

Policy Guidelines for the Formalization of Micro-, Small and Medium-sized Enterprises in Kenya



**United
Nations**

Department of
Economic and
Social Affairs

**POLICY GUIDELINES FOR THE FORMALIZATION OF MICRO-, SMALL AND
MEDIUM-SIZED ENTERPRISES (MSMEs) IN KENYA**

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Abbreviations and acronyms

ACCOSCA	African Confederation of Cooperative Savings and Credit Associations
AfCTA	African Continental Free Trade Area
AGMARK	Agriculture Market Development Trust
AGPO	Access to Government Procurement Opportunities
BDS	business development services
CCD	Commissioner for Cooperative Development
CoG	Council of Governors
CS	Cabinet Secretary
COTU	Central Organization of Trade Unions
COVID-19	coronavirus disease 2019
FCDO	Foreign Commonwealth and Development Office
GDP	gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)
ICA	International Cooperative Alliance
IGRTC	Intergovernmental Relations Technical Committee
ILO	International Labour Organization
JICA	Japanese International Cooperation Agency
KAM	Kenya Association of Manufacturers
KEPSA	Kenya Private Sector Alliance
KRA	Kenya Revenue Authority
KUSCCO	Kenya Union of Savings and Credit Cooperatives
MSEA	Micro and Small Enterprises Authority
MSME(s)	micro-, small and medium-sized enterprise(s)
MESPT	Micro Enterprises Support Programme Trust
NAAIP	National Accelerated Agricultural Input Programme
OECD	Organisation for Economic Co-operation and Development
PIN	personal identification number
PREG	Partnership for Resilience and Economic Growth
PS	Principle Secretary
SACCO	savings and credit cooperative
SDGs	Sustainable Development Goals
SIDA	Swedish International Development Cooperation Agency
TMEA	Trademark East Africa
TVET	technical and vocational education and training
UK	United Kingdom of Great Britain and Northern Ireland
UN	United Nations
UN DESA	Department of Economic and Social Affairs of the United Nations Secretariat
UNDP	United Nations Development Programme
WOCCU	World Council of Credit Unions

Executive summary

The policy guidelines on the formalization of micro-, small and medium-sized enterprises in Kenya, which are set out in the 16 sections of the present report, are modelled on the policies and guidelines for the formalization of cooperatives.

Section 1 provides the background for the assignment and the methodology used to accomplish it, as well as the legal definition of “micro-, small and medium-sized enterprises (MSMEs)” as given under the Micro and Small Enterprises Act, 2012 – a definition based on number of employees, annual turnover and capital employed -. The transition of enterprises from informal to formal status is described from different theoretical perspectives.

Section 2 discusses the various approaches to formalization in Kenya, which has two business registries: the Cooperative Registry managed by the Commissioner for Cooperative Development (CCD) and the Company Registry based at the State Law Office. Situated in-between are community groups which operate under the supervision of the State Department for Social Protection.

Section 3 offers a detailed description of the Cooperative Registry and shows how the Government’s approach to cooperatives has evolved over time. The policy of the early 1960s based on total control ultimately gave way to the present liberalized approach under which cooperatives are allowed to carry out their business with little interference.

Section 4 lays out the step-by-step approach to registering a cooperative society and identifies county and national functions. The right of aggrieved persons to appeal the decisions of the commissioner and cabinet secretary is discussed.

Section 5 lists other services offered by the Cooperative Registry.

Section 6 considers the legal instruments upon which the CCD relies in carrying out his or her registration function.

Section 7 focuses on the services rendered by the Company Registry and the cost of those services.

Section 8 lists the other government authorities with which registration is required after formalization.

Section 9 discusses community groups, which is the alternative available to Kenyans if they do not wish to formalize. While community groups do not offer the security provided by limited liability organizations, they do accord their members recognition and enable them to access credit and conduct limited forms of business.

Section 10 examines the challenges to formalization: lack of managerial training for MSME owners and managers; inadequate finance and limited access to credit; rapid technology changes; and rapidly changing laws and regulations. Other general challenges include poor infrastructure and bureaucratic bottlenecks.

Section 11 lays out the benefits of formalization. Formalization minimizes the business risk incurred by individuals. Once formalized, organizations have the opportunity to bargain with government on policy and legal matters. Other benefits accruing from formalization include access to credit; access to government contracts; and establishment of owners’ credibility in the eyes of suppliers and other business entities, including the general understanding that the business will outlive its owners.

Section 12 considers the various types of cooperatives in Kenya and demonstrates how they have penetrated all spheres of the country’s economy. Savings and credit cooperatives are the most prevalent followed by produce marketing cooperatives. The performance of agri-based cooperatives has been adversely impacted by policies emanating from certain government departments associated with the agricultural sector. Highlighted here is the unfavourable image projected by the Jua Kali concept which fosters the belief that the terms “Jua Kali” and “MSME sector” are synonymous.

Section 13 focuses on policy issues which need to be adequately addressed if the MSME sector is to achieve resilience. Those issues include regulation; business development services; business incubation; the concept of warehousing; financing; publicity and advocacy; and challenges faced by youth, women and persons with disabilities. This section highlights the central role of information and communications technologies (ICT) in the formalization process.

Section 14 offers strategic recommendations reflecting a recognition of the presence of the many stakeholders within the MSME arena. A key recommendation in this regard focuses on the establishment of an interdepartmental coordinating committee on MSMEs. To improve coordination among the many stakeholders and to enable provision of secretariat services to the proposed committee, it is recommended that the Micro and Small Enterprises Authority (MSEA) be strengthened. It is proposed that strong linkages be created between MSMEs and other manufacturers to enable MSMEs to secure access to larger markets within the African region and beyond.

Section 15 comprises a schedule of all identified stakeholders (each classified as either a government ministry or agency, a private sector actor, a United Nations organization or a non-governmental or development organization), their roles and responsibilities and the level of their possible influence on MSMEs. .

Section 16 centres on the development of a policy and legal framework for MSME formalization, with emphasis on the recognition of cooperatives as private business organizations; and the interdependence of the national and county governments within the devolved system of government. Within this section, the need is reiterated for formalization to be voluntary and for recognition of those entities that do not wish to be formalized.

The need to maintain national registries is emphasized, even if the county structure is used as the basis for mobilization.

Section 17 emphasizes the need for granting legal waivers, i.e., exemptions from the provisions of strict solvency laws, in cases where formalized MSMEs are winding up.

In section 18, it is stated that the role of non-State actors in this context – as well as the nature of the reports they provide to the MSEA and to county governments - should be clearly defined.

An action plan for the implementation of the policy guidelines is included in annex I. Annex II sets out the cooperative registration workflow and annex III provides the consultancy workplan.

Introduction

1.1 Background

In a report by the Organisation for Economic Co-operation and Development, (OECD),¹ it is noted that micro-, small and medium-sized enterprises (MSMEs) constitute 99 per cent of all business enterprises internationally. They are the main source of employment (accounting for about 70 per cent on average) and are a major contributor to value creation, generating 50-60 per cent of value added of produce. According to a report of the International Labour Organization (ILO),² about 2 billion workers are hired by the informal sector globally, consisting mainly of informal MSMEs, which provide 90 per cent of employment in low-income countries and 67 per cent in middle-income countries. Frequently, employment in informal MSMEs provides critical livelihood opportunities for women, youth, migrants and refugees and their families.

ILO acknowledges that most people enter the informal sector not by choice but as a consequence of lack of opportunities in the formal sector. When their business registration has not been carried out, MSMEs face multiple challenges, such as limited access to credit, training opportunities and markets of higher value. Employees in informal MSMEs, particularly in developing countries, do not have basic social protections and often work in hazardous work environments. Rapid urbanization in developing countries often means that informal MSMEs are located in overcrowded and often peripheral areas without adequate access to public goods and services such as transport, affordable energy, clean water and sanitation, among others. Most informal MSMEs in African countries operate in the agriculture, manufacturing and services sectors which are highly susceptible to the challenges triggered by the COVID-19 pandemic.

In Kenya - as in the other countries of the world - MSMEs are the backbone of the economy. MSMEs constitute about 98 per cent of all the business entities in the country. They provide about 30 per cent of job opportunities in Kenya annually. In 2017, the MSME sector contributed 3-6.4 per cent of the country's overall GDP growth. As is the case in developing countries, the majority of MSMEs in Kenya are informal, i.e., they have not registered their businesses with government authorities.

While national Governments have launched stimulus packages aimed at protecting small enterprises from collapse, such support has failed to trickle down to informal MSMEs. Without officially registering their businesses, informal MSMEs cannot access economic stimulus packages released by national Governments. Further, employees of informal MSMEs are not covered by social protection programmes.

Promoting MSME formalization is an objective included under SDG target 8.3. Formalization would expand access of MSMEs to business development services, financial resources, innovative technologies and the linkages with markets of higher value. As a result, it would improve capital and technical accumulation among MSMEs, improving their productivities and enlarging their contributions to inclusive economic growth and sustainable development. However, policy frameworks for MSME formalization in developing countries are often fragmented and overlapping, resulting in substantial transaction costs. Not only do businesspersons in the informal MSME sector confront compliance and transparency issues but they have found very little incentive to formalize their businesses.

1.2 Methodology

In order to deliver the assignment, the consultancy adopted a combination of participatory methodologies for researching and working with people. It should be noted that, in cases where person-to-person consultation was required, the prevailing national and international health protocols that were in place to manage the impact of the COVID-19 pandemic were strictly followed.

¹ OECD, 2017.

² ILO, *Women and Men in the Informal Economy: A Statistical Picture*, 3rd ed. (Geneva, International Labour Office, 2018).

The following approaches were adopted:

➤ Cooperative inquiry

Under cooperative inquiry, a group of people come together to explore issues of mutual concern and interest. All of the members of the group are stakeholders with respect to the issue that is being researched, and contribute collectively to the body of ideas that fuel the work. The purpose of interviews conducted under this approach is to collect and collate information that would determine the policy direction best suited to yield benefits for the sector. It is understood that within the MSME context, stakeholders have different experiences and expectations.

➤ Systems thinking

Systems thinking requires the use of various techniques for studying many kinds of systems under an integrated approach. It is to be noted that there are many stakeholders with different expectations, which must be taken into consideration as the policy guidelines are developed.

1.3 Objective

The important role played by the MSMEs in Kenya's economy cannot be underestimated. They constitute almost 98 per cent of all businesses in the country. It is estimated that in 2017 MSMEs contributed 3 per cent of the country's 6.4 per cent overall GDP growth. Unfortunately, most of the MSMEs in the country continue to operate informally, thus making it very difficult for the Government to plan for their growth and development.

In this regard, the United Nations wishes through this consultancy to support the Government of Kenya and recommend ways of leveraging existing regulations and policies governing cooperatives for use in developing the MSME formalization framework. It will also provide a guideline for application to the process of formulating the national MSME formalization policy.

1.4 Defining criteria for micro-, small and medium-sized enterprises (MSMEs)

The absence of universally accepted defining criteria for MSMEs presents a large challenge in the context of identifying and seeking means of addressing MSME-related problems. To overcome this challenge, some researchers have suggested classification of different economies of similar strength into four broad categories cover high-income, upper middle income, lower middle income and low-income countries.³ Individual countries would then place themselves within the appropriate broad category. According to these researchers, an independent parameter like turnover can then be applied as a single definer of MSMEs irrespective of all the other parameters.

The Kenyan defining criteria are based on the following five parameters: employees, turnover, financial investment, asset base and capital employed. However, while three of the defining criteria are specifically set by law, decisions on the other two are left to the discretion of the Cabinet Secretary (CS) in charge of industrialization. It should be noted that Kenya has no official classification of medium-sized enterprises.⁴

³ Esubalew Amare Abawa and A. Raghurama, "Revisiting the global definitions of MSMEs: parametric and standardization issues", *Asian Journal of Research in Business Economics and Management*, vol. 7, No. 8 (2017), pp. 429-440.).

⁴ Micro and Small Enterprises Act 2012.

The table set out directly below provides further clarification.

MSME TYPE	Employees	Annual turnover	Financial investment	Asset base	Capital employed	
					Manufacturing	Agriculture and service
Micro	0-9	< 500000	To be determined by CS	To be determined by CS	<10 million	<5 million
Small	10-49	500000 < 5m	To be determined by CS	To be determined by CS	10 < 50 million	5 < 20 million

1.5 Transitioning from informal to formal status

Theories have been advanced on how and why businesses will transition from informal to formal status. Three main points of views can be found in the literature: the exclusion view; the exit view and the dual-economy view.⁵

1.5.1 Exclusion view

According to this view, there are no material differences between informal and formal enterprises in terms of skill, competence levels and motivation that might impact their potential productivity. This view holds that the potential of informal firms to contribute to economic growth is comparable to that of formal firms, which implies that if entry costs, taxes, fees and social contributions were considerably reduced, then informal businesses would very easily switch to formal status. This conception is advanced by Kenya's ease of doing business policy.

1.5.2 Exit view

The proponents of this theory are of the view that many informal businesses will not formalize because, in their view, the costs of formalizing far outweigh the benefits. Since the presence of these informal businesses has a distortive effect on macroeconomic growth, the best alternative is to drive out these businesses to make room for the development of more productive enterprises. Policy implication: increased law enforcement. Many county and local authorities have practised this strategy.

1.5.3 Dual-economy view

Many people start informal businesses not because they want to be entrepreneurs, but because they have no access to formal employment. Often, these people have neither the business skills nor the education needed to become successful business persons. Formalization of these businesses would hence be of no value to the economy since the owners view themselves as subsistence entrepreneurs, the implication being that the focus of Governments should therefore be on developing new formal businesses. The formal businesses would grow and create more decent jobs. Those jobs would absorb subsistence entrepreneurs, leading to the natural death of the informal sector.

⁵ International Labour Organization and Deutsche Gesellschaft für Internationale Zusammenarbeit, *Enterprise Formalization: Fact or Fiction? – A Quest for Case Studies* (Eschborn, Germany, Deutsche Gesellschaft für Internationale Zusammenarbeit, 2014). Pp. 5-6.

1.6 Features of formal and informal organizations

A formal organization will operate openly with clear goals and objectives, authority structures, channels of communication and products and services. It will also have clear-cut policies and procedures and job descriptions for its workers. An informal organization, in contrast, will tend to operate on the basis of general beliefs, assumptions, feelings, group norms and informal leadership. It will generally try to disguise its existence.⁶

2 Approaches to formalization of business enterprises in Kenya

The present assignment is restricted to formalization of business enterprises that are geared towards promoting the economic and social welfare of their owners. To this end, the focus of attention will be on two national business registries: the Company Registry based at the Kenya State Law Office and the Cooperative Registry based at the State Department for Cooperative Development. The registries of community groups (popularly known as *chamas*) which are operated at county level by the State Department for Social Protection will also be considered. Although not strictly speaking business organizations, the groups classified under this concept often operate as legal business entities.

3 Cooperative registry

The International Cooperative Alliance (ICA) defines a cooperative as “an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly and democratically controlled enterprise”. The cooperative identity is underpinned by the following principles: open and voluntary membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and concern for the community. These seven principles are anchored on the cooperative values of self-help; self-responsibility; democracy; equality; equity; and solidarity. These principles and values are reflected in the society by-laws on registration.

The rapid growth of the cooperative movement in Kenya can be traced back to session paper No. 10 of 1965 entitled “African socialism and its application to planning” under which the independence Government mainstreamed the cooperative movement as a driver of the emerging economy. Cooperatives were to be used by the indigenous population as vehicles for transforming the peasantry economy into a monetary economy. The success of this strategy depended on heavy government regulation and monetary support for cooperative institutions. This position was actualized through the enactment of the Cooperatives Societies Act of 1966 which created the all-powerful position of Commissioner for Cooperative Development. Indeed, during those early years, cooperatives were viewed more as government institutions than as private enterprises.

By 1986, with the advent of structural adjustment programmes, this cooperative management partnership between government and the movement was no longer a tenable arrangement. The Government commenced the process of withdrawing from active participation in the day-to-day management of cooperative societies. By 1997, the withdrawal process had been completed through policy and legal changes, as attested by the publication of sessional paper No. 06, entitled “Cooperatives in a liberalized economic environment”, and the enactment of Cooperative Societies Act No. 12 of 1997.

⁶ M Libraries (University of Minnesota Libraries), “Organizational structure”, in *Principles of Management*. Available at <https://open.lib.umn.edu/principlesmanagement/chapter/7-3-organizational-structure/>.

This is significant for three reasons:

- (a) The Government of Kenya recognized the cooperative movement as an important economic driver at independence and put structures in place to actualize its potential;
- (b) As the current social and economic environment is different from that of the 1960s, the structures put in place to revitalize the MSME sector through the cooperative model will require the deployment of strategies that reflect present-day political social and economic realities;
- (c) Correcting the general perception of cooperatives as government-owned institutions is key to a successful mobilization of MSME owners' acceptance of the cooperative model of business.

The Kenya Constitution of 2010 set up a devolved system of government, whose main objective is to promote equitable distribution of resources for the achievement of balanced national development and enhance national cohesion. Cooperatives management is one of the devolved functions. In this regard, the State Department for Cooperatives and the Council of Governors (CoG) have jointly reviewed the cooperative policy and are in the process of developing an enabling legal framework.

The National Cooperative Policy (2019) recognizes a self-supporting cooperative structure based on a four-tier system which includes primary cooperatives, Unions, federations and one apex cooperative organization. The structure focuses on enhancing the image of cooperative societies as private organizations and strategically positions them for expansion of their businesses within the country, the African region and beyond. The Policy retains the registration function at the national level while recognizing the important role played by county Governments in the promotion and training of both potential and current cooperative members and leaders.

4 Critical steps leading to cooperative formalization

The following five critical steps are necessary for the registration of a new cooperative society:

4.1 Promotion

Promotion is a county government function. Once the community has identified the need for a cooperative society, it approaches county officials who then organize a training session with potential members. This is referred to as **pre-cooperative education**. During the forum session, members voice their expectations and are given a run down on:

- Benefits of a cooperative society vis-à-vis other types of business organizations, including a discussion of cooperative principles and values
- Rights and duties of cooperative members
- Documents required to register a cooperative society

The forum also decides on:

- Objectives of the proposed society
- Proposed area of operation and the society's proposed name
- Entrance fees and the minimum share capital per member
- Election of an interim committee charged with advancing the registration of the proposed society. The interim committee includes a **chairman, a vice chairman, and an honorary secretary and Treasurer**, at least three of whom shall endorse the proposed by-laws.

As this is a first meeting, no technical materials are disseminated to the participants, who may also request another meeting with the officials if they believe more time will be needed for their own internal consultations.

4.2 Application for registration

Upon agreeing to proceed with the registration of the proposed society, the interim committee will:

- Prepare the by-laws for the society in line with the provisions of the Cooperative Societies Act (Chapter 490). While many will employ a lawyer for this purpose, others may utilize already prepared templates with the assistance of local cooperative officials.
- Prepare an economic viability report providing details on the expected profitability of the venture. The interim committee may in this case – as in the case of the preparation of by-laws - decide to engage a qualified accountant or utilize the services of cooperative officials.
- Complete a prescribed application-for-registration form that plus their details provides details on:
 - Proposed name of the society
 - Registered address
 - Proposed area of operation
 - The language in which the records shall be kept
 - The name of the secretary of the organization and is signed by at least 10 persons expected to be members of the society, including their identifying information.

