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Business Competitiveness in the Informal Sector in Rural Areas Against A Background of Regulatory Frameworks: A Study of SMEs in Kesses Division, Uasin Gishu District, Kenya

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Abstract
Businesses in the informal sector in the rural areas (such as those found in Kesses division, Uasin Gishu District) are constrained largely by the problems associated with the government's regulatory frameworks, relative to their urban counterparts. This is contrary to the general view that urban-based enterprises are more negatively affected by the regulations as opposed to rural enterprises. This could be mainly because urban-based entrepreneurs know how to evade the authorities and effectively manage the consequences and costs of non-compliance, or comply and make minimal profits. However, rural-based entrepreneurs have demonstrated a rare ability to get started, grow, compete and survive even longer than some urban-based SMEs even when they choose to comply. Currently, few studies have been done to establish this unusual resilience of rural SMEs. The main aim of the study was to shed more light on how government regulatory frameworks and procedures affect business competitiveness of rural-based enterprises. This was done bearing in mind that government regulatory frameworks have costs whether an entrepreneur complies or not. More specifically, the study looked at the impacts of government regulations and procedures on the competitiveness of rural-based SMEs as exemplified by those in Kesses Division, Uasin Gishu District, Kenya. The findings of the study would be used to improve the policy environment since the real impacts of the regulatory constraints would have been brought to light. This would then assist in the improvement of the rural SMEs and hence the sector as a whole in its development and provision of employment.

Keywords: informal sector, business competitiveness, business establishment, government regulations and procedures, regulatory frameworks.

INTRODUCTION

Business competitiveness is the ability to direct strategy and operations of a business by proper utilization of valuable time and reduction of unnecessary costs (Mullei et al, 1999) or ability to make profits despite the presence of other similar businesses. This study considers business competitiveness in the Informal Sector. The informal sector (alternatively referred to as Small and Medium Enterprise, SME, or Micro and Small Enterprise, MSE, sector) is generally assumed to comprise those heterogeneous economic activities, which do not fall within the realm of modern or traditional sectors as conventionally defined. One major characteristic of this sector is that it constitutes spontaneous economic activities by the people and that the government has little or no promotive role. The informal sector does not enjoy the privileges and facilities available in the formal sector such as access to formal credit, legal protection, modern technology and basic infrastructure facilities (GoK, 1982). The rural informal sector is dominated by trade activities and male sole proprietors with basically no further training after graduating from school (Ng'ethe ,N. and Ndua, G. , 1989). The most recent national MSE baseline survey conducted by the Central Bureau of Statistics (CBS) in conjunction with the International Center for Economic Growth (ICEG) and K-Rep Holdings Ltd shows that 1.3 million SMEs exist in Kenya, employing some 2.3 million people. It further points out that about 26% of the total households in the country are involved in some kind of non-farm business activity (*CBS, K-Rep and ICEG, 1999*).

The provision of both employment and income to a majority of people in both rural and urban areas by the SMEs has made this sector important in all sectors of the Kenyan economy (K'Obonyo et al, 1999). As of 1995, Kenya was producing nearly 0.5 million people into the labour market annually. The modern and small farm sectors could only accommodate 0.24 million workers. The remaining 0.26 million people engaged in economic activities outside the formal sector, which include the SMEs sector (Daniels et al, 1995). The sector was projected to increase in employment from 1.3 million in 2000 to 2.366 million in 2010 (K'Obonyo et al, 1999), but this projection was based on an annual growth rate of 8.8%. The situation now is that even as of 1999, the sector was already employing 2.3 million people. This further shows the fast growth

rate of this sector (CBS, K-Rep & ICEG, 1999). The MSE baseline survey of 1999 further shows that the average number of enterprises per 1,000 residents of the Kenyan population is about 43 MSEs. It also points out that almost two thirds (66%) of the Kenyan MSEs are found in the rural areas, and that whereas the density of MSEs is higher in the urban areas, the aggregate or relative number of MSEs is higher in the rural areas. Considering the fact that 72.3% of all enterprises are based in the rural areas as indicated above, calculations show that out of 1.3 million enterprises, 939,900 enterprises exist in the rural areas.

Table 1: Distribution of SMEs in Kenya and the Proportion of Workers They Employ

	% of National Population	SMEs		Workers		Mean
		Number	%	Number	%	
Nairobi & Mombasa	9.7	204,280	15.8	394,838	16.9	2.0
Other major towns	6.2	157,533	12.2	279,133	11.8	1.8
Rural towns	2.1	81,320	6.3	135,349	5.6	1.6
Rural areas	82.0	845,879	66.6	1,551,930	65.7	1.8
TOTAL	100.0	1,289,012	100.0	2,361,250	100.0	1.8

Source: CBS, K-Rep and ICEG, 1999:5

The legal and regulatory frameworks are a major hindrance to SME development. For instance, many licences are required for one to operate a single business (Mullei et al 1999). This study also points out that although the policy environment towards the sector is considered positive, the regulatory environment has remained largely hostile to many small business operators. He also says that legal and regulatory constraints hinder the development of the informal sector by inhibiting business competitiveness and that besides imposing costs and inflexibilities that frustrate enterprises, they also hamper innovation, deter investments and minimize opportunities for employment creation.

The legal and regulatory frameworks are (among other things like public health regulations) in the form of trade licensing and registration of business names (Caps 497 and 499, Laws of Kenya) and Local Authority Licensing by-laws (Cap 265, Laws of Kenya). The regulatory procedures contained in these frameworks have remained a hindrance to the development of SMEs. This is because of the fact that they have costs whether an entrepreneur complies with them or not (K'Obonyo et al, 1999). Such costs may affect the establishment, growth and competitiveness of SMEs, more so in the rural areas as opposed to the urban.

First, for a person wishing to establish a business enterprise, he or she for example, must obtain a license. This implies that such a person will have to incur costs in acquiring the license, in terms of application fees, transport costs (bus fare to and from the licensing offices and other travel expenses) and time costs (time spent in applying and waiting for the license). In addition to these costs, the person may incur some unofficial costs like bribes (K'Obonyo et al, 1999). These costs may have a negative effect on the establishment of the intended business since part of the capital initially planned for its establishment may be used in the process of compliance. If that is the case, then the rural SMEs may be affected more as opposed to the urban ones because rural entrepreneurs have poor capital formation or lack enough capital (K'obonyo et al, 1999).

Secondly, as the business grows or develops after establishment, it may still be affected. This is especially so if the entrepreneur chose not to comply with the regulations. The entrepreneur for example, may incur costs such as bribes to licensing officials, loss of goods due to confiscation and loss of valuable time due to the frequent closures (K'Obonyo et al, 1999). These may in turn affect the growth of the business. Again, if this happens and given that rural entrepreneurs have poor or lack infrastructure and managerial capacity to go around the regulations (Mullei et al, 1999), they are more adversely affected as opposed to their urban counterparts.

Thirdly, from the above two scenarios, it can be inferred that the entrepreneurs may incur unnecessary costs and waste a lot of valuable time. If that is the case, then their competitiveness may be affected, in that they cannot direct the strategy and operations of the business by proper utilization of valuable time and reduction of unnecessary costs (Mullei et al, 1999). Considering the reasons given earlier, and the fact that rural entrepreneurs have poor knowledge of legal issues (Mullei et al, 1999), this may have a greater impact in the rural areas than in the urban. This and the other two cases above imply that regulations and procedures may have a stronger negative effect on the rural based SMEs, as opposed to the urban ones.

FIGURE 1: Conceptual Model

The Conceptual Model Shows the Relationships between Compliance and Non-Compliance with Business Regulations and Procedures and the Establishment/Development of Small and Medium Enterprises. The study was carried out in Kesses Division, Uasin Gishu District in the Rift Valley Province of Kenya.Kesses Division is one of the six

divisions of Uasin Gishu District. Others are Soy, Ainabkoi, Turbo, Kapsaret and Moiben Divisions. Kesses Division has a population of 84,894 people representing 13.6% of the total population of Uasin Gishu District. It also has a population density of 123 people per square kilometre (GoK, 2001:3).Kesses Division has 7 locations and 10 sub locations. The Divisional Headquarters is based at Kesses centre, which is under Wareng County Council (GoK, 1997:4)

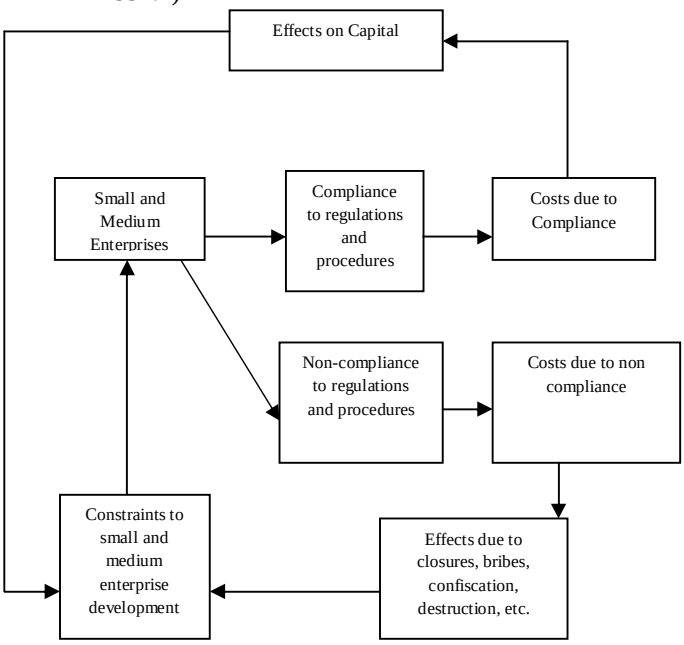

Figure 1: Conceptual Model

The major centres of business include Cheplasgei, Cheptiret, Kesses, Chebarus, Stage (Moi University) and Cheboiywo. The number of businesses in these centres has grown at a faster rate in the recent years since 1985 and constitute all types of enterprise. The major types of businesses are wholesale shops, retail shops, food and beverage outlets (including hotels and restaurants, bars, butcheries and cafeterias), wood workshops (carpentry and joinery), petrol stations (in Kesses and Cheptiret), motor vehicle garages (Kesses and Cheptiret), groceries, transport (matatus), salons and open air vegetable vending. There are also illegal* brew sellers (Busaa and Chag'aa) especially at Cheboiywo centre.

The main reason for choosing Kesses Division as the research site was because different types of enterprises, (about 700 in number) exist there.The other reason was that since the researcher came from around this place, the knowledge of the place would reduce the time and costs, which would otherwise be used in getting familiar with the place. Another factor was also because the researcher would be able to use the Margaret Thatcher Library in Moi University's Main Campus.

SCOPE AND LIMITATIONS OF THE STUDY

The study dwelt on licensing, business names registration and local authority by-laws related to the establishment and running of businesses. Emphasis was laid on the effects of such regulations and procedures on the establishment of small and medium enterprises. The research encountered problems especially from hostile respondents who could not readily accept to give the correct information about the legal stati of their enterprises. Since what concerns legal issues is sometimes sensitive, some respondents took undue caution, but the researcher allayed and dispelled their fears by explaining the intention of the study and its importance to the researcher and ultimately the Small and Medium Enterprise sector.

METHODS

Probability sampling techniques were employed in this research to select a sample of 105 enterprises from the population of 700 SMEs in Kesses Division. The sampling frame was obtained from the District Trade Development Office. The specific technique employed was stratified random sampling, which enabled all the enterprises in all the categories to get equal chances of being included in the sample (Singleton et al, 1988). Stratified random sampling is described below:

It involves subdividing the population into mutually exclusive segments called strata, based on the categories of one or a combination of relevant variables. Simple random samples are then drawn from each stratum, and these sub samples are combined to form a complete stratified sample (Singleton et al, 1988). The size of a sub sample depends on the size (quantity) of the category.

Considering the population of 700 SMEs for this study, it was divided into eight (8) categories including all major types of SMEs in Kesses division. These were then converted into sub samples depending on their sizes as described below:

Table 2: Stratified Random Sampling

SME Category	Size of category *	No. of SMEs to be selected
General wholesalers	94	94/700x105 = 14
Retail shops	180	180/700x105 = 27
Food and beverage	293	293/700x105 = 44
Wood workshops	47	47/700x105 = 7
Petrol stations	7	7/700x105 = 1
Hardwares	20	20/700x105 = 3
Salons	59	59/700x105 = 9
TOTALS	700	105

Source: Uasin Gishu District Trade Development Office's records.

**The sizes of categories are approximations.*

The sample for entrepreneur profiles was selected purposely from among the entrepreneurs already selected from each category of business. They were identified during the course of the study.

The sample size of this study was 105 enterprises, representing about 15% of the total number of SMEs in Kesses Division. This sample size was considered because it would enable the researcher to interview all the SME owners in the sample within the scheduled time. At a rate of 10 enterprise owners/managers per day, and given the two weeks allocated for data collection, the researcher would have been able to interview all the 105 within 11 days. However, the researcher was able to interview only 74 enterprise owners and managers. Those who had not been interviewed (31 in number) at the end of the period just filled the questionnaires. Out of these (31), 23 were received back. There was also extra time allocated in the work plan to cater for any eventualities. The sample size was also affordable to the researcher in terms of the cost of preparing questionnaires and travel expenses.

The research used both qualitative and quantitative techniques to collect primary and secondary data respectively. This is because the combination of both techniques provided the necessary data for the study. Being a survey, it was necessary to collect data from the field using primary techniques. For proper and accurate conclusions, it was necessary to use secondary data.

- Under primary techniques, the research employed entrepreneur profile interview guide and structured sample survey questionnaires.
- Under secondary quantitative techniques, the research used official records from the district registration officer's office.
- In the secondary qualitative techniques, the research employed the Internet and other available records.
- The tools used for data collection were a sample survey questionnaire and an entrepreneur profile interview guide. A structured sample survey questionnaire was given to each of the enterprise owners/managers in the sample. The entrepreneur profile interview guides were used to collect information for construction of the profiles.

The data collected from the field (raw data) was analyzed both quantitatively and qualitatively in order to arrive at conclusions. The quantitative analysis was done through the use of MS computer data processing, the MS Excel. Qualitative analysis was done using content analysis of the literature reviewed and by making the necessary inferences. Entrepreneur profiles were constructed to provide a clear understanding of the effects (positive and negative) of the existing regulatory framework using the information from the entrepreneur profile interview guides. The error margins were established using statistical error analysis. The means used for collection of data was analyzed by establishing their reliability and validity. Testing the instruments (questionnaires) first before presenting them to the actual respondents did this. An instrument could be said to be reliable if for several repetitional tests, it yielded the same result. It could also be said to be valid if the results did not vary much with what was known or expected of the variables being measured (Singleton et al, 1988).

RESULTS AND DISCUSSIONS

A higher percentage of enterprises in each category of business studied indicated they had been licensed by the Central Government.

Table 3: Proportion of Businesses Licensed by Central Government According to Business Category (type)

Types of Business	% of Licensed Businesses	Average Time Taken Between Application and Receipt of Licence (Days)	Average License Fees Paid (Ksh.)	Average Unofficial Amount Paid e.g. bribes, tips, etc. (Ksh.)
General Wholesalers	92.5	4	5,000.00	2,000.00
Retail Shops	74	3	1,200.00	500.00
Food and beverages	85	7	1,800.00	500.00
Workshops (metal and wood)	57	2	3,000.00	500.00
Petrol Station	100	7	5,000.00	2,000.00
Hardwares	94	2	1,500.00	300.00
Salons	54	2	800.00	----

Source: Survey data, 2004.
Margin of error = + /- 2%

The table above (table 5) summarizes information gathered on business licensing by the Central Government. With reference to categories, it can be seen that the average time taken by General wholesalers to acquire a licence is 4 days and the average licence fee is Kshs.5,000.00. This implies that an entrepreneur planning to run a wholesale shop must have an amount of Kshs.5,000.00 on average, depending on what the business deals in. For example, those who deal with animal feeds part with a lot of money in licence fees as opposed to those who deal in other goods. Many of these entrepreneurs (about 80%) felt that the fees were not reasonable and that they should be reduced. The average amount they proposed was Kshs.2,000.00, citing the hard economic times and general lack of (poor) business. Of the entrepreneurs who responded in this category (general wholesalers), 97% felt that the amount paid in fees reduced their operation capital. This is in the sense that some of the money earmarked for start-up capital was used to pay the licence fee. Given that the licences have to be renewed annually, this affects their annual turnover because they have to make a provision for the licence fees.

For entrepreneurs planning to run a retail shop, the government requires an average of Ksh.1,200.00 in

license fees and the applicants have to wait for an average of 3 days before they can get a license. The respondents felt that the amount was reasonable since it translated into about a hundred shillings (on average) per month, were 65%. In the food and beverage category, an entrepreneur requires an average of Ksh.1, 800.00 and may wait for up to seven days before receipt of the license. In the workshops category, one has to wait for up to two days before receiving a license after paying Ksh.3, 000.00. For a petrol station, an entrepreneur will not only pay Ksh.5, 000.00, but will also wait for up to seven days to receive the licence. For hardwares and salons, one pays Ksh.1, 500.00 and Ksh. 800.00 respectively and have to wait for an average of 2 days to receive the licence. For each category, the average amount of unofficial money paid (e.g. bribes, tips) range from Ksh.300.00 to ksh.2,000.00. Entrepreneurs in all categories admitted to have paid at least some money in the form of unofficial levies.

Almost all categories of business in Kesses division have a high percentage of local authority licensed enterprises. General wholesalers category have 100% of licensed shops. The same applies to food and beverage, petrol stations and hardwares. Retail shops and workshops are 98% and 96% licensed respectively. The least licensed are salons who have only 51% of the enterprises licensed. The average time to wait between application and receipt of licence is 1 to 3 days n all business categories. The license fees range from an average of Kshs.1,500.00 to Kshs.3,000.00. The unofficial money paid to officials was not recorded in other categories except in food and beverages, which indicated to have paid an average of Kshs.300.00.

Table 4: Businesses Licensed by the Local Authorities According to Business Category

Type of Business	% of Licensed Businesses	Av. Time Taken Between Application & Receipt of License (Days)	Av. Licence Fees Paid (Ksh.)	Av. Unofficial Money Paid to Officials (Ksh.)
General wholesalers	100	1	2,500.00	-
Retail Shops	98	1	1,500.00	-
Foods and beverages	100	2	1,500.00	300
Workshop (metal & wood)	96	1	2,000.00	-
Petrol station	100	3	3,000.00	-
Hardwares	100	1	2,500.00	-
Salons	51	1	1,500.00	-

Source: Survey data, 2004.Margin of error = + /- 2%

Some of the respondents (about 41% or 39 out of 95 respondents) indicated that regulations affect positively the aspects of business competitiveness. The respondents who felt that regulations benefited cost reduction strategies, in terms of compliance, utilization of time business and personal goals, risk minimization strategies and implementation of new infrastructural changes were 81%, 90%, 22%, 20% and 34% respectively. They all felt that compliance to regulations and procedures provided freedom for performance without undue disturbance. It is only when one doesn't comply that they are punished hence they do not perform to their expectations.

The respondents who considered the effect as negative were 34%. About 14% of these respondents felt that regulatory frameworks hindered cost reduction strategies since it was a cost on its own. Regulations have costs whether an entrepreneur complies or not and thus they are an unnecessary cost. Around 42% of the respondents considered regulations as hindering proper and maximum utilization of time since, for example, when one has not complied, they have to close from time to time. No respondent considered regulatory frameworks as affecting customer care and relations.

On goals (both business and personal goals), 18% of the respondents felt that regulatory frameworks had a negative effect. They felt that regulations dictated what and where to do business and thus for a new business there is always a new licence. On achievement of these goals, some felt that one might not achieve them due to unnecessary rules outlined in the regulatory frameworks.

There were 32% and 62% of respondents who felt that regulations and procedures hindered risk minimization strategies and implementation of new infrastructural changes respectively. There were no clear explanations to these but many pointed at the fact that there was a lot of risk in not complying with regulations since authorities could take punitive actions.

Table 5: Effects of Regulatory Framework on Business Competitiveness

Level of Effect	Proportion of Entrepreneurs Considering Positive Effect (%)	Proportion of Entrepreneurs Considering Negative Effect (%)	Remainders (%)
Cost reduction strategies	81	14	5
Utilization of time	50	42	8
Customer care and relations	0	0	100
Business and personal goals	22	18	60
Risk minimization strategies	20	32	48
Implementation of new infrastructural changes	34	62	4

Source: Survey data, 2004.Margin of error = + /- 2%

The major problems facing entrepreneurs in Kesses division due to non-compliance with business regulations and procedures are closure of businesses, eviction from premises, confiscation of goods, destruction of property, bribery of officials and arrests. About 66% of the respondents indicated that they had experienced one or more of the problems mentioned above. Around 87% of these respondents said business closure at one time or another had negatively affected them. Nearly 52% of these felt that the problem affected their business a great deal, in that they had not been able to recover since the last time their business was closed. All of them said they decided to comply with regulations as the only solution to the problem.

The respondents who claimed to have experienced eviction from their premises were 76%. They indicated that besides looking for proper premises, they also decided to comply with all the other regulations. About2% claimed they had initially decided to move out of business, but later on reconsidered their decision. Almost 23% of the total respondents said their goods had been confiscated at one time or another. However, they claim, the problem is not very common. There were about 81% who claimed that their property had been destroyed and they had to deal with the big losses by finding more capital. Almost 97% of the respondents indicated that they had bribed licensing officials at one time or another. There was no clear solution to the problem since amounts varied. Nearly 29% of them claimed to have been arrested. The majority, over 90% of them indicated that they had considered compliance as the only solution to the problem. The following table summarizes the information.

Table 6: Main Problems Faced by Entrepreneurs due to Non-Compliance with Regulations and Procedures

Problem Faced	Proportion of Entrepreneurs who have Faced the Problem (%)	Remainders (%)
Closure of business	87	13
Eviction from premises	76	24
Confiscation of goods	23	77
Destination of property	81	19
Bribery of officials	97	3
Arrests	29	71

Source: Survey data, 2004.
Margin of error = +/-2%

Overall, about 41% of respondents indicated that regulatory frameworks affected business competitiveness positively. Of these 34% considered regulatory frameworks as hindering or negatively effecting business competitiveness. All these made a 62% on average of enterprise owners. They all considered regulatory frameworks as affecting business competitiveness. The explanations as given earlier, basing on the different aspects of business varied. The error margin was +/-2%. The remaining percentage either saw no effect or felt they were not sure.

CONCLUSIONS AND RECOMMENDATIONS

From the study, it can safely be concluded that regulatory frameworks affect business establishment, growth and competitiveness of enterprises in Kesses division more positively than negatively. From the summary, it can be seen that 41% of respondents considered positive effect on business competitiveness. This is as opposed to 21% who felt negative effect. This shows that generally the regulations affect business more positively than negatively in the area of study.

The other important conclusion is that some of the enterprise owners in Kesses division have considered compliance as the solution to most problems hindering the running and development of businesses. This can be supported by the fact that the enterprises, which have complied, tend to have more annual turnovers than those who have not complied. The average annual turnover for licensed businesses was Ksh. 800,000 and for the unlicensed Ksh. 580,000. It may also be supported by the fact that more enterprise owners (67%) have chosen to comply in the Division as opposed to 33% who have not complied.

Lastly, as can be seen from the entrepreneur profiles, more rural entrepreneurs have succeeded while complying although a few may have failed while complying. Some have also succeeded while not complying and many others have failed for not complying. This shows the nature of effects which the regulatory frameworks can have on enterprises. The frameworks are not always favourable and may depend on the ingenuity of the individual entrepreneurs for either success or failure. All these can explain the reason why some rural-based enterprises have demonstrated some ability to get started, grow, compete and even survive longer than some urban-based SMEs, despite the somehow unfavourable nature of the government regulatory frameworks in place.

Based on the above conclusions, this study recommends that regulatory frameworks currently in place in Kenya should be made to provide order in the Small and Medium Enterprise sector without being a hindrance to its development in any way. The regulatory frameworks should not only provide a structure for operations but should also be seen to be friendly. This will ensure that the enterprises are able to direct their strategies by minimization of unnecessary costs and optimal use of time without undue interference from authorities either through the regulatory frameworks or other means.

Given that both compliance and non-compliance have costs, there is need to reduce the costs of compliance. Compliance should not lead to failure in business as can be seen in the survey results and entrepreneur profiles. The government should ensure that the regulatory frameworks are more favourable so that more entrepreneurs will be willing to comply. As exemplified by the entrepreneurs in Kesses Division, there is more success in compliance than in non-compliance and if the regulations are more favourable than they are currently, more entrepreneurs would readily be willing to comply.

To achieve the above, it is recommended that the government and local authorities should be strict only in the sense that the law is followed, to achieve order in the sector, while ensuring that the necessary licences and documents are affordable. The offices for issuance of licences should be decentralized so that all people can get them easily without unnecessary transport costs. This can be done if possible, at least, at the Divisional administrative level. More officials should be posted to the centers so set up so that less time is taken to process the documents. The government should also ensure discipline among its officers to rid out corruption.

Lastly, entrepreneurs and potential business enterprise owners should be encouraged to abide by the law, since they stand to benefit in so doing, but only if the government regulatory frameworks in place are more favourable.

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