

# **A Review of Kenya's Institutional and Regulatory Environment in Domestic Trade**

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## **Abstract**

*This study sought to analyze the institutional and regulatory framework relevant to the wholesale and retail trade in Kenya. In order to realize this objective, the study relied on roundtables and comparative case studies. The study revealed there is no institutional and regulatory framework which is specific to the wholesale and retail trade, but all the institutions and regulations in the domestic trade affect all businesses. There exists multiple licenses and fees which reduce investment in this sector. Consideration should be put in strengthening the Joint Loans Board (JLB) facility, owing to the fact that many business enterprises still face credit constraints. This will involve recruitment of more staff to reduce time taken before the disbursement of loans and also increase the amount lent out to traders. The cost of doing business in Kenya is high due to the cumbersome process of business registration and difficulties in complying with various forms of taxes. There is need to have one institution to give direction and regulation to this key sector for it to realize its function. Although licensing of businesses is an important way of regulating businesses for public health, order and safety, many local authorities use the single business permit (SBP) as a way of raising revenue and not for regulation purposes. There is need to improve on the infrastructure in the country to promote inter-county trade. More reforms are required to reduce the number of procedures, time and costs related to business registration.*

## **Abbreviations and Acronyms**

ACA	Anti-Counterfeit Agency
BBRU	Business Regulatory Reform Unit
CCK	Communication Commission of Kenya
CIN	Consumer Information Network
CBD	Central Business District
COMESA	Common Market for East and Southern Africa
DCED	Donor Committee for Enterprise Development
DIT	Directorate of Industrial Training
EAC	East African Community
EPC	Export Promotion Council
GDP	GrowthRate of Domestic Product
GTZ	German Technical Cooperation
ICDC	Industrial and Commercial Development Corporation
IFC	International Finance Corporation
JLB	Joint Loans Board
KAM	Kenya Association of Manufacturers
KCC	Kenya Cooperative Creameries
KEBS	Kenya Bureau of Standards
KenInvest	Kenya Investment Authority
KEPHIS	Kenya Plant Health Inspectorate Services
KFA	Kenya Farmers Association
KIBT	Kenya Institute of Business Training
KIPI	Kenya Industrial Property Institute
KMC	Kenya Meat Commission
KNCCI	Kenya National Chambers of Commerce and Industry
KNTC	Kenya National Trading Corporation Limited
KRA	Kenya Revenue Authority

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KSC	Kenya Seed Company
MSEA	Micro and Small Enterprise Authority
NCPB	National Cereals and Produce Board
NCWTO	National Committee on World Trade Organization
NEMA	National Environment Management Authority
NHIF	National Hospital Insurance Fund
NITA	National Industrial Training Authority
NSSF	National Social Security Fund
OECD	The Organization for Economic Cooperation and Development
PIN	Personal Identification Number
RBE	Regulatory Business Environment
SAPs	Structural Adjustment Programmes
SBP	Single Business Permit
SMEs	Small Medium Enterprises
SSA	sub-Saharan African Countries
STE	State Trading Enterprises
UNCTAD	United Nations Conference on Trade and Development
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WTO	World Trade Organization



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## 1. Introduction

### 1.1. Background

There has been rapid transformation of the wholesale and retail trade in Kenya, which has resulted from economic growth and the rise of the middle income class in the past decade. This transformation has been spearheaded by supermarkets. The leading supermarkets in Kenya include Nakumatt, Tuskys, Uchumi, Naivas and Ukwala. One common feature of these supermarkets is that they are home-grown, and are mainly concentrated in Nairobi. Nakumatt is the biggest supermarket in Kenya with about 40 retail stores in Kenya, including those in Uganda, Rwanda and Tanzania. Tuskys is the second largest with 47 branches; 41 in Kenya and 6 in Uganda. Uchumi, which is the oldest supermarket in Kenya, has since been overtaken by Nakumatt and Tuskys and has 28 stores countrywide. In the fourth place is Naivas, with 27 retail stores and Ukwala supermarket is position five.

Reardon (2005) identified the main determinants of growth of supermarkets in recent years in developing countries. They include urbanization; and the entry of women in workforce outside the home, which has increased their opportunity cost of their time and incentive to seek shopping convenience and processed food to save home preparation. Supermarkets, often in combination with large-scale food manufacturers, reduce the prices of processed products. The growth of the supermarkets has also been attributed to real per capita growth in the 1990s, along with rapid rise of the middle income class which has increased the demand for processed foods, the entry point for supermarkets. Rapid growth in ownership of refrigerators has increased the ability to shift from daily shopping in traditional retail shops to weekly or monthly shopping, and the growing access to cars and public transport has reinforced this trend. The growth of supermarkets is replacing the traditional '*dukas*' that have dominated the retail trade since independence in Kenya.

Another development in the retail sector has been the emergence of large shopping malls with a large assortment of businesses such as supermarkets, food kiosks, barber shops, salons, banks and other forms of businesses. These shopping malls are concentrated mainly in Nairobi (Westgate shopping mall, Sarit Centre, Village Market and Yaya Centre). There has also been transformation of the "old shop" models (*dukas*), especially within the Central Business District (CBD) of Nairobi, where a new business model called "stall" has emerged. These stalls are specialized. They deal with cosmetics, electronics, clothing, medicaments and mobile money transfer services and are mostly operated by young people.

The wholesale trade involves the selling of merchandize to retailers involved in industrial, commercial and institutional goods, farm inputs, construction materials or acting as agents or brokers in buying merchandize or selling merchandize to such firms. They act as middlemen between the producers/manufacturers and the retailers, although a few supply merchandize directly to the final consumers.

Retail trade sub sector, on the other hand, comprises enterprises generally engaged in retail goods and services, without transforming the physical nature of the product except bulk breaking. These enterprises fall into various categories including the general retail shop or specialized retailers such as food, beverages and tobacco, butcheries, oil and petrol/gas; building materials, timber, and domestic hardware. Others deal with textile, soft furnishings, clothing and shoes, photography, pharmaceutical goods, restaurants, cafes and other drinking places, and lodging places.

Traditionally, manufacturers would sell their products at the factory door to authorized distributors who would transport them at their own costs to the wholesale markets. The wholesalers, in turn, sell to the retailers who would arrange transportation of the goods to their outlets. Today, the distribution channels have been shortened by direct deliveries from manufacturers to retail stores, with larger supermarkets buying directly from producers and importers. Likewise, the retail sector has transformed radically in the last decade, with significant portion of the market converting from small shops, outdoor markets and kiosks to self-select stores, convenient stores and large supermarkets (Johannesson and Palona, 2010). The wholesale and retail trade structure in Kenya today can be summarized into three main categories:

- i. Formal wholesalers and retail traders among them leading supermarkets (Nakumatt, Tusksys, Uchumi, Naivas and Ukwala) and other small supermarkets which control around 35 per cent of market share. It is estimated that Kenya has more than 300 registered supermarkets spread in various parts of the country (Kenya Institute for Public Policy Research and Analysis-KIPPRA, 2011);
- ii. Informal micro-small enterprises operating in markets and makeshift kiosks across the country; and
- iii. Informal trade where millions of hawkers trade wares along the streets of major towns in the country.