4.3 Presentation of documents to the Commissioner for Cooperative Development

The completed documents are returned to the local cooperative officer who forwards them to the Commissioner for Cooperative Development. The forwarding letter must clearly indicate, with reasons, whether or not the officer is in favour of the application and confirm the area of operation of the society. It is significant that the Commissioner for Cooperative Development still operates a manual registration process despite efforts to introduce digital processes. So far only name searches can be conducted online.

A non-refundable application fee of K Sh 3,700 (\$37) is charged, which includes a K Sh 200 (\$2) name search fee. The fees charged by counties for their services vary, with K Sh 2,800 (\$28) being the highest.

4.4 Registration

The ministry's service charter indicates a period of one month from receipt of the application by the registry to release of the certificate for return to the county or sub-county (district) cooperative officials.

The Commissioner reviews⁷ the application and if satisfied, issues a certificate of registration and updates the register for cooperative societies accordingly. In the case where the Commissioner rejects the application, the applicants will be informed accordingly and the Commissioner will update the register of rejected applications, indicating reasons for rejection.

4.5 Right to appeal

In a case where the applicants are aggrieved by the decision of the Commissioner to reject their application, they may appeal to the Cabinet Secretary responsible for cooperative development. The decision of the Cabinet Secretary on the matter, if not satisfactory, may be appealed at the High Court.

5 Other services offered by the cooperative registry

Apart from the registration of new cooperative societies, the cooperative registry offers the following services:

- Registration of amended by-laws

⁷ A detailed workflow is provided in annex II below.

- Registration of change of name
- Replacement of a lost or damaged certificate
- Searches for the status of cooperative societies
- Certification of documents
- Registration of charges and debentures.

6 Legal and policy structures supporting cooperatives

- (a) Constitution of Kenya 2010
- (b) Cooperative Societies Act (CAP 490)
- (c) National Cooperative Policy 2019
- (d) County governments' subsidiary laws and policies

7 Companies registry⁸

The company's registry is domiciled at the State Law Office of the Republic of Kenya. It is fully digitized and accessible online to the members of the public. Accessing online services requires registration on the e-citizen platform managed by the Huduma Centre whose services can be accessed at all major post offices in the country. The specific requirements for application and registration are available in the Act.

Company's registry: charges and timelines.

<i>Type of company</i>	<i>Time required to register</i>	<i>Fee charged (K SH)</i>
Sole proprietorship (business name)	2 days	850
Limited liability partnership	1 day	25 000
Company limited by guarantee	3 days (after vetting by security agencies)	10 000
Unlimited company	5 days	20 050
Private limited company	5 days	10 650
Public limited company	5 days	10 650

8 Other registrations required

Following registration of a business entity (cooperative or company) in Kenya, registration with the following authorities is required:

- (a) Kenya Revenue Authority;
- (b) National Social Security Fund;

⁸ Operating under the Companies Act, No. 17, of 2015 of the laws of Kenya.

(c) National Hospital Insurance Fund;

(d) National Environmental Management Authority for businesses whose activity is likely to affect the environment;

(e) Any other authority, depending on the organization's business interests.

9 Community groups (*chamas*)

The *chama*, or self-help group, is, among all types of organizations, the nearest in form to a cooperative society. Its basic objective is to address the social needs of its members, most often by engaging in economic activity. *Chamas* are registered by the Ministry of East African Community, Labor and Social Protection through the State Department for Social Protection. To be registered a *chama* is required: (a) to have at least five members, (b) to have a group constitution (also referred to as by-laws) which clearly states the objectives of the group, (c) to have minutes of the meeting at which the group's formation was proposed, (d) to have a list of elected officials and (e) to pay a registration fee of K Sh 1,000 (approximately US\$ 10).

There is no central registry for *chamas* in the country. The registration process is carried out at county level and the certificate issued is valid for only one year. However, registration of the *chama* may be renewed on payment of K Sh 200 (US\$ 2) for every successive year of its existence.

Upon registration, the groups can own property or incur debts but *chamas*, unlike cooperatives and other limited liability companies that enjoy perpetual succession, have their assets or liabilities usually tied to individual members. For example, in the case of a *chama* attempting to open a bank account, the bank would insist that each member provide his or her Revenue Authority personal identification number (PIN) and national identification numbers apart from indicating occupation.

The registering authority expects periodic submission of progress reports. However, the registration certificate does not bestow any legal privilege on the group.

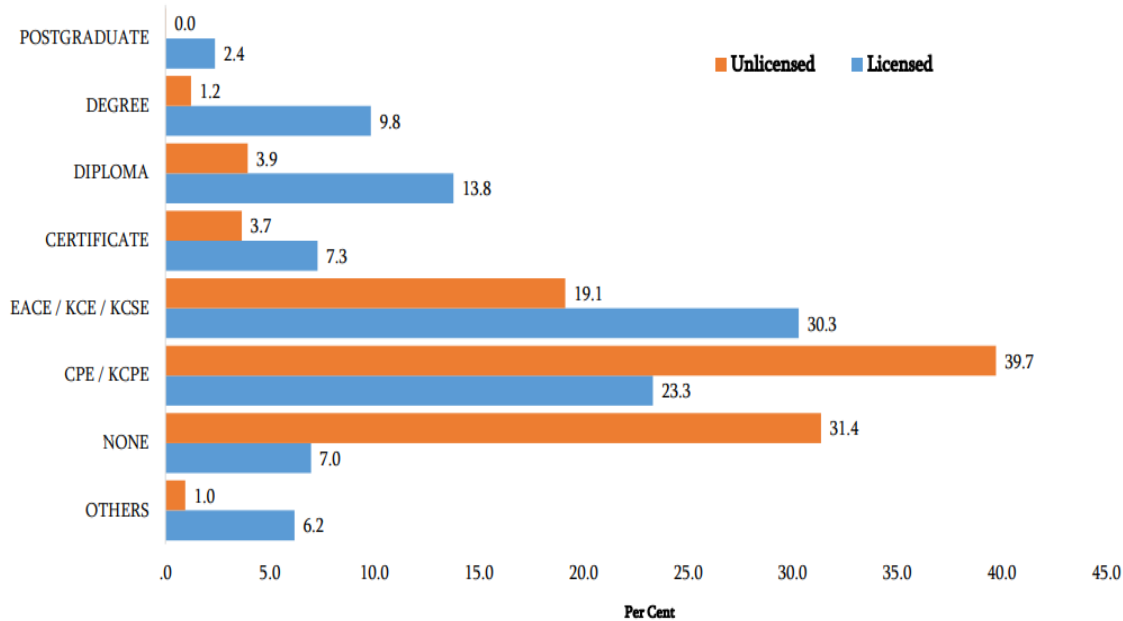
10 Challenges to formalization

10.1 Lack of adequate managerial training

Persons of diverse academic backgrounds establish micro-small and medium-sized enterprises. As many of those entrepreneurs will be neither trained nor adequately prepared for the situation in which they find themselves, they will end up employing managerial strategies that are based on trial and error. Their managerial techniques often focus on operational plans and are not driven by any strategic objectives. The owners and managers of small and medium-sized enterprises are in most cases inadequately prepared to handle business challenges.

The figure below displays the general academic qualification of most MSME operators in Kenya.

Education Qualification of Business Owners/Operators



Abbreviations: KCE, Kenya Certificate of Education; EACE, East African Certificate of Education; KCSE, Kenya Certificate of Secondary Education; CPE, Certificate of Proficiency in English; KCPE, Kenya Certificate of Primary Education.

Source: Kenya Bureau of Statistics, MSME survey 2016.

10.2 Inadequate finance and limited access to credit

A study conducted by the Kenya Bureau of Statistics in 2016 established that 85 per cent of informal MSMEs prefer to use own funds or borrow from family and friends, with only 0.8 per cent being able to borrow from commercial banks. The situation is not significantly different for registered MSMEs. Among registered MSMEs, 76 per cent prefer to use own funds or borrow from friends and relatives. Only 5.6 per cent of businesses in this category utilize finances from commercial banks.

The study does not indicate why this is so. However, the most probable explanation is that the owners fear losing their businesses to financiers. Or it could be that most of the businesses, by their very nature, are unable to put up the collateral required by financiers or that they simply lack the knowledge required to fill out the paperwork essential for securing such financing. Many will therefore remain underfunded until they run out of funds entirely and possibly close down.

10.3 Rapid technology changes

Technology change poses a big challenge to the growth of small and medium-sized enterprises. New technology is usually costly to acquire and install. It therefore becomes difficult for micro- and small businesses to move with the times, especially if they are required to upgrade even before they have fully reaped the benefits of the "old" technology. Similarly, owing to their level of education and technical skills, these business owners are unable to assess rapidly evolving changes.

Infrastructural development has been slow and has not kept pace with the need to support the adaptation of new technology in all parts of the country non-marching. Further, there has been a general breakdown in the extension services that could support the translation of innovative ideas into practical skills and knowledge for utilization by the MSMEs.

10.4 New laws and regulations

Every day, the Government and other stakeholders continue to introduce new regulations for industries and enterprises in Kenya. New laws are being enacted in an effort to regulate the operations of enterprises. These laws are also meant to spearhead sustainable economic growth in the country. However, such regulations sometimes pose a tremendous threat to the growth of small and medium-sized enterprises in Kenya because some of them are too tough and rarely consider the situation of the MSMEs.

10.5 Other challenges

Other challenges facing small and medium-sized enterprises include poor infrastructure, poor management of resources and what could generally be referred to as the bureaucratic bottlenecks of government. If properly organized, micro-, small and medium-sized enterprises will serve as the backbone of a restoration of the crippled economy. Therefore, the government should intervene and help these enterprises gain developmental momentum through formalization.⁹

11 Benefits of formalization

The biggest benefit conferred by formalization on a business is the ability to acquire a voice of its own - separate from that of the owner. The benefit is even greater if the business is a limited liability enterprise. The realization that the business is different from its owners makes it easier for the owners to put aside their personal prejudices and recognize their weaknesses, and more likely that they will then hire expert managers. A qualified manager would be more inclined to seek employment with a formal organization than with an informal organization. The ability to attract competent management will facilitate better planning and a better utilization of resources, which translates into a better chance of survival.

Formality gives organizations the opportunity to bargain with government at the policy and legal levels and ensure that their views are incorporated in government plans. Formal businesses are able to lobby and influence government fiscal policy. By virtue of a 45 per cent contribution to the country's gross domestic product (GDP), MSMEs could be a force to reckon but only if the majority were formalized. There are still no tax breaks offered by the country for formalization of MSMEs. However, as a means of incentivizing more MSMEs to pay taxes, the turnover tax was reduced from 3 to 1 per cent. Tax breaks, if effected, will have a major influence on the survival of many businesses in this sector.

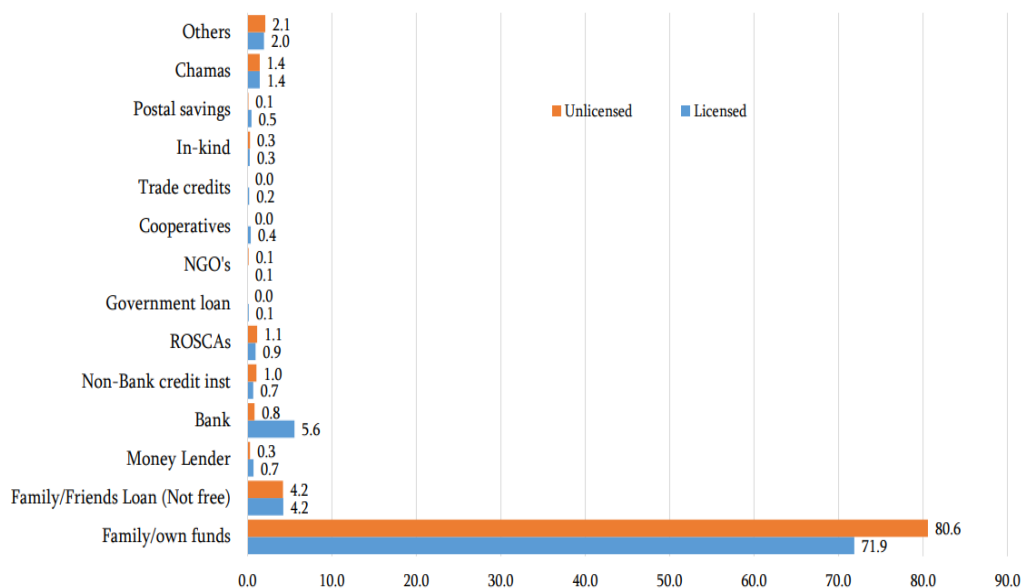
⁹ See Kenya Agribusiness and Agroindustry Alliance, "Challenges faced by small and medium enterprises in Kenya", 2016. Available at <https://kaaa.co.ke/challenges-faced-by-small-and-medium-enterprises-in-kenya/>.

11.1 Access to credit

Finance is important to all businesses at all times. No matter how well a business is doing, it has to prepare for the bad times which will inevitably occur under normal business cycles or (as was the case in 2020) through natural disasters. A disaster may be either localized or widespread. In either case, a business needs a fallback position.

The fallback position usually entails the savings drawn from the past year's profits or borrowings. As can be seen from the figure below, most MSME start-ups rely heavily on own and family financing and if they do have to borrow, they still rely heavily on the support of family members or close friends. During hard times, however, it is unlikely that the members of this close circle would be able to offer any meaningful support, as they themselves might be experiencing similar needs. Under such conditions, external financial support would be required.

MAIN SOURCE OF CAPITAL FOR MSME BUSINESSES



Abbreviations: NGOs, non-governmental organizations; ROSCAs, rotating savings and credit organizations. *Source:* Kenya Bureau of Statistics MSME survey 2016.

It is therefore noteworthy that formalized MSMEs are more likely to access credit and financing from banks, postal savings, cooperatives and Government. Even moneylenders are more likely to lend to formal businesses than to informal ones. The ability to access financing during hard times renders a business more resilient.

11.2 Access to government contracts

Formalization makes it possible for MSMEs to do business with Governments and their agencies. Kenya's special Access to Government Procurement Opportunities (AGPO) programme specifically targets youth, women and persons living with disabilities. The programme's operation is made possible through the implementation of the legal requirement that 30 per cent of government procurement opportunities be set aside specifically for enterprises owned by these groups. The programme's aim is to empower them by giving them more opportunities to do business with government.¹⁰

¹⁰ See Kenya Youth Employment and Opportunities Project (KYEOP), "AGPO and affirmative action funds: how to join access to government procurement opportunities". Available at http://mis.kyeop.go.ke/?page_id=6362.

11.3 Credibility

Most important, entering the formal sector establishes a business's **credibility**. Credibility enables a business's activities to be advertised without fear of a run-in with the authorities, which can lead to the creation of a bigger market for the business. Formalization enables business operations to be carried out in the open.

Credibility makes it possible for small firms to piggyback on large firms for the purpose of product marketing, importation of wares or even provision of services by means of offshore contracts. Formalization of a business attests to the confidence of the owner in his or her own stability and the willingness to invest in the future of the business.¹¹

The resilience of the MSME sector depends largely on the networks created to facilitate easy access to raw materials and markets, navigation of government regulations and the restrictions they impose, and enjoyment of economies of scale through collaboration. These will be achieved when operating as formal organizations. It is easy for formal organizations to develop goals and objectives and implement clear-cut policies and procedures because they enjoy the assurance of legal protection. The nature of the planning dimension within formal organizations gives them an edge over informal businesses with respect to the ability to survive tough times.

12 Types of cooperatives

Statistics from the State Department for Cooperatives show a steady increase in the number of cooperatives registered over the years. In the early years, agri-based cooperatives were the dominant type. However, starting in 2000, there has been a rise in the number of savings and credit cooperative societies compared with other types of cooperatives, which could be attributed partly to the government policy under which those cooperatives were given a significant role to play in the reorganization of other sectors of the economy. In this regard:

(a) In 2007, the Government decided to use cooperatives as a vehicle for driving the slum upgrading programme. Consequently, slum dwellers were encouraged to form and save through savings and credit cooperatives (SACCOs) which would enable them to purchase improved units;

(b) In order to regularize the transport sector, in 2010, the Government decided that only formalized groups would be licensed as public transport operators. Many of the informal transporters (commonly known as matatus) opted to formalize through the cooperative model, registering as SACCOs;

(c) In 2013, as a means of empowering the youth, the Government decided that all youth joining the National Youth Service would be organized into SACCOs to enable them to save part of their allowances. These savings would allow them engage in business upon leaving the Service.

These policy interventions helped not only to boost the number of cooperatives in the country but also to build the cooperative brand as an easily acceptable business model, especially when there existed a need for mass mobilization. The table below illustrates these developments.

¹¹ Jon Gosier, "Are there *any* advantages to formalize your business?" APPFRICA blog, 14 August 2009. Available at <https://appfrica.wordpress.com/2009/08/14/are-there-any-advantages-to-formalizing-your-business/>.

NUMBER OF REGISTERED COOPERATIVES, BY TYPE

TYPE\YEAR	1986	1990	1995	2000	2005	2010	2015	2017
Agricultural	1,619	2,351	3,080	4,349	4,304	4,686	5,451	5,055
SACCOs	1,642	2,251	2,810	3,627	4,678	6,267	8,914	13,200
Others	377	722	896	1,378	1,885	2,200	3,034	4,628
Total	3,638	5,324	6,786	9,354	10,867	13,153	17,399	22,883

Source: State Department for Cooperatives, Ministry of Agriculture, Livestock, Fisheries and Cooperatives.

The apparent drop in the number of agricultural cooperatives between 2000 and 2005 was associated with a 2003 policy review in under which small unviable cooperative societies in the coffee sector were amalgamated. In 2017, there was a mass cancellation of dormant cooperatives, many of which were in the agricultural sector.

Provided directly below is a general overview of the different types of cooperatives.

(a) Savings and credit cooperatives

The most prevalent and certainly the most successful type of cooperative is the savings and credit cooperative (SACCO), or credit union. The SACCOs pool resources from among their members and lend them to those members at affordable interest rates. SACCOs are very popular with salaried persons and individuals with regular source of income earned from businesses involving agricultural activity, transport or other lawful forms of trading. SACCOs operate on the principle of mutual trust whereby members guarantee one another for the loans, which eliminates the need for any other form of collateral. For a long time, many SACCOs operated back-office services only and were not positioned to offer banking services. The situation changed in the 1980s and 1990s when Kenya was obliged to adhere to structural adjustment programmes by the Bretton Woods institutions. Banking services suddenly became inaccessible to a majority of Kenyans owing to uncontrolled interest rates. The resulting reduction in demand for banking services forced many banks to scale down their presence in rural Kenya. SACCOs were the best, if not the only option for a majority of Kenyans. They remain so to date.

(b) Produce marketing cooperatives

These pioneer cooperatives in Kenya are engaged mainly in produce marketing and farm input supply. The drivers for farmers is the bulking of their produce for easy access to the market; access to better storage facilities; and accumulation of produce to enable them to engage in value addition ventures. For a long time, these cooperatives relied heavily on the government-controlled marketing boards as their sole market. During this period, many cooperatives enjoyed monopoly status over produce marketed within their areas of operation. Through licensing and movement permits, the Government controlled the movement of any agricultural product it deemed strategic. Farmers were paid at government-controlled prices. The biggest challenge remained the dependence of cooperatives on the government. By relying on the marketing boards, the cooperatives were reduced to operating as agents of the boards and could not make any independent decisions concerning the welfare of their members. Because of this relationship, any failure on the marketing board side was easily profiled as a failure of the cooperatives, thus making them unpopular with farmers.

This was the situation obtaining in the cooperatives at the onset of the structural adjustment programme. Bereft of government management support, denied automatic access to markets owing to government withdrawal from

business ventures and faced with competition from sometimes cheaper imports, the cooperative movement experienced some very rough moments. Competing government policies made matters worse for the cooperative societies. While the cooperative law still required members to market their produce through the cooperative societies, the agriculture act allowed for the practice of farm gate marketing which gave farmers the freedom to sell their produce to anyone who showed up at their gates. This led to the defaulting by many farmers on their loan repayment obligations, with the societies left with huge unserviced loans from financial institutions. Other farmers simply abandoned their farming activities. Indeed, the government was forced to write off the loans to bring farmers back to production.

Another illustration of how different sector policies and programmes have impacted the performance of cooperatives involves the Kilimo Biashara (farming as a business) programme under the State Department for Agriculture. Under this programme, a financier works with farm input agribusinesses to advance inputs to farmers' groups. The financier deals directly with the individual farmer within the group and is responsible for loan recovery. Cooperatives participate in the programme not as body corporates but as groups. In one reported case, a project that was intended to cover 15,000 agribusinesses and 2.5 million farms could achieve the coverage of only 407 agribusinesses and 45,000 farmers.¹² The same report attributes the poor performance of the programme to the fact that the State Department for Agriculture was operating the philanthropic National Accelerated Agricultural Input Programme (NAAIP) which targeted the same areas and the same farmers. It is possible that if cooperatives had been used as the contact point for both programmes, there would have been better farmer identification, an elimination of duplication and achievement of a better success rate. The presence of one contact point increases confidence in government programmes as a result of synchronized messaging.

Notwithstanding these challenges, many agri-based cooperatives around the country have moved on and are effectively serving the needs of their members. Most notable are those dealing in dairy products and coffee cherry processing. However, cereals, cotton and farm input supply continue to be a challenge.

(c) Consumer cooperatives

The consumer cooperative concept encompasses bulk buying and selling to cooperative members at affordable prices. While consumer cooperatives are not a common type of cooperative in Kenya, they can be a very useful, given that most MSMEs trade in or use purchased goods. Consumer cooperatives can also be very powerful mechanisms for businesses engaged in importation or retail.

(d) Industrial cooperatives

One visitor to Kenya had this to say about Jua Kali artisans: “[U]nder the beating rays of the equatorial sunshine, shaded by plastic bags or at best beneath an antique sheet of *mabati* (tin roofing), Jua Kali entrepreneurs make it their mission to keep things alive and working ... There is no legal contract involved when seeking street expertise, no guarantee or warranty that things will actually function ... The creativity of Jua Kalis in Kenya is sometimes mind boggling; things that you didn't imagine could work again, somehow manage to *keep breathing*.”¹³

This is the enduring image of the informal sector. Whatever engagement you have with the Jua Kali is transient and one expects no accountability from the service provider after the parting of the ways. Recognizing the importance of the Jua Kali sector, especially in employment creation, the Government of Kenya introduced cooperatives as a

¹² Cardno Emerging Markets, *Evaluation Report of Kilimo Biashara Credit Guarantee Scheme: Final Report* (Nairobi, September 2011), p. ix.

¹³ Mark Wiens, “Jua Kali - the informal Kenyan sector for 'get er done'” (2011). Migrationology blog. Available from migrationology.com/about/.

means of making the operations of those working in the sector predictable and respectable. At least the cooperative would be able to account for the actions of any of its members.

Today, the Jua Kali offers some of the finest furniture one can buy in the country and very fine farm implements and is home to highly qualified motor vehicle, plant and equipment mechanics and engineers.

(e) Service cooperatives

Worker and transport cooperatives, which are service-based, are at the promotional stage under the State Department for Cooperatives. The worker cooperatives are being introduced in tandem with the promotion of youth cooperatives. The youth are expected to pool their labour through the cooperatives and offer themselves to employers as a team. This will apply in all spheres of activity including skilled and non-skilled labour.

Transport cooperatives were first introduced as SACCOs. However, the Department realized that the operations of many of them do not include a savings component in and is now poised to transform them into true transport cooperatives. The aim is to separate the transport service activity from the savings activity.

This overview not only demonstrates the extent to which cooperatives have penetrated the Kenyan business environment but also offers a lesson on how disharmony in policies can adversely impact enterprises. The detailed discussion confirms that through implementation of the cooperative business model, it is possible to promote individual industry through collective action. Cooperatives minimize competition and encourage collaboration for enhanced benefit to all.

Cooperatives offer a platform through which the government can reach a critical mass of the population for the purpose of achieving its desired objectives based on the principle of a mixed economy. They also offer the country the best strategy for accelerating the attainment of economic independence by its people while still promoting social parity. This assessment is as true today as it was in 1963 when Kenya attained political independence, with very low literacy levels, an almost non-existent private sector and a local peasant populations.

13 Policy issues and the resilience of the MSME sector

As a result of the COVID-19 pandemic and the accompanying decline in economic performance, the country is faced with a situation that mirrors post-independence experiences. The cooperative movement can serve as a highly effective vehicle for the rejuvenation of the economy. Only this time around, the private sector ought to be activated to drive the strategy, with the government playing mainly a catalytic role. Action in the following key areas is important for achieving the success of this strategy. On a basic level, the strategy must involve creation of an economic ecosystem where businesses feed on one another both horizontally and vertically instead of engaging in crude competition. The formalization policy should therefore focus on the following areas:

(a) Regulation

Regulation is important as a means of maintaining standards and establishing order and security for all concerned persons and organizations. It is a government function that can be carried out at either national or county level. Regulations are good because they align the operations of the organization with government expectations, thus enabling achievement of the intended objective.

It is important to create structures for the sector that will promote self-regulation among the players. The best example of such an approach was that adopted by the telecommunication companies to handle money transfer platforms even before the government stepped in.

The registration of the MSME Federation is a positive step. MSME policies should recognize this as an apex body and empower it to act as the link between the government and the MSME sector.

Self-regulation will be most effective if the functions of the Federation are replicated at regional, county and sub-county levels in a manner that is functional and business supporting. The formalization policy should be clear with respect to structure and the role it will play in the integration of the MSME sector in the country.

(b) Business incubation centres

The country has 10 major incubation centres operated either as private sector initiatives or as public-private partnerships.

This initiative should be expanded to cover many tertiary learning institutions in order to equip the majority of the graduates with the necessary business skills as they enter the job market.

To be sure, this is a very expensive venture. The involvement of major corporations in the country – acting in accordance with their corporate social responsibility - will go a long way towards ensuring that the desired objectives are realized.

The National Youth Service (NYS) is a government programme that targets secondary school leavers and is focused on equipping them with the practical knowledge needed to join the Kenyan labour force. In 2013, NYS introduced a *Kazi Mtaani* programme to promote a savings culture among the participants and supply them with starting capital for their own businesses upon leaving the service. There should be facilitation of the formalization of the businesses of programme participants before they leave the NYS.

(c) Market development

One evident outcome of formalization is increased production by the sector. A clear market strategy both local and for exports should be a major component of the formalization policy. Locally, in terms of promotion, MSMEs that will feed into major manufacturing companies should be given preference. Regionally, the African Continental Free Trade Area offers an opportunity for MSMEs but only if they present a united front.

Kenya Vision 2030 has a clear export market development priority for which there should be formalization policy buy-in.

(d) Warehousing and aggregation centres

In July 2020, the Government of Kenya inaugurated the Warehouse Receipt System in the agricultural sector. Under this system, owners of commodities, who may be producers or dealers, deposit produce in certified warehouses. They are issued a title document called a warehouse receipt as proof of ownership. The receipt can be used as collateral to access credit from participating financial institutions or it can be traded in commodity markets,¹⁴ reducing pressure on producers to sell their commodities immediately after harvests when prices are usually low.

¹⁴ AGRA, “Warehouse Receipt System operational in Kenya”, AGRA News, 14 August 2020. Available at <https://agra.org/warehouse-receipt-system-operational-in-kenya/>.

As currently structured, the system is designed for dry agricultural produce. The system ensures quality control and standardization, improves produce security and, most importantly, instils consumer confidence in the quality of the product.

The underlying concept can be replicated in many other sectors and with all sorts of products. Of greater significance is how to facilitate ownership of these certified warehouses by the producers or owners of the commodities.

The warehousing system can be a very effective tool for MSMEs engaged in cross-border business by assisting them in creating economies of scale without compromising individual business efforts.

(e) Standardization

Standards are a prerequisite for trade whether local or cross-border. They establish a platform for the synchronization of the expectations of both suppliers and consumers, facilitating linkages within sectors where MSMEs may manufacture components for larger manufacturers and assemblers.

Standardization will increase the competitiveness of goods and services produced by MSMEs for the export market for both the region and beyond. It should be noted that for the export market, there is no difference between the product of an MSME and a product from a multinational. It is expected that standards will be set, maintained and monitored by both government agencies and the industry itself. Standardization leads to the maintenance and improvement of an environmentally friendly business setting. The county governments maintain and upgrade trading and market centres. These centres could be managed by the users themselves.

Town planning should be revisited to ensure that there is enough land available for business centres.

(f) Business development services

Business development services (BDS), which are the non-financial services and products offered to entrepreneurs to meet their business needs at various stages of their development, are oriented primarily towards skills transfer and business advice.¹⁵ Common business development services include legal services, accountancy services, bookkeeping and business planning.

BDS may be provided by commercial for-profit agencies or non-for-profit agencies. Up to the late 1990s, the Government of Kenya was a major provider of such services. This changed with the advent of structural adjustment programmes, at which point the government was called upon to review its involvement in business.

There has been a general trend towards the revival of the provision of extension services by the county governments with varying degree of success.

The policy questions would revolve around whether it would be desirable to revert to government provision of extension services or to privatize or employ a mixed strategy including both government and the private sector. Other policy questions would be centred on how to make these services available and affordable to all business persons, and on how to encourage young professionals emerging from technical institutions to stay and make their services available in the country's rural areas?

¹⁵ See International Finance Corporation, "The role of business development services (BDS)". Available at www.ifc.org/wps/wcm/connect/86f9010c-1e56-46b3-a274-5be599dee766/SouthAfrica_Women_Sections5-7.pdf?MOD=AJPERES&CVID=jbB89e8.

While government extension services policies are underpinned by the premise that availability of officials offering extension services will lead to the demand for those services, business development services are most effective when they are demand-driven instead of supply-driven. Studies have shown that only about 5 per cent of MSME owners and managers exhibit a high degree of initiative and are able to actively seek and take full advantage of information (e.g., on international best practices in micro- and small enterprise development). How can the remaining 95 per cent learn to appreciate the need for BDS?

(g) Research and innovation

Despite the presence of the many institutions that are engaged in research and innovation, the challenge still exists of translating research and innovation outputs into production. This has been compounded by the collapse of the extension services of government departments. It is therefore important for all policies to specifically address the linkage between research institutions and production. All the more so because, while most research institutions belong under government, BDS providers are mostly private.

The structure of the MSME sector should be set up in such a way as to be receptive to research findings and innovations.

How can the beneficiaries of research and innovation be motivated to provide financial support for such activities? Can industries be linked to research and learning institutions so as to generate new technology for consumption by industry?

(h) Publicity and advocacy

The MSME sector in Kenya is generally referred to as Jua Kali, (literally "hot sun" or figuratively "anything goes"). This image of the MSME sector not only reinforces the notion of informality, but also creates a sense of uncertainty regarding the functionality of the products of the sector. This being the case, the transition from informality to formalization must be preceded by an examination of the image of the sector as it exists in the minds of its entrepreneurs and of consumers. Indeed, are MSME traders even aware that their businesses are crucial to the growth of the economy?

An MSME brand should be built to incite admiration and a wish for participation. The following strategies could be deployed in this regard:

1. Access to information

What type of information is needed and how it is communicated to MSME sector participants are crucial to the success of the sector. Both the formal and informal players in the sector should have access to the same information, which should enable them to decide whether they should formalize or remain informal. Of greater importance is creating a platform designed to create awareness of the opportunities available within the sector.

This is particularly important for young persons who have to decide whether to seek employment or start their own businesses.

2. Stakeholder mobilization and coordination

The MSME sector encompasses a myriad of stakeholders, with each pursuing its own course propelled by a variety of objectives. Such a multiplicity of efforts have tended to curtail the growth of the sector despite the breadth of human resources and business opportunities within it.

Quite often, the conflicts of interest that are played out lead to unnecessary losses. It is therefore important for a mechanism to be developed that can assist in consensus building and help forestall conflicts.

3. MSME day

In its resolution 71/279 of 6 April 2017, the United Nations General Assembly designated 27 June as Micro, Small and Medium-sized Enterprises Day, as a means of celebrating the sector and raising public awareness of its importance to the world's economies. Among the provisions of the resolution was that the observance of the Day should be facilitated by fostering research presentations and policy discussions on MSMEs. Observance of the Day therefore provides Kenya with an opportunity to reflect on the importance of this sector of the economy.

(i) Financing

1. MSME fund

The MSME fund should be activated and made more responsive to the needs of MSMEs. The fund needs to be enhanced to provide venture capitalists with the opportunity to participate. The Fund's Board should be expanded to represent all the major stakeholders.

2. Coordinating financial institutions

While there are colossal funding opportunities targeting MSMEs, what is lacking is a coordinating unit designed to ensure optimal access to such funds by the enterprises. According to the Kenya Economic Report 2020,¹⁶ the main barriers to greater financial inclusion are related to:

- (a) Proximity to financial providers;
- (b) Level of trust of financial providers;
- (c) Excessive documentation;
- (d) Financial literacy;
- (e) Cost of accessing financial services.

Strategies to address these limiting factors are required.

3. Taxation and licensing

Taxing MSMEs remains a complicated matter for many tax regimes. Not only is it burdensome to collect taxes from small payers, but the smaller firms also find it a bigger burden trying to comply with tax payment rules. When you include other bureaucratic bottlenecks, many small taxpayers find that not paying taxes is cheaper than what results from attempting to pay. This problem is compounded if the small firms are informal businesses.

Kenya has attempted to overcome this by introducing a simple turnover tax calculated at 6 per cent of annual turnover. This was adjusted downward to 3 per cent in response to the COVID-19 pandemic. The challenge, however, is, many of our MSMEs are operating at subsistence level and will perceive payment of

¹⁶ Kenya Institute for Public Policy Research and Analysis (KIPPRA), *Kenya Economic Report 2020: Creating an Enabling Environment for Inclusive Growth in Kenya* (Nairobi, 2020).

taxes as an intrusion rather as an obligation. It might be important to offer tax incentives based on the firm's ability to grow.

4. Insurance

Tailor-made insurance products for the sector's different players would serve as necessary cushions given the environment in which most MSMEs operate.

Establishing a dedicated insurance provider is one options.

(j) Special interest groups

Several interventions have been initiated by the government and development agencies to address issues concerning women, persons with disabilities and youth. One such initiative is the Access to Government Procurement Opportunities (AGPO) programme which provides for at least 30 per cent of government procurement opportunities to be set aside for enterprises owned by women, youth and persons with disabilities.¹⁷ Other government interventions include the Youth Fund, the Women Enterprise Fund and the Uwezo Fund.

1. Youth

Youth unemployment remains an immense policy challenge that can be addressed through MSMEs. According to the 2019 Kenya Population and Housing Census, 68 per cent of the economically active persons seeking jobs are youth. The youth aged 15-34 years account for 36 per cent of the Kenyan population. Over 36 per cent of persons employed in Kenya's MSME sector are youth.

The youth aged 18-35 years constitute more than 50 per cent of the country's total labour force. The concern is how to create gainful but decent employment for this population category.

Many youths join the labour market equipped with only a basic education. The important issue related to the technical training needed to prepare them for the job market and creation of labour-force versatility through retraining programmes should be addressed.

2. Women

Women make up the most vulnerable proportion of the population. Many cultures still discriminate against women with respect to their access to factors of production and therefore with respect to their ability to access capital. The MSME survey (2016) established the following distribution of MSMEs by gender of business owner: 47.9 per cent of licensed establishments were owned by males; 31.4 per cent were owned by females; and 20.7 per cent were jointly owned. Further, 60.7 per cent of unlicensed establishments were solely owned by females. It has been determined that access to capital by women-owned enterprises is inadequate and that women lack the skills, information and networking opportunities necessary to enable them to engage in productive business-related activities.¹⁸

3. Persons with disabilities

This category of persons has been factored into the AGPO programme. However, it is important to recognize that in addition to confronting the technical challenges affecting both women and youth, persons with

¹⁷ See <https://agpo.go.ke/pages/about-agpo>.

¹⁸ *Kenya Economic Report 2020*.

disabilities are faced with physical barriers which are taken mostly for granted. Policies must be cognizant of such barriers and implement measures to mitigate their impact.

(k) Information and communications technologies (ICT)

Information and communications technologies (ICT) offer all businesses, irrespective of their size and location, an opportunity to access information and services related to local and international trade. Indeed, it has been noted that the advent of mobile-based financial services has had a transformative impact on the financial system in Kenya.

Through utilization of ICT, the Government should collect data on the needs of MSMEs in order to develop targeted policies and programmes. This will facilitate easy monitoring of traders within the sector to allow for development of tailor-made initiatives for capacity-building and training programmes to stimulate increased participation in trade and the general economy. Keeping track of persons is an important means of differentiating between those that are resilient and those that are transient.

Indeed, 40 per cent of new businesses fail in their first month, another 30 per cent in the following four months. MSMEs, whether formal or informal, are not an exception to this trend. In this context, the following recommendations are proposed:

- MSME formalization is impacted by a myriad of policies encompassing all sectors of the economy including agriculture, livestock, fisheries, trade, cooperatives, forestry, and mining, among many others. The MSME formalization policy should take into consideration all of those policies to prevent disputes which might lead to conflict and competition among the implementers. It is therefore important for an interdepartmental coordinating committee on MSMEs to be set up under the Ministry of Industrialization, Trade and Enterprise Development to oversee MSME formalization and growth.
- The interdepartmental coordinating committee on MSME's should establish working groups for specific thematic areas including:
 - Policy and legal
 - Financial
 - Publicity and advocacy
 - Business development
- In the past, cooperatives have been used as special vehicles for achieving desired government goals and objectives. They have played a role in, e.g., the slum upgrading programmes in Nairobi, Mombasa and Kisumu and the reorganization of the transport sector. As cooperatives provide a recognizable and accepted business model, they would encounter little resistance if used as a vehicle for MSME formalization.
- The image of existing cooperatives can be improved by enhancing their governance structures, which would include training and certification of directors and strengthening of the Ethics Commission for Cooperative Societies (ECCOS) in the context of the certification of cooperative managers and workers by the Kenya Society of Professional Co-operators (KSPC).
- The success of the sector will lie not in expanding and tightening government regulations and control but in encouraging self-regulation by the MSMEs themselves. The revitalization of the MSME Federation and the setting up of county structures to reflect the reality of devolution will constitute a big step in the direction of actualizing self-regulation. The Federation should assist in developing a code of ethics for the sector.

- Since the imposition of the structural adjustment programmes of the 1980s, the national Government has divested from providing extension services to all enterprises, including in the agri-based and general trade sectors. With devolution, the county governments have expanded their involvement in providing extension services; however, this is not sustainable as it tends to tie up development funds with recurrent expenses. We therefore recommend that governments at all levels provide incentives to the private sector to provide effective extension services through BDS, with the government function to be limited to the enforcement of standards and certification where necessary. The government should ensure that BDS providers are accessible to all businesspersons in the country. Cooperatives through their secondary structures comprising unions and federations should assume this role, with the government providing subsidies in cases where it deems a service to be essential.
- To foster sustainable research and innovation which would drive the growth of the MSME's sector, the Government should provide for the establishment of a research and innovation fund. Contributions to the fund, as well as board representation, should be open to all stakeholders.
- To improve working conditions and create a decent work environment for the MSME players, it is important for the Government to invest in support for infrastructure development, including the construction of roads, markets and market centres. Where applicable, these facilities should, after construction, be acquired and managed by the traders themselves. Acquisition of these facilities by the MSMEs should be facilitated.
- Expansion and encouragement of the consumption of local components in the manufacturing sector should be facilitated, bearing in mind, of course, the international protocols on trade. Linkages between the MSMEs and manufacturers and assemblers should be created as part of value chain development. Through these linkages the quality of goods produced by MSMEs would be improved, the standards required for regional and international trade would be maintained and compliance with delivery timelines would be ensured. There would be an immediate ACFTA-related benefit from this cooperation.
- In Kenya, the term "Jua Kali" has been accepted as a synonym for "MSME sector". The term, however, has a negative connotation and does not fully convey the essence of all the enterprises in the MSME sector. An MSME brand should be developed and built up, with a view to encouraging and expanding the scope of MSME formalization. A publicity and communication strategy that will enhance information sharing within the sector and project positivity and prosperity for the stakeholders should be developed. The visibility of the sector should be increased by choosing a date for celebrating its success, in line with General Assembly resolution 71/279. For maximum impact, a date in any month but June should be chosen to prevent conflict with cooperative-related celebrations.
- Education and training for all MSMEs, informal and formal, on the importance of formalization, including how they can access business development services, should be enhanced. To promote participation of women, youth and people with disabilities in trade and the general economy, it is necessary to develop tailor-made capacity-building and training programmes and enhance their access to credit facilities.
- Many of the country's ministries, departments and agencies are already involved in the formalization and development of MSMEs. The strengthening of MSEA is recommended to enable it coordinate and synchronize the activities of other departments and act as the secretariat of the proposed interdepartmental coordinating committee on MSMEs.

- The Government, which uses taxation to raise the revenue needed to finance its budget, recently introduced turnover taxes as a means of expanding tax compliance. MSMEs are identified according to many parameters other than turnover. Simplifying the legal defining criteria for MSMEs will be of assistance to the government.

14 Stakeholder identification

Many stakeholders - classified broadly as government, private sector and non-governmental players - operate within the MSME sector at both regulatory and promotional levels.

Indicated in the table below is what are considered to be the degrees of influence (high, medium or low) exerted by those organizations on the development of Kenya's MSMEs. Also presented are the roles and responsibilities of these various types of organizations.

Table 1: Mapping of stakeholders

GOVERNMENT MINISTRIES AND AGENCIES		
MINISTRY/ AGENCY	ROLES/RESPONSIBILITIES	LEVEL OF INFLUENCE
Ministry of Industrialization and Enterprise Development	Ministry responsible for the development and regulation of all types of business organizations in the country. It is the parent ministry for MSEA, the authority responsible for MSMEs	High
Ministry of Agriculture, Livestock, Fisheries and Cooperatives	Most of the MSMEs in the country are agri-based. The policies and practices of this ministry have a direct impact on the success of the MSMEs. MSMEs offer an immediate marketing outlet for the agriculture sector for either raw or processed produce. The sector also constitutes the easiest entry point into the monetary economy for the youth and women	High
National Treasury	Revenue collection continues to be a challenge. The country's attempt to employ various taxation strategies to collect revenue achieved very little success. This has forced the National Treasury to continuously increase the level of direct taxation on an ever shrinking formal sector. Formalization of MSMEs will ensure an expanded tax base, which in the long run will result in the lowering of direct tax rates for a majority of Kenyans, leading to increased savings and consumption	High
Ministry of Planning and National Development	Planning for the economy becomes easier when the parameters are predictable. That the informal sector accounts for more than 50 per cent of GDP growth makes it very difficult to engage in economic planning. Indeed, a strong MSME sector can exert a powerful influence on the privatization process in the country	High
Ministry of East African Community, Labour and Social Protection	The human development index (HDI) continues to be a better measure of national development than purely aggregate GDP figures. Provision of a decent working environment for many persons in the informal sector will immediately raise the HDI ranking	High

Ministry of Education	Through universities and other training institutions, the ministry plays an important role in curriculum development and coordination of research institutions	Medium
State Law Office	Apart from housing the registrar of companies and societies, the office exerts its main influence through its role as parent organization for the Kenya Law Reform Commission, the mission of the commission being to develop laws that promote national development and cohesion	Low
Council of Governors	This is a secretariat body which coordinates county activities with those of the national Government	Medium
Counties	The onus of developing and managing markets that host many of the informal MSMEs is on the counties. They also license all traders and businesses that operate in their jurisdictions	High
Intergovernmental Relations Technical Committee (IGRTC)	This is a secretariat body set up to handle intergovernmental relations between the national and county governments. At policy level, it operates as secretariat of the National and County Government Coordinating Summit	Low
PRIVATE SECTOR PLAYERS		
INSTITUTION	ROLES/RESPONSIBILITIES	LEVEL OF INFLUENCE
Kenya Private Sector Alliance (KEPSA)	A policy and advocacy forum for private businesses in the country	High
Kenya Association of Manufacturers (KAM)	A policy and advocacy forum for manufacturers and employers in the private sector. It also trains and advises businesses on governance and strategic planning practices	High
Central Organization of Trade Unions (COTU)	As the premier trade union organization in Kenya, COTU has an obligation to champion workers' rights in the country. Through formalization, the numbers of MSMEs employees are bound to grow	Medium
MSME Federation	An umbrella organization bringing together all MSMEs in the country	High
Cooperative Alliance of Kenya (CAK)	This is the apex body for the cooperative movement in Kenya whose cardinal role is to advocate for an enabling environment for the application of the cooperative business model	Medium
Banking sector	Major banks in the country have a weighty commitment to the development of MSMEs. Most notable are Equity and KCB. They have developed different strategies to bank both formal and informal MSMEs. Mobile banking platforms are attractive to MSMEs	High
Business Incubation Association of Kenya	Supports MSME businesses, promotes advancement of entrepreneurship and facilitates partnerships, sharing and mentoring of stakeholders in both rural and urban areas	High

Kenya National Federation of Jua Kali Associations	The Federation needs to become more robust in driving advocacy for the MSME sector. Its role needs to be enhanced in policymaking in the context of self-regulation	High
Insurance sector	Owing to the vast reach of informality in the MSME sector, the insurance sector has virtually no involvement with the businesses of MSMEs. This would change with formalization.	Medium
Kenya Union of Savings and Credit Cooperatives (KUSCCO)	MSMEs working as collectives are able to access financing from the KUSCCO Central Finance Fund. It possesses adequate experience, having conducted cook-stove promotion through MSMEs and supported agricultural production interventions by smallholder producers. Stima Sacco as well as Unaitas Sacco, both members of KUSCCO, have been at the forefront of development of products for MSMEs	High
Kenya Industrial Research and Development Institute (KIRDI)	KIRDI is a leading government institution in the area of provision of technology targeting MSMEs. It has incubation centres in various localities including Nairobi, Kisumu and Eldoret	High
UNITED NATIONS AGENCIES		
ORGANIZATION	ROLES/RESPONSIBILITIES	LEVEL OF INFLUENCE
Department of Economic and Social Affairs of the United Nations Secretariat (UN DESA)	UN DESA is providing support to the Micro and Small Enterprises Authority (MSEA) on strategic planning for the growth of the MSME sector in Kenya, including catalysing the formulation and implementation of MSME formalization policies in Kenya	High
United Nations Development Programme (UNDP)	UNDP has taken an interest over time in the development of micro- and small enterprises in Kenya, investing in efforts to understand the dynamics of the sector and how growth of such enterprises can be triggered	High
International Labour Organization (ILO)	ILO has a Small and Medium Enterprises Unit whose efforts focus on unlocking the potential of such enterprises to create more jobs. Earlier, it supported training of MSMEs through the Start and Improve Your Business (SIYB) initiative	High
United Nations Industrial Development Organization (UNIDO)	UNIDO is a United Nations organization that promotes the clustering and construction of quality infrastructure for MSMEs	High
NON-GOVERNMENTAL ORGANIZATIONS/DEVELOPMENT AGENCIES		
ORGANIZATION	ROLES/RESPONSIBILITIES	LEVEL OF INFLUENCE
Foreign, Commonwealth and Development Office (FCDO) of the Government of the United Kingdom of Great Britain and Northern Ireland	Operation of FCDO is underpinned by the belief that MSMEs are the motor of growth of the economy, driving innovation and greater productivity, finding solutions and creating jobs.	Medium

Swedish International Development Cooperation Agency (SIDA)	SIDA is at the forefront of the drive towards innovative ideas centred on financial inclusion of MSMEs	High
Danish International Development Agency (DANIDA)	DANIDA supports the MSME sector through collaboration with its partner, the Micro Enterprises Support Programme Trust (MESPT)	Medium
Micro Enterprises Support Programme Trust (MESPT)	MESPT is a development agency that supports smallholder farmers and the growth of agricultural MSMEs with a view towards increasing their productivity and creating jobs for youth and women	High
GIZ Deutsche (Gesellschaft für Internationale Zusammenarbeit) (German Agency for International Cooperation)	The German Agency for International Cooperation promotes innovation and development of entrepreneurial skills which enhance the competitiveness of MSMEs	Medium
Japan International Cooperation Agency (JICA)	Through its COVID-19 Emerging and Frontier Markets MSME Support Fund, JICA intends to enhance financial inclusion of women in developing countries, and JICA is investing up to \$35 million in the Fund. Kenya and JICA maintain a bilateral relationship	Low

The above list is in no way exhaustive. A successful MSME sector, given the number of persons it employs, will significantly impact national security and the health of the population as well as the environment. Indeed, a thriving MSME sector will have a positive impact on achievement of all the SDGs, more specifically on SDG 8 on the promotion of sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

15 Policy and legal framework

15.1 Development of the policy on formalization of MSMEs

Within the context of development of the policy on formalization of MSMEs, it is important for the following elements, actions and perspectives to be considered:

1. Respect for devolution, as stated in article 10 2010 Constitution of Kenya.
2. Recognize the functions of national Government and county government, bearing in mind that whereas industrialization is a national function, agriculture, cooperatives, fisheries, livestock and trade, being the drivers of industrialization, are all devolved functions.
3. Recognize the principle of intergovernmental relations between the national Government and the county governments
4. Provide for specific roles of both the national Government and county governments
5. Provide for coordination while recognizing the interdependence among the various government departments
6. Recognize that the term “MSMEs” focuses on enterprise size and that upon formalization, the firm might take the form of a sole proprietorship, a partnership, a private limited company, a public limited company or a cooperative.
7. The level of digitalization and the technology employed by the firm might distort the accuracy of any categorization.

15.2 Micro and Small Enterprises Authority (MSEA)

Adoption of the MSEA Act of 2012 was the initial step towards bringing order to the sector. The role of the Authority is clearly stated as providing “a legal and institutional framework for the promotion, development and regulation of micro- and small enterprises” in Kenya. It is charged with formulating and coordinating policies that facilitate integration and harmonization of public and private sector initiatives within the sector.

The Act creates the office of the Registrar, among other offices. The actualization of this provision has taken time but the process is now on course. However, the Act gives the Registrar the mandate to register business associations and umbrella organizations that are not well defined in law. It is easy to suspect that the confusion arose from the fact that the country already has a registrar of companies as well as a registrar for cooperatives. However, it is important to establish clarity when promoting formalization of MSMEs.

Given that the country already has two well-established business registries, the policy and legal framework should be clear on how best to utilize these registries to promote MSME formalization without duplication of activities.

It may be worth giving consideration to transforming MSEA in its current form into an agency charged with responsibility for coordinating activities within the MSME sector.

15.3 Sector coordination

To improve coordination between the different departments that impact the MSME sector, it is important that an interdepartmental coordinating unit be set up to manage the formalization process, for a period to be agreed upon.

In any event, the matter of converting the MSEA from an authority to an agency is of enduring importance and ought to be pursued.

15.4 Policy issues

Whereas it is important that MSMEs be formalized, it is fundamental that the carrying out of this exercise be understood as a voluntary process. It would be counterproductive to conduct a mandatory formalization exercise, thereby giving the impression that formalized organizations are government-owned rather than private enterprises. Any organization of limited liability should be accepted into the process of formalization of MSMEs. MSMEs should therefore be free to formalize either as companies or as cooperatives.

A business registry should provide a business with an identity that is recognized by the enacting state and entitles the business to participate in the legally regulated economy of the state and reap the benefits from such participation, in addition to making information public in respect of the registered entity.¹⁹ This position is important in the context of deciding whether to maintain one national registry for MSMEs or to operate county-based registries or to combine the two modalities.

Having a national registry signifies that the registered business can operate anywhere in the country, thus facilitating the unfettered growth of that business. It also signifies that anyone making an enquiry regarding the business has only a single reference point rather than 48 reference points. Establishment of county-based registries would give the impression of compliance with the Kenya Constitution of 2010, given that the trade function is a devolved function. However, such a position would lead to a curtailment of the growth of businesses and might necessitate multiple registrations of the same business across counties.

A national registry operated together with satellite registries at county level could accommodate all levels of the sector: this would encourage micro- and small businesses to formalize without having the sense that they are thereby being thrust into the depths of a labyrinth smothered by national government regulations.

¹⁹ United Nations Commission on International Trade Law (UNCITRAL), Working Group I (MSMEs), working paper No. 103, entitled “Compilation of draft recommendations on key principles of a business registry: note by the Secretariat” (A/CN.9/WG.I/WP.103), 23 February 2017.

The policy should indicate the specific roles to be played by the county governments and those to be played by the national Government in the formalization process. Any dispute between the national and county governments shall be handled as provided for in the Intergovernmental Relations Act. Disputes between either level of government or an MSME should be referred to the High Court of Kenya. Disputes among MSMEs and/or their service providers shall be referred to an alternative dispute resolution (ADR) mechanism to be established.

The policy should establish the standards and compliance issues to be enforced by different levels of regulators. These standards will be for the MSMEs, BDS providers and other stakeholders involved in the formalization process. It is important for the legal framework to be clear on the issue of sanctions against any default on the provisions of the law. The fiscal policies affecting MSMEs should promote the growth of the sector. This would include tax breaks for start-ups, number of employees and possible capital plough-back.

The success or failure of formalization will rest on the communication strategy adopted. The starting point should be an unpacking of the meaning of the term “MSMEs” in everyday life and banishment of the use of the term “Jua Kali”, however popular - or however well-intentioned - its use might be. The policy and legal framework should provide for the cabinet secretary in charge of MSMEs to grant a waiver to any MSME from abiding by any of the provisions of the MSME Act.

Annex I

Action plan

Strategies		Actionable tasks	Responsibility		Time frame		
			Primary	Secondary	S	M	L
1	Enhance interdepartmental coordination	<ul style="list-style-type: none"> Establish a coordinating committee Establish a secretariat Set up thematic areas to be coordinated by the committee 	Principal Secretary Industrialization Cabinet Secretary Industrialization MSEA	MSEA MSEA Committee secretariat	xx xx xx		
2	Cooperatives as primary enterprise type	Policy direction	Cabinet Secretary Industrialization		xx		
3	Strengthen registries to enable them to handle MSME registration	<ul style="list-style-type: none"> Enhance capacity of cooperative registry to handle increased workload Enhance capacity at county level to improve processing of applications 	Principal Secretary Cooperatives, Commissioner for Cooperative Development National Government/ County governments	MSEA	xx xx	xx	
4	Enhance self-regulation within the sector	Establish a national MSME structure	MSEA			xx	
5	Facilitate access of MSMEs to a better working environment	<ul style="list-style-type: none"> Assist MSMEs in accessing better working conditions in commercial and industrial areas Establish market areas for access by MSMEs 	National Government, county governments National Government/ county governments	MSEA	xx	xx xx	xx

6	Facilitate the growth of private sector business development services	<ul style="list-style-type: none"> Government policy review 	National government	Council of Governors			xx
7	Provide a mechanism for enhancing research and innovation within the sector	Establish a research and innovation fund	Cabinet Secretary Industrialization	National Treasury			xx
8	Expand use of local materials in manufacturing sector	Review of government policy	Cabinet Secretary Industrialization	State Law Office		xx	xx
9	Sensitize MSMEs on importance of formalization	Publicity and awareness campaigns	MSEA	State Law Office, Commissioner for Cooperative Development	xx		
10	Improve the image of the sector for consumers	<ul style="list-style-type: none"> Change the sector brand Develop a clear communication and publicity strategy 	MSEA		xx	xx	
11	Enhance the effectiveness of MSEA in the coordination of MSME activities	Strengthen and empower MSEA to operate as a coordinating agency	Cabinet Secretary Industrialization	Parliament			xx
12	Reduce tax burden on MSMEs	<ul style="list-style-type: none"> Rationalize tax administration between different layers of government Review tax obligations of MSMEs Institute tax breaks for formalizing MSMEs 	National Treasury, county governments National Treasury, county governments National Treasury	Kenya Revenue Authority Kenya Revenue Authority	xx xx xx		

13	Improve data collection, transmission and analysis	Establish a data centre	Cabinet Secretary Industrialization, County governments			xx	
14	Enhance intergovernmental communication between the two levels of government	Set up an intergovernmental coordinating unit	Cabinet Secretary Industrialization, Council of Governors			xx	
15	Empower women, youth and persons with disabilities	Establish a special desk	Principal Secretary Industrialization MSEA Principal Secretary Cooperatives		xx xx xx		

Abbreviations: S, short term; M, medium term; L, long term.

Annex II

Cooperative registration workflow

1. Pre-cooperative education: members identify need for a cooperative and approach the local cooperative office.
2. County cooperative office: processes the necessary pieces of documentation and forwards them to the Commissioner for Cooperative Development
3. Registration documents received at the cooperative registry, dropped off either by hand or from the Ministry Common Registry; the registration documents include a letter from county/by-laws/economic appraisals and any supplementary information
Time allocated: 0 days
4. The Registry presents the payment cheque to the cash office and obtains official payment receipt.
Time allocated: 1 day
It records the application in the application-for-registration register, indicating the official receipt number, and attaches the official receipt on the application documents.
Time allocated: 1 day
5. The officer in charge of the registry distributes applications received to reviewing officers in the department.
Time allocated: 1 day
6. The reviewing officer examines the proposed society's by-laws and economic appraisals (usually of the expected business of the society within the first year of operation, showing income and expenditure)
Time allocated: 3 days
7. (a) If application is accepted, it goes back to the registry for preparation of certificates.
Time allocated: 0 days
(b) If rejected, the application is taken to the head of section for further review.
Time allocated: 0 days
8. (a) If, in the opinion of the section head, the reasons for rejection are material then the application is taken back to the county for correction and resubmission.
Time allocated: 2 days
(b) If the reasons are not material, then the application is corrected and taken to the registry for the processing of the certificate.
Time allocated: 2 days

Total time allocated for head of section: 2 working days

9. (a) If recommended, the registry updates the register of new societies with the necessary information and prints the registration certificate for the signature of the Commissioner for Cooperative Development.
(b) If rejected, the registry enters the information in the register of rejected applications and presents it to the Commissioner for Cooperative Development for endorsement Time allocated: 5 days
10. The Commissioner signs the certificate of registration, the proposed by-laws and the registers (registered or rejected)
Time allocated: 5 working days
11. Certificate plus registration documents (registered or rejected) are taken back to registry for dispatch
Time allocated: 2 days

Total time allocated: 20 working days. (time allocated takes into account the matter of bureaucratic convenience)