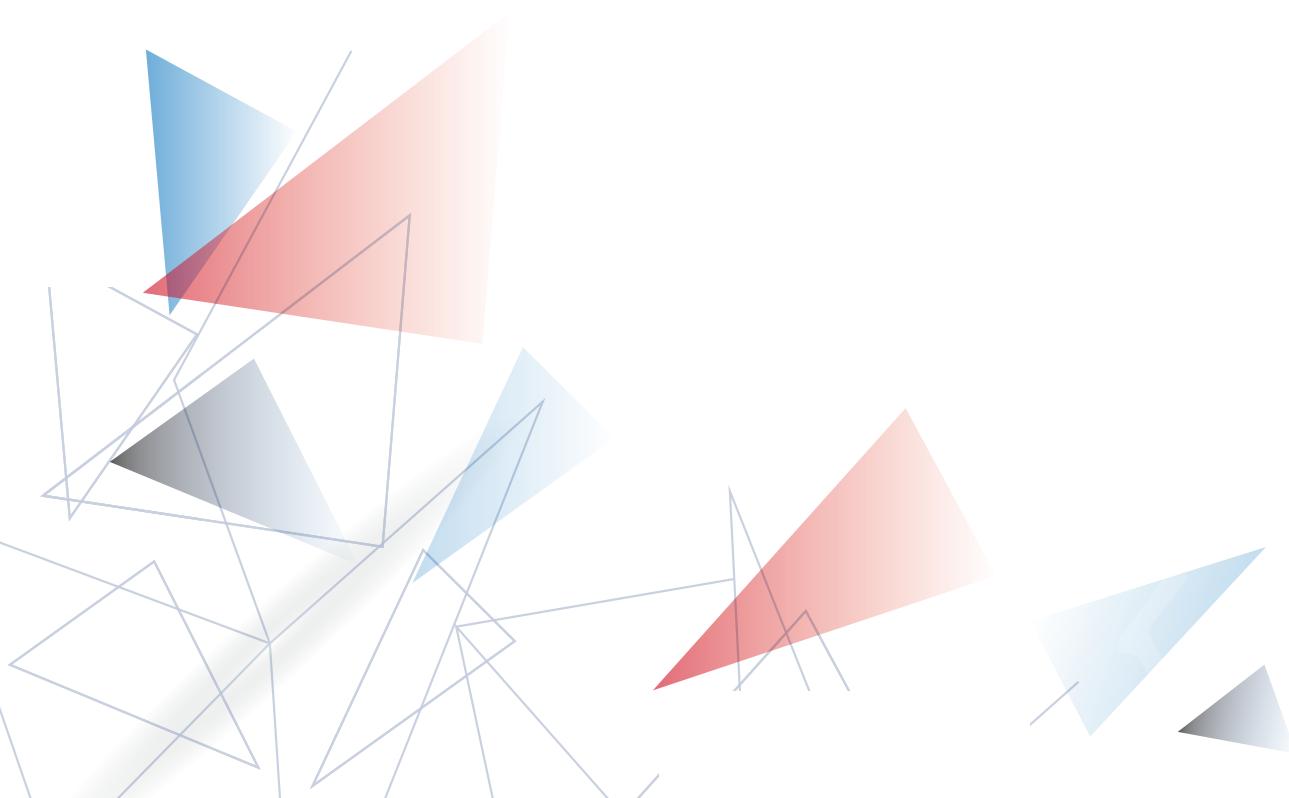
The first set of measures included closure of all learning institutions, banning of public gatherings, encouraging workers to do remote work, emphasising physical and social distancing, imposing nationwide night curfew, and decreeing containment in Nairobi metropolitan area, and Mombasa, Kilifi and Kwale counties. Other measures in this category were restricting the number of passengers in public service vehicles to at most 60 percent of the vehicle capacity, banning of international and domestic passenger flights, imposing quarantines, and emphasising on cleanliness and hygiene (Omolo, 2020a). While some of the containment measures have been relaxed, the restrictions are still largely in place.

The COVID-19 rescue package was in two sets. The first set were fiscal, monetary and social insurance policy measures aimed at moderating the social and economic impact of COVID-19. They included exempting those earning at most KSh. 24,000 from paying income tax, reducing Pay As You Earn (PAYE) capping from 30 percent to 25 percent, lowering value added tax (VAT) from 16 percent to 14 percent, reducing turnover tax from 3 percent to 1 percent, boosting the Social Protection Fund (SPF) by KSh. 10 billion, suspension of blacklisting of small businesses and corporates by Credit Reference Bureau (CRB) and ordering immediate payment of verified pending bills by MDAs. Monetary policy measures implemented were lowering of Central Bank Rate (CBR)

from 8.25 percent to 7.25 percent, reducing Cash Reserve Ratio (CRR) from 5.25 percent to 4.25 percent and encouraging commercial banks to negotiate appropriate loan scheduling with individual borrowers.

The second set of COVID-19 stimulus package came in form of 8-point economic stimuli at a cost of KSh. 53.7 billion. The first stimulus focused on rehabilitation of access roads, footbridges and other public infrastructure through public works programme. It targeted use of local labour and construction materials. The second point targeted education and focused on hiring of additional 10,000 teachers, and 1,000 information and communications technology (ICT) interns to support digital learning; and acquisition of 250,000 locally fabricated desks. The third point targeted SMEs through allocation of KSh. 10 billion to fast-track payment of outstanding VAT refunds and other pending bills, and an additional KSh. 3 billion given as seed capital for SME Credit Guarantee Scheme. The fourth point on health aimed at hiring additional 5,000 health workers and expansion of bed capacity in public hospitals.

The fifth point in the 8-point economic stimuli targeted supply of farm inputs to 200,000 small scale farmers, and an allocation to support horticultural farmers to access international markets. The sixth point aimed to support tourism sector through renovation of facilities, employment of community scouts and support to community conservancies. The seventh point was an allocation for greening the environment, which targeted employment of 270,000 young people at a daily wage of KSh. 455 under the *Kazi Mtaani* programme. The eighth point is targeted support to the manufacturing sector under the “Buy Kenya Build Kenya” initiative. The extent to which these measures have impacted on the informal economy is discussed in section 4.8.



► Section 3: Methodology

3.1 Introduction

This section presents the study design, sampling design and technique, including the sample size. It also presents the data types and sources, and the analytical methods used in the assessment.

3.2 Study design

The study employed a mixed methods design and was carried out in three phases. In the first phase, an in-depth desktop mapping of the characteristics, perception and needs for support services among informal economy enterprises was done through a systematic review of secondary data, relevant reports and publications. The second phase involved a survey of informal enterprises in selected towns in Kenya in order to understand their characteristics, perceptions and needs. The survey was conducted in Nairobi, Kiambu, Kajiado, Nakuru, Mombasa and Kisumu, and sampled 1,476 respondents. It also included a total of 14 KIIs, which involved one interview with Ministry of Labour and Social Protection (MoL&SP), seven interviews with various *jua kali* associations, and six interviews with public providers of financial and non-financial BDS. Four FGDs were also conducted in Nairobi, Mombasa and Kisumu. Additional qualitative data was obtained through personal in-depth interviews involving 429 respondents, and two FGDs with selected respondents in Kakuma and Kalobeyei refugee towns.

The final phase involved a broader analysis of the national situation of informal economy using two large nationally representative datasets: The 2016 MSME allows an analysis of informal sector economic units (and employment within those units) in non-agriculture; and 2015/2016 KIHBS provide elements regarding informal employment, including forms of informal employment. The 2016 MSME Survey is the most current nationally representative dataset that provides information on the nature of MSMEs in Kenya. The survey captured sector specific variables such as characteristics of the MSMEs, capital and technology, employment and remuneration, and business organization and performance. It mainly sampled MSMEs in non-primary product and service activities or businesses. Majority of MSMEs in primary activities including agricultural production, animal husbandry, fishing and forestry were excluded. Activities relating to growing of perennial cash crops or subsistence farming were also excluded since they were considered a way of life and not a business. On a limited scale, some agricultural activities carried out mainly for profit or for market were included in the data set.

The 2016 MSME survey frame was drawn from both the business registers held by counties (for licensed establishments) and the household survey (for unlicensed establishments). For the establishment-based sample, the survey adopted a stratified random sampling method in which a systematic random sample of establishments was drawn using equal probability selection method. For the household-based sample, two-stage sampling criteria was applied. The first stage involved a stratified sample selection of 600 clusters (354 in rural and 246 in urban) from the country's national master sampling frame. In the second stage, a uniform random sample of 24 households in each cluster was selected using the systematic random sampling method. The survey yielded an unweighted sample of 21,863 MSMEs. When extrapolated to the populations it yielded 7,409,939 million enterprises out of which 6,987,090 (94.29%) were informal and 422,849 (5.71%) were formal (see Appendix 3 for tools)

Since selected samples were not self-weighting owing to varying probabilities of selection across different strata, weighting of the data was necessary. The design weights for the licensed establishments applied the probabilities of selection of the establishments from the establishments sampling frame. Household weights were used for the unlicensed establishments. The weights were based on the probability of selection of the MSME clusters from the National Sample Survey and Evaluation Programme (NASSEP) sampling frame.

The 2015/16 KIHBS was undertaken to provide data on a wide range of indicators such as household characteristics, education, employment and income, credit, and ICT. The sample was drawn from the NASSEP V household sampling frame. Since the data was not self-weighted, appropriate weights drawn from the NASSEP V frame were used.

The 2015/16 KIHBS was based on a three-stage sampling approach where a total of 24,000 households were sampled out of which, 21,773 households were interviewed. For the purpose of this study, workers considered to be informal were those who had no contract (excludes verbal or implied), their employers did not contribute towards NSSF and NHIF, and did not provide for paid annual leave and medical benefits. Section 9 (1a&b) of the Employment Act makes a written contract of service to be mandatory if the period of engagement exceeds three months, otherwise the contract may be oral. A contract of service can, however, be express or implied (Republic of Kenya, 2007c). The implication is that a worker may be engaged without any written contract. The requirement for a contract of employment was relaxed to reduce errors in the data.

In addition to the two surveys, more qualitative data was collected in Nairobi City, Kitui, Meru, Nyandarua and Kiambu counties. The data was collected through purposely selected 14 key informants. These include one interview with public financial microfinance, three interviews with private financial institutions, two interviews with trade unions, four interviews with county governments, one interview with Ministry of Industry, Trade and Cooperatives, one interview with MSEA, one interview with KNFJKA, and one interview with an informal economy association. Two FGDs of three persons each were also conducted with informal economy associations in Nairobi City county.

3.3 Analytical Approach

Data analysis followed a combination of descriptive statistics, econometric techniques and thematic analysis. Before assessment, the quantitative primary data collected through the survey of 1,476 respondents (Nairobi, Nakuru, Mombasa, Machakos, Kajiado, Kiambu and Kisumu) was entered into a spreadsheet and then cleaned for any inconsistencies, errors, missing data and outliers. In addition, MSME (2016) and KIHBS (2015/16) datasets were examined for any errors and inconsistencies before analysis could be done. The datasets were then analysed along the relevant themes using STATA and EXCEL. Descriptive statistics included means, comparisons and cross tabulations while econometric analysis used logistic regression models to determine relevant relationships such as drivers of informality or formality. Qualitative data from the KIIs and FGDs were analysed through the framework analysis method.

► Section 4: Findings and Discussions

4.1 Introduction

This section presents the analysis, interpretation and discussion of the findings. The analysis and findings are thematically presented in line with the objectives of the study. Section 4.2 presents the characteristics of informal enterprises, section 4.3 discusses employment and remuneration of informal economy workers, section 4.4 presents access to credit and finance by informal enterprises while section 4.5 presents the market conduct of the informal enterprises. Section 4.6 delves into formalization aspects of the informal enterprises while section 4.7 presents the constraints faced by the informal enterprises and their perceived solutions. The last section, 4.8 describes the effects of COVID-19 on the informal economy.

4.2 Characteristics of informal enterprises

Informal enterprises in Kenya are largely unlicensed microenterprises aged seven years and require capital of up to KSh. 200,000 to start. Disaggregation of distribution of MSMEs by size is important in designing products for the enterprises in a particular country, proper spending of donor funding in private sector development and designing support programs for the enterprises (Gibson and Van der Vaart, 2008). Analysis of the 2016 MSME survey data shows that majority of informal enterprises in Kenya are unlicensed microenterprises. Of the 6,987,090 informal enterprises captured in the 2016 MSME Survey, 99.4 per cent were micro enterprises, 0.5 per cent were small enterprises and 0.1 per cent were medium enterprises⁶. Irrespective of the size, the start-up capital for all the MSMEs surveyed ranged from KSh. 0-200,000. This finding is similar to that of TIFA (2020) that established that 57 and 10 per cent of informal enterprises invested KSh. 30,000 and KSh. 100,000 as initial capital, respectively. The average age of the enterprises was estimated at seven years for microenterprises and ten years for small and medium enterprises (Table 1). A higher average age shows higher enterprise survival rates, which is important for long-term stability of the business. While only 16.2 percent of the microenterprises were licensed, all the small and medium enterprises were licensed, implying the significance of firm size in enhancing likelihood of formalization.

		Micro Enterprises	Small Enterprises	Medium Enterprises
Proportion (%)		99.4	0.5	0.1
Initial capital (KSh.)	Minimum	0	0	3000
	Maximum	200000	200000	200000
Average age (years)		7	10	10
Proportion of licensed enterprises		16.2	100	100
Source of Data: MSME Survey, 2016				

Table 1: Distribution of informal enterprises by size, value of initial capital and age

Source of Data: MSME Survey, 2016

Majority of informal enterprises operate in the wholesale and trade sector while a few others engage in manufacturing, and accommodation and food service activities. The 2016 MSME survey data shows that 63 percent of the micro enterprises were engaged in wholesale and retail activities compared to 31 percent for small and 34 percent for medium enterprises (Table 2). The distribution of these enterprises around these sectors was consistent across the major towns surveyed (Table A2 in the Appendix). This is in consonance with TIFA (2020) survey that established that 52 percent of informal enterprises were in wholesale and retail. The low proportion of enterprises reported in agricultural and allied activities is owing to the fact that many agricultural activities were excluded from the MSME sampling since they did not fall within the realm of a business establishment (KNBS, 2016). Though the non-diversification of these enterprises across different sectors is often associated with ease of entry and exit in a particular sector, it increases concentration risk in the economy. In addition, the concentration of informal enterprises in a few sectors raises questions on the ability of policy design to increase participation of informal enterprises in priority sectors such as manufacturing. This is against the backdrop of the government's commitment in the MTP II and III to prioritise the growth of MSEs in manufacturing sector as a key source of economic growth and employment by the year 2022 (Republic of Kenya, 2013b;2018).

Sector (%)	Micro Enterprises	Small Enterprises	Medium Enterprises
Wholesale and retail	62.5	30.8	34.2
Manufacturing	12.0	5.5	24.9
Accommodation and food services	9.1	24.4	15.7
Other services	6.1	3.2	6.4
Agriculture and allied activities	3.5	1	0
Others	6.8	35.1	18.8

Table 1: Distribution of informal enterprises by size, value of initial capital and age

Source of Data: MSME Survey, 2016

Informal enterprises experience financing constraints at inception, which can be minimized if they are formalized. Knowledge of the source of capital for any going concern is critical in identifying financing constraints experienced by the establishments and sectors to which they belong. Analysis of the 2016 MSME data revealed that 88.5 percent of informal microenterprises were financed through own savings and family income compared to 76.6 percent for small enterprises and 74.5 percent for medium enterprises (Table 3). The remainder (11.5 per cent) of the microenterprises were financed by other sources such as family/friends loan, non-bank credit institutions/MFIs, Rotating Savings and Credit Association (ROSCAs), government loan, formal and informal cooperatives, trade credits, in-kind donations, postal savings and *chamas* ⁷. This finding is in keeping with TIFA (2020) survey that noted that 67 per cent of informal enterprises relied on personal savings and income to start their businesses. The alternatives to own savings and family income may not be available for informal enterprises due to financial exclusion – a phenomenon associated with lack of access to useful and affordable financial products and services especially from formal institutions. Many of the formal financial institutions demand books of accounts, evidence of business registration, tax compliance and collateral as a precondition for accessing credit, things which most traders in the informal economy do not have. This finding is corroborated by a KII respondent from a commercial bank who indicated that:

...depending on the size of the business, requirements differ. However, in all forms of businesses, for one to qualify for a business loan he/she must have an account with us. The person must have operated the account for at least six months. We do not finance start-ups...

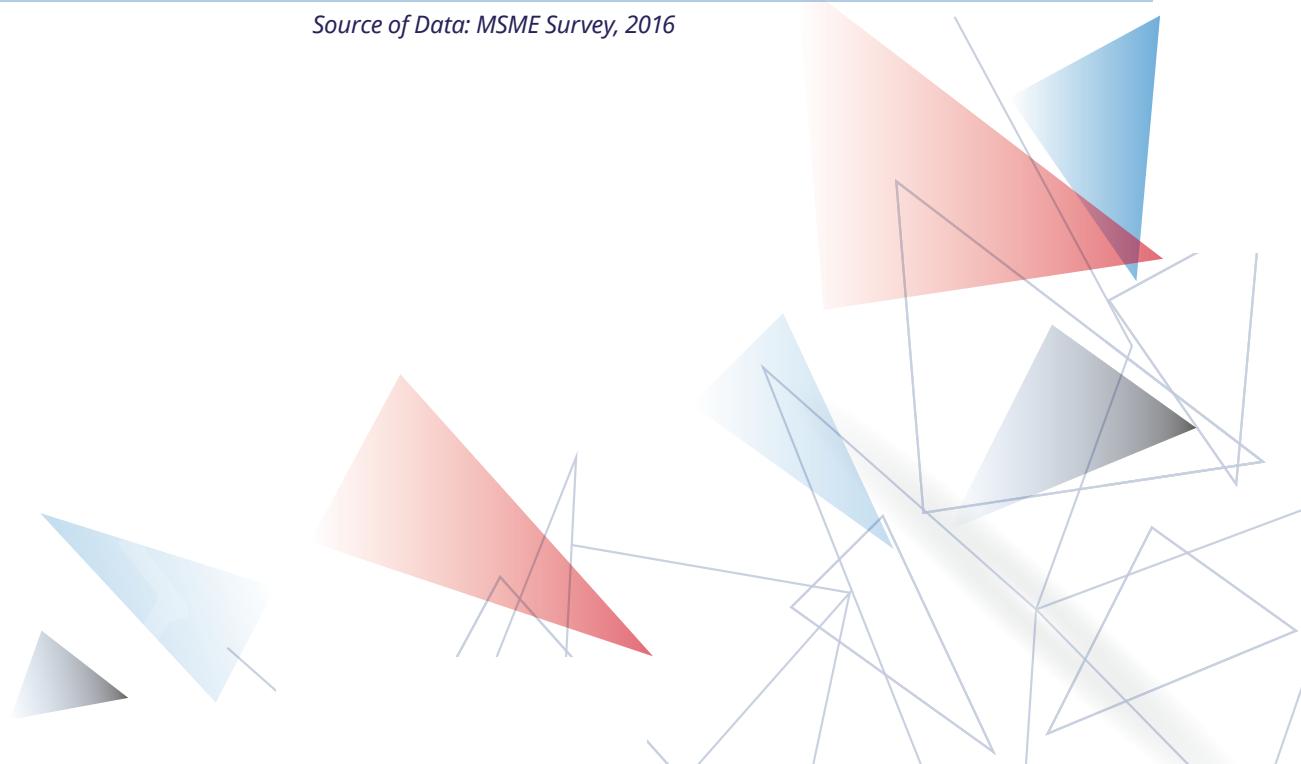
The main motivation for starting informal enterprises varies with enterprise size. Analysis of the 2016 MSME survey data set shows that micro enterprises are mostly established for betterment of income, small enterprises are mainly established to facilitate better utilization of owner's skills while the main motivation for starting a medium enterprise is to take advantage of existing markets and market demand. The different motives for establishing the various sizes of informal enterprises may explain why informal enterprises do not graduate in size. Informal micro enterprises appear to be for survival. In fact, analysis from the TIFA (2020) survey suggests that nearly one-third of informal entrepreneurs engage in business for lack of any other available economic activity (Figure A1 in Appendix 2). In contrast, informal microenterprises, are for professionals who want to utilize their skills while medium enterprises are for responding to an existing entrepreneurial opportunity. The different motivations for starting these informal enterprises has implications on the effort and resources that firm owners invest in the business in order to succeed.

Majority of entrepreneurs in the informal economy regard it as "a waiting sector". According to the 2016 MSME Survey, microenterprises motivated by betterment of income generated the least average monthly income of KSh. 6,000 followed by medium enterprises at KSh. 20,000 and small enterprises at KSh. 50,000 (Table 3). It is also noted that while nearly one quarter of the micro businesses are driven by the need to better their income, additional results from TIFA (2020) survey showed that 32 percent of the respondents engaged in the informal economy due to lack of any other work. This was confirmed by KIIs and FGDs with respondents drawn from informal business owners and workers, who indicated that majority of new entrants into the informal economy were those who were unable to get any other work or lost their jobs due to COVID 19 or normal redundancy. The findings point to a situation where majority of workers and entrepreneurs in informal economy engage themselves in the business due to lack of an alternative, thus making the informal economy a "a waiting sector". This is against the spirit of MTP III that seeks to focus on promoting entrepreneurship culture in the country as the main stay rather than an alternative to joblessness (Republic of Kenya, 2018).

	Micro Enterprises	Small Enterprises	Medium Enterprises
Main source of capital (family and own funds)	88.5%	76.7%	74.5%
Main reason for Starting the business	Better income (24.5%)	Individual is skilled in the business (25%)	High demand and ready market (23.2%)
Monthly income from the business (Median KSh.)	6,000	50,000	20,000

Table 3: Source of capital and income generated from informal enterprises

Source of Data: MSME Survey, 2016



Ownership of informal enterprises is skewed in favour of male entrepreneurs with tertiary education. The gender and level of education of the owner of an informal enterprise is important in determining the success of the enterprise. The 2016 MSME survey established that females own more than half (58.5%) of the informal microenterprises while males own more than half of informal small (55.6%) and medium enterprises (51.2%). Joint male-female ownership is higher for informal medium enterprises (23.5%) compared to small (23.1%) and micro enterprises (7.5%). A large proportion (30.7%) of the males who own medium enterprises have college level of education while 35.4 percent of those who own microenterprises have secondary level of education. Most males who own small informal enterprises are college (30.7%) and university (22.5%) graduates (see Table 4). This means that males dominate ownership of small and medium enterprises while females with primary and secondary level of education dominate ownership of microenterprises. This enunciates a gender gap in the ownership of informal enterprises with males owning the more productive small and medium enterprises while females own the less viable microenterprises.

(%)		Micro Enterprises	Small Enterprises	Medium Enterprises
Domain				
Gender of the owner(s)	Male	34.5	55.6	51.2
	Female	58.5	21.3	25.3
	Both	7.0	23.1	23.5
Level of education	Primary	30.8	14.0	14.8
	Secondary	35.4	28.7	28.7
	College	19.7	30.7	30.7
	University	5.0	22.5	18.0

Table 4: Distribution of informal enterprises by gender and level of education of owner (%)

Source of Data: MSME Survey, 2016

Informal enterprises have low levels of social capital. The 2016 MSME Survey data shows that on average, 66 per cent of the owners of informal enterprises do not belong to any organization such as MSME associations, chamber of commerce, merry go rounds, women/men associations or any other form of business association. The implication is that only one-third of the informal enterprises belong to any of the organizations in question. Membership to organizations is positively related to enterprise size with a relatively larger proportion (37.9%) of medium enterprises belonging to some organization compared to 32.8 percent for small enterprises and 30.6 percent for microenterprises (see Table 5). Most of the informal enterprises are in *merry go rounds* (17.1%), MSE associations (6.7%), ROSCAs (4.3%), men and women associations (4%) or other business associations (1.9%). Less than one percent of the enterprises are members of chamber of commerce. The findings support those of TIFA (2020) survey, which established that only 44 percent of the informal enterprises belonged to various associations such as *chamas* (31%), SACCOS (10%), religious groups (8%) and co-operative movement (3%).

Informal enterprises do not participate in activities of support organizations. Non-membership of informal enterprises to organizations mirrors their low level of participation in activities of support groups, which is estimated at 33.8 percent. In relative terms, a larger proportion (67.3%) of small enterprises do not participate in activities of support organizations compared to 64.3 percent for medium enterprises and 62.4 percent for microenterprises. A negative aspect of low membership and/or participation in activities of membership organizations or support groups is that it constrains informal entrepreneurs from accessing credit particularly from institutions who use such association to guarantee the loan. This was reiterated by a key informant from a public micro-finance institution who indicated that,

...for a member to qualify for a loan he/she must be operating a business. However, in the event someone had a business but the business collapsed and there is proof by group members, he/she can still qualify for a loan to start up a business again. Meeting attendance is a requirement. For any member to qualify for a loan, he/she must have attended at least six meetings during training...

Mdoe and Kinyanjui (2018) also observed that the quality and quantity of networks and associations or social capital that individuals and businesses keep influences the decisions that they make. The implication is that the informal enterprises may not be benefitting from social capital.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Belongs to some organization	30.6	32.8	37.9
Does not belong to any organization	69.4	67.2	62.1
MSE associations	3	8	9
Chamber of commerce	0.03	0.76	0
Other business associations	1.14	4.42	0
Merry go round	21.68	14	15.6
ROSCAs	3.58	3.22	6.22
Men and women associations	4.31	5.6	2
Not participating in support groups	62.4	67.3	64.3

Table 5: Membership and participation of informal enterprises in organizations or support groups (%)

Source of Data: MSME Survey, 2016

Informal enterprises experience seasonal variations in business and have monthly turnover of between KSh. 27,016 and KSh. 1,428,048. Analysis of the 2016 MSME Survey data shows that, on average and irrespective of size, all informal enterprises experience booming business for only three months in a year usually between October and December. On the downside and irrespective of enterprise size, all informal enterprises experience a low season for three months between January and March. The worst month for majority of the informal enterprises is January as expressed by 45.6 percent of the microenterprises, 44.8 percent of the small enterprises and 40.8 percent of the medium enterprises. December is considered to be the best month for the businesses and particularly for micro enterprises (56%) and small enterprises (50.7%). The monthly turnover for informal enterprises varies with firm size. Medium enterprises record a monthly turnover of KSh. 1,428,048 which is 53 and 13.6 times the monthly turnover of micro and small enterprises, respectively (Table 6). The county governments, however, continue to levy same amount of fees and taxes on the informal economy irrespective of the cyclical variations in business and turnover, contributing to financial distress on some informal economy operators.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Good months in a year	3	3	3
Normal months in a year	5	5	5
Bad months in a year	3	3	3
Best month in the year	December (56%)	December (50.7%)	December (43.2%)
Worst Month	January (45.6%)	January (44.8%)	January (40.8%)
Monthly Turnover (KSh.)	27,016	105,240	1,428,048

Table 6: Seasonal variations in business and turnover by informal enterprises

Source of Data: MSME Survey, 2016

Informal enterprises access formal financial infrastructure through their owners. Banks and other financial institutions are important in channelling resources to various productive units in an economy (Mdoe, Omolo and Wawire, 2019). Access to banking services by MSMEs is, therefore, critical in ensuring that they are linked with an important source of finance. The 2016 MSME Survey data showed that 80.1 percent of the informal small enterprises have a bank account compared to 53.7 percent for informal medium enterprises and 22 percent for informal micro enterprises. This is surprising considering that the enterprises are unregistered

and may not open accounts. This contrast may be due to innovations in the financial markets that have allowed enterprises that are unregistered to open accounts through their owners (see Box 2 and 3).

MSMEs make and receive payments through mobile money platforms and keep some records. More than half (57.2%) of the small informal enterprises have mobile money platforms compared to 54.4 percent for informal medium enterprises and 34 percent for informal micro enterprises. All the informal enterprises maintain some form of records with a relatively higher frequency found in small enterprises (88.7%) compared to medium enterprises (68%) and micro enterprises (28%). The most common form of records maintained by the entrepreneurs are cash sales and receipts, sales daybook and monthly ledger, cashbook and petty cashbook, bank reconciliation statement, records of external accountancy services and personal notes (Table 7). These results are corroborated by TIFA (2020) survey, which indicated that only 33 percent of the informal enterprises kept a complete set of accounting records with the proportion varying widely across towns. The finding reaffirms the dearth of information among informal microenterprises. The findings also confirm that informal small enterprises are more likely to be connected to bank finance compared to informal medium and microenterprises due to records. Overall, the finding that the proportion of enterprises with bank accounts is uniformly lesser than that of enterprises keeping records shows that failure to keep records may be keeping a number of enterprises out of the formal financial infrastructure in the country.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Has a bank account	22	80.1	53.7
Keeping records	27.8	88.7	68
Has mobile money platform	34	57.2	54.4
Keep cash sales and receipt	11	68	32
Keep sales daybook and monthly ledger	5	38	16
purchases daybook and monthly purchases ledger	2.3	34	21
Cash book and petty cashbook	1.5	30	10

Table 7: Possession of bank accounts, mobile money platforms and record keeping by informal enterprises (%)

Source of Data: MSME Survey, 2016

Informal enterprises have low levels of innovation⁸. The ability of a firm to innovate is an important driver of firm survival and growth (Minitti, 2008; McCormick & Maalu, 2011; Audretsch, Coad & Segara, 2014). Minitti (2008) and Ainon, Kamarulzaman and Farida (2010) argue that innovation is an important ingredient for competitiveness of MSMEs as it aids the enterprises to move to higher return activities and eventually facilitate a graduation from micro to small to medium and finally to large enterprises. Such vertical growth should lead to creation of more and higher quality jobs (Minitti, 2008). The 2016 MSME Survey revealed low innovation capability among the MSMEs. According to the survey, 96 percent of the informal microenterprises had neither introduced new products, new marketing methods, nor new production techniques between 2013 and 2015. The level of rigidity to innovation in microenterprises is similar for medium enterprises (92 per cent) and small enterprises (89 percent). The implication is that in 2013-2015, the informal enterprises did not introduce (i) new or significantly improved their goods or services; (ii) new marketing method involving significant changes in product design or packaging, product placement, promotion or pricing; or (iii) new or significantly improved methods of manufacturing or producing goods or services.

Micro and medium enterprises have a higher level of rigidity to innovation than small enterprises. An inspection of the innovation rigidity levels reveals that informal micro and medium enterprises are more rigid to innovation than small informal enterprises (Table 8). The problem of low or lack of innovation by enterprises in the informal economy is decried in various government policy documents such as the Sessional Paper Number 2 of 1992; Sessional Paper Number 2 of 2005; Medium Term Plans I, II and III and the National Trade Policy of 2016. Though the policy documents prescribe measures aimed at promoting innovation in the informal economy such as establishment of SME Industrial Parks, MSME centres of excellence, and incubation

8. Refers to implementation of a new or significantly new product/service, new production process, new marketing method and/or a new business organizational practice that facilitates an enterprise to expand its employment and sales turnover. It encompasses product innovation, process innovation, organizational innovation and market innovation.

activities by KIRDI, the challenge of weak innovation capability among informal enterprises persists. This may be attributed to weak implementation and poor targeting of the interventions.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Did not introduce a new product	96	89	92
Did not introduce new marketing method	99.2	93.2	98
Did not introduce new production methods	97.4	89.7	96.6

Source of Data: MSME Survey, 2016

Table 8: Innovation capability by informal enterprises (%)

Source of Data: MSME Survey, 2016

Small informal enterprises are more than twice as productive as micro and medium enterprises.

Informal employment in Kenya accounted for 83 per cent of total employment in 2019 (KNBS, 2020). This means that increasing productivity of the informal enterprises is critical for growth, equality and employment. The KNFJKA maintain that informal economy produces almost everything else that requires skills and is not imported. When measured in terms of monthly sales per worker, small informal enterprises are on average more than twice as productive as the informal micro enterprises with a mean monthly sales per worker of KSh. 34,345 compared to KSh. 16,741 for informal microenterprises. Informal medium enterprises have low levels of productivity relative to micro and small enterprises (see Table 9). When productivity is disaggregated in terms of ease of entry⁹, informal enterprises in sectors with ease of entry and exit such as agriculture and fishing, mining and quarrying, wholesale and retail trade, administrative support services and arts entertainment are less productive compared to those informal enterprises in sectors with restricted entry and exit such as electricity gas steam and air, water supply sewerage and waste management, transportation and storage, real estate activities, professional and scientific activities, public administration, and education services. When disaggregated in terms of gender, male owned informal enterprises are about twice as productive (KSh. 24,764) as female owned enterprises (KSh. 12,408), demonstrating gender gaps in productivity of informal enterprises in Kenya.

Criteria	Characteristic	Median Sales	Mean sales
Size	Micro	6,667	16,741
	Small	7,645	34,345
	Medium	656	16,540
Sector	Easy to enter	6,700	17,411
	Difficult entry	9,000	17,952
Gender	Female	5,760	12,408
	Both	6,667	17,496
	Male	9,600	24,764

Table 9: Productivity of informal enterprises (monthly sales per worker in KSh.)

Source of Data: MSME Survey, 2016

9. A sector has ease of entry if there are no government regulations or other forms of barriers that bar entry into those sectors.

Majority of the informal enterprises do not use technology in their operations. Technology has been widely used by firms to improve their productivity. However, this is not the case among the informal enterprises. According to 2016 MSME Survey, less than 15 percent of informal enterprises have internet (see Table 10). The TIFA (2020) survey also established that only about 14 percent of the informal enterprises surveyed incorporated use of ICT in their operations. This may be informed by the nature of activities that the informal enterprises engage in. Majority of the informal enterprises engage in business activities that are artisan-oriented, which may not be executed over the internet. The KNFJKA concurred with this finding when it opined that the members are hard hit by COVID-19 because their activities cannot be conducted over the internet or remotely. Unlike the formal enterprises, which use internet for business related activities, less than half (48%) of the informal enterprises make use of mobile money for payments. This shows that informal enterprises are willing to adopt technologies that work for them. As established by TIFA (2020) survey, the few informal enterprises that make use of internet do it mainly for marketing, communication, production, records management, accounting and finance, planning and budgeting and human resource in that order. This further explains why informal enterprises hardly use the internet since majority use social networks for marketing and do not maintain any records whether financial, production or otherwise.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Use internet	1	15	13
Does not use internet	99	85	87
Uses mobile money	33	57	54
Does not use mobile money	67	43	46

Table 10: Use of technology informal enterprises (%)

Source of Data: MSME Survey, 2016

Almost all business failures in the informal economy occurs in the micro segment. Studying business failure is important in creating lessons for future and present entrepreneurs. Though a negative event, the outcomes of failure are usually positive because they help entrepreneurs to focus their skills in opportunity recognition, opportunity exploitation and interpersonal skills (Atsan, 2016). The 2016 MSME Survey showed that eight percent (93,638) of the informal licensed enterprises failed in the last five years before the survey. The failure rates are predominantly an informal micro establishments affair, which accounted for 97 percent of all the failure cases (Table 11).

Female-owned informal enterprises are more likely to fail. More than half (61%) of the informal economy business failures occur in the first five years and to a larger proportion affect female owned microenterprises. The 2016 MSME Survey Basic Report attributes these failures to shortage of funds occasioned by increased operating costs, declining income and losses incurred. In addition, the failure rates are exacerbated by social and biological reasons with most of the female owned establishments closing down due to obligation arising from prenatal and postnatal care of children. This means that business failure is associated with firm size, age and the gender of the owner. An informal establishment will most likely fail if it is micro, is within the first five years of operation and is female owned (see Tables 11 and 12).

	Total	Male	Female	Both
Micro	90,862 (97.0)	41,407 (95.7)	34,434 (99.6)	15,021 (95.3)
Small	2,774 (3.0)	1,881 (4.3)	149 (0.4)	744 (4.7)
Medium	2 (0.0)	2 (0.0)	0 (0.0)	0 (0.0)
Total	93,638 (100.0)	43,290 (100.0)	34,583 (100)	15,765 (100.0)

Table 11: Closure of establishment by size and gender of the owner (%)

Source of Data: MSME Survey, 2016

Age in years	Micro	Small	Medium
0-5	55,854 (61)	946 (34)	2 (100)
6-10	18,488 (20)	847 (31)	0 (0)
>10	16,520 (18)	981 (35)	0 (0)
Total	90,862	2,774	2

Table 12: Closure of establishment by age and size

Source of Data: MSME Survey, 2016

4.3 Workers in the informal economy

About nine in every ten informal economy workers are in micro enterprises. The number of workers in the informal economy stood at 15,051,600 in 2019 (Republic of Kenya, 2020), representing a 27.5 percent increase over the 11,806,646 captured in the MSME survey of 2016 ¹⁰. The informal micro enterprises engaged majority (93%) of the workers followed by informal small enterprises (5%) and informal medium enterprises (2%). Of the 3,949,147 workers whose gender and form of employment were stated in 2016, 35.9 percent were females ¹¹ (Table 13). This situation, however, contrasts with the KIHBS (2015/2016) data, which showed that majority (53%) of informal workers are females . Also, according to the 2016 MSME Survey, majority (55.1 %) of the workers in informal enterprises were regular employees followed by unpaid family workers (21%), casuals (16.7%), part-time regular workers (5.2%) and those on attachment, internship and apprenticeship (2.2%). This is not any different from the TIFA (2020) survey, which found that majority of workers in informal enterprises are temporary staff with no or verbal contract agreements. This trend is consistent with the employment dynamics in Kenya, which show increasing trends towards non-standard employment (NSE) relations with increased casualization of work, contract engagement, outsourcing of jobs, subcontracting, piece-rating and temporary employment (Omolo, 2020b). It is also a manifestation of precariousness and decent work deficits in the informal economy.

10. This figure may have understated the number of workers in the informal economy because the 2016 MSME survey focused on informal sector units, with no or little coverage of agriculture. This may have biased the 27% growth in the proportion of workers in the informal economy between 2016 and 2019.

11. These variations may be attributed to the workers whose gender were not specified in the 2016 MSME Survey and the differences in the unit of study for both the 2016 MSME Survey and KIHBS (2015/2016). While the 2016 MSME Survey focused on enterprises as the unit of study, the KIHBS (2015/2016) focused on households.

Type of employee	Micro Enterprises		Small Enterprises		Medium Enterprises	
	Male	Female	Male	Female	Male	Female
Regular	1,037,018	685,690	175,807	172,564	62,755	40,437
Part time regular	94,465	85,016	13,478	6,779	3,410	258
Unpaid family workers	540,261	233,067	15,592	7,539	25,418	1,680
Casuals	407,109	117,176	63,865	26,758	36,903	7,908
Attaches, Interns and apprentices	46,267	22,647	10,873	8,249	0	158
Total specified	2,125,120	1,143,596	279,615	221,889	128,486	50,441
Unspecified	2,810,482	4,897,087	56,455	48,377	10,969	34,129
All workers hired by size and gender	4,935,602	6,040,683	336,070	270,266	139,455	84,570
Proportion (%)	92.96		5.14		1.9	
Total number of workers			11,806,646			

Table 13: Workers employed by informal enterprises

Source of Data: MSME Survey, 2016

Informal enterprises have low levels of unionization. According to the 2016 MSME Survey, the levels of unionization in the informal enterprises range from almost none (0.5%) in micro enterprises, to 3 percent for medium enterprises and to 6.5 percent for small enterprises (Table 14). The low level of unionization in informal enterprises is corroborated by the KIHBS (2015/2016), which showed that up to 99 per cent of the informal workers covered in the survey were not members of any trade union. The low levels of unionization in the informal economy is a negation of the fundamental principles and rights at work as enshrined in Article 41 of Kenya's Constitution, domestic labour laws and relevant ILO Conventions. It is also a manifestation of focus by trade unions and employers' organizations to organize and recruit formal sector workers and employers for purposes of collective bargaining and negotiations. The shrinking formal employment has, however, made most trade unions and employers' organizations to increasingly target the informal economy for membership organization and recruitment.

Nature of employment relationship in the informal economy blurs the distinction between a worker and employer. Low membership of informal economy workers in trade unions may be attributed to low levels of awareness and knowledge of the workers about trade unions, and the focus of the trade unions in organizing and recruiting workers from the formal sector. It may also be attributed to the nature of employment relationship in the informal economy, which blurs the distinction between a worker, employer and owner, and strict existence of employment relationship. Lack of clarity in existence of employment relationship and social networks between informal economy workers and entrepreneurs may inhibit workers' desire and undermine their vigour to exercise the right to freedom of association, inclusive of other fundamental principles and rights at work.

The monthly wage paid by informal enterprises is below the minimum wage. Analysis of the 2016 MSME survey data showed that in sum micro, small and medium enterprises that had hired workers incurred monthly wage expenditures of KSh.15 billion, KSh.2.9 billion and KSh.441 million, respectively (Table 14). This translates to a monthly wage of KSh. 3,525, KSh. 4,975 and KSh. 2,082 per worker for the micro, small and medium enterprises in that order. These monthly wages are below the 2020 statutory minimum wage rates for a labourer of KSh. 13,572.88, KSh. 12,522.72 and KSh. 7,240.96 for cities, former municipalities and other areas, respectively (KNBS, 2020). The estimated monthly wages for informal economy workers in micro and medium enterprises are below the 2015/2016 overall poverty line of KSh. 3,252 per month per adult equivalent in rural and peri-urban areas. The monthly wages paid by all categories of informal enterprises are in all instances lower than the KSh. 5,995 monthly overall poverty line per adult equivalent in core urban areas¹². The TIFA (2020) survey averred, however, that majority of workers in informal enterprises have verbal contracts and do not work throughout the month hence attracting an average income that ranges between KSh. 1,001 and KSh. 2,000 per week (TIFA, 2020). Overall, informal economy jobs do not provide income security, which is a critical pillar of decent work.

Range/Type of Enterprise	Micro Enterprises	Small Enterprises	Medium Enterprises
Monthly wage expenditures (KSh)	15,545,498,682	2,909,991,607	440,825,230
For how many workers (KSh)	4,410,058	584,938	211,723
Monthly wage per worker (KSh.)	3,525	4,975	2,082
Proportion of unionized workers (%)	0.5	6.5	3

Table 14: Monthly wage expenditures by informal enterprises and level of unionization

Source of Data: MSME Survey, 2016

Majority of informal workers are at most 46 years of age. The KIHS (2015/2016) data shows that the informal economy taps workers who are both within and outside the working age population. According to the survey data, 8.3 per cent of the informal economy workers were aged 5-14 years, confirming existence of child labour in the informal economy. Similarly, 7.1 percent of the workers were aged 65 years and above and by definition are outside the working age population. The survey data also shows that 44.2 percent of the informal economy workers were young (15-34 years) while 22.3 percent of the workers were aged 35-46 years. Close to three-quarters (74.8%) of informal economy workers are at most 46 years (Figure 1). The findings are in line with those of TIFA (2020) survey, which showed that the informal economy mostly employs young workers aged between 21 and 34 years.

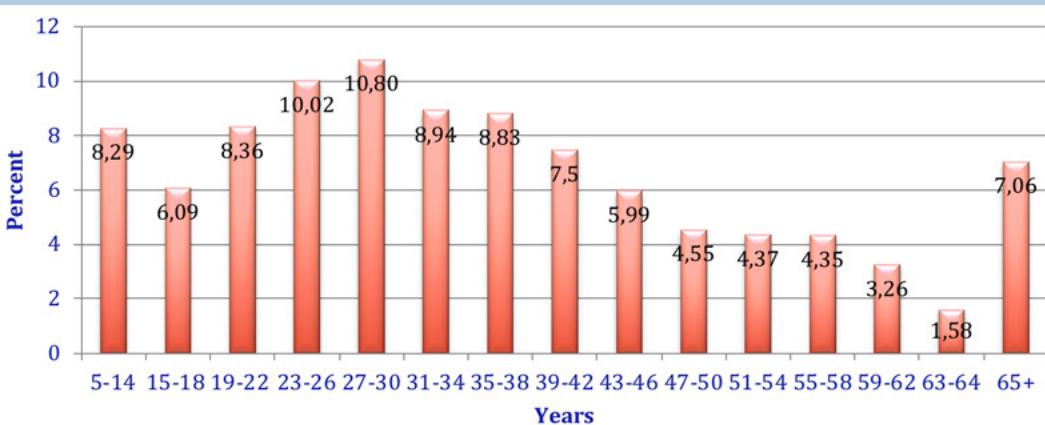


Figure 1: Informal economy workers by age

Source of Data: KIHS (2015/2016)

12. Kenya National Bureau of Statistics [KNBS, 2018]. Basic Report on Well-being in Kenya, Nairobi: Kenya National Bureau of Statistics

Informal small and micro enterprises are more likely to hire secondary school leavers. Further analysis of the 2016 MSME Survey data shows that informal micro and small enterprises are more likely (34.2% and 29.5%, respectively) to hire workers with secondary level of education unlike medium enterprises that are more likely (39.3%) to hire workers with primary level of education. Across the board, all the three categories of enterprises have at least an employee with diploma, degree or postgraduate level of education (see Table 15). This implies that the informal enterprises in Kenya are a key labour sponge and a reserve of skills. The 2016 MSME Survey data is consistent with the KIHBS (2015/2016), which indicate that slightly more than three in every four (78%) of informal economy workers have at most secondary level of education, and three in every 25 (12%) of the informal economy workers have no education. Consistent with the 2016 MSME Survey, informal economy workers have educational attainment spanning different levels of tertiary education from middle level vocational colleges to university (see Table 16). This finding debunks the notion that the informal economy is for those who have not gone to school or those with limited skills.

	Micro Enterprises		Small Enterprises		Medium Enterprises	
	Frequency	(% of specified)	Frequency	(% of specified)	Frequency	(% of specified)
None	185,279	8.8	17,426	3.5	15,900	8.0
Lower primary	1,872	0.1	0	0.0	0	0.0
CPE/KCPE	608,157	28.8	73,579	14.9	78,288	39.3
Lower secondary	4,555	0.2	0	0.0	0	0.0
KCE/KCSE	723,385	34.2	145,726	29.5	65,908	33.1
Certificate	168,084	7.9	59,873	12.1	0	0.0
Diploma	286,353	13.5	88,501	17.9	12,681	6.4
Degree	117,791	5.6	88,787	17.9	25,223	12.7
Postgraduate	18,921	0.9	20,803	4.2	1,272	0.6
Total Specified	2,114,397		494,695		199,272	
Unspecified	8,861,888		111,641		24,753	
Total Number of workers	10,976,28		606,336		224,025	
	5					

Table 15: Distribution of informal enterprises by workers' level of education

Source of Data: MSME Survey, 2016

Education level completed	Proportion (%)
Pre-primary	1.23
Primary	53.05
<i>Madrasa/Duksi</i>	0.17
Secondary	24.98
None	12.04
College (Middle-level)	5.25
Post-primary, Vocational	1.33
University undergraduate	1.21
Other	0.62
University Postgraduate	0.12

Table 15: Distribution of informal enterprises by workers' level of education

Source of Data: MSME Survey, 2016

Less than 19 percent of informal enterprises make NSSF and NHIF contributions for their workers. An analysis of the monthly expenditures by informal enterprises towards NSSF and NHIF revealed that an average of 24.3 percent of the MSMEs paid monthly NSSF and NHIF contributions for their workers. A further disaggregation of the data by enterprise size reveals that medium informal enterprises paid the most (KSh. 22,742.80) contribution per worker while micro enterprises paid the least amount (KSh.457.8) per worker. However, workers in the micro enterprises accounted for the highest number of workers for whom NSSF and NHIF payments were made while medium enterprises had the lowest number of workers for whom such contributions were made (Table 17). It is noted, however, that the reported NSSF and NHIF contributions by small and medium enterprises are higher than the sum of maximum statutory matching contribution of six percent of the basic wage for NSSF, and the maximum limit of KSh. 1,700 per employee for NHIF. This points to either understatement of the number of workers or overstatement of NSSF and NHIF expenditures by the enterprises. This, notwithstanding, the low coverage of the informal economy by NSSF and NHIF is corroborated by TIFA (2020) survey, which established that only one percent of the employers in the informal economy remitted member contributions to NHIF and NSSF.

Paying enterprise (%)	4.4	30.8	21.2
Total monthly expenditure (KSh)	164,287,110	78,023,240	15,169,479
For how many employees? (No.)	358,847	13,214	667
How much per employee (KSh)	457.8	5,904.5	22,742.8

Table 17: Payment of NSSF and NHIF contributions by informal enterprises

Source of Data: MSME Survey, 2016

Informal economy suffers low social security coverage. The NSSF and NHIF had a membership of 4.2 and 8.5 million in 2019, respectively compared to total employment of 18.1 million in 2019 ¹³. This represents a coverage of 23.1 percent and 46.7 percent of all workers in 2019 by NSSF and NHIF, respectively. Informal economy workers constituted 49.2 percent (4.2 million) of the total membership of the NHIF in 2019, which was a paltry 27.7 percent of the total employment in the informal economy. Informal economy workers join the NHIF scheme as voluntary contributors. It is estimated that only about 1.5 million of the informal economy workers in the NHIF scheme are active and paid up members ¹⁴. The high proportion of informal enterprises that do not pay monthly NSSF and NHIF contributions for their workers is a reflection of the generally low coverage of workers by the two schemes, and the disproportionate focus by the two schemes to workers and employers in the formal sector.

Informal economy requires hybrid social security and health insurance schemes. Low coverage of informal economy workers by NSSF is also attributed to perceptions amongst the workers and entrepreneurs in the sector that NSSF does not yield immediate benefits. The NSSF functions as a provident fund providing benefits as a lump sum rather than providing a consumption smoothing mechanism that offers payments on a predictable monthly basis. This limits its effectiveness as a social protection mechanism particularly for the informal economy workers and entrepreneurs. Overall, while the low coverage is a manifestation of decent work deficit, it is also inconsistent with the high levels of vulnerability of informal economy workers. The low coverage can, however, be reversed through promotion of hybrid social security and health insurance schemes with centralized management, oversight and risk-pooling combined with association-based membership mobilization, collection and remission of premiums towards the social security and health insurance schemes as demonstrated by the case studies in Box 1.

Measures introduced by NHIF to curb adverse selection further excludes informal economy workers from the social health insurance. Low informal economy population coverage by NSSF and NHIF together with the low premiums paid per worker reflects the non-comprehensive nature of social security in Kenya.

¹³ KNBS (2020). Economic Survey 2019, Nairobi: Kenya National Bureau of Statistics

¹⁴ Voluntary members are required to make a monthly contribution of KSh. 500. Active and paid up members are those who have paid their premiums in the last 12 months.

In addition, the measures introduced by the NHIF to curb adverse selection by voluntary contributors such as requiring voluntary members to pay their premiums one year in advance before accessing the health insurance benefits, and imposition of a 90-day post-payment waiting period for those who default monthly premium payments further excludes the informal economy workers from the social health insurance. Coupled with weak occupational safety and health mechanisms in the informal economy, the situation leaves the informal economy workers and entrepreneurs highly exposed and vulnerable to shocks, especially at the time of COVID-19.

Box 1:

Increasing social security and social health insurance coverage of informal economy workers

Case study 1: Risk-pooling and association-based collection and remission of NHIF and NSSF subscriptions

Better Life Welfare Association is an informal economy association operating in Kayole and Waithaka in Nairobi City County. The welfare association is registered with the Registrar of Societies and comprises about 100 self-employed members (mostly women and youth) who trade in different goods including food, second-hand clothes and general merchandise. To promote welfare and livelihoods of the membership, the association undertakes risk-pooling combined with association-based collection and remission of NHIF and NSSF contributions on behalf of its members. Each member of the association is required to pay KSh. 20 every Thursday towards NSSF and may choose to pay the KSh. 500 NHIF monthly premium as a lump sum or by instalments as long as the required premium is cleared by the end of the month. This is besides the mandatory one-off entry fee of KSh. 300 and KSh. 50 monthly membership subscription. All the payments are made to the association through an established mobile money platform. At the end of every month, the leaders of the association compile the payment records against each member and remits the money collected to the respective agencies. This model works better for the members compared to when each member had a choice to contribute to these schemes directly.

Case study 2: Association-based voluntary subscriptions to NSSF and NHIF

Nyakinyua Nairobi Central Hawkers' Association is an informal economy welfare association operating in Muthurwa market in Nairobi City County. It is a women-only association with a membership of 50 women groups or associations who have strong business relationships including applying and receiving government sponsored funds, lending money to each other, promoting supply linkages and social welfare. The association uses the social capital amongst the membership to encourage members to make voluntary contributions towards NSSF and NHIF. It charges an entry fee of between KSh. 500 and KSh. 10,000 depending on the asset that a group has, and members contribute KSh. 400 per week. Though the group has no enforcement mechanism, it has a compliance rate of about 50 percent for both NSSF and NHIF. This is accredited to the strong social network amongst the members, which is attributed to the success of the group in accessing government grants through the Women Enterprise Development Fund (WEDF).

Case study 3: Partnership between trade unions and informal economy association to promote access to social protection

The Kenya Union of Commercial Food and Allied Workers (KUCFAW) signed a Memorandum of Understanding (MOU) with the Nairobi Informal Sector Confederation (NISCOF) in 2018. The collaboration and partnership between the two parties focuses on improving access to the right to freedom of association, right to organize and collective bargaining, improving access to social protection and promoting social dialogue. Under the arrangement, NISCOF seeks to leverage on KUCFAW's established working relationship with NSSF and NHIF¹⁵ to negotiate for innovative and responsive products for its members. The KUCFAW also seeks to benefit from NISCOF's advantage of having a large membership of informal economy operators and being a recognized NHIF agent to encourage NISCOF's members to enroll with NSSF and continue subscribing to NHIF. The partnership would also help KUCFAW to enlist NISCOF members into its membership and use it as a platform to further organize the informal economy workers. The KUCFAW and NISCOF initiated discussions with NSSF and NHIF in early 2020, and are awaiting response from the NSSF and NHIF. They have proposed to the two agencies to develop attractive and targeted social security and social health insurance packages, to which the informal economy entrepreneurs and workers can make daily payments through mobile money platforms. In the proposal, each worker is to have an account with NSSF into which they make daily payments. However, the members are to pay an agreed amount daily to NISCOF directly to cater for monthly NHIF premium, and membership subscriptions fees to NISCOF and KUCFAW. Being an NHIF agent, the NISCOF would compile the list of those who have paid and remit the NHIF premium payments and KUCFAW subscriptions at the end of each month.

Source of Data, FGDs and KIIs with various respondents in Nairobi (August 2020)

15. KUCFAW has long-standing recognition agreement and collective bargaining arrangement with NSSF and NHIF.

4.4 Access to credit and finance

Only one percent of informal enterprises source their initial and additional capital from commercial banks¹⁶. In Kenya, about 80 percent of informal enterprises use family/own sources as initial capital requirements for the businesses and nearly 36.8 percent of the enterprises depend on the same source for additional capital requirements (see Table 18). Dependence on family/own resources as source of initial capital for informal enterprises is higher compared to 60.7 percent of the formal enterprises that depend on family/own for initial capital with 24.5 percent depending on the same source for additional financing. Only 1.5 percent of the informal enterprises use banks for both initial and additional funding compared to 8 percent for formal enterprises. The findings compare well with those of TIFA (2020) survey, which showed that majority (67%) of the informal enterprises interviewed got initial capital for their businesses from family income/savings, 23 percent from friends and only 7 percent acquired loans. The findings are not surprising considering that many formal financial institutions do not finance start-up businesses as evidenced from respondents from financial institutions. A KII respondent from a leading commercial bank indicated that the bank does not provide start-up capital.

...one must have a business that has operated for one calendar year, in addition to having an account with us... on the size of the business, requirements differ. However, in all forms of businesses, for one to qualify for a business loan he/she must have an account with us. The person must have operated the account for at least six months and we do not finance start-ups...

	Informal	Formal	Informal	Formal
Other	1.99	3.48	1.97	4.86
None	7.73	20.42	52.66	52.80
Family/own funds	80	60.7	36.81	24.50
Family/Friends (With interest)	4.26	3.23	2.04	2.61
Bank	1.46	8.04	1.19	8.62

Table 18: Sources of capital for informal and formal enterprises

Source of Data: MSME Survey, 2016

Informal enterprises leverage credit constraints through digital lending platforms. Digital credit has developed rapidly in Kenya (Gwer, Odero & Totolo, 2019) and this seems to have reduced the credit access constraints faced by majority of informal enterprises. Many of the traders are able to access loans at the comfort of their homes so long as they own a mobile phone. The largest digital lenders in Kenya comprise a few banks and financial technology companies such as Kenya Commercial Bank, Commercial Bank of Africa, Equity Bank, Wakanda Credit and Zenka Finance. Business loans are easily accessible through the digital lenders who neither require collateral nor impose any stringent requirements. The relaxed requirements are attractive to informal entrepreneurs who borrow money on their own account so as to service their businesses. The downside, however, is that the loans are costlier compared to those offered through formal financial platforms. In addition, the relative ease of accessibility of the loans has made most informal economy workers and entrepreneurs, including ordinary youth to be highly indebted and blacklisted by the CRB. Some informal economy operators, including the youth acquire the digital loans but use it to finance daily consumption expenditures rather than investing in the business (Gwer, Odero, & Totolo, 2019). This aspect was aptly captured by a KII respondent who observed that

...due to lack of financial access in mainstream sources, most traders in the informal economy are in debts due to easy access to online borrowing. With low financial literacy, most informal economy traders especially the youth borrow recklessly and end up defaulting risking their credit worthiness due to ignorance and don't care attitude...

16. In certain instances, firm owners can borrow money on their personal account and then use to start or support their firms.

The implication is that informal economy entrepreneurs are still facing obstacles in access to capital despite Kenya's high levels of formal financial inclusion. In 2019, Kenya had the third highest rate (82.9%) of formal financial inclusion in Africa only behind Seychelles (95%) and South Africa (90%) ¹⁷.

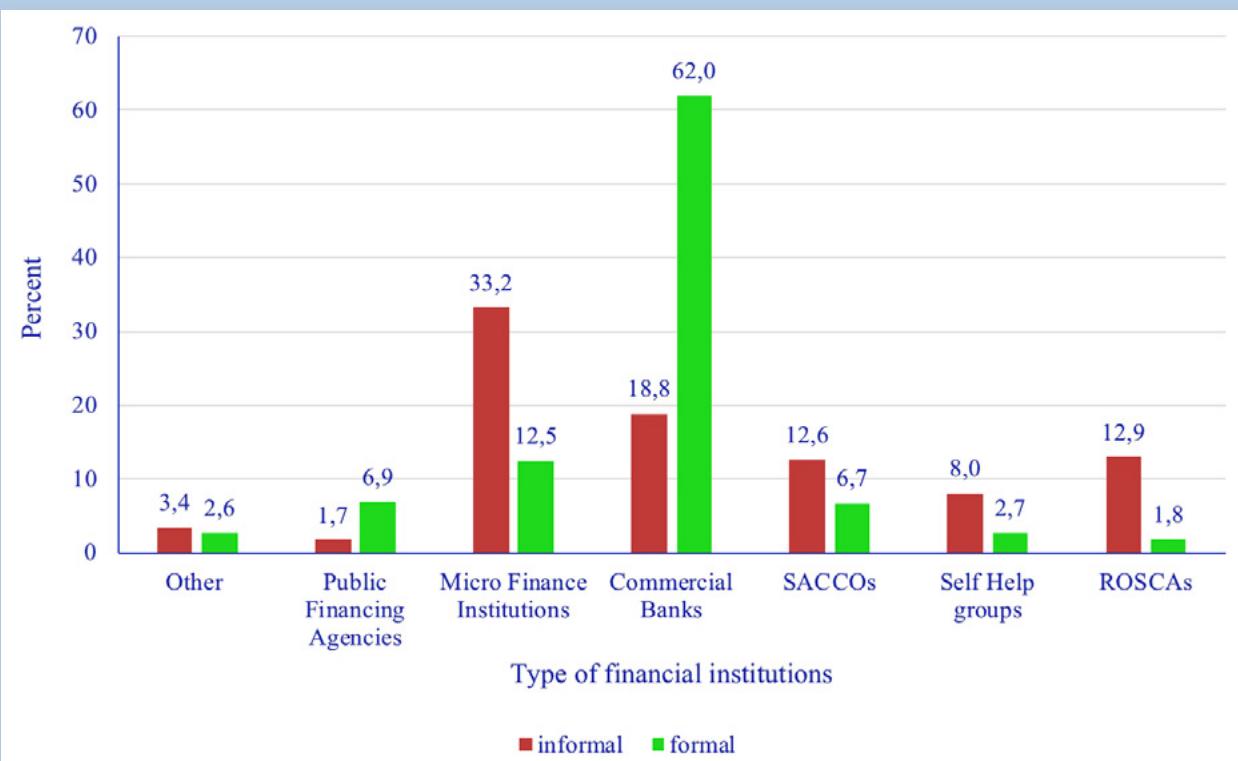


Figure 2: Main sources of credit for informal and formal enterprises

Source of Data: MSME Survey, 2016

Firm owners circumvent formal credit requirements by borrowing on own account and channelling it to business. While formality (possession of formal business documents) is a requirement for access to formal credit, firm owners circumvent this by borrowing money in their individual capacities then channel it into their businesses. In many instances, the distinction between personal and firm finance is not clear for many enterprises. This shows that financial institutions are aware of the challenges micro businesses face and at times, relax some of the requirements to accommodate them. This finding is corroborated by KIIs from both public and private financial institutions. A KII from a private financial institution said that:

... different business loans have different requirements. For businesses considered large, we ask for proof of registration, certificate of incorporation to know the directors, tax compliance certificate, invoices, books of accounts for scrutiny of when supplies are done, who are the suppliers/buyers, duration taken for payments among other information. Under micro-loans, we do not require the business to be registered. However, the person should be having an account with us even if it is personal bank account which he/she operates, and which the loan is processed. Since, most of these micro loan borrowers have no security, we request them to provide household items such as electronics, furniture among others to act as collateral...

Majority of informal enterprises do not apply for credit but those who do, have a high success rate. Success of application for credit is key to ensuring that firms get support they need and in time. The 2016 MSME Survey showed that only 46.4 percent of the informal enterprises attempted to borrow in the last 12 months. When disaggregated by

gender, more female-owned enterprises applied for credit compared to male-owned enterprises, pointing to potential financial exclusion on the basis of gender (Table 19). However, of those who applied for credit, 81.6 percent were successful. Interviews with informal enterprises identify possible drivers of success to include evidence of some income or savings presence of collateral such as land, and use of group borrowing approaches. Informal enterprises who applied for credit but were unsuccessful were turned away by MFIs (38.6%), followed by commercial banks (24.4%) and SACCOS (17.3%). Admittedly, access to credit to formal sources of credit remains a key challenge particularly for informal firms. More female-owned enterprises (84%) applied for and accessed the credit compared to male-owned enterprises (71%). The FGDs and KII conducted also confirmed that women borrowers had better chances of accessing funds and/or credit from public funding agencies and private sector lenders particularly those that are keen on addressing inequalities in economic participation including access to credit.

Table 19: Distribution of informal enterprises by credit application success and gender

Domain	Whether firm owner attempted borrow money on the last 12 months (%)		Whether the firms who applied were successful (%)			
	Overall sample	Female owned	Male owned	Overall sample	Female owned	Male owned
Yes	46.38	46.73	35.39	81.56	84.22	71.15
No	53.62	53.27	64.61	17.15	14.13	28.45

Table 19: Distribution of informal enterprises by credit application success and gender

Source of Data: MSME Survey, 2016

More than one-third of informal enterprises use borrowed funds as working capital. The 2016 MSME Survey data show that more than one-third (34.2%) of the informal enterprises use borrowed funds as working capital or operating cash with slightly more than one in every ten (13.3%) of the enterprises using the credit to refurbish their businesses. However, about 23.4 percent of the enterprises apply for credit but uses it on areas that are not related to the business (see Figure 3). About one-half (49%) of the informal businesses use credit as working capital or to purchase inventory, reflecting high degree of reliance on borrowed funds in operating the businesses. This, coupled with the constraints that the businesses face in accessing credit could explain the high failure rates, especially among the microenterprises. This position supports earlier finding, which indicated that about one-third of the informal businesses that closed between 2011 and 2016 cited lack of operating funds or working capital as the main reason for closure.



Figure 3 : Main uses of credit by informal enterprises in Kenya

Source of Data: MSME Survey, 2016

Informal enterprises are financially constrained. Perceptions on the firms' probability of success in credit application are vital for expanding credit outreach. As shown in Table 19, slightly more than one-half (53.6%) of the informal firms did not apply for any credit in the last 12 months before the 2016 MSME Survey. Majority (44.1%) of the informal enterprises who did not apply for credit indicated that they did not require the money (Figure 4). Another 21.9 percent of the firms thought that credit was either too expensive or they did not have sufficient collateral. The view that some enterprises did not borrow due to perceived high cost of credit or inadequate collateral implies that the enterprises are financially constrained¹⁸.

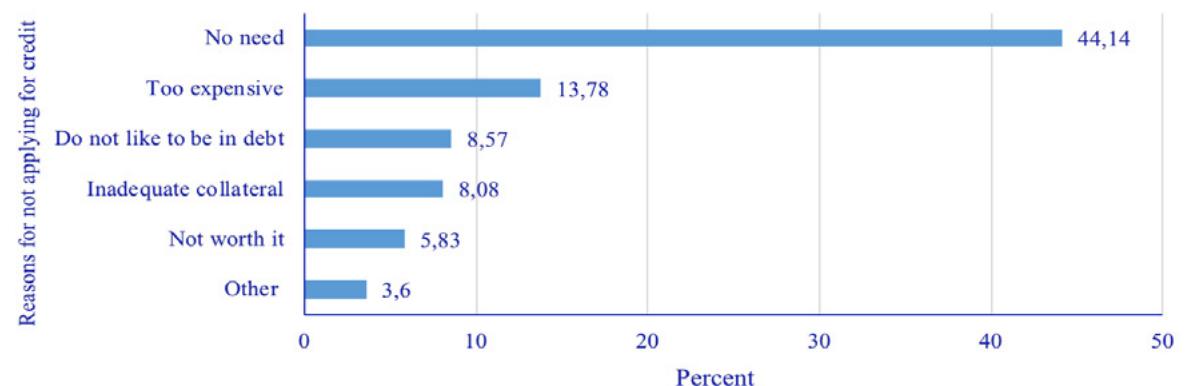


Figure 4: Why informal enterprises do not apply for credit

Source of Data: MSME Survey, 2016

Financial constraint undermines informal economy operations. The 2016 MSME Survey shows that about 45 percent of the informal enterprises are potentially financially constrained and that the financial constraint increases with enterprise size. The constraints were mainly due to lender ceilings (34%), lack of collateral (31%), high interest rates (24%) and other residual reasons (11%) as illustrated in Figure 5. These findings are corroborated by those of TIFA (2020) survey, which established that enterprises in the informal economy were denied credit due to lack of or insufficient collateral (54%), unconvincing documents (39%), activities deemed unviable (32%) and insufficient business plan (30%). The gap in financing of informal economy enterprises could explain the rapid development of innovative financing models by public and private institutions as illustrated by the case studies in boxes 2 and 3.

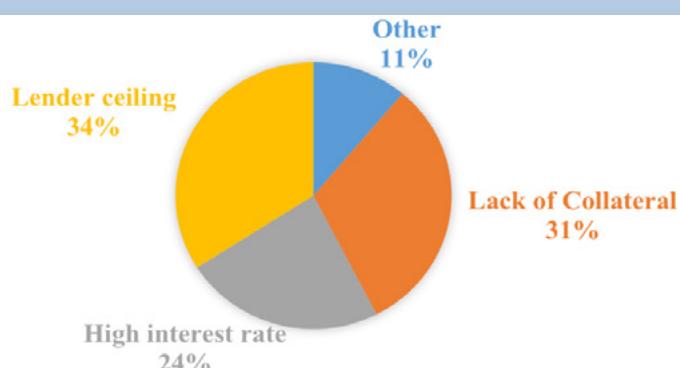


Figure 5: Indicators of financial constraint by informal enterprises

Source of Data: MSME Survey, 2016

18. The World Bank (2016) defines a firm to be financially constrained if it did not apply for a loan during the last year and the main reason for not doing so is either high interest rates, lack of required guarantees, complex application procedures, it did not think it would be approved, and the residual category of other reasons.

Box 2:**Private sector initiatives in facilitating access to credit by informal enterprises****Case study 4: Advancement Possible Finance (APF)**

Advancement Possible Finance is an MFI based in Nairobi, which specializes in lending to own account workers and micro enterprises such as vegetable vendors (mama mboga), milk vendors and other retailers. The APF recruits these borrowers through direct approach to the business owners, referrals from previous and existing borrowers and individuals in the networks of workers. It offers unconventional products for each enterprise or group. To address credit access constraint of inadequacy or unavailability of records, the MFI estimates the revenues, costs and gross profit of the enterprises and evaluates how much loan an enterprise qualifies for and its capacity to repay. To avoid overburdening the enterprise with huge monthly installments, the MFI allows the borrowers to make daily or even weekly loan repayments through mobile money and mobile banking platforms. The APF personal and business loans are lent to individuals on behalf of the business. The MFI uses the individual's passport photos and national identity cards for identifying a going concern. It has substituted requirement for valuable collateral with groups such as community-based organizations, local administration such as neighborhood associations and merry go rounds. According to the MFI, what matters to informal enterprises is not the cost or repayment of the loans but the appropriateness and accessibility of the loan.

Case study 5: Equity Bank model of offering both personal and business loans

Equity Bank offers both business and personal loans targeted at the informal economy enterprises and households. The bank lends to unregistered but licensed informal micro enterprises that are owned by households using an innovation by the bank. The bank noticed that there are unregistered micro enterprises that are owned by households that could not borrow separately because they are not registered and, most of the time, they lack records. To address the credit access constraint, the bank allows the household to borrow on behalf of the business as long as the head of the household is able to prove that the business is licensed by submitting a single business permit. The business loan is processed as a personal loan on account of the single business permit and details of the household head.

Box 3:**Public sector initiatives in promoting access to credit by informal enterprises****Case study 6: Meru County Microfinance Corporation**

Meru County Microfinance Corporation is a microfinance institution established by the Meru County Government in 2019 (<https://youtu.be/ezYWg-mV22o>). It lends to women and men in the county, including youth through groups (teams) with relevant business idea. Though lending is done to a group, financing and loan servicing is on individual ventures, thus using the group as a form of guarantee. Loans are custom made to suit the client's needs to avoid business failure and non-repayment. To access a loan, interested individuals must form a group of 8-30 members and register with the county government using their national identification cards and passport photos. It is upon registration with the county government that the group registers with the County Microfinance Corporation. The group is then trained on bookkeeping, co-guaranteeing and entrepreneurship for a period of eight weeks. Each member is required to save KSh. 200 per week with the County Microfinance Corporation during the weekly training meetings, which translates to a savings of KSh. 1,600 per member. Members are subsequently required to meet at least once a month. A member must have attended at least six of the eight weekly training meetings and must have an operating business or proof by group members that their business collapsed to qualify for a loan. A member is eligible for a loan, which is at most 10 times their savings. The loan is processed within 10 working days.

Source of Data: KII with Meru County Government (August 2020)

Kenya is one of the most vibrant economies in fintech, but the benefits of the digital revolution are yet to be fully leveraged on by informal economy. Kenya is recognized around the world to have exceptionally done well in advancing formal financial inclusion agenda through leveraging in financial technology (Ferrand, 2019). Advances in credit scoring, presence of few regulatory barriers, mass usage of mobile phones and advancement of mobile money have resulted in exponential growth of the digital lending subsector in the country. In 2018, for example, more people borrowed from a digital source (13.5%) than from non-digital formal source (8.6%) (Central Bank of Kenya, KNBS, & FSD Kenya, 2019). While the digital borrowing is more convenient and accessible to the borrowers, there are concerns that digital borrowers are more likely to show signs of

debt stress than other non-digital formal borrowers or informal borrowers. In addition, digital borrowers are nearly twice as likely to default on any loan than non-digital borrowers (FSD Kenya, 2019). Findings from the FGDs confirmed that some informal traders borrowed from the digital platforms such as *M-pesa*, *Mshwari*, *Fuliza* and *Eazzy loan*¹⁹ but are now blacklisted by the CRB. As a result, they are unable to borrow from any other formal sources. Indications from the field were that informal enterprises never clearly understood implications of default on digital loans, interest rates being charged and process of clearance from the CRB. These findings have implications on future policy designs to protect borrowers, and enhance BDS on financial literacy.

4.5 Market Conduct

About four in every five informal firms do not advertise their products. Different methods of marketing have implications on firm competitiveness and growth. Analysis of the 2016 MSME Survey reveals that about 80 percent of informal firms in Kenya did not advertise their products compared to 46 percent for formal firms (Figure 6). This is in line with TIFA (2020) survey, which established that 86 per cent of informal enterprises experienced problems and difficulties related to marketing. For the firms who employed some form of marketing, 12.7 percent used quality of product or clientele satisfaction method. Less than 10 percent of the informal enterprises used above-the-line strategies such as outdoor marketing and print and electronic media. In addition, when asked if they employed any new marketing strategies in the past two years (2013-2015), more than 95 percent of the informal enterprises indicated that they did not use any new innovations to market their products. The implication is that the informal economy enterprises have not fully embraced marketing and innovation as a business strategy. This points to the fact that the interventions put in place by the government to address markets and marketing information, innovation and capacity building are yet to create the desired changes.

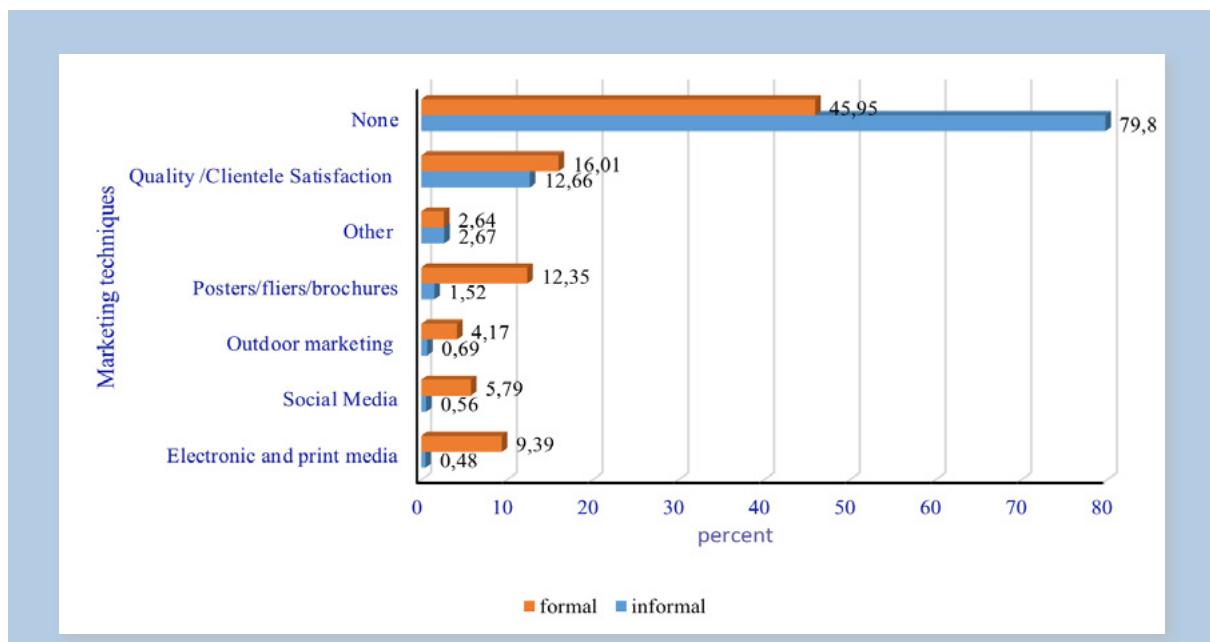


Figure 6: Techniques of product marketing by formal and informal enterprises

Source of Data: MSME Survey, 2016

19. M-pesa is the biggest mobile money transfer service in Kenya. Mshwari is embedded in the M-pesa menu and allows for people to borrow or save money under certain conditions. Fuliza is an overdraft facility that allows people to overdraw their mobile balances based on their transaction history. Eazzy loan allows for mobile borrowing and is run by Equity Bank, one of Kenya's largest banks that focusses on the informal sector

Almost five in every ten informal enterprises source inputs from other informal enterprises. Most informal enterprises in Kenya source their inputs from their counterpart enterprises or from individual suppliers (Table 20). The 2016 MSME Survey data shows that 47.3 percent of the informal enterprises largely rely on other informal-based MSMEs for inputs compared to 48.4 percent for formal firms. The finding point to existence of strong horizontal linkages among the informal firms and vertical linkages between the formal and informal firms. A similar position is supported by the FGD with informal traders and workers in the metal industry who confirmed existence of linkages between formal and informal firms. In this framework, formal firms supply inputs, goods and services to informal firms through an informal arrangement. The informal firms also supply intermediate products or other value-added services to the formal firms.

Informal economy enterprises have no formal contracts with suppliers of inputs. Consistent with the informal nature of the enterprises, about 90 percent of the informal enterprises and 74.1 percent of the formal enterprises do not have any contractual arrangement with the informal-oriented MSME input providers (Table 20). Less than 15 percent of the enterprises have some form of input supply contracts with MSMEs, non-MSMEs or middlemen. Since formality increases the level of contractual arrangements, it is plausible to infer that formal enterprises have a lower risk of input supply shocks since formality increases inter-firm linkages for inputs. Considerations for backward and forward linkages is important for the survival and graduation of businesses from informality to formality. Enhancing the supply value chain interactions between the formal and informal economy can encourage informal enterprises to formalize. Literature has shown that integration of formal and informal enterprises into the value chain can help informal economy enhance their market position, promote value addition of their products, tap into new technologies and innovations and increase their management and human resource management capacity (ILO, 2016).

Main source of inputs (%)	Informal	Formal	Existing contractual arrangements for inputs with providers	Informal (%)	Formal (%)
MSMEs	47.28	48.39	None	89.85	74.09
Individual suppliers	27.04	24.33	MSMEs	4.68	13.9
Non-MSMEs	6.71	13.51	Non-MSMEs	1.33	4.55
Other	4.36	4.79	Middlemen	3.96	5.65
Direct imports	1.55	6.55	Other	0.17	0.89

Table 20: Sources of inputs for informal enterprises and contractual obligations

Source of Data: MSME Survey, 2016

Formal-informal economy linkage is undermined by absence of policy framework. Virtually all policy blueprints on growth and development of the MSMEs, and transition of informal enterprises to formal enterprises emphasize the need for linkages between MSMEs and large enterprises. Despite the policy stance, there is no policy and/or industry guidelines to anchor and strengthen the inter-and-intra linkages between informal and formal enterprises. A sub-contracting policy whose development is being spearheaded by the Ministry of Industry, Trade and Cooperatives is still in draft form ²⁰. According to a key informant from the Ministry, the sub-contracting policy is expected to promote linkages between informal and formal enterprises and also between the small and large enterprises. It is envisaged that the policy would lead to creation and consolidation of stable subcontracting relationships, transfer of technologies and practises, access to markets, and enforcement of contracts and fair-trade practices amongst the parties in the sub-contracting arrangement.

20. Based on KII with a respondent from Ministry of Industry, Trade and Cooperatives

Majority of informal enterprises set prices for their products independently. Pricing strategies have implications on business survival, profitability and competitiveness. Results from the 2016 MSME Survey showed that 57.2 percent of the informal enterprises use internal price mechanism to set prices for their products (Figure 7). This implies that the enterprises set the prices independently following their cost structure and market conditions. This finding compares well with TIFA (2020) survey, which established that at least 50 percent of informal enterprises surveyed relied on market conditions to set their prices. Admittedly, since most informal enterprises do not keep records and also have high competition, it is not clear to what extent their price setting behaviour follows well established economic principles. In addition, the nature and level information available in the market has implications on how they firms set their prices. Consequently, policies and BDS on pricing and market information is key in ensuring that businesses remain profitable and competitive.

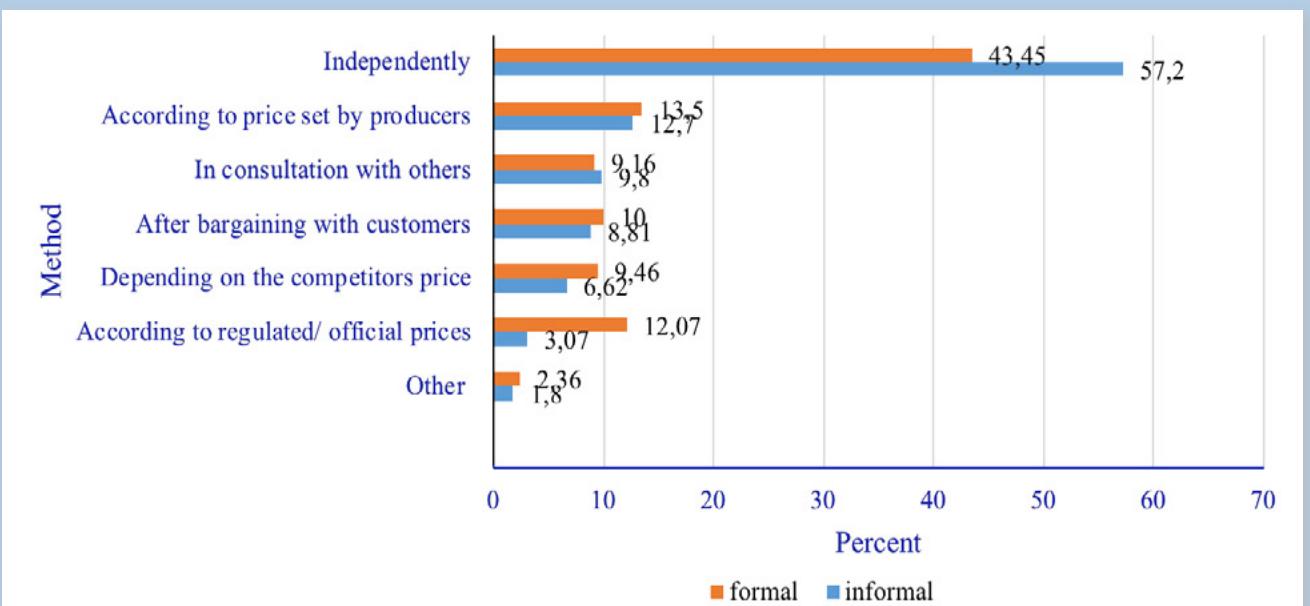


Figure 7: Main method of setting prices

Source of Data: MSME Survey, 2016

Informal enterprises have high customer concentration risk. Understanding the nature and diversity of customers is important in addressing customer concentration risk. Analysis of the 2016 MSME Survey data shows that on average, 86.4 percent of informal MSMEs rely on individual consumers for purchase of their products and services with the proportion varying inversely with the size of the firm (Table 21). Intensity of reliance on individual consumers is higher for informal micro enterprises (86.4%) followed by small enterprises (86%) and medium enterprises (81.3%). In relative terms, formal enterprises particularly the medium-sized ones depend less on individual consumers, and customer diversity for formal firms increases with firm size. In Kenya, apart from shortage of operating funds and personal reasons, over 15 percent of the establishments that close cite too few customers as a key cause of business closure (KNBS, 2016). The government has attempted to expand customer base for MSMEs through ring-fencing of 30 percent of public procurement to MSMEs under the Access to Government Procurement Opportunities (AGPO) Programme (Republic of Kenya, 2015). Majority of the MSMEs particularly the informal ones are yet to fully benefit from AGPO due to stringent and bureaucratic public procurement procedures.

Buyer	Informal			Formal		
	Micro	Small	Medium	Micro	Small	Medium
Other	1.18	2.0	1.87	1.23	5.14	5.05
MSMEs	9.30	10.92	14.11	8.19	12.84	11.81
Non-MSMEs	2.59	0.88	2.73	2.24	6.33	10.57
Direct exports	0	0	0	0.26	1.55	4.86
Individual consumers	86.39	86.04	81.3	87	70.1	63.80
Government	0.48	0.16	0	1.09	4.04	3.88

Table 21: Distribution of main buyers of products by firm size

Source of Data: MSME Survey, 2016

Majority of enterprises have key training needs in customer service, marketing and communication. Capacity building and training in various business aspects is necessary to increasing productivity and performance of informal enterprises. The TIFA (2020 survey showed that customer service (54%), marketing (44%) and communication (27%) were the top three skills needed by informal enterprises (Figure 8). This finding reinforces the importance of training in light of the low levels of marketing, innovation and productivity among informal enterprises. Further, results from the FGDs and KIIs highlighted priority training support needs by informal enterprises to be in areas of technology adoption, innovation and entrepreneurship. The identified areas for skills training constitute a strategic point, which the private sector and employer organizations can use to engage with and support the informal economy. A participant in one of the FGDs with entrepreneurs and workers of metal industry informal association in Nairobi observed that:

...technology is changing so fast that our members cannot keep up. A few years ago, a large motor company used to train us on the latest technology in the vehicle but they have since stopped, and we need such training back...

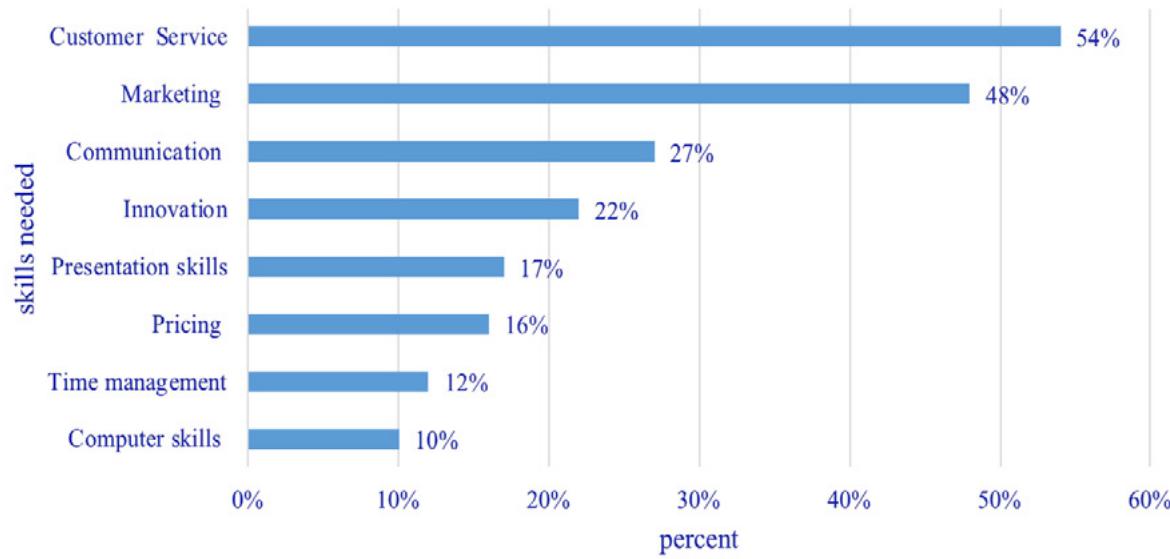


Figure 8: Informal enterprises training needs

Source: TIFA (2020)

4.6 Formalization

There are two competing views of measuring formality: the dichotomous view and the continuum view. The dichotomous view refers to classification of the economy as either formal or informal while the continuum view is based on the premise that enterprises in the economy have varying degrees of formality (Nogueira et al., 2019). This study has so far considered formality in the light of the dichotomous view that looks at the economy as being dual with the informal economy existing alongside the formal economy. This subsection continues with this view but advances it to the continuum view and attempts to group the MSMEs in various degrees to which they have completed all steps of formalization.

4.6.1 Formalization under the dichotomous view

Females have a higher chance of owning an informal enterprise while males have a higher probability of owning a formal enterprise. The 2016 MSME Survey covered a total of 7,409,939 enterprises out of which 6,987,090 (74%) were informal. Informality, in this context, refers to those firms that were not registered at the registrar of companies under the applicable business ownership forms. A cross tabulation of informality with respect to

enterprise size and gender revealed that informality is majorly a phenomenon associated with microenterprises that are female owned. Of the informal enterprises surveyed, female owned informal micro enterprises were 57.7 per cent of the total compared to 34.3 per cent for male owned informal microenterprises. However, 45.2 percent of the formal microenterprises were owned by males. Male-owned formal microenterprises was, therefore, more than double those owned by females (20.6%), implying that formality is not only a size but also a gender issue (Table 22). Overall, while 57.8 percent of the informal enterprises were owned by females, males owned 54 percent of the formal enterprises.

		Formal		Informal	
		Frequency	Proportion (%)	Frequency	Proportion (%)
Micro	Female	87,070	20.59	4,027,760	57.65
	Male	191,200	45.22	2,395,471	34.28
	Both	62,218	14.71	523,869	7.50
Small	Female	8,931	2.11	7,856	0.11
	Male	33,472	7.92	20,490	0.29
	Both	31,641	7.48	8,491	0.12
Medium	Female	286	0.07	787	0.01
	Male	3,872	0.92	1,614	0.02
	Both	4,159	0.98	742	0.01
Total		422,849	100	6,987,080	100

Table 22: Distribution of enterprises by status of formalization

Source of Data: MSME Survey, 2016

About eight in every ten of the informal enterprises do not pay tax ²¹. The 2016 MSME Survey showed that on average, 94.3 percent of the MSMEs in the informal economy do not pay taxes and this is independent of the size of the enterprise. A cross tabulation of payment of taxes by informal enterprises reveals that majority (94.4%) of the microenterprises do not pay taxes followed by medium enterprises (83.6%) and small enterprises (82.8%). Only 5 percent of the informal enterprises reported to have a Personal Identification Number (PIN) certificate issued by the Kenya Revenue Authority (KRA) for purposes of managing firm tax obligations ²². The implication is that either the informal enterprises are not aware of the tax payment requirements and practices or they find it cumbersome or just choose not to comply with the tax laws and regulations. According to the 2016 MSME Survey data, a microenterprise with a monthly turnover of KSh. 27,016 has a mean tax expenditure of KSh.460.8, which is about 1.7 percent of its turnover (see Table 23). Small enterprise with a monthly turnover of KSh. 105,240 have a mean tax expenditure of KSh. 6,175, which represent 6 percent of its turnover. Kenya introduced turnover tax for small businesses through the Finance Act (2019). It applies to businesses with an annual turnover of between KSh. 1 million and KSh. 50 million and pegged at the rate of one (1) percent of gross sales ²³.

21. The enterprises have zero tax expenditures

22. PIN registration requires that firms are formally recognised by the Registrar of Companies. In practise, however, firm owners make tax returns on account of their personal individual PIN registration. They need not register the firm to make returns.

23.Turnover tax for small businesses used to be levied at 3% of gross sales but was reduced to 1% as part of the government's COVID-19 rescue package.

	Micro Enterprises	Small Enterprises	Medium Enterprises
Pays tax (%)	5.6	17.22	16.4
Does not pay tax (%)	94.4	82.78	83.6
Mean tax expenditures (KSh.)	460.8	6,175	10,000

Table 23: Distribution of informal enterprises by payment of taxes

Source of data: MSME Survey, 2016

4.6.2 Formalization under the continuum view

The continuum view of formalization is based on a four-point process namely (i) registration status (ii) licensing status (iii) level of compliance with tax regulations and (iv) level of compliance with social security regulations. Given the four-point continuum and the two possibilities under each point (semi-formal or semi-informal), various degrees to which the formalization process has been completed emerge. There are eight possible formalization steps irrespective of the dichotomy one assumes as shown in Table 24²⁴. The degree to which the formalization process has been completed increases as an enterprise moves from level 8 to 1. On the other hand, formal enterprises may shift into informality if they move from level 1 to 8. As such, MSMEs at level 1 are fully formal while the MSMEs at level 8 are completely informal

Semi-Formality					Semi-Informality				
Level	Registered	Licensed	Compliant with tax regulations	Compliant with social security regulation	Registered	Licensed	Compliant with tax regulations	Compliant with social security regulation	
1	✓	✓	✓	✓	✗	✓	✓	✓	
2	✓	✓	✓	✗	✗	✓	✓	✗	
3	✓	✓	✗	✓	✗	✓	✗	✓	
4	✓	✓	✗	✗	✗	✓	✗	✗	
5	✓	✗	✓	✓	✗	✗	✓	✓	
6	✓	✗	✓	✗	✗	✗	✓	✗	
7	✓	✗	✗	✓	✗	✗	✗	✓	
8	✓	✗	✗	✗	✗	✗	✗	✗	

Key: ✓ Yes X No

Table 24: Steps in the formalization process in Kenya

Slightly above one-quarter of the informal enterprises are oscillating towards formality. Application of continuum with steps to transition to formality illustrated in Table 24 allows for establishment of the degrees to which MSMEs have completed formalization steps. This in turn assists in establishing the kind of incentives that various MSMEs need to formalize. Analysis of the 2016 MSME Survey data shows that 0.8 per cent of all the enterprises were formal (had attained all the four aspects of the formality continuum) while 73.3 per cent were informal (had not achieved any of the four aspects on the formality continuum) as illustrated in Table 25.

24. The eight levels arise from the possible permutations considering the four points and two outcomes of yes and no. these levels can easily be constructed with a four-decision point tree diagram.

This leaves 25.9 per cent of the enterprises oscillating towards formality in terms of either being ready to formalize (1.4%), midway to complete all formalization steps (5.4%) or a step from informality (19.1%) as illustrated in Figure 9. A disaggregation of the informal enterprises that were ready to formalize (1.4%) shows that 85.7 percent had completed some steps and in need of social security and tax regulation compliance with the rest also having completed some steps and required registration by the registrar of companies²⁵. This means that incentives in the form of training on social security compliance and registration processes by registrar of companies would likely move the 1.4 percent of the enterprises to formality.

One in every 20²⁶ of the enterprises is midway to completing all formalization steps. A breakdown of the informal enterprises that were midway²⁷ to completing the formalization process shows that 44 per cent of these enterprises were semi-formal and 56 per cent were semi-informal. The semi-informal enterprises required registration and compliance with tax regulation²⁸ (61.3%), registration and compliance with social security²⁹ (22.6%), and registration and licensing³⁰ (16.1%). All the semi-formal enterprises required compliance with the tax and social security regulations³¹ to be formal. This means that training on the importance of taxation and social security compliance could lead more MSMEs to formalize. Informal enterprises that are a step away from informality are either registered, compliant with social security requirements or tax regulations. These enterprises are fragile and may easily slide back to informality than move towards formality if not incentivized.

Level	Frequency	Proportion (%)	Frequency	Proportion (%)
1	54,317	0.8	17,452	0.2
2	32,988	0.5	46,718	0.7
3	51,423	0.7	133,618	1.9
4	169,108	2.4	887,139	12.5
5	0	0	36,106	0.5
6	0	0	298,364	4.2
7	0	0	141,339	2.0
8	26,768	0.4	5,214,099	73.3
Total	334,604	4.7	6,774,835	95.3
Unclassified enterprises	88,245		212,255	
All the enterprises in the data set	422,849		6,987,090	

Table 25: Distribution of enterprises in the various levels of formalization

Source of Data: MSME Survey, 2016

25. It may be surprising that unregistered enterprises are licensed, pay tax and comply with social security regulation. This is possible in Kenya especially for own account enterprises that use the owner's status to pay taxes, pay NHIF and NSSF and get licensed by counties.

26. 385,550 out of 7,109,439 enterprises are midway

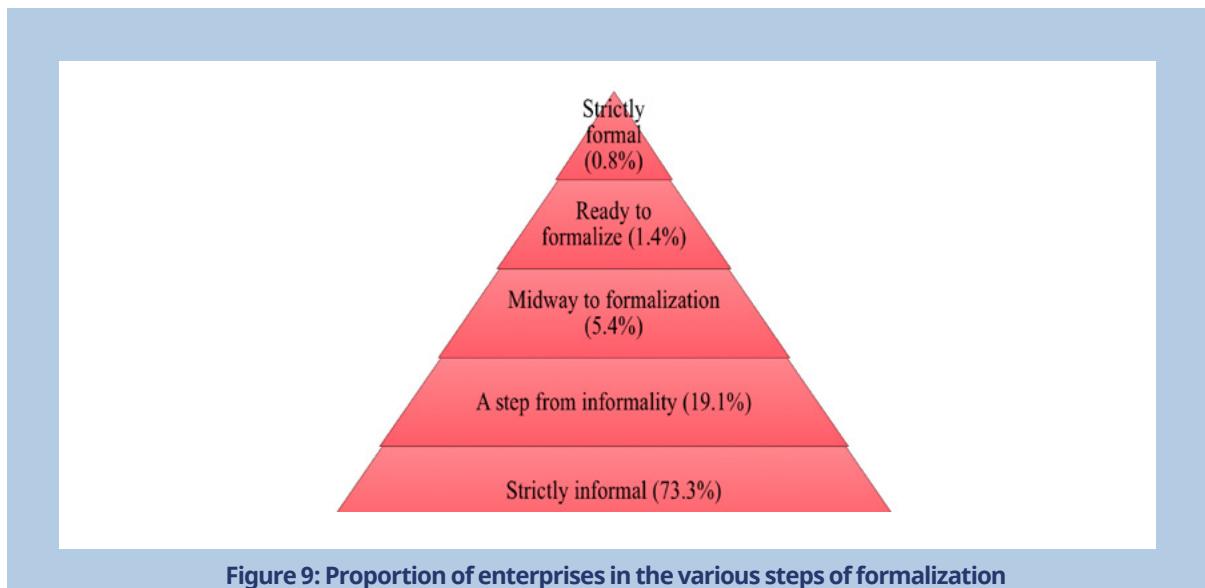
27. Those in levels 4, 6 and 7 under semi formality (169,108) and levels 2, 3 and 5 under semi-informality (216,442).

28. Level 3 under semi-informality (133,618/216,442)

29. Level 2

30. Level 5

31. Level 4

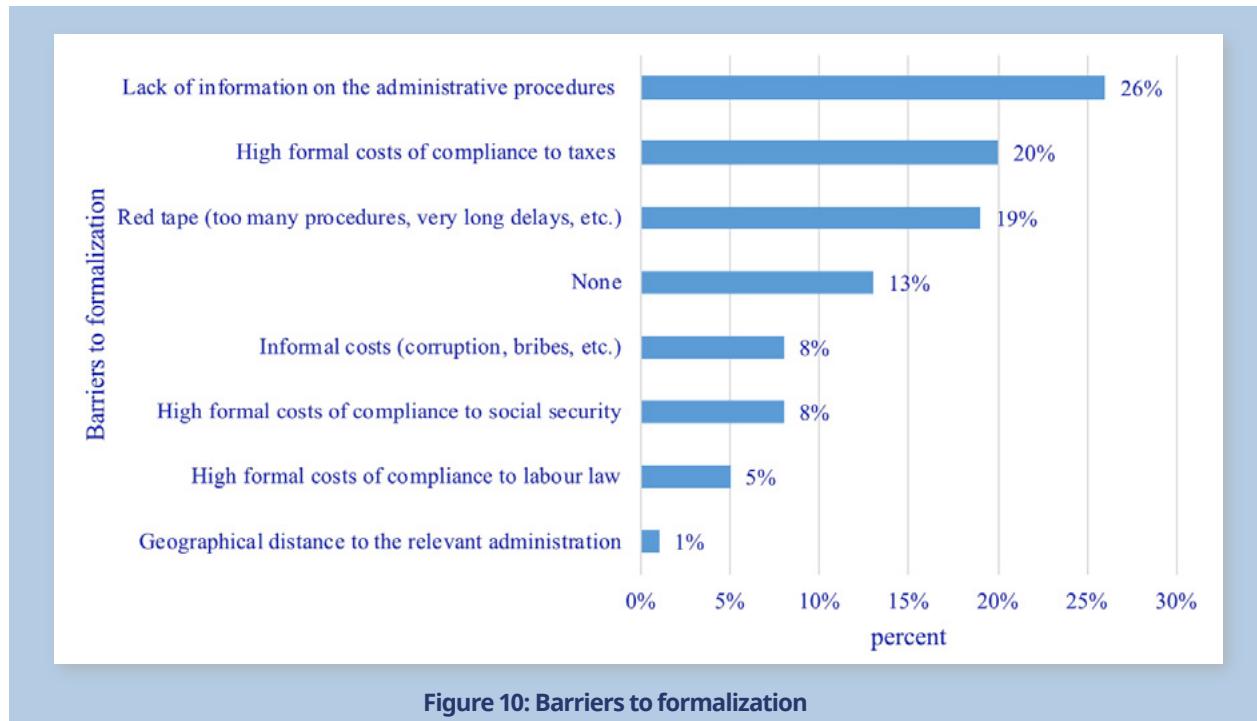


Source of Data: MSME Survey, 2016

More than one-half of informal enterprises cite high cost of compliance and red tape as a barrier to formalization. The 2016 MSME Survey data show that 52 percent of informal enterprises consider high cost of compliance with tax regulations, existence of too many procedures and delays, and high cost of compliance with social security regulations and labour laws as the main barriers to formalization (Figure 10). Slightly more than one in every four (26%) of the informal enterprises cited lack of information as an impediment to formalization while another eight percent cited informal costs incurred through corruption and bribery to constrain formalization. One percent of the informal enterprises indicated that long geographical distance to the relevant administrative offices hinders formalization while another 13 percent did not see any barrier to formalization. This implies that some enterprises choose to remain informal. This finding is consistent with the TIFA (2020) survey results, which showed that 25.3 percent of the informal enterprises surveyed did not see any advantage in complying with any of the criteria for formality. According to the TIFA (2020) survey, 35 percent of the enterprises did not see any advantage of complying with social security regulations, 25 percent did not see advantage of fulfilling requirements for payment of taxes, 22 did not see the importance of business registration while 19 percent saw no advantage of maintaining records (Table 26).

4.6.3 Barriers and incentives to formalization

Desire to reduce inspections, access to credit and BDS are key incentives for formalization. Understanding what informal enterprises consider as incentives for formalization is important in designing appropriate policies and incentive structure to promote formalization. Results from the TIFA (2020) survey revealed that about 23 percent of the informal enterprises would register their businesses, pay taxes, maintain records and comply with social security regulations to reduce inspection of their businesses by authorities (Table 26). Another 22.8 percent would do the same to access credit and finance while 15.5 percent of the enterprises would go through the formalization processes to qualify for BDS. Compliance with business registration and payment of taxes were considered to be useful in facilitating expansion of clientele base, access to public procurement opportunities and access to good worksites. More than half (53%) of the enterprises surveyed cited formal book keeping as important in improving business management while an average of 25 percent of the enterprises identified compliance with social security regulations to be useful in providing social health insurance (29%), promoting labour productivity (25%) and reducing unforeseen expenses (20%).

**Figure 10: Barriers to formalization**

Source of Data: MSME Survey, 2016

Reason	Business registration	Payment of taxes	Formal bookkeeping	Compliance to social security
To reduce inspections	28%	29%	19%	17%
To get better access to credit/financial assistance	26%	24%	30%	11%
No importance / no advantage	22%	25%	19%	35%
To expand the clientele	19%	17%	18%	-
To access to public procurement	18%	17%	-	-
To access to the best business location	17%	13%	-	-
Eligibility for support programs (non-financial)	16%	17%	16%	13%
To better manage the enterprise	-	-	53%	-
To increase the productivity of workers	-	-	-	25%
To protect employees in case of illness/accident	-	-	-	29%
To reduce unforeseen expenses	-	-	-	20%

Table 26: Reasons why the informal business would formalize their business

Source: TIFA (2020) Survey

4.6.4 Drivers of informality of informal enterprises

Factors that drive informality of an enterprise were analysed using a choice regression model (Appendix 4) based on the 2016 MSME Survey data. Table 27 gives a summary of the drivers of informality based on the relative strength of the factors while Table A3 in Appendix 4 gives the full estimation results.

The single most important factor driving informality in Kenya is lack of opportunities to trade with government and failure to export goods and services. According to the regression analysis, MSMEs that trade with the government and export their goods and services are 38.3 percentage points more likely to be formal than those who do not. Inability of MSMEs to trade with government and export goods may be explained by the numerous documentations required to trade with the government and to export goods and services. This means that public procurement requirements and the conditions for export have a considerable influence in determining whether enterprises graduate to formal or remain informal. According to the survey data, MSMEs in sewerage and waste management, transportation and storage, real estate activities, professional and scientific activities, public administration as well as those in education services are more likely to formalize because they deal with clients who require them to be formalized.

Information dividend arising from availability of internet drives formalization. The second most important driver of formality is availability of internet. Enterprises that have access to internet were 24.1 percentage points less likely to be informal. It is not the availability of internet that makes an enterprise informal or formal but the information dividend arising from availability of internet. Enterprises that had access to internet were, for example, able to send and receive emails, conduct online research, conduct online transactions, access government services such as searching a business name, applying for government tenders through e-procurement, applying for single business permits and obtaining information from government websites. This means that enterprises that had no access to internet could not conduct simple steps required for formalization such as search of business name and application for licenses.

The third most important factor driving informality in Kenya is the size of the enterprise. Compared to microenterprises, medium enterprises have 20.4 percentage points less chance of being informal while small enterprises have 13.6 percentage point less chance of being informal. Since size of the enterprises was defined in terms of the number of workers that an enterprise hires, the finding means that the more the workers an enterprise engages, the less likely it is going to be informal. Therefore, enterprises in sectors that are labour intensive such as real estate activities, public administration and education services are more likely to be formal compared to those in labour-saving capital-using sectors.

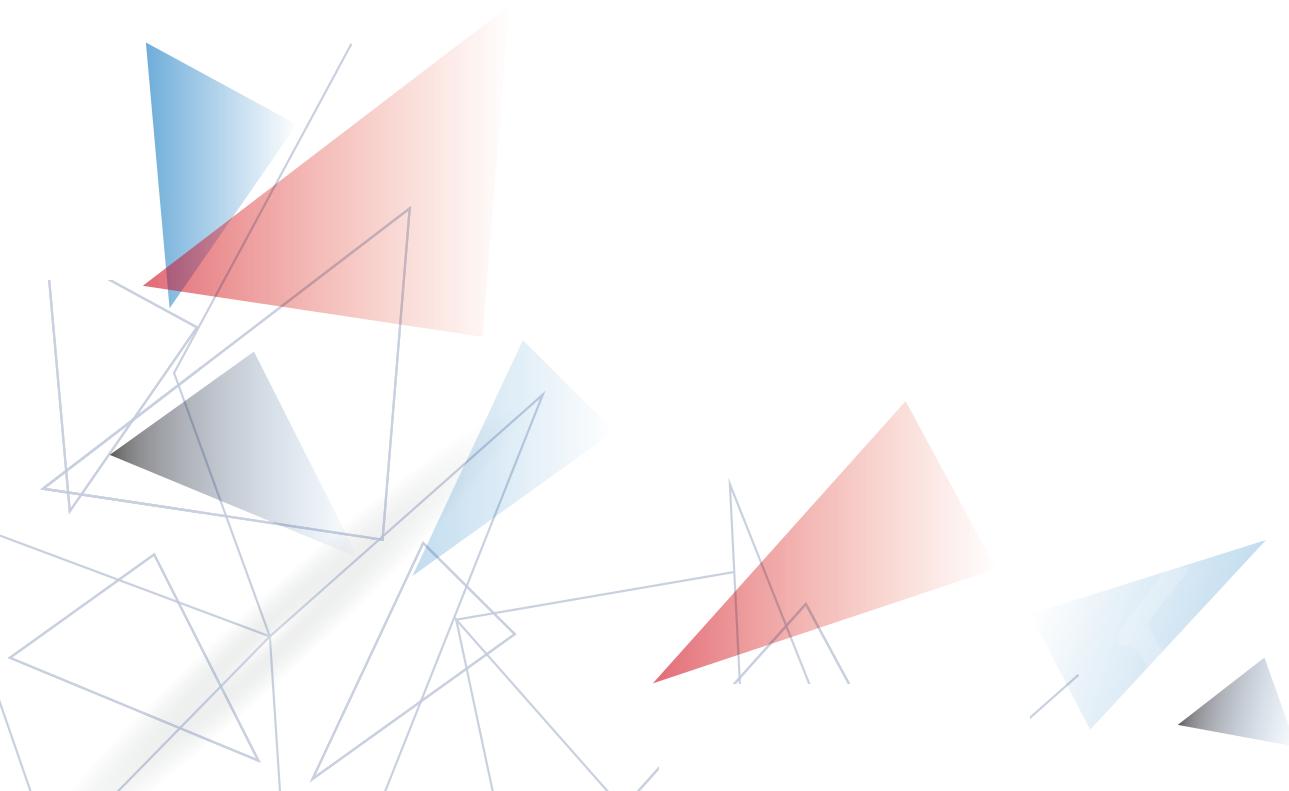
The fourth most important driver of informality is receiving business support. Enterprises that receive business support are eight percentage points less likely to be informal. Based on the definition of this variable, the finding implies that enterprises that received BDS in form of market and marketing information, accounting services, legal services, business training, business planning and stock layout training were less likely to be informal. This is expected since the support services received help an enterprise to grow. From the regression analysis, a record keeping enterprise has 7.3 percentage points less chances of being informal.

The fifth most important driver of informality is access to a good road network. Enterprises that were close to a tarmac road had 7.1 percentage points less chances of becoming informal. Good roads are known to make it easy for enterprises to be reached by a wide range of clientele. The enterprise is also able to undertake effective distribution of its products and services, and easily access or be accessed by regulators. This means that a good road network increases the probability of unregulated enterprises to be caught by regulators while it also serves as an incentive for them to increase their levels of compliance with the regulatory requirements. Such enterprises may opt to formalize to avoid unnecessary business disruptions by authorities.

The sixth most important driver of informality is interactions with financial and payments systems. Enterprises that have bank accounts, mobile money platforms and keep records have 5.3, 7.3 and 0.9 percentage points less chances of being informal. This means that interactions with banking infrastructure, mobile money platforms and keeping records is more likely to make an enterprise to be formal. This is explained by the formality and record keeping that is required by banks and mobile money service providers.

Enterprises that are owned by male or both genders are less likely to be informal compared to those owned by females. According to the analysis, male owned enterprises are 3.5 percentage points less likely to be informal while those owned by both sexes (male and female) are 1.6 percentage points less likely to be informal relative to those owned by females. The low likelihood of female enterprises being formal may be explained by the social and biological gender roles such as prenatal and postnatal care that adversely affect female owned enterprises, including increasing their chances of the businesses dying.

Tenancy risk increases informality. Enterprises that face substantial tenancy risk have 0.6 percentage points more chance of being informal than those that do not face any risks at all. In the survey, tenancy risk was defined using ownership of the land tenure system on which an enterprise is built. Based on the tenure system, an informal enterprise that does not own the land on which it is operating has a higher risk of being evicted by the national government, county governments or landlords making them more likely to be informal than those who do not experience substantial tenancy risk. The issue of tenancy is traced to the introduction of Trade Licensing Act (1968), which requires that traders seeking trade licenses must state space ownership, titles/lease or any evidence permitting them to access and make use of the space for which the application is being sought for and a physical address of the space. Thus, since a majority of the traders in the informal economy operate in undesignated areas including roadsides, the implication is that the businesses cannot be licensed hence continue to operate informally. The situation is further complicated by the requirement that the planning authority in collaboration with the health department must certify the location to be suitable for business before the trade license is issued.



Variable	Chances of being informal (Percentage points)
Belonging to business associations	2.01
Number of days of operation	1.08
Tenancy risk	0.55
A sector's ease of entry	0.17
Trading with the government and exporting goods	-38.3
Having internet	-24.1
Size (Medium enterprise)	-20.4
Size (Small enterprise)	-13.6
Receiving business support	-8
Keeping records	-7.25
Having tarmac roads	-7.05
Having a bank account	-5.33
Having electricity	-5.28
Ownership structure other than sole proprietorship	-3.87
Gender (Male)	-3.49
Gender (Both male and female)	-1.64
Years of schooling	-1.26
Using mobile money platforms	-0.93
Age of the business	-0.16

Table 27: Drivers of informality in Kenya

Source of Data: MSME Survey, 2016

The more the flexible the entry and exit in business, the higher the level of informality. Enterprises engaging in business activities that are easy to enter and exit have 0.2 percentage points more chances of becoming informal than those that are difficult to enter and exit. Based on the categorization of sectors with regard to ease of entry, businesses in sectors with ease of entry such as agriculture and fishing, mining and quarrying, manufacturing, wholesale and retail trade, accommodation and food services, information and communication, financial and insurance activities, administrative support services, human health and social work as well those in arts entertainment and recreation are more likely (0.17 percentage points more chances) to be informal compared to those in electricity gas steam and air, water supply sewerage and waste management, transportation and storage, real estate activities, professional and scientific activities, public administration as well as education services. It is no surprise, therefore, that majority of informal enterprises are in the wholesale and retail sector (hawking).

Other factors driving informality in Kenya are related to access to electricity and social networks. The estimation results showed that enterprises that have access to electricity are 5.3 percentage points less likely to remain informal. Contrary to expectation, enterprises that belong to business associations such as MSE associations, chamber of commerce and industry, other business associations, *merry go round*, ROSCAs and men and women associations have a two percentage points more chance of being informal than those not belonging to business associations. This means that enterprises that have to explain their behaviour or have their decisions sanctioned by other enterprises are more likely to be informal. As much as this may sound contradictory, the contradiction is resolved when the quality of these associations is considered. Literature has established that the quality of networks can adversely affect the decisions made by other individuals (Mdoe and Kinyanjui, 2018). Individuals or enterprises with low quality networks end up with low quality decisions compared to those with high quality networks. The fact that the networks that informal enterprises have make them remain informal shows that the networks could be of low quality.

4.6.5 Employer and Business Membership Organizations and informality

Employer and Business Membership Organizations (EBMOs) offer representational, lobbying and advocacy, and capacity building services. In Kenya, EBMOs are generally composed of large formal enterprises. Their membership is based on subscription in return for various representational and direct services. These organizations perform a key role of representing enterprises in both industrial relations and lobbying and advocating for appropriate policies and legislations. The EBMOs also provide direct services such as information and data sharing, training, advisory, networking and sensitization to their members. In taking care of these interests, employer organizations help enterprises to become more productive, efficient and competitive (Vandenberg, n.d).

EBMOs have limited outreach in the informal economy. Given the requirements for membership with EBMOs such as fees and registration status, employer bodies have limited reach to the informal economy. There is a growing view that EBMOs must have more active presence within the informal economy context, which constitute a considerable majority of all the enterprises in many developing economies. In addition, there are now some vertical and horizontal linkages between the formal and informal economy in terms of production and distribution of goods and services. The value chains of different sub-sectors now have a blend of both the formal and informal economy (Chen, 2007).

Knowledge of existence and role of employer organizations is very low among informal enterprises. The level of awareness of existence and functioning of employer organizations (EOs) such as FKE is an important step towards creating a mobilization and communication strategy for engaging informal enterprises. The results from the TIFA (2020) survey showed that only one percent of informal enterprises interviewed had knowledge and understanding of the role of EOs (Figure 11). A further 9 percent of the enterprises had heard about EOs but had no knowledge of their functions while nine in every ten of the informal enterprises surveyed neither knew nor heard of EOs. Results of the TIFA (2020) survey were supported by reflections of the informal economy entrepreneurs and workers who participated in the FGDs. Most of the FGD respondents had never heard about EOs and the few who had heard about them perceived the EOs to be only representing the big organizations as equipped by an informal entrepreneur interviewed. The low level of awareness requires various actions that would increase the level of knowledge and awareness of EOs amongst informal economy entrepreneurs.

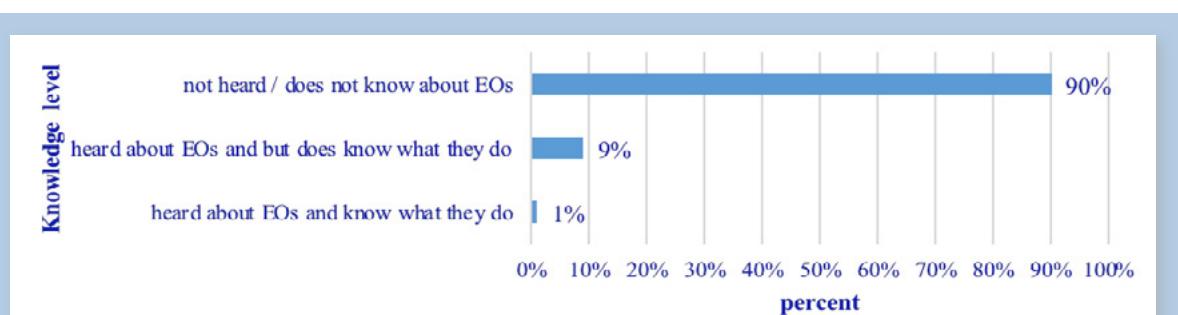


Figure 11: Knowledge and awareness about employer organizations

Source: TIFA (2020) survey

... we only see FKE in the media when they are fighting for the big corporates. We are not sure if they represent the informal economy in any way...

Informal enterprises believe that EBMOs help in growth and development of MSMEs. Perceptions of informal enterprises about what EBMOs can do to support them is necessary in designing intervention and support packages that are responsive to the needs and aspirations of informal enterprises. The TIFA (2020) survey results showed that majority (57%) of informal enterprises who had heard about EBMOs perceived them to be important for their business and wished that they become stronger. Others provided varied perspectives (Figure 12) such as belief that EBMOs help in development of MSEs (31%) and advocate for MSEs (37%). Other informal enterprises, however, considered EBMOs to be corrupt (33%) and inefficient (30%). Indications from the FGDs and KIIs were that informal economy agents are open to discussing with EBMOs for as long as they plan to address their needs directly. The entrepreneurs prefer that the EBMOs approaches them through their associations to establish a clear framework of operation. The EBMOs particularly FKE has a strategic fit in partnering with informal economy associations in areas of lobbying, advocacy and social dialogue. This bipartite collaboration can play an important role in initiating and activating bottom-up response measures to counter and/or complement the top-down government actions.

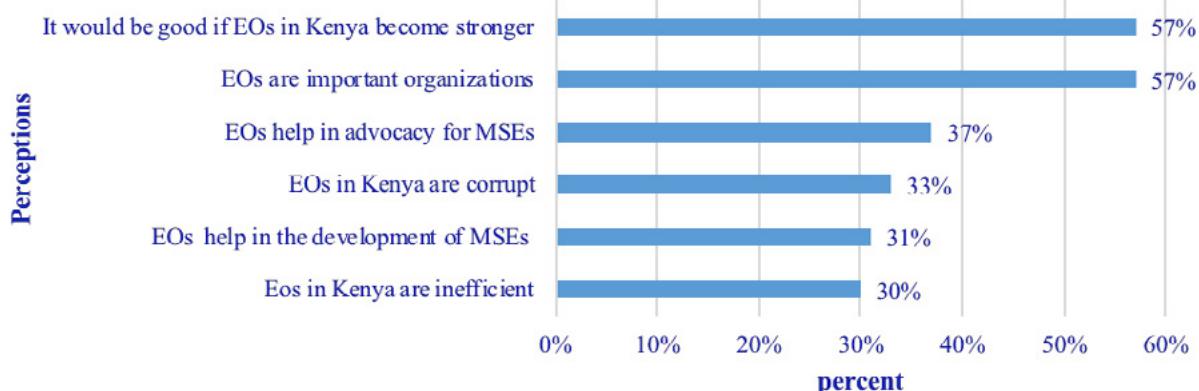


Figure 12: Perceptions of informal enterprises about EBMOs

Source: TIFA, 2020

Informal entrepreneurs do not consider themselves to be employers. The weak employment relationship and structure of informal enterprises make majority of the operators not to view themselves as employers. A member of an FGD in Nairobi warned:

...please do not call us employers, we are simply here to empower our fellow human beings to earn a living. The term employer brings complications of contracts and obligations that people in the informal sector cannot meet...

The survey findings indicated that trade unions that have made progress in organizing the informal economy workers treat the entrepreneurs as self-employed. Therefore, their view was that the EBMOs approach to the informal enterprises must be clear and separate or compliment what the other organization are doing. Both the KIIs and FGDs conducted with the respondents from informal enterprises identified current needs as linkages to formal enterprises for markets and businesses, training, access to finance and credit, access to space for business, access to technology and tools and support for personal protective equipment (PPE) and sanitizers as part of the measures to contain COVID-19.

4.7 Constraints facing informal enterprises and perceived solutions

This section provides an overview of the constraints that affect informal enterprises inclusive of their perceived levels of severity. The possible solutions to the constraints as perceived by the enterprises is also provided.

4.7.1 Major constraints faced by informal enterprises

Lack of markets, difficulties in getting licenses and high local competition are the key constraints faced by informal enterprises. Informal enterprises face a number of constraints (Figure 13). The 2016 MSME Survey identified the key obstacles to include lack of markets (16.7%), licensing issues (5.1%), high local competition (15.5%), poor roads/transport (7.8%), lack of reliable power (1.6%) and insecurity (3.2%). Except for licensing issues, the proportion of the firms that reported these challenges is nearly the same for both formal and informal enterprises. These findings are corroborated by KII respondent from one of the county governments who said:

...most traders in the informal economy are not registered. This may lead to the challenge of over taxation, especially when traders are required to make daily payments of fees/rates which may not be equivalent to the business they are doing. There is also an issue of compliance with laws. The county government have enforcement officers and the services are devolved to the wards and to the villages. Enforcement is done in collaboration with the police, village elders and enforcement officers. In the process of enforcing laws, some traders claim they are being harassed. Sometimes, the traders like hawkers and mama mbogas may not be making a lot of money, yet they have many needs to meet especially considering that the business could be the only source of their income. This may make the traders not to pay the required fees leading to confiscation of their goods. Market spaces are also a challenge, and this makes some traders to operate on the roadsides hence the running battles between the traders and city askaris...

Other constraints identified by the KII respondent included market access especially with things like crafts which may not be locally consumed and need to be exported; and lack of financial access in mainstream sources leading to online borrowing which is easily accessible compounded with financial illiteracy pushing many traders in to debts. The long process of getting business permits was also identified as a major constraint to the informal enterprises.

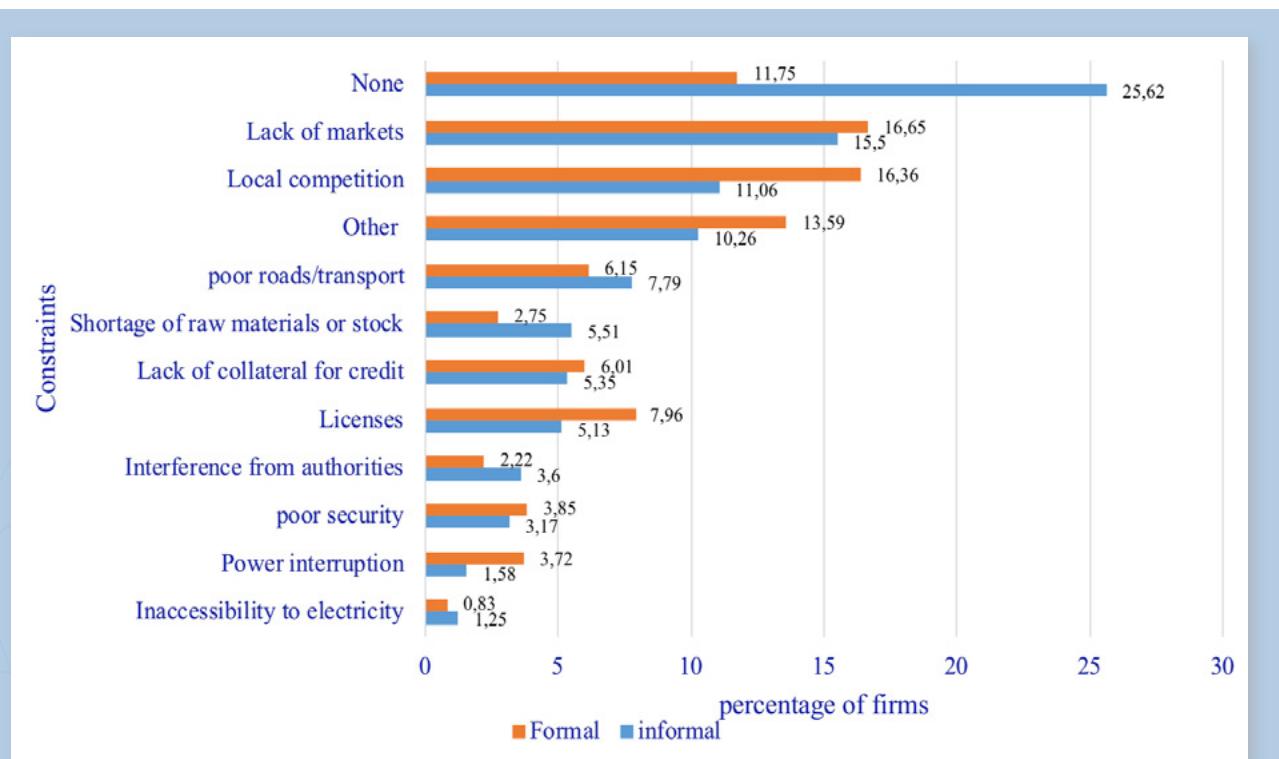


Figure 13: Business constraints faced by MSMEs

Source of Data: MSME Survey, 2016

Lack of markets, poor roads and licensing are most severe constraints faced by informal enterprises.

Constraints are deemed to have more negative effects on businesses depending on their relative severity. The 2016 MSME Survey asked firms to rank the seriousness of the constraints in the scale of most severe, severe and manageable. Figure 14 shows that the most severe constraints faced by informal enterprises are lack of markets (16.8%), poor road transport (16%) and licenses (10.8%). Local competition, lack of collateral for credit and interference from authorities are also regarded as being most severe constraints as identified by 8.7, 7.2 and 6.6 percent of the informal enterprises, respectively. Qualitative data from KII's and FGDs indicated that harassment by authorities is among the most severe constraints. According to the informal economy operators, harassment is mainly meted on them by the county authorities who confiscate or destroy their merchandise. Others reported that they are frequently arrested while going on with their businesses. Most of these challenges have also been highlighted in various policy and legislative documents. The Sessional Paper No. 1 of 1986 and Sessional Paper No. 2 of 2005 identifies challenges related to markets, access to credit, harassment and technology adoption. The MSE Act (2012) was legislated to put in place mechanisms to address the challenge of financial access. This was to be achieved through establishment of MSE Development Fund with the mandate of providing affordable and accessible financial services to MSEs. The Act also established MSEA to provide the institutional framework for addressing the challenges facing the informal economy. Persistence of the constraints signal weak implementation of the established policy, legal and institutional frameworks.

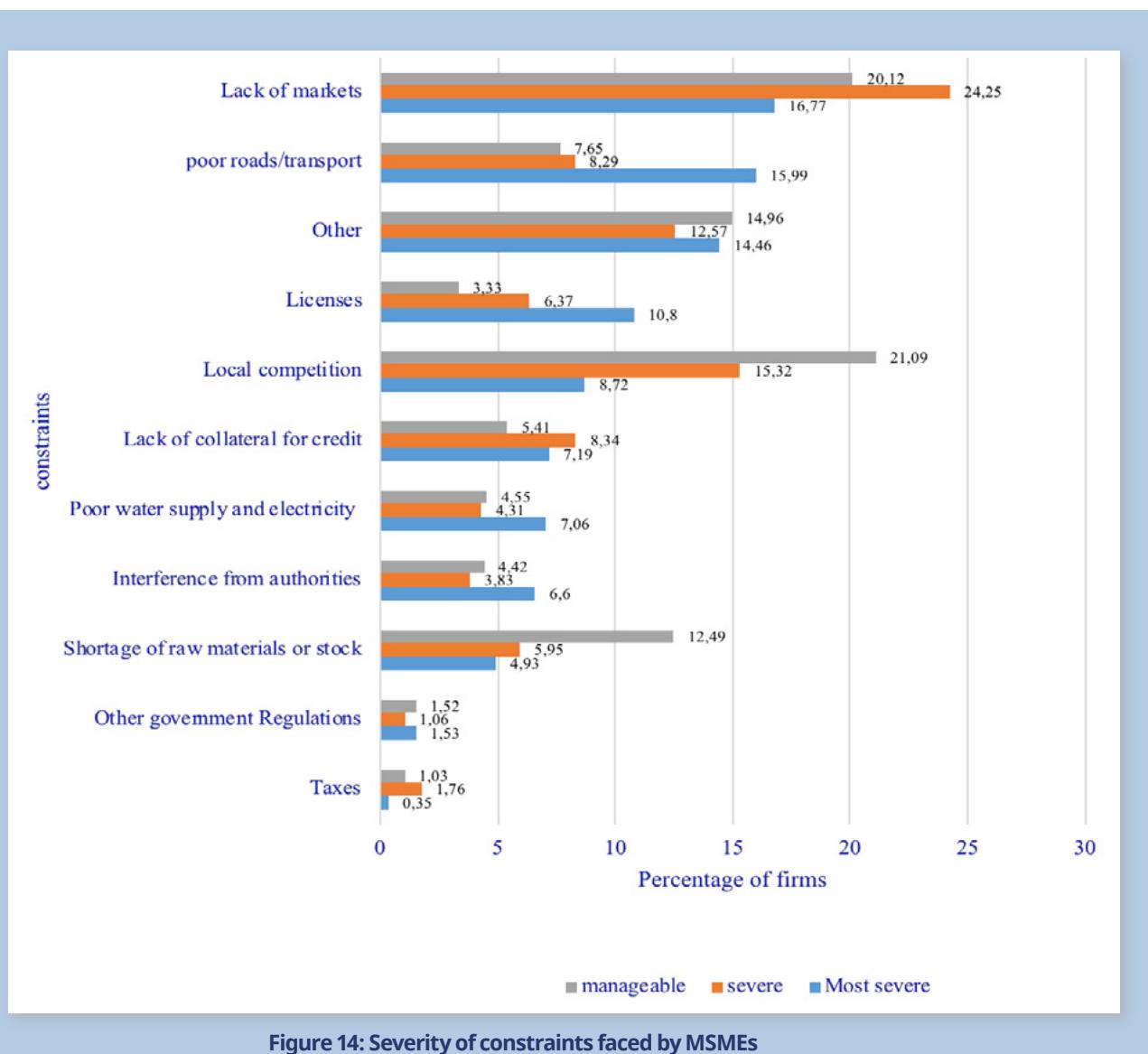


Figure 14: Severity of constraints faced by MSMEs

Source of Data: MSME Survey, 2016

4.7.2 Perceived solutions to constraints facing informal enterprises

Access to markets and market promotion is critical to informal businesses. The 2016 MSME Survey sought to know what the informal enterprises perceived to be the solutions to the constraints that they face. The survey results show that the key perceived solution to the constraints experienced by informal enterprises is assisting with markets and marketing information (see Figure 15). The high rating of markets and market promotion is consistent with the earlier finding that close to 95 percent of the informal enterprises had not introduced new products, new marketing methods nor new production techniques between 2013 and 2015. Providing an enabling environment for businesses to thrive, improvement of access roads, relaxing credit conditions and licensing requirements inclusive of provision of better worksites were cited as possible solutions to the identified constraints. Other perceived solutions to the constraints are improvement in electricity supplies, reduction of business risks and improvement of water supplies.

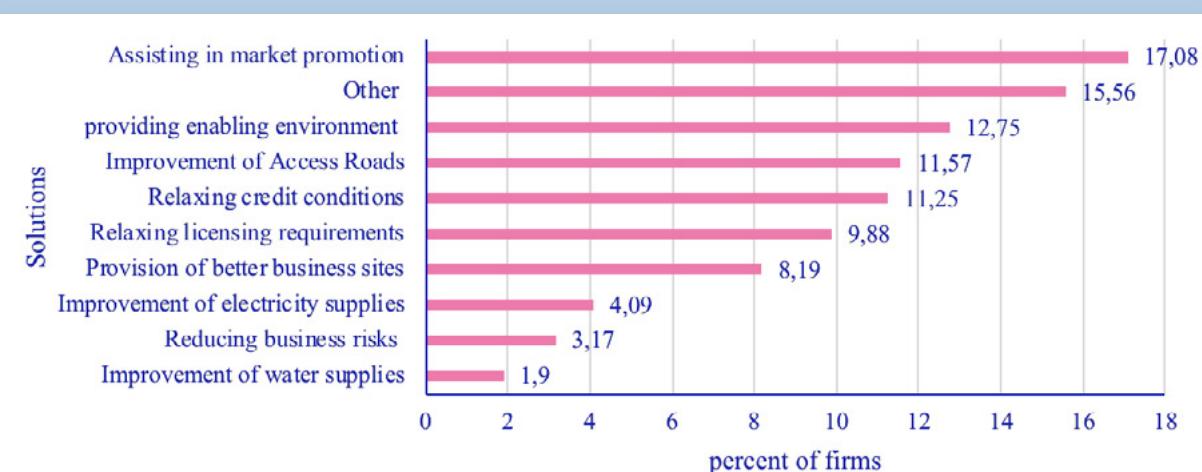


Figure 15: Perceived solutions to business constraints

Source of Data: MSME Survey, 2016

Some county governments have started addressing marketing and credit access challenges. Some county governments have come up with innovative ways of addressing some of the marketing and credit access constraints faced by informal enterprises. In regard to marketing, the County Government of Makueni established and operates *Kalamba* Fruit Processing Plant, which is involved in buying of fruits from farmers and processing for sale. A key informant from the County Government of Makueni indicated that the *Kalamba* Fruit Processing Plant also ensures value addition to the produce by farmers. The key informant further indicated that the county government also offers extension services to producers and farmers to help them in value addition of their products. In respect to access to credit, the County Government of Meru established the Meru County Microfinance Corporation in 2019 to facilitate access to credit by the informal enterprises. A similar initiative is in Kitui and Makueni counties. A key informant from Kitui county government noted that:

...as a county, to assist those in the informal economy, we introduced a revolving fund which is less costly and is easily accessible by those in the informal economy...

A key informant from Makueni county government also indicated that the county government operates a fund commonly referred to as *Tetheka*³² Fund. The Fund is used to assist small and medium enterprises, both individuals and groups. It is operated by the county government in partnership with Kenya Commercial Bank.

Some county governments are addressing skills, infrastructural and regulatory constraints facing informal enterprises. Key informant interviews with respondents from Kitui and Makueni county governments indicated that the two counties are facilitating informal economy operators to acquire skills training. While the Kitui county government is doing the skills training alone, the Makueni county government have partnered with

32. *Tetheka* is a Kamba dialect, which means get helped.

the National Industrial Training Authority (NITA) to offer the training. A key informant from Makueni county government noted that:

...the county government has an apprenticeship programme that targets graduates to work along with craftsmen to gain skills...

The County Government of Makueni is also implementing other interventions aimed at easing infrastructural and regulatory constraints faced by informal enterprises. A key informant from Makueni county government observed that:

... as a county government, we have taken it upon ourselves to improve infrastructure in wards. The county government is involved in upgrading of markets by constructing market shades, provision of sanitation and water. The county government is also acquiring spaces for construction of markets... regulating fees paid at the markets and mobilizing young people particularly boda boda riders to form SACCOS to facilitate them to benefit from services provided by the government...

4.8 Informal economy and COVID-19 in Kenya

This section assesses the effect of COVID-19 inclusive of the response and management measures adopted by the government on the informal economy.

4.8.1 Effect of COVID-19 on the informal economy

COVID-19 has both supply and demand shocks on the informal economy. The COVID-19 presents both challenges and opportunities to the informal economy in Kenya. As a challenge, it portends both supply and demand shocks to the informal economy. Restrictions in movements, in-county travel bans, border closures, closure of some workplaces and social distancing sharply reduced the economic opportunities for the informal economy actors who rely to a large extent on the personal contact with consumers. The in-country travel bans and restrictions affected informal economy producers, suppliers and other traders who could not freely access either rural or urban markets while border closures particularly by Kenya and her trading partners in the East African Community (EAC) had devastating impact on cross-border trade. Overall, the COVID-19 containment measures adopted by the government disrupted the informal economy supply chains by constraining production, marketing and distribution of goods and services. The disruptions in businesses lowered production while the loss of income, fear of contagion and heightened uncertainty makes people to spend less thus lowering aggregate demand. Consequently, COVID-19 has made informal economy workers and operators to lose employment, income and consumption.

Informal economy has lost at least 1.1 million jobs due to COVID-19. The KIHBS (2015/2016) estimated that Kenya had 11.8 million workers employed in the informal economy, which number had increased to 15 million by 2019 (KNBS, 2020). According to the KIHBS (2015/2016), the bulk (93%) of the informal economy workers are in micro enterprises followed by small enterprises (5%) and medium enterprises (2%). Majority (55.1%) of the informal economy workers are regular employees followed by unpaid family workers (21%), casuals (16.7%), part-time regular workers (5.2%) and those on attachment, internship and apprenticeship (2.2%). It is estimated that the informal economy has lost more than 1.1 million jobs due to COVID-19 with wholesale, retail trade, hotels and restaurants bearing the greatest brunt (59.8%). This is followed by manufacturing (20.2%), community and social services (9.7%), transport and communication (3.1%), construction (2.6%) and others (4.5%).

Disruptions in supply chains aggravate COVID-19 related employment and income losses in the informal economy. The COVID-19 related employment and income loss in the informal economy is aggravated by disruptions in supply chains and actions by some county governments to demolish informal business structures; close or relocate open air markets; close barber shops, salon and massage parlours; limit hotels, restaurants and other food vendors to providing takeaway services only; and restricting the number of passengers on motorized and non-motorized transport. Some live-in domestic workers have also been declared redundant as their services are no longer required by their employers who are also confined in the houses due to the pandemic while the services of others have been terminated as they are considered potential risks to COVID-19 contagion. Live-in domestic workers who are in employment have to forego their weekly rest day as a mitigation mechanism but live-out domestic workers have borne a greater brunt of job and income losses as they are considered high risk. Closure of learning institutions has also meant reduced demand for metal and wood made boxes, beds, chairs, tables and other school accessories. It has also cut the supply chain for the informal enterprises dealing in food and other food products.

Cessation and restriction of movement presents a major challenge to informal enterprises. The bulk (99.4%) of informal establishments in Kenya are micro enterprises, which are mainly in wholesale and retail sector (62.5%). These enterprises hardly use technology (99.5%), do not innovate (95%) and experience financial constraints (88.5%). The COVID-19 response of cessation and restriction of movement, and promotion of remote and online working, therefore, present a considerable challenge to these enterprises. Majority of informal economy enterprises have neither adopted nor integrated technology in their operations hence not ready for remote operations or marketing. In addition, the financial constraints experienced by informal economy enterprises hinder them from acquiring electronic gadgets that would help them move their business online as part of strategic response to both exploiting opportunities presented by COVID-19 and mitigating its negative effects.

Most informal enterprises will face survival challenges due to COVID-19. Informal microenterprises in Kenya generate an average monthly income of KSh. 27,016. McKinsey (2020) projected that COVID-19 would trigger shrinkage in wholesale and retail sector of 15 and 60 percentage points, in the best and worst cases scenario, respectively. The implication is that under the best case scenario, informal enterprises will experience a reduction of their average monthly income to KSh. 22,964 with a possibility of a deeper slump to KSh. 10,806. The projected slump in income due to COVID-19 presents a survival challenge for Kenya's informal economy enterprises, especially the microenterprises. This is coupled by the fact that county governments have continued to impose and collect levies, fees and other taxes from the informal enterprises while informal enterprises who had secured loans from financial institutions or other agents have also had their property attached by auctioneers for non-servicing of the loans. This is besides the loan interest, which continue to accumulate for others.

Decent work deficits heighten the risk of COVID-19 on the informal economy. Majority of the informal economy workers have higher exposure to occupational safety and health (OSH) risks. This is particularly due to the need to make a living and lack of appropriate protection and thus an increased likelihood of suffering from illness, accident and death. The workers are particularly vulnerable to health shocks since most of them do not have guaranteed access to medical care or income security through sickness or employment injury benefits. Informal economy workers also have low coverage of the social health insurance system offered through the NHIF, earn their livelihood from low and irregular income, and are not adequately represented in local and national governance structures. Though Kenya's labour laws including the Occupational Safety and Health Act (2007) is universal in its application, there is generally low level of compliance and enforcement of the labour laws in the informal economy. The workers are, therefore, not protected by the labour laws. These deficiencies heighten the risk of COVID-19 on the informal economy.

Some informal economy enterprises may not bounce back to business after COVID-19. The 2016 MSME Survey established that 8 percent or 93,638 of the informal enterprises failed in the last five years before the survey with micro enterprises constituting 97 percent of all the failure cases. More than half (61%) of the failures occurred in the first five years, and that majority of the enterprises that failed were female owned microenterprises. The business failures were attributed to shortage of funds occasioned by increased operating costs, declining income and losses incurred. In addition, the failure rates were exacerbated by social and biological reasons with most of the female owned establishments closing down due to obligation arising from prenatal and postnatal care of children. This means that reduced income, closures or reduction in working hours due to COVID-19 is likely to trigger high levels of failure of informal economy enterprises. It also follows that some of the informal economy enterprises may not bounce back to business after COVID-19.

Low level of unionization in the informal economy contributes to their exclusion in COVID-19 pandemic response and management policy discourses. Informal economy enterprises have low levels of unionization estimated at 0.5 percent for micro enterprises, 6.5 percent for small enterprises and 3 percent for medium enterprises. The estimates from the 2016 MSME Survey are corroborated by the figures from the KIHBS (2015/2016) survey, which showed that up to 99 per cent of the informal economy workers were not members of any trade union. Low levels of unionization mean low frameworks for social dialogue and absence of a platform for inclusion in public policy discourses, including those relating to COVID-19 pandemic response and management. Consequently, the COVID-19 response package designed by the government largely circumvented the informal economy because of absence of informal economy actors in discussions regarding the design of such packages. Omolo (2020a) argued that the informal economy-blind nature of the government rescue packages confirms the long-standing contention that the informal economy is a policy-orphan, often excluded in policy discourses.

COVID-19 has further exposed vulnerability of informal economy in respect to social protection. It is estimated that only 15 percent of the informal enterprises remit social security and health insurance contributions for their employees, implying low social security coverage. Workers employed by the informal micro and medium enterprises also earn relatively low monthly wages, estimated at KSh. 2,273 and KSh. 6,000, respectively. The wages are below the 2020 statutory minimum wage rates of KSh. 13,572.88, KSh. 12,522.72 and KSh. 7,240.96 for cities, former municipalities and other areas, respectively. The implication is that informal economy workers neither have health insurance nor income security to cushion them against the health and income loss challenges occasioned by COVID-19. Furthermore, due to loss of employment and reduced income, some informal economy workers and enterprises registered with the NSSF and NHIF are no longer able to remit their contributions. This means that these workers have ceased to be covered by NHIF for their healthcare needs. Furthermore, such workers will have to bear with the 90 days' post-payment waiting period imposed by the NHIF before they can resume accessing the health insurance. This challenge is in addition to the requirement by the NHIF for voluntary members of the scheme to make one-year advance payment of their premiums before they can access the social health insurance scheme.

4.8.2 COVID-19 Government stimulus package and effect on informal economy

The first set of fiscal, monetary and social insurance measures by government did not benefit informal economy workers and enterprises. The first set of fiscal, monetary and social insurance policy measures implemented by the government to cushion the country against the negative effects of COVID-19 were largely not beneficial to the informal economy workers and entrepreneurs. Most informal economy workers and operators are neither netted in the tax brackets nor earning above KSh. 24,000 per month to qualify for the tax reliefs. Furthermore, the benefit of the two percent reduction in VAT is conditional on suppliers of inputs and consumables passing it over to the consumers. This has largely not happened since the country has not recorded any reduction in the cost of living. As it is, the two percent reduction in turnover tax rate is only a reprieve to licensed informal economy enterprises while

the increased liquidity by commercial banks is only useful to informal economy businesses that are already in financial distress. Informal economy entrepreneurs and workers fall outside the targeted SPF programmes hence excluded from the social assistance intervention. Furthermore, majority of the informal economy workers and their associations are not even aware of the cash transfers being provided under the programme. The temporary suspension of blacklisting by CRB and moral suasion for loan restructuring can only benefit a few informal economy workers and operators who may have borrowed from the lending institutions.

Informal economy enterprises stand to benefit more from the 8-point stimulus package by government.

The second set of government intervention has better prospects for supporting the informal economy. The COVID-19 stimulus package on infrastructure (KSh. 5 billion) that targets hiring of local labour and utilization of local construction materials is aimed at stimulating growth and development of the MSEs. Furthermore, the 250,000 locally fabricated desks that are poised to be acquired under the education stimulus package is an opportunity for local artisans and builders. The KSh. 13 billion stimulus package towards the SMEs, especially the KSh. 3 billion seed capital for SME Credit Guarantee Scheme is expected to facilitate affordable credit to MSEs. Expansion of bed capacity in public hospitals is also expected to present an opportunity to the informal economy, especially those in metal fabrications and other manufacturing services, including trade.

Some county governments also designed and implemented informal economy-targeted support programmes. Key informant interviews with respondents from selected county governments showed that a number of counties designed and implemented programmes to support the informal economy wade through the COVID-19 pandemic. The measures included sensitization of the informal economy actors about the COVID-19 and its prevention strategies, development of operational guidelines for eateries to ensure social distancing and thereby avoiding total closures, testing for COVID-19, and provision of masks and sanitizers particularly to informal economy operators in the transport sector. Some county governments also ensured provision of water and handwashing facilities in markets, and putting signage and markings in market places to promote adherence to hygiene and physical distancing protocols.

COVID-19 presents an opportunity which informal enterprises can tap into. Overall, COVID-19 presents an opportunity that informal economy enterprises could use to reorient their production towards supply of facial masks, manufacture of sanitizers and home-made detergents, portable handwashing stands, and innovate on low-cost ventilators. They could also use the window to harness and strengthen digital revolution particularly in product development, online marketing and delivery systems.

► Section 5: Main Findings and Recommendations

5.1 Introduction

Kenya has a large informal economy that makes significant contribution to employment creation, income generation, poverty reduction and economic growth. The FKE with the support of the ILO implemented a project aimed at increasing the knowledge base and understanding of informal enterprises from perspectives of policy and membership development services. It commissioned an assessment of the informal economy in Kenya to better understand the characteristics of the informal economy, employment and remuneration of workers in the informal economy, market conduct of informal enterprises, the potential for formalization among informal enterprises, employer organizations and informality, constraints experienced by informal enterprises and their perceived solutions, and the effects of COVID-19 on the informal economy. The key findings of the assessment are as follows:

Characteristics of informal enterprises:

1. There were 6,987,090 informal enterprises in 2016, majority (99.4%) of whom were unlicensed micro enterprises with an average age of seven years and engage workers with at most certificate level of education
2. Majority (58.5%) of informal microenterprises are run by females who have primary level of education while 55.6 percent of the informal small and 51.2 percent of the informal medium enterprises are run by males with college level of education
3. Informal enterprises are mainly engaged in wholesale and retail trade activities and generate an average monthly turnover that ranges between KSh. 27,061 for microenterprises and KSh. 1,428,048 for medium enterprises.
4. Informal enterprises are financially constrained owing to inadequate collateral, lending ceilings and high interest rates. Up to 99 percent of the informal enterprises rely on informal sources of capital with majority of the enterprises seeking credit from MFIs, SACCOs and ROSCAs.
5. Informal enterprises have low levels of innovation and competitiveness and are exposed to customer concentration and supplier risks. The informal microenterprises are the majority in this category at 96 percent followed by medium enterprises (92%) and small enterprises (89%).
6. Informal enterprises experience seasonal variations in business. The enterprises record booming business between October and December and a slump in the months of January to March. However, the license fees and levies to the county governments are not graduated in accordance with business performance, at times causing financial distress to the entrepreneurs.

Employment and remuneration

7. About nine in every ten informal economy workers are in informal microenterprises
8. Social security coverage is generally low in the informal economy with 75.7 percent of the enterprises not paying monthly NSSF and NHIF contributions for their workers
9. There exist low levels of unionization among informal enterprises ranging from 0.5 percent, 3 percent and 6.5 percent for micro enterprises, medium enterprises and small enterprises, respectively. Up to 99 percent of informal workers are not members of any trade union.
10. Informal micro, small and medium enterprises pay an estimated monthly wage of KSh. 3,525, KSh. 4,975 and KSh. 2,082 per worker, respectively. These wage rates are below the 2020 statutory minimum wages of KSh. 13,572.88, KSh. 12,522.72 and KSh. 7,240.96 for a labourer in cities, former municipalities and other areas, respectively.

Access to credit and finance

- 11.** About one-half of informal enterprises are financially constrained owing to inadequate collateral, lending ceilings and high interest rates.
- 12.** Up to 99 percent of informal enterprises rely on informal sources of capital with majority of the enterprises seeking credit from MFIs, SACCOS and ROSCAs.
- 13.** The MFIs is a major source of credit for at least one third of the informal firms
- 14.** At least thrice as many informal enterprises sought credit from ROSCAs and self-help groups than did formal enterprises.
- 15.** While formality as demonstrated by possession of formal business documents is a requirement for access to formal credit, informal firm owners circumvent this by borrowing money in their individual capacities then channel it into their businesses.

Market conduct

- 16.** About 80 percent of informal firms did not advertise their products compared to 46 percent for formal firms.
- 17.** More than 95 percent of the informal enterprises did not use any new strategies/innovations to market their products.
- 18.** About 90 per cent of informal enterprises and 74.1 percent of the formal enterprises do not have any contractual agreements with the informal-oriented MSME input providers.
- 19.** More than half (57.2%) of the informal enterprises set prices for their products independently by only using internal price mechanism such as cost structure.
- 20.** There is no policy framework and/or guidelines to anchor and strengthen backward and forward linkages between enterprises in the informal economy and formal firms.
- 21.** Key training needs for informal enterprises include customer service (54%), marketing (44%) and communication skills (27%).

Formalization

- 22.** Formalization of informal sector enterprises in Kenya has a pyramidal shape with majority (73.3%) of informal enterprises yet to start their formalization journey, a few (19.1%) are a step away from informality, another minimal proportion (5.4%) are midway the journey. A paltry 1.4 per cent of informal enterprises are ready to formalize while slightly less than one per cent are fully formalized.
- 23.** The costs of formalization which include high cost of compliance with tax regulations, existence of too many procedures and delays, high cost of compliance with social security regulations and labour laws, lack of information and informal costs incurred through corruption appear to outweigh the gains from formalization. These gains include reduced cost of inspection, better access to credit, access to strategic business location, expansion of clientele base and eligibility for business development services and other support programs.
- 24.** On average, 94.3 percent of the MSMEs in the informal economy do not pay taxes regardless of their size.
- 25.** A mere 5 percent of the informal enterprises indicated to have PIN Certificate which is issued by KRA in order to manage firm tax obligations.
- 26.** Enterprises that have access to internet were 24.1 percentage points less likely to be informal.
- 27.** One of the most important factors driving informality in Kenya is lack of opportunities to do business with the government and failure to export goods and services. MSMEs that trade with the government and export their goods and services are 38.3 percentage points more likely to be formal than those who do not.

Employer and Business Membership Organizations and informality

28. There exists low level of knowledge and awareness of existence and role of EBMOs. Only one percent of the surveyed informal enterprises had knowledge and understanding of the role of these organizations, while nine in every ten of the informal enterprises surveyed neither knew nor heard of the EBMOs.
29. On average, 66 percent of the owners of the informal enterprises do not belong to any organization as MSME associations, chamber of commerce, merry go rounds, women/men associations or any other form of business association.
30. Majority (57%) of informal enterprises who had heard about EBMOs perceived them to be important for their business and wished that they become stronger
31. About one third of informal enterprises who have knowledge and awareness of EBMOs believe that the EBMOs help in development of MSEs (31%) and advocate for MSEs (37%).
32. Other informal enterprises considered EBMOs to be corrupt (33%) and inefficient (30%).
33. Informal entrepreneurs do not wish to be referred to as employers due to complications of contracting and the obligations that formal employers have, which they do not wish to go through.
34. Informal economy entrepreneurs are open to partnering and collaborating with EBMOs if the plan is to address their needs directly.
35. Informal economy entrepreneurs prefer that the EBMOs approaches them through their associations to establish a clear framework of operation.
36. Informal economy entrepreneurs prefer the collaboration and partnership between them and EBMOs to focus on linkages to formal markets and businesses, training, access to credit and finance, access to market spaces and worksites, promotion of adoption of modern technology and use of modern tools, and provision of PPEs particularly during the COVID-19 period.

Constraints and perceived solutions

37. Lack of markets, difficulties in getting licenses, poor infrastructure and stiff local competition are some of the major and severest constraints faced by informal enterprises.
38. Informal enterprises consider relaxation of licensing requirements, support towards access to markets, and provision of an enabling business environment to be priority solutions to their most pressing challenges.
39. Enhancing access to information and services on compliance to taxes, easing of social security requirements, and access to credit and skills training are viewed as important elements in enhancing growth of informal enterprises and their progress towards formalization.

COVID-19 and the informal economy

40. The informal economy has lost more than 1.1 million jobs due to COVID-19 with wholesale, retail trade, hotels and restaurants bearing the greatest brunt and accounting for 59.8 per cent of the jobs lost.
41. Majority of informal economy workers have a higher exposure to occupational safety and health risks that have been heightened by the risk of COVID-19.
42. There is low level of unionization and social dialogue in the informal economy, which contributes to their exclusion in COVID-19 pandemic response and management interventions including stimulus packages by government.

Gender gaps in the informal economy

- 43.** More females are in informal micro enterprises compared to males. Females own more than half (58.5%) of the informal microenterprises while males own more than half of informal small (55.6%) and medium enterprises (51.2%).
- 44.** Male owned informal enterprises are about twice as productive (KSh. 24,764) as female owned enterprises (KSh. 12,408), demonstrating gender gaps in productivity of informal enterprises in Kenya.
- 45.** Female-owned informal enterprises are more likely to fail compared to male owned enterprises.

Recommendations

Arising from the study findings, the following agents can contribute to growth of the informal economy and its eventual formalization through the following ways.

National Government and State Agencies

- 1.** In view of the informal economy being supported by a complex structure of diverse stakeholders, the Micro and Small Enterprises Authority should step up its coordination role as mandated by the Micro and Small Enterprises Act (2012). The strengthening of multi-stakeholder coordination framework will enhance synergy, address duplicity of roles and overlapping mandates among the players. The coordination mechanism should undertake regular audit of the effectiveness of informal economy policy, legal and regulatory framework; drive change of attitude towards the sector; and enhance monitoring and evaluation of the policies and programmes targeting the informal economy.
- 2.** In light of informal enterprises being financially excluded from the formal financial system, the Ministry of Industry, Trade and Cooperatives in conjunction with the Registrar of Companies, KRA, NSSF, NHIF and the National Treasury should review their procedures and flex regulations around acquisition of relevant documents for formalization.
- 3.** The informal economy suffers low social security coverage. The NSSF and NHIF should develop, implement and promote hybrid social security and health insurance schemes with centralized management, oversight and risk-pooling. This should be combined with informal economy association-based membership mobilization, collection and remission of premiums towards the social security and health insurance schemes.
- 4.** To enhance access to credit, the National Treasury should increase the allocation to the SME Credit Guarantee Scheme and provide guidelines to allow promising informal or semi-formal enterprises to access the funds through registered formal associations or groups.
- 5.** To further address financial exclusion of the informal economy, the Central Bank of Kenya in conjunction with the National Treasury and other financial institutions should establish a low risk weighting for informal enterprise' loans. The credit to the informal economy operators should be embedded with specific business development services, which addresses identified informal economy growth and competitiveness gaps.
- 6.** Laws and regulations have a direct bearing on formation, growth, competitiveness and sustainability of enterprises. To strike a balance between promotion of compliance with labour laws and labour-related regulations, and competitiveness of the informal enterprises, the MoL&SP in consultation with the social partners and informal economy associations should establish a responsive labour and labour-related code that balances low cost of doing business with incentives for compliance. The differentiated code, which should be implemented gradually, should prioritize compliance with fundamental principles and rights at work. This would include freedom of association and effective recognition of the right to collective bargaining, effective abolition of child labour, adherence to basic occupational safety and health regulations and promotion of access to social protection.

7. To strengthen the linkages between the informal economy and the formal sector, the Ministry of Industry, Trade and Cooperatives in consultation with the informal economy actors and industry players should finalize and implement the subcontracting policy.
8. The National Government in conjunction with the County governments and other key stakeholders should support formalization of informal enterprises through short and medium to long term measures:

a. Short term measures

- Enhance productivity through multi-stakeholder training and capacity building in marketing, technology adoption, pricing and customer service and other needs
- Provide decent spaces, sanitation and infrastructure where the informal economy operates
- Enhance provision of targeted credit and financial services in form of grants, loans and revolving funds both at national and county levels
- Reduce unnecessary level of inspections in the informal economy.

b. Medium to long term measures

- Promote participation of the informal economy in public procurement through special channels such as use of registered informal sector groups than individual groups who are not registered
- Reduce the number of procedures and delays associated with the formalization processes of registration, taxation and licensing
- Integrate the informal economy's space and infrastructure needs in national and county physical planning activities. This will ensure a sustainable supply of adequate infrastructure in the long run
- Create a sound multi-stakeholder monitoring and evaluation system that will ensure tracking of formalisation policies and programmes, and enhance coordination of the formalization process
- Enforce existing laws and regulations relating to employment contracts and promotion of creation of full and productive employment and decent work for all
- Increase awareness about the potential benefits of compliance with
- the legal and regulatory framework including penalties for non-compliance through a sustained communication and media campaign strategy. This would enable the informal economy operators to view formalization as a means to sustained growth and competitiveness
- Simplify tax administration by having a single or fewer tax obligations depending on the size of informal enterprise. In addition, leverage on technology to further simplify tax returns processes
- 9. The COVID-19 pandemic may decimate the informal economy if not moderated. The national and county governments should, therefore, ensure timely implementation of the 8-point economic stimulus package unveiled by the government to protect the informal enterprises from the adverse effects of COVID-19.
- 10. The DOSHS in collaboration with the social partners and the informal economy associations should develop and implement mechanisms to promote occupational safety and health within the informal economy.

County Governments

The county governments in collaboration with other stakeholders may undertake the following:

11. Since informal enterprises experience cyclical variations in their businesses, the county governments should review and tailor payments of levies, fees and taxes by the informal enterprises to fit in the cyclical business cycles experienced by the enterprises. This can be achieved by tying the levies to a variable such as sales turnover that correspond to the changes in business prospects

12. To provide an enabling environment for informal economy, county governments should create package of solutions that respond to area-specific needs of the informal economy. These packages can be in form of legislation or executive actions, and may include:

- Provision of decent spaces and infrastructure where the informal economy operate
- Training and capacity building in areas such as marketing, technology adoption, pricing and customer service
- Provision of credit and finance services in form of grants, loans and revolving funds
- Implementation of occupational safety and health measures, and improvement of sanitation services in informal economy workplaces.

FKE and other EBMOs

13. To effectively support the informal economy in lobbying, policy advocacy and social dialogue, FKE and other EBMOs should work with informal economy associations to undertake large scale membership organization and recruitment of the informal enterprises into their membership. This may promote joint initiation and activation of bottom-up measures that promote growth and competitiveness of the informal economy

14. There is low knowledge and awareness of existence and role of FKE and other EBMOs among informal enterprises in Kenya. This provides opportunity for the FKE to popularize itself among the informal enterprises based on their perceived needs. A package of these needs and aspirations could include linkages to formal enterprises for markets and business opportunities, training and capacity building on management skills, pricing and production, access to finance and credit, access to space for business, access to technology and tools, and mitigation of the negative effects of COVID-19.

15. Another entry and intervention point is for FKE to partner with the informal economy operators to advocate and lobby for convenient formalization procedures, voice concerns against harassment of informal enterprises by authorities at national and county levels, and promotion of social dialogue through establishment of collective bargaining and other policy dialogue platforms that informal economy operators and associations can use to voice their concerns and engage with the government and other partners.

16. To strengthen vertical linkages between formal and informal enterprises, FKE and other EBMOs should develop guidelines and support systems that encourage their members to source and sub-contract in input supply, production, distribution, marketing and other services with the informal economy enterprises. Informal enterprises who are willing to participate in these linkages can use existing formal groups or associations as a vehicle for trading.

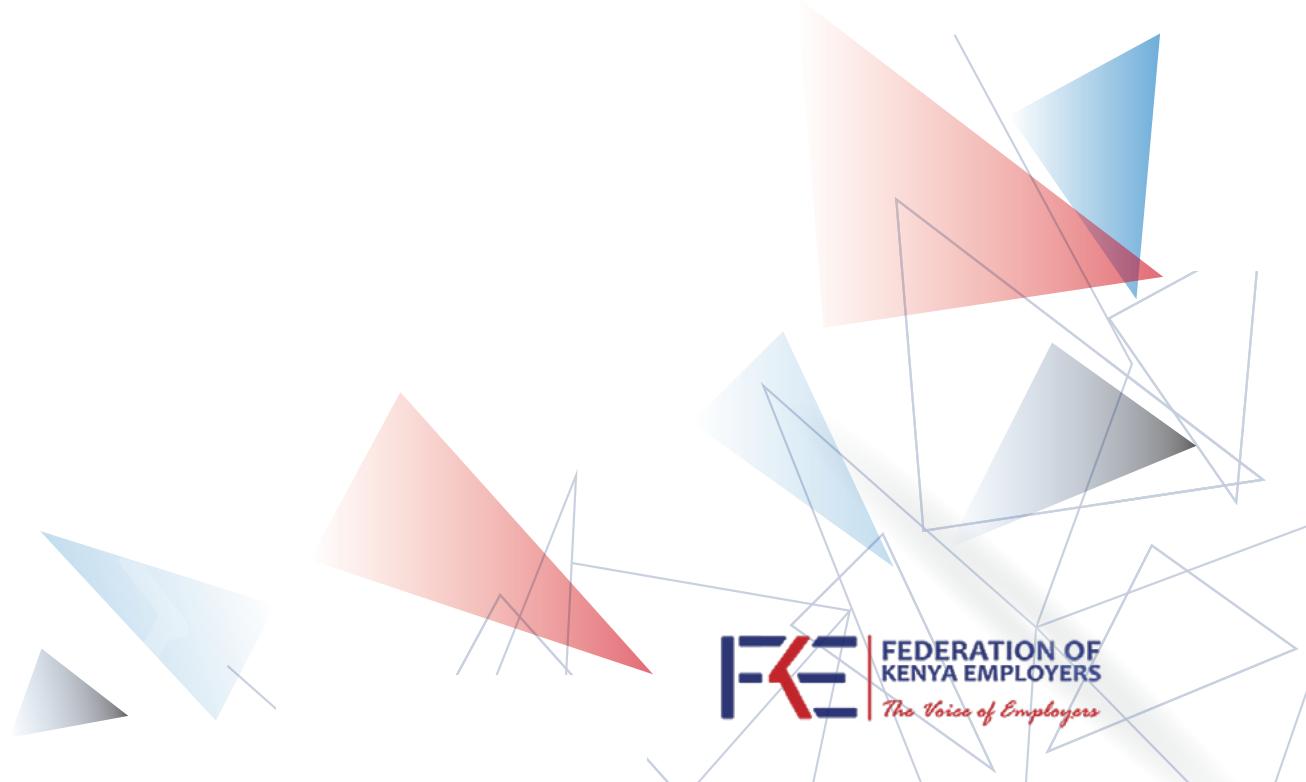
17. FKE has a strategic niche in promotion of occupational safety and health. The Federation could, therefore, utilize its internal capacity including mobilization of its members to work with the informal economy operators to improve safety and health in the informal economy. This intervention is critical at this time of COVID-19 and post COVID-19 and would target provision of personal protective equipment, safety masks, hand sanitizers, and handwashing facilities. The formal-based members of the Federation could also partner with relevant informal economy enterprises to produce the relevant COVID-19 products. In designing the intervention package, FKE should have clarity of the needs of the informal economy and what other partnering organizations are offering to the informal economy. This would enable the Federation to design and implement targeted and more competitive informal economy support interventions thereby endearing the partnership as value adding.

18. The fact that most COVID-19 response packages circumvent the informal economy is largely because there are no informal economy actors participating in the discussions regarding the design of such packages. Informal actors must themselves be central to all policies, legislations and institutions including COVID-19 responses that affect them. Social dialogue can provide the principle vehicle to bringing about informal

economy participation and involvement. This calls on FKE and COTU-K together with their constituents to work with the informal economy operators and promote social dialogue. The social partners can also work with the informal economy associations and workers to disseminate information about COVID-19; assess the impact of COVID-19 on specific professional groups within the informal economy; and propagate, supervise and enforce social distancing and hygiene protocols within the informal economy workplaces.

Technical and Vocational Training Institutions

- 19.** In view of the weak levels of competitiveness of the informal enterprises, TVET institutions, MSE, NITA, FKE, COTU-K, KNCCI and county governments in partnership with informal economy associations should establish mechanisms to build the capacities of the enterprises. Areas of training needs would include marketing, innovation, contracting and price determination. This may be done in the format of targeted tailor-made skills training through workplace-based training programmes. The skills training should incorporate assessment that would culminate in recognition of prior learning and certification for attainment of industry recognized skills within the Kenya National Qualification Framework.



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