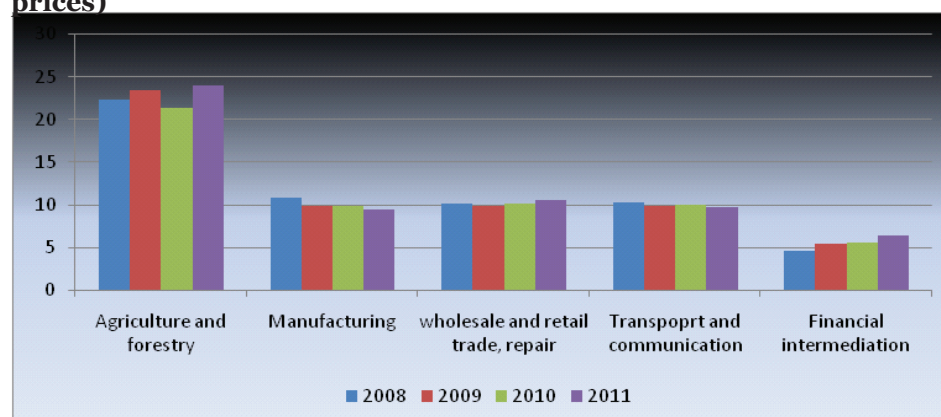
The wholesale and retail trade sector is one of the priority sectors expected to spur the Kenyan economy towards attainment of Vision 2030 goals. Vision 2030 envisions a wholesale, retail and trade sector that is formal, efficient, multi-tiered and diversified in product range and innovativeness. The sector is, therefore, crucial in supporting the creation of productive and durable employment opportunities

and realization of the desired 10 percent growth rate of domestic product (GDP). The main challenges facing the wholesale and retail trade in Kenya include fragmentation of the supply chain and inadequate market infrastructure. Towards this end, Vision 2030 seeks to construct wholesale hubs and producer markets in major Kenyan towns (with a pilot scheme in Maragua) and construction of model tier one retail market with a pilot project in Athi River near Nairobi.

The importance of the wholesale and retail sector to the Kenyan economy cannot be overlooked as the sector contributes approximately 10 per cent of GDP and 10 percent of formal employment in both the formal and informal sectors. The sector was third in terms of growth (23%) after financial intermediation (34%) and agriculture (33%) between 2010 and 2011, increasing its value from Ksh 261 billion (US\$3.2 billion) to Ksh 321 billion (US\$3.80 billion) (Kenya National Bureau of Statistics, 2012). In terms of its contribution to GDP, the sector was second after agriculture in 2011, contributing 10.6 per cent (Figure 1.1). The wholesale and retail trade sector is, therefore, a key economic driver which deserves a clear policy framework to guide its sustained growth.

For the wholesale and retail trade to continue contributing towards economic performance, there is need to improve and promote a favourable business or investment climate in the country. The fundamental premise of doing business is that economic activity requires good rules that are transparent and accessible to all. Such regulations should be efficient, striking balance between safeguarding some important aspect of business environment and avoiding distortions that impose unreasonable costs of business (World Bank, 2013). In order to rationalize the license regime and to transform Kenya into a competitive investment destination, the Kenyan government launched a review and reform of business licenses and permits from 2005 through the establishment of the Working Committee on

**Figure 1.1: Percentage contributions to GDP by main activity (current prices)**



Source: Kenya National Bureau of Statistics, 2012

Business Licenses in Kenya. Through the committee recommendations, Business Regulatory Reform Unit (BRRU) was formed to reform the business environment in the country. Due to BRRU's effort, Kenya was recognized as one of top ten reformers in the World Bank's 'Doing Business Report 2008'.

However, despite this tremendous progress, the country seems to have lost steam and it has since been declining in World Bank's 'Doing Business Report' rankings. For example in 2011, the country was position 106 out of 182. In 2012 and 2013, the country performance declined further to position 109 and 121, respectively. This compares poorly with other countries in the region like Rwanda, which has consistently performed well at position 45 and 52 in 2012 and 2013, respectively. Uganda has also shown good progress and was placed at position 120 in 2013 rankings. Other factors necessary for the growth of this sector include promotion of private sector and manpower development, broadening and deepening of the local and export market base, and fostering productive linkages and collaboration mechanisms.

## **1.2 Rationale for Institutions and Regulation**

The environment in which any business is operating is critical in determining to what extent that enterprise will be in exploiting business opportunities. Institutions and regulatory framework are critical for that environment. According to World Trade Organization (WTO, 2004), market exchange where the choices of individuals reflect their own values and firms make choices to maximize their profits, will lead to an efficient allocation of scarce resources. Efficiency requires that individual buyers and sellers cannot affect the price at which exchange takes place in a market. In addition, markets must exist for all goods. If these conditions are met, markets are said to be competitive and complete, and there will be an efficient allocation of resources. Institutions and regulations are meant to increase the efficiency of the market.

There are conditions under which the market does not function efficiently; for example, due to the presence of monopolistic tendencies; imperfect information between buyers and sellers (the market for 'lemon' problem) which could lead to a reduction in market transactions; and presence of negative externalities. Presence of these market failures necessitates government intervention. Market is said to fail when market mechanism leads to an inefficient allocation of resources. Regulations and institutions are introduced by most governments to improve on the market performance.

Institutions can be defined as "formal and informal rules of behaviour, ways and means of enforcing these rules, procedures for mediation of conflicts, sanctions

in the case of breach of rules, and organization supporting market transactions” (North, 1990; 1994). Institutions exist to reduce asymmetric information and uncertainties. In the market place, institutions “perform a variety of functions including consultation with stakeholders, policy coordination, review of existing rules and regulations, and information dissemination” (Wickramasinghe, 2006).

The quality of institutions has long been recognized as an important component of a well-functioning market. Market activities involve the interaction of human beings, and institutions exist to reduce the uncertainties that arise from incomplete information concerning the behaviour of other individuals in this process of human interaction. Institutions can act through a number of channels:

- (i) They decrease information asymmetries as they channel information about market conditions, goods and participants;
- (ii) They reduce risk as they define and enforce property rights and contracts, determining who gets what and when; and
- (iii) They restrict the actions of politicians and interest groups, making them accountable to citizens.

On the other hand, regulation is regarded a part of the traditional role of government in which public officials set standards and rules to guide the operation of private business (Hood, 1994). They are necessary for the private sector to operate efficiently. Economic regulation concerns those interventions whose purpose is related to improving the functioning of the market (Cordova-Novion and Hanlon, 2002). Regulatory reforms should reduce barriers to competition and market openness and foster market dynamics, while ensuring essential social and environmental welfare.

With the introduction of the Structural Adjustment Programmes (SAPs) in early 1980s, the Kenyan economy has over time progressed towards a state of less government intervention in the market towards a free market economy. Like other countries in East and Southern Africa, Kenya has over the last decade experienced rapid transformation in the wholesale and retail trade spearheaded by the growth of supermarkets. This new dynamism has been brought in the south-south trade and regional economic and trade arrangements. Distribution services are crucial in building export capacities in these countries.

Theoretically, regulating businesses can be justified where there are market failures of one sort or another, for example monopoly, imperfect information or significant externalities. In many cases, without government intervention, individual firms may not take into account the social cost of their actions. For example, a firm may pollute unless it incurs some implicit or explicit cost for polluting. In some cases, regulation is necessary for improving economic

efficiency. If economies of scale exist, a single firm may, in theory, be able to produce more efficiently than several competing firms, but its monopolistic power may need to be restrained through regulation (Guasch and Hahn, 1999). However, it is important to note that correcting market failure through regulation may not always be successful because just as there can be market failure, governments can also fail.

### **1.3 Statement of the Problem**

Institutions and regulatory framework are a critical part of business environment which are crucial in determining the success of any enterprise and its contribution to economic growth. According to Djankov, McLiesh and Ramalho (2006), friendly business environment is an important pre-requisite for economic growth and poverty reduction. In recognizing the need for improved business environment, the Government of Kenya through the Ministry of Finance established a Working Committee on Regulatory Reforms for Business activity in Kenya in 2005. This was born from the fact that the network of Government agencies with regulatory functions was broad and complex, with overlapping and contradicting functions. In addition, the regulatory decisions and actions were unilateral and not guided by any principles such as costs and benefits. Following the committee's recommendations and other initiatives thereafter, a number of business reforms have been undertaken in the country. In spite of these business reforms, Kenya continues to lag behind globally in improving the business environment.

Majority of the players in the wholesale and retail trade in Kenya are small sized firms and their growth and performance is particularly dependent on favourable institutional and regulatory setting. Small sized firms are usually in a weaker position to search for information, enforce contract and property rights and protect themselves against rent-seeking and predatory behaviour based on might (Ronnås, Sjöberg and Hemlin, 1998). This, however, does not mean big players in the wholesale and retail trade do not need a favourable institutional and regulatory environment.

Further, institutional and regulatory reform is a dynamic and not a static process. Therefore, there should be periodic review of the progress made in creating a good business environment for businesses to flourish. Due to the prominent role the wholesale and retail trade sector is supposed to play in Kenya in line with Vision 2030, it is important to analyze how the institutional and regulatory environment has been changing given the dynamism of the sector.

#### **1.4 Objectives of the Study**

Overall, the study seeks to analyze institutional and regulatory environment in the wholesale and retail trade in Kenya. Specific objectives include:

- i. Review the domestic institutions and regulatory framework relevant to the wholesale and retail trade in Kenya and their effectiveness;
- ii. Undertake a comparative analysis of Kenya's regulatory framework with best practices in the world; and
- iii. Propose policy interventions for improving institutional and regulatory framework affecting wholesale and retail trade in Kenya.

#### **1.5 Relevance of the Study**

Given the business reforms undertaken in Kenya so far, substantial opportunities for progress still remain. There is evidence that simplified regulatory procedures and supportive institutions stimulate job-creating domestic investment, encourages development of small and medium enterprises, and leads to higher economic growth (Djankov, McLiesh and Ramalho, 2006). The United Nations Conference on Trade and Development-UNCTAD (2003), identifies three problems associated with heavy and complex regulatory framework in developing countries. First, it discourages smaller enterprises from entering the formal sector of the economy. Second, it yields very few benefits to enterprises as it does not provide a clear framework in which business transactions can be enforced or in which property rights are clearly defined. Lastly, it is often associated with high levels of corruption.

#### **1.6 Organization of the Study**

This paper is organized as follows: Chapter two has the literature review. Chapter three explains the methodology that will be used to achieve the objectives of the study. Chapter four reveals the institutional and regulatory framework and their effectiveness. Also analyzed in this chapter is the business environment in Kenya and how it compares with that of Mauritius, Rwanda, South Africa and South Korea. Chapter five concludes and provides policy recommendations.

## **2. Literature Review**

### **2.1 Theoretical Literature Review**

This study argues that regulations and institutions are ingredients of an enabling business environment. Christy *et al.* (2009) defines an enabling business environment as a set of policies, institutions, support services and other conditions that collectively improve or create a general business setting where enterprises and business activities can start, develop and thrive. The concept of favourable business environment can, therefore, be associated with “a situation in which domestic and foreign firms can operate and grow as a result of the presence, interaction and capacity of different institutions, policies and services” (Konig, Carlos and Mhlanga, 2013).

The Organization for Economic Cooperation and Development-OECD (2008) and Donor Committee for Enterprise Development (DCEd) defines business environment as a “complex of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy as well as the institutional arrangements that influence the way key actors operate (for example, government agencies, regulatory authorities, and business membership organizations including business women associations, civil society organizations, trade unions, etc)”.

According to United Nations Economic Social Commission for Asia and the Pacific-UNESCAP (2004), enabling policy and regulatory framework, efficient institutions and good governance are the most important factors determining the ability of an economy and therefore an enterprise to supply to global markets. UNESCAP (2004) further notes that “a good business climate is characterized by smooth operating markets and accessible, efficient, transparent and accountable public and private sector institutions, good infrastructure, a skilled and productive workforce, access to capital and technology, easy, low-cost and timely access to information, access to efficient and competitively priced business support services, including transport, information and communication services, and efficient trade procedures and support services”.

According to United Nations Industrialization Development Organization (UNIDO) and German Technical Cooperation-GTZ (2008), there is a growing consensus among development researchers and practitioners that a vibrant private sector is crucial for poverty reduction and the existence of a business-friendly condition must exist to unleash private sector dynamism. While it is difficult to precisely state what constitutes a good business-environment, there is agreement



that low levels of red-tape, an independent judiciary, good infrastructure, and a functional education system are among the key conditions for business to thrive.

According to Altenburg and von Drachenfels (2008), there are two approaches that explain the key elements that constitute successful private sector development: neo-structuralist and neoclassical approaches.

### **2.1.1 The neo-structuralist approach**

The neo-structuralist approach stresses the ability to upgrade and build knowledge-based competitive advantages as additional determinants influencing the private sector dynamism (UNIDO and GTZ, 2008). It assumes that markets on their own cannot provide socially optimal quantity and quality of goods and services that the private sector need for their development. This is due to market failures in the following areas: (i) materialization of knowledge spill overs and dynamic scale economies that impede the creation of competitive advantages in knowledge intensive markets; and (ii) highly asymmetric markets that prevent economic growth from trickling down to the sectors and industries where the majority of people work. According to the neo-structuralist approach, to enhance the competitiveness of the private sector, market failures have to be addressed by strengthening the management capacity of firms and encouraging the supply of business development services (Krause *et al.*, 2010). According to Krause *et al.* (2010), neo-structuralist approach puts more focus on the small medium enterprises (SMEs).

### **2.1.2 The neo-classical approach**

The neoclassical approach, on the other hand, does not focus on SMEs but on the private sector as a whole. Advocates of this approach assume that factor markets work well without government intervention, if property rights and competition are guaranteed. The approach contends that government intervention hinders private sector development, but market-based solutions are the most efficient. This approach is thus skeptical about the government ability to promote private sector development through selective support measures and emphasizes market-based solutions to improve business environment, regardless of the size (Krause *et al.*, 2010). In this approach, the role of the government should be that of monitoring the good functioning of the markets, ensure the security of private property rights, and ensure a stable macroeconomic environment.

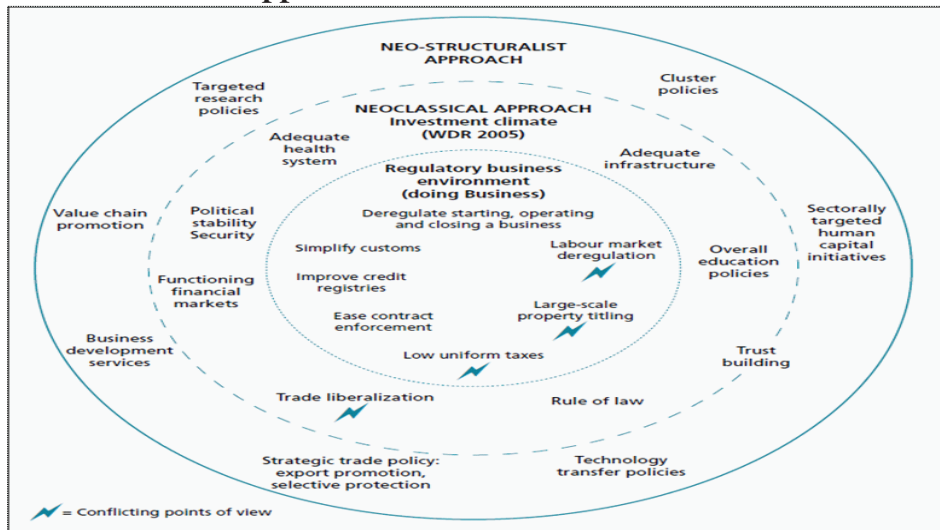
Within the neoclassical approach, a narrow concept of regulatory business environment (RBE) and the broader concept of business climate can be identified. According to Altenburg and von Drachenfels (2008), the concept of RBE covers regulations that immediately affect businesses through the cost of compliance. This concept characterizes the regulations that affect the core activities of the

private sector including business registration, licensing, employment of workers, and payment of taxes (Krause *et al.*, 2010). This is usually the focus of 'Doing Business Report' of the World Bank and International Finance Corporation (IFC). The report emphasizes the importance of deregulation of bureaucratic processes and strengthening the private property rights and contract enforcement. According the Doing Business Approach, excessive bureaucratic procedures and regulation are seen as major constraints for private sector development.

In terms of investment climate, it is a broader definition than RBE since it comprises all the elements of RBE and other factors such as quality of infrastructure, trade policies, political and macroeconomic stability, rule of law, quality of the health and education systems, and international rules and standards.

Figure 2.1 illustrates neo-structuralist and neoclassical approaches in relation to enabling business environment. The neo-structuralist approach addresses wider elements (cluster policies, research policies technology transfer policies value chain promotion etc) than the neoclassical or the RBE. Most of the elements in the inner circle are recognized as a critical part of an enabling business environment.

**Figure 2.1: The business enabling environment: Neoclassical and neo-structuralist approaches**



Source: United Nations Industrial Development Organization and German Technical Cooperation, 2008

## **2.2 Empirical Literature Review**

Jacobs, Ladegaard and Musau (2007) reviewed the radical licensing reforms 2005-2007 in Kenya. In 2005, the Kenyan government launched an innovative reform to reduce its growing number of business licenses and fees, and corruption connected to those instruments. Through the support of World Bank and a consultant, the National Committee moved beyond previous strategies based on reforming licenses one at a time, and adopted ‘guillon approach” to rapidly identify, review and streamline all business licenses and associated fees in Kenya. The study finds that businesses face multiple licenses and government must therefore understand the scope of the problem before designing reforms. The study recommended the problem should be accurately measured for it to be addressed properly. Further, a successful implementation reforms depends on the strong and consistent political support and availability of technical capacity. The study argued that broad solutions, even “radical” solution to improve regulatory environment can work better than small reforms.

Devas and Kelly (2001) point out that licensing is often a crude form of regulation, which may be less effective than other instruments such as codes of practice, producer’s insurance and liability assignment, or targeted taxes and subsidies. However, many countries lack legal and institutional framework to put these alternative approaches into practice. The study further argues that the regulatory aspect of local business licensing in many developing countries are ineffective at best and counterproductive at worst. In the case of Kenya, the introduction of the single business permit at the initial level achieved the twin objective of increasing revenue and reducing regulatory compliance costs of business. Globalization of trade makes regulation both more difficult and more likely to have undesirable economic consequences, as investors can easily relocate their operations. In United Kingdom for example, general licensing of businesses was abandoned in 1970s while in New Zealand and Australia, licensing of certain businesses was replaced by a system of notification by operators of businesses involving risks, together with ex-post inspection (Government of Australia, 1996).

Kenya Investment Authority (2010) sought to analyze the laws and regulations and impediments to investment in the wholesale and retail trade sector. The results show there was no specific institution which controls the wholesale and retail trade in the country which may be one of the main reasons inhibiting investment in the sector. In addition, the study found that lack of training in the sector, dumping of substandard goods, market accessibility and infrastructure are other factors inhibiting its growth. The study proposed mapping of market hubs and identification of centres that are potentially suitable as business incubators.

Johannesson and Palona (2010) observe the major problems facing retail and wholesale trade in the East African Community (EAC) is lack of a refrigerated warehouse and storage yard, high inventory requirement, specialized trucks and debilitated railway and road systems. The study further points out that retail environment in the EAC is undeveloped and unsophisticated, hence providing great opportunities for international retailers. The study recommends that distribution strategies address longer distribution channels and frequent interruptions in supply. Product strategy should emphasize low cost medium quality products due to limited competition and price elasticity.

### **2.3 Overview of Literature**

A favourable business environment is crucial for any business enterprise to grow and thrive and institutions and regulations are integral parts of that environment. Various definitions of favourable business environment exist, but what is common among these definitions is that such an environment should allow businesses to thrive and grow as they interact with different institutions, policies and services. There are two theoretical approaches that define what can be considered as constituting elements of successful private sector development: neo-structuralist and neoclassical approaches. Neo-structuralist approach is based on the belief that markets on their own cannot function efficiently due to the presence of market failures, making government intervention in the market place necessary. Neoclassical approach holds that markets work well without government intervention, if property rights and competition are guaranteed.

Empirical literature review has revealed that there are few empirical studies on institutional and regulatory framework in the wholesale and retail trade relevant to Kenya (a few include Kenya Investment Authority, 2010 and Johannesson and Palona, 2010). Some studies have focused on the supermarkets (for example, Reardon, 2005), while others have focused on business sector reforms (Devas and Kelly, 2001; and Jacobs, Ladegaard and Musau, 2007). This study will add to literature in the following ways: first, it will provide evidence on whether the institutional and regulatory reforms that have been undertaken to improve business environment have been favourable to the wholesale and retail trade. Second, comparative analysis with the best practices will give an indication of the areas that Kenya will require to strengthen so as to improve the business environment.

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### **3. Methodology**

#### **3.1 Introduction**

This study relied on the following methodologies to achieve its objectives; expert opinion discussions and comparative case study both augmented with literature review.

#### **3.2 Expert Opinion**

This involved bringing together the main players such as the business community, regulatory agencies, among others, to discuss the pertinent issues arising from the analysis. This is premised on the idea that there are many dynamics in the business environment requiring constant change as a response to these dynamisms. Therefore, the institutional and regulatory framework affecting the business climate should change to facilitate the growth of enterprises and not to become a hindrance to their progress.

The agencies which participated in the expert opinion discussions were selected purposively based on the authors' assessment of their relevance. The expert opinion discussions were held on 5 April 2013 at the Kenya School of Monetary Studies (Appendix 1).

Expert opinion was the preferred method because it allows the engagement of the people directly affected by the issue. Also, given the dynamism in business environment, constant dialogue among stakeholders is necessary so as to make the institutional and regulatory environment to respond accordingly. Lastly, it allows for probing detailed discussions and understanding of different perspectives.

#### **3.3 Comparative Case Studies**

This study uses data from Doing Business Reports of the World Bank which measures various dimensions of business regulation and breaks down regulatory burdens into more operational categories. This study compares Kenya's RBE with that of Mauritius, South Africa, Rwanda and Botswana, and South Korea as an aspirator country. The choice of these countries was based on the following reasons. First, the countries in Africa, specifically those from sub-Saharan African (SSA) countries can be considered, to some extent, that they have some similarity with Kenya. Second, they were ranked the best in the Africa by the World Bank's 'Doing Business Report 2013', and were in position 23, 36, 45 and 54 respectively,

out of the 183 countries that were surveyed. South Korea was ranked at position six in the 2013 rankings. The reports data is advantageous given that the same instrument was used for all the countries, and therefore, it eliminates biases in the analysis and enhances comparability.

The 'Doing Business Report' indicators usually include the number or procedures, time and official costs related to core activities of private businesses. However, these categories change from time to time. Table 3.1 gives the operational categories according to 'Doing Business Report 2013', which will be used in comparative analysis. Out of the 11 topics in the reports, the following were considered for this study: starting a business, getting electricity, getting credit, protecting investors, and paying taxes which are more relevant to the wholesale and retail trade in Kenya. Chapter four reviews the business and regulatory framework for the wholesale and retail trade in Kenya.

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## **4. Institutional and Regulatory Environment in Kenya**

### **4.1 Introduction**

This chapter discusses the institutional and regulatory framework and their effectiveness in the wholesale and retail trade in Kenya. In addition, a comparative analysis of Kenya's RBE with that of Mauritius, Rwanda, South Africa and South Korea is undertaken.

### **4.2 Institutional and Regulatory Framework in Wholesale and Retail Trade in Kenya**

The distribution of both locally manufactured and imported goods in the country was controlled by the government prior to the 1990s liberalization. The government, through State Trading Enterprises (STE), set out policies to control and influence the distribution of bulky commodities that were considered essential to the welfare of the people. Some of these STE included Kenya National Trading Cooperation (KNTC), the National Cereals and Produce Board (NCPB), Kenya Farmers Association (KFA), Kenya Meat Commission (KMC), Kenya Seed Company (KSC), Kenya Cooperative Creameries (KCC), National Oil Corporation, among others. These STEs were involved in a range of commodities ranging from beverages, dairy products, edible oils, meat and livestock, sugar, grains, rice and wheat among other products. The policy prohibited manufacturers from engaging in the distribution, wholesale or retail trade. Similarly, an importer of bulk common user goods could not be licensed to engage in retail trade.

The STEs were prominent immediately after independence up to 1990s, when the country started adopting free market reforms and economic liberalization measures in an effort to boost economic development. Initially, they were seen as the best way to propel government policy in protecting the welfare of the majority poor. The STEs, however, became inefficient due to bureaucracy and red tape, and, as result; they were not able to perform their duties as expected. With the liberalization of the economy, the role of STEs diminished markedly and the policy on distribution was also relaxed. Many of these STEs have since been privatized, while others have been reformed to compete in the market with other privately owned enterprises. Today, manufacturers are engaging in the distribution of their own manufactured products, as importers of bulky common user goods are engaging in wholesale and retail trade (KIPPRA, 2011).

The Constitution of Kenya recognizes international trade as a function of National government, and domestic trade is under the county governments. The

4<sup>th</sup> schedule, part 2 of the Constitution points out that the county government will be in charge of trade development and regulation, including markets, trade licenses, fair trading practices, local tourism and cooperative societies. This means the current institutions and regulatory framework for wholesale and retail trade is likely to change once county governments are fully operational.

In general, the institutions relevant to the wholesale and retail trade in Kenya include:

1. Those that register and license businesses; Kenya Revenue Authority (KRA), Registrar of Companies, National Environment Management Authority (NEMA), National Social Security Fund (NSSF) and National Hospital Insurance Fund (NHIF).
2. Those that guarantee product standards and consumer protection; Kenya National Bureau of Standards (KEBS), Kenya Plant Health Inspectorate Services (KEPHIS), Kenya Industrial Property Institute (KIPI), consumer information network, and department of Weights and Measures etc.
3. Business promotion institutions; Kenya National Trading Corporation Limited (KNTC), Micro and Small Enterprise Authority (MSEA), Kenya National Chambers of Commerce and Industry (KNCCI), Kenya Investment Authority (KenInvest), and Export Promotion Council (EPC).
4. Competition-Competition Authority.
5. Counterfeits and fair trade; Anti-counterfeit Agency (ACA) and Kenya Association of Manufacturers (KAM).
6. Workers protection and training; that is National Industrial Training Authority (NITA).

The above institutions fall under various ministries including The National Treasury; Ministry of East Africa, Commerce and Tourism; Ministry Industrialization and Enterprise Development; Ministry of Health; Ministry of Interior and Coordination of National Government; Ministry of Environment, Water and Natural Resource; and Ministry of Labour, Social Security and Services among others. On the other hand, the regulatory framework includes laws and regulations passed overtime to enhance and control trade in the wholesale and retail trade.

#### **4.2.1 Business licensing and permit**

Formal business registration in Kenya is undertaken by the Registrar of Companies, whose department falls under the Attorney General. For business registration, one must obtain a company's Personal Identification Number (PIN) for taxation



and which is issued free by the KRA. Other requirements include approval from the NEMA, registration of workers with the NSSF and the NHIF. In addition, all businesses in Kenya must obtain a Single Business Permit (SBP) introduced in 2000 under the Ministry of Local Government.

In the former government set-up (before implementation of Kenya Constitution 2010), licensing of wholesale and retail business was done by the local authorities under the Ministry of Local Governments through issuance of a SBP under section 163 of Cap 265 of the Local Government Act. With the new devolved system of governance, the business licensing is now under the county government and the Act will continue to be in operation until it is repealed. Businesses are only required to have one business permit per premise regardless of the range of activities carried out, hence the name single business permit. The SBP allows for the distribution of goods and services in another local authority (now counties) without having to obtain another permit. In addition, businesses are allowed to apply for a 1- or 2-year permit (World Bank, 2012). Across Kenya, it takes between 2 and 8 days to get the single business permit. The business permit fee varies among cities and it ranges between Ksh 1,000 and Ksh 80,000. The fee depends on the type of local authority (county) and type of business, size, number of employees and location. For example, megastores and hypermarkets with more than 100 employees and located in prime areas are charged between Ksh 15,000 to Ksh 72,000. Small traders with less than 10 employees are charged between Ksh 1,250 and Ksh 6,000 while kiosks are charged between Ksh 1,000 and Ksh 4,800.

In order to rationalize the license regime and to transform Kenya into a competitive investment destination, the government launched a review and reform of business licenses and permits starting from 2005 through the establishment of the Working Committee on Business Licenses in Kenya. The committee identified 1,325 business licenses, fees and user licenses in Kenya. As a result, the BRRU was formed in 2006 under the Ministry of Finance to keep track of all regulatory regimes and licenses in Kenya and ensure that new regulations, licenses, fees and charges do not create unnecessary burdens on business and meet international best practices (OECD and WTO, 2010).

Following the Committees recommendations, the government took a drastic measure to simplify or eliminate most of these licenses. The government eliminated 110 business licenses and simplified 8 in 2006/2007. In 2007 through the License Law Bill, the government eliminated an additional 205 licenses and simplified another 371 licenses. In total, 379 licenses were simplified, 294 retained, while 315 licenses were eliminated.

The success of the SBP has been limited because many local authorities used it as a source of revenue rather than a regulation tool. Indeed, the SBP accounts for

at least 15 per cent of local authorities revenues. In spite of having the SBP, many local authorities have continued to charge additional fees, hence defeating the original objective of SBP. The administration of the SBP is, however, considered a significant constraint on business particularly new enterprises and MSMEs. Local authorities often treat representatives of registering businesses very poorly, tagging on “informal fees” to the SBP process, failing to issue the actual SBP until after expiry; and in general, diverting people from time that could have been spent building their businesses (United States Agency for International Development-USAID, 2009).

The BRRU has registered mixed results since its establishment. It took a leading role in identifying short term measures aimed at improving the regulatory environment to improve on business environment with much success. It is because of BRRU effort that Kenya was recognized as one of top ten reformers in the World Bank's ‘Doing Business Report 2008’. The e-registry operated by BRRU has been successful in providing details on relevant business licenses and permits, including requirements, costs, application forms and contact details for the relevant regulatory agency. By 2012, BRRU had processed 441 licenses. The process is, however, not fully automated and one cannot complete a license form electronically and/or make payments remotely. The BRRU initiatives seem to have lost steam lately. In addition, the BRRU faces challenges relating to conflicting interests of government departments and other regulators incharge of various critical aspects of licensing businesses and investments.

The issuance of the SBP will be reviewed with coming into force of the two bills; the County Government Bill 2012 and National Trade Development Bill 2012. The County Government Bill 2012 gives powers to the county governments to make laws and regulations to effect tariff and pricing policies. The National Trade Development Bill 2012; on the other hand, proposes the establishment of the Domestic Trade Directorate which will be responsible for the formulation and implementation of policies and measures aimed at improving the business environment for the development of domestic trade. The Directorate will be responsible for the promotion and harmonization of all laws and regulations governing trade licensing and regulation, and co-ordination of all institutions and agencies responsible for trade licensing and regulation. The Directorate will also be responsible for the restructuring and strengthening of the BRRU to enable it undertake the simplification and rationalization of the distribution and wholesale licensing and establishment of e-commerce in the wholesale and distribution sub-sector. In addition, there is the proposed Business Regulation Bill which seeks to regulate the manner in which the regulatory agencies impose licensing and other regulatory requirement on business activities. It provides for the establishment of a Business Regulatory Committee and the Business Regulatory Unit, which

shall be responsible for its implementation. The bill also seeks to establish a Department of the Registrar General as a semi-autonomous statutory body for the efficient administration of laws relating to incorporation, registration, operation and management of companies.

#### **4.2.2 Standards and consumer protection**

The Constitution of Kenya recognizes the right of consumers in Article 46. Firms operating in the country adhere to some procedures in order to protect consumers from substandard goods and counterfeits. Several institutions exist in the country to check this including Weights and Measures Department, KEBS, KEPHIS, KIPi, and Ministry of Health among others.

Weights and Measures Department enforces two Acts of parliament, namely the Weights and Measures Act, Cap 513 Laws of Kenya; and the Trade Descriptions Act, Cap 503. The main purpose of Weights and Measures laws is to establish a uniform system of units of measurement, control weighing and measuring equipment in use for trade, control transactions in some goods, and to protect the public against false trade descriptions.

KEBS was established in 1974 under the Standard Act, Cap 496 of the Laws of Kenya. The aims and objectives of KEBS include preparation of standards relating to products, measurements, materials and processes and their promotion at national, regional and international levels; certification of industrial products; assistance in the production of quality goods; quality inspection of imports at ports of entry; improvement of measurement accuracies and dissemination of information relating to standards. During the roundtable, participants argued that traders require education concerning standardization and conformity. There should also be certification accorded to small scale operators to enable them gain access to the market.

KEPHIS is mandated to regulate procedures for importation and exportation of any form of plant material such as seeds, cuttings, bud wood, fresh fruits, flowers, plantlets, timber, and agricultural produce. These regulations are enforced through the Plant Protection Act, Cap 324; The Suppression of Noxious Weeds Act, Cap 325 and The Agricultural Produce (Export) Act, Cap 319. These regulations are aimed at protecting Kenya's agriculture from foreign pests (insects and pathogens) as agriculture is the mainstay of the economy.

KIPi was established in 2002 and is responsible for the implementation of two Acts of Parliament that provide for the protection of industrial property rights, that is, the Industrial Property Act, 2001 and the Trade Marks Act, Cap 506 of the Laws of Kenya. The industrial property includes inventions (patents), trademarks, industrial designs, and geographic indications of source. The protection of such

distinctive signs aims to stimulate and ensure fair competition and to protect consumers, by enabling them to make informed choices between various goods and services. KIPi is responsible for administering industrial property rights through protection, provision of information and training, and promotion of inventive and innovative activities for social economic development.

The Consumer Information Network (CIN) is a leading consumer organization in Africa founded in Nairobi in 1994. The CIN is a non-governmental and non-profit making organization which has developed a sound expertise in the areas of the environment, food safety, health and trade for the benefit of the consumer. Today, CIN represents consumers in a number of decision and policy making boards including product standards specification technical committees at KEBS, trade policy review with the National Committee on World Trade Organization (NCWTO), and health and environment committees/boards.

Weights and Measures ensures fair trade practices and consumer protection by shielding consumers' health, safety and economic interests and deals with compensation for loss or injury arising from defects in goods or services provided or sold by traders. However, the department currently does not have enough personnel in all counties which limit its operations. The Act establishing weights and measures needs to be reviewed to take into account the current environment.

#### **4.2.3 Promotion and business development**

The Department of Internal Trade in the Ministry of East Africa, Commerce and Tourism is responsible for the promotion of retail and wholesale trade according to the Presidential Circular No. 1 of 2008. The Ministry is responsible for promotion of business through a number of institutions and programmes. Key among them includes KNTC, and Joint Loans Board (JLB), Kenya Institute of Business Training (KIBT) and MSEA. KenInvest under the National Treasury promotes investment in the country. The KNCCI also exists as a non-governmental institution promoting trade in the country.

The KNTC is wholly owned by the Government through the Ministry of Industrialization and Enterprise Development and Industrial Commercial Development Corporation (ICDC). KNTC's main objective is to promote wholesale, retail business and electronic (e)-trade. In addition, the corporation seeks to develop SMEs markets, expansion and diversification of trade, improve and strengthen the supply chain and distribution systems, ensure availability of stocks and act as a procurement agent for the government and general public at a minimum fee.

The JLB was established under the provisions of the Local Government Act, Cap 265, section 104 in 1954. The loans under this scheme are administered

and advanced by the Ministry of Trade through the department of trade field's offices. In the district level, the running of the loan board's activities is vested on the District Trade Development Officers. The scheme seeks to promote small scale enterprises through provision of affordable credit. Among the businesses that benefit from this loan are light industries, services industries, wholesale and retail establishments. The funding is between Ksh 20,000 and Ksh 100,000 and attracts a 12 per cent interest payable in 1-2 years with a grace period of one month. The Board continues to perform well in terms of disbursement of loans to traders despite some challenges. Between 2007 and 2010, the loans disbursed by the board increased from Ksh 45.6 million to Ksh 205.7 million (MTEF 2011/12-2013/14).

Since inception in 1954, the JLB has succeeded to advance over Ksh 600 million to over 40,000 enterprise owners in most districts of Kenya. The scheme, however, faces some challenges including poor repayment and non-payment of loans. In addition, the scheme lacks the capacity to handle its functions and, as a result, it takes long to process the loans and disbursement (six months). Monitoring of the loan usage is also not possible with lean staff. With the counties in place, the JLO functions will now be transferred to county governments.

MSEA is established under the Micro and Small Enterprise Act (2012). In addition to MSEA, the Act sets up rules and other institutions to support micro (one to nine employees) and small (10-50 employees) businesses in the country to succeed. The key function of MSEA include review of policies and programmes, raise revenue resources, zone and manage land and develop credit access and other financial services for MSE among others. In spite of having the highest percentage of businesses in Kenya, the MSE has been largely unregulated despite the many challenges it faces. It is now expected that the establishment of MSEA will address some of these challenges including financial hurdles, lack of proper business management skills such as accounting, book keeping and marketing.

The KenInvest established in 2004 under the Investment Promotion Act 2004, No. 6 of 2004 (revised in 2009) seeks to promote and facilitate investment in the country. KenInvest issues investment certificate to both local and foreign investors and assists in obtaining necessary licenses and permits. The investment certificate issued by the authority covers 70 various trading and business laws inclusive of all the by-laws made under the Local Authorities Act. The authority acts as a one stop shop for investors, especially foreign investors. KenInvest gives a temporarily operating license as an investor seeks for formal registration.

The KNCCI is a non-profit, membership-based private sector lobby institution established in 1965. KNCCI has a countrywide outreach of over 100 branches and more than 10,000 members. The organization seeks to promote, protect and

develop commercial, industrial and investment interests of members. In addition, it seeks to promote trade within and outside Kenya and organize participation in trade activities. The organization provides information on a wide range of business matters including registration, licenses, security, taxes, pricing, investment opportunities, market research and many others.

#### **4.2.4 Competition and consumer welfare**

Fair competition enhances consumer welfare. Prior to 2010, the competition in Kenya was guided by the Restrictive Trade Practices, and Monopolies Price Control Act, Cap 504. The Act was repealed in 2009 under the Competition Act 2009, and operationalized in August 2011 by the Minister of Finance. The Competition Act 2009 seeks to promote and safeguard competition in the national economy and to protect consumers from unfair and misleading market conduct. The Act provides for the establishment of Competition Authority. An appellant body, the Competition Tribunal, is also established with the mandate of adjudicating appeals resulting from determination of the Authority.

The Competition Authority has the primary jurisdiction in regard to competition and consumer welfare matters in the economy and is the government's advisor on competition matters. All mergers/acquisitions in the country require the Authority's authorization to take effect. In addition, the authority prohibits misleading/deceptive advertising, regulates market conduct so as to ensure the dominant firms do not abuse their position, and provides for the establishment of modern enforcement institutions.

The Competition Authority being an independent and autonomous entity is expected to be more efficient in carrying out its mandate. This is opposed to the previous authority under the Trade Practices, Monopolies and Price Control Act, Cap 504 which was merely a division within a department. With stiffer penalties and fine of Ksh 10 million and/or imprisonment of up to five years, the Authority is expected to ensure better competition and consumer welfare. The authority, however, is still very young and so it may be early to assess both the capacity and resources to carry out its wider mandate effectively.

Owing to rapidly rising food and fuel prices in 2011, the government signed into law a new Price Control (Essential Goods) Act 2011. The Act grants the National Treasury Minister powers to set maximum prices for any goods designated as essential upon consultation with the relevant stake industry. Essential goods in this case include maize, maize flour, cooking oil, sugar, paraffin, diesel and petrol. Although the industry players have criticized the passage of this bill as a drawback from the free market ideals, its proponents, however, see it as the best way to protect consumers from the monopolistic tendencies of the market structure. So

far the Cabinet Secretary in charge of National Treasury has not used the Act to control prices of any of the designated goods.

Competition in the wholesale and retail sectors are bipolar with highly competitive markets in urban areas and minimal competition in rural areas (KIPPRRA, 2011). The competition in the urban areas seems to be driven by the number of competing wholesalers and retailers, carrying similar product lines. Wholesale businesses compete on terms of trade offered to customers, prices and services. The dominant role in domestic trade is acquired by large monopolies, which appear in specific organizational forms such as chain and branch systems and multi-unit systems and large department stores. Monopolistic tendencies in wholesale and retail trade in Kenya are not prominent, although it is slowly developing as the five main supermarkets spread to the country side.

#### **4.2.4 Counterfeiting**

Counterfeiting and product piracy constitutes a serious problem against legally run businesses and owners of intellectual property right. Counterfeit trade is costing the business community and government billions of shillings annually in profits and revenue, respectively. In addition, counterfeits continue to pose health and safety risks to the consumers (Kenya Association of Manufacturers-KAM, 2009). Counterfeiters target fast moving consumer goods such as soaps and detergents, food products, alcoholic beverages, and dry cell batteries. Others include cosmetics, electrical and electronic equipment, medicines, shoe polish and apparels.

Considering Kenya's strategic location as a gateway to East and Central Africa, it is a challenge in dealing with counterfeits. As a result, counterfeits have affected all sectors of the economy including retail and wholesale trade, foreign direct investment, innovation and growth, and employment. In considering this problem, the government passed the Anti-counterfeit Act in 2008 which came into effect in 2009. The principal aim of the Act is to prohibit trade in counterfeits. Through the Act, the Anti-Counterfeit Agency (ACA) was established and became operational in 2010. The ACA is a state corporation under the Ministry of Industrialization and Enterprise Development and is mandated to enlighten and inform the public on matters relating to counterfeiting, trade and other dealings in Kenya, and co-ordinate with national, regional or international organization involved in combating counterfeit

The ACA has powers to destroy fake goods imported into the country as well as investigate and arrest people who trade in them. The ACA is responsible for coordinating the efforts of Kenya's intellectual property rights enforcement bodies including Kenya Bureau of Standards, Kenya Copyright Board, Kenya Industrial Property Institute and Pharmacy and Poisons Board.

Following the integration of the regional market under the EAC and the Common Market for East and Southern Africa (COMESA) trade regimes, there has been increased cases of illegal replication of known brand names and designs on their packages and labels, flooding the domestic market with cheaper and sub-standard version of locally available products.

Since the establishment of ACA in 2010, the agency has been able to seize a number of counterfeit good in the country. However, the agency faces a number of challenges in discharging its mandate, key among them insufficient funding and the conspicuous absence of implementing regulations to accompany the Act. Independent investigations have proven nearly impossible for the ACA, given its current budget and the prohibitively high cost of environmentally sound destruction of seized products, meaning counterfeits remain in warehouses where they can be stolen and returned to the market. Although the penalties under the Act are much more punitive than under the previous intellectual property laws, the law enforcement agencies have failed to implement the improved laws and regulations, and convictions are virtually non-existent (Investment Climate, 2012).

#### **4.2.5 Trade remedy in Kenya**

Fair trade is based on dialogue, transparency, and respect, and it seeks greater equity among trading partners. Fair trade contributes to sustainable development by offering better trading conditions to and securing the rights of marginalized producers and workers (Mare, 2008). Dumping and subsidization are common unfair trade practices, which can hurt domestic industries.

The fair trade in Kenya is currently guided by the Trade Remedy Law under the Customs and Excise Act, 2001. The Act provides for the constitution of an Advisory Committee on Anti-dumping and imposition of dumping and countervailing duties as measures to counter adverse trade effects arising from dumping and subsidization. The trade remedy regulations are to be applied in conformity with the obligations of Kenya under the international agreements to which it is party. However, it is important to note that, to date, Kenya has not taken any trade remedy measures and, accordingly, these laws and procedures remain untested. Likewise, the Advisory Committee on Dumping and Subsidization of Goods has never been constituted or convened. Likewise, the Act lacks strict enforcement of the relevant laws leading to unfair trade practices such as display of cheap imported merchandize by hawkers at the doorsteps of licensed permanent business premises, thus blocking potential customers from accessing these premises.

To address the above and advance on the work on trade remedy laws, the Ministry of Trade with the assistance of WTO Secretariat and other stakeholders



organized a national workshop on trade remedy laws in 2011. The participants deliberated extensively on the provisions of the WTO Agreements on anti-dumping, subsidies and countervailing measures, and safeguard measures. The workshop further established a National Task Force to spearhead the preparation and implementation of the trade remedy laws for Kenya. The task force has since completed the drafting of the Kenya Trade Remedies Bill, 2012 which proposes the establishment of the trade remedy agency.

#### **4.2.6 Labour standards**

The wholesale and retail trade sector constitutes one of the single biggest employment creators in the country. It is, therefore, guided by labour laws consisting of five pieces of statutes enacted by parliament in 2007. These include Labour Relations Act (2007), the Employment Act (2007), the Work Injury Benefits Act (2007), the Labour Institutions Act (2007) and Occupational Safety and Health Act (2007). The labour laws provide the basic terms applicable to all employment contracts including prohibition against forced labour, discrimination in employment, sexual harassment, employment relationship and rights of employees and obligations of employers. The laws also provide for the registration, regulation, management and democratization of trade unions and employers organizations or federations to promote sound labour relations through the protection of freedom of association, the encouragement of effective collective bargaining and promotion of orderly and expeditious' dispute settlement conducive to social justice and economic development. Minimum staff welfare requirements such as minimum wage levels, compensation of employees and workplace conditions, exist to protect employees who individually have limited bargaining powers with employers. These minimum standards help prevent exploitation and encourage citizens to find employment in the formal sector.

National Industrial Training Authority (NITA) in the Ministry of Labour recently transformed from the Directorate of Industrial Training (DIT) operates under the Industrial Training Act, Cap 237 (Amendment), Laws of Kenya of November 2011. The NITA is supposed to spearhead training in industry and trade, thus encourage industrial and skills management. The Ministry of Labour, however, lacks the resources and the capacity to enforce the laws effectively.

#### **4.2.7 E-commerce**

E-commerce is the use of electronic communications in business transactions. The growth of e-commerce is highly related to the growth of internet usage. The internet penetration in Kenya has been increasing tremendously so that by the end of 2012, Kenya had 14.03 million internet subscribers and 29.4 million mobile subscribers (Communications Commission of Kenya-CCK, 2013). One of the

major achievements in Kenya is the connection of e-commerce to mobile payment systems such as Mpesa, Zap, Orange Money and Yu Cash. It is however important to note that Kenya, as an emerging economy and regional leader, lags behind in having a legal framework for e-commerce. Kenya Communications (Amendment) Act 2008 provides an avenue for the promotion of electronic trade within Kenya and between Kenya and other trading partners. The Act also provides a conducive legal environment for all players to do business and transact and protect the privacy of the public, interests of consumers, and clients from potential misuse.

The challenges facing the development of the e-commerce in Kenya is lack of credit card among majority of Kenyans, in addition to the slow internet connection. However, things have changed as we now have local payment platforms like *mpesa* that have integrated payment methods that work for and in Kenya. Without a proper regulatory framework, the KRA will lose a lot of tax as it is not easy to monitor digital traders.

### **4.3 Comparative Analysis of Regulatory Business Environment**

This section compares Kenya's RBE with that of Mauritius, South Africa, Rwanda and Botswana based on 'Doing Business Report 2013' data. Given that the variables are measured the same way, this allows for comparability.

**Table 4.1: Starting a Business**

	<b>Indicator Measure</b>	<b>Mauritius</b>	<b>Rwanda</b>	<b>South Africa</b>	<b>Kenya</b>	<b>South Korea</b>
1.	Procedure to legally start and operate company (number)	5	2	5	10	5
2.	Time required to complete each procedure (calendar days)	6	3	19	32	7
3.	Cost required to complete each procedure (% of income per capita)	3.3	4.3	0.3	40.4	14.5
4.	Paid-in minimum capital (% of income per capita)	0.0	0.0	0.0	0.0	0.0

*Source: World Bank and International Finance Corporation, 2013*

**Table 4.2: Getting electricity**

	<b>Indicator measure</b>	<b>Mauritius</b>	<b>Rwanda</b>	<b>South Africa</b>	<b>Kenya</b>	<b>South Korea</b>
1.	Procedure to obtain an electricity connection (number)	4	4	5	6	4
2.	Time required to complete each procedure (calendar days)	84	30	226	146	28
3.	Cost required to complete each procedure (% of income per capita)	295.1	3,948.1	1,505.8	1,208.2	33.3

*Source: World Bank and International Finance Corporation, 2013*

Table 4.1 shows that Kenya is an expensive country to start a business. It takes five times more procedures to start and operate a business in Kenya than in Rwanda, and twice the number compared to Mauritius and South Africa. In

Kenya, each procedure of registering a business takes 10.7 times the amount required in Rwanda. The cost of completing each procedure is also very high in Kenya compared to comparator countries; for instance, it is 134.7 more expensive in Kenya relative to South Africa. Kenya also fairs poorly on all accounts compared to South Korea.

From Table 4.2, Kenya has slightly more procedures of obtaining electricity connection than comparator countries. The time required to complete each procedure is 146 days in Kenya compared to 30 days in Rwanda and 84 days in Mauritius. South Africa has a slightly higher number of days at 226. The cost of electricity has often been cited as a major constraint to doing business in Kenya and, therefore, a constraint to private sector development. Cost required to complete each procedure for electricity connection in Kenya is four times higher than that of Mauritius, but cheaper compared to Rwanda and South Africa. South Korea fairs better than all countries in terms of the cost required to complete each procedure.

Access to credit is a key factor for development of wholesale and retail sector and, on average, the strength of legal rights is weakest in Kenya (10) and highest in South Africa (10) with Mauritius and Rwanda having an index of 6 and 7, respectively. Kenya still has the weakest in terms of depth of credit information as compared to the other countries (Table 4.3). Depth of credit information and

**Table 4.3: Getting credit**

	<b>Indicator Measure</b>	<b>Mauritius</b>	<b>Rwanda</b>	<b>South Africa</b>	<b>Kenya</b>	<b>South Korea</b>
1.	Strength of legal rights index (0-10)	6	7	10	1	8
2.	Depth of credit information index (0-6)	5	6	6	4	6
3.	Public credit registry coverage (% of adults)	56.3	0.0	0.0	0.0	0.0
4.	Private bureau coverage (% adults)	0.0	7.1	54.0	4.9	100.0

Source: World Bank and International Finance Corporation, 2013

private bureau coverage is maximum in South Korea, while in Kenya, it is 4 and 4.9, respectively.

Table 4.4 indicates Kenya has the lowest extent of disclosure index relative to the comparator countries in SSA in terms of protecting investors. The ability of shareholders to hold interested parties and members of the approving body liable

in case of related party transactions (extent of director liability index) is lowest in Kenya (2) and highest in Rwanda (9). The ease of shareholder suits index, that is the ability to access documents and information during trial is highest in Kenya (10). Overall, the strength of investor protection index is lowest in Kenya (5) and highest in South Africa (8.0). South Korea has not fared well in protecting investors.

**Table 4.4: Protecting investors**

	<b>Indicator Measure</b>	<b>Mauritius</b>	<b>Rwanda</b>	<b>South Africa</b>	<b>Kenya</b>	<b>South Korea</b>
1.	Extent of disclosure index (0-10)	6	7	8	3	7
2.	Extent of director liability index (0-10)	8	9	8	2	4
3.	Ease of shareholder suits index (0-10)	9	3	8	10	7
4.	Strength of investor protection index (0-10)	7.7	6.3	8.0	5.0	6.0

Source: World Bank and International Finance Corporation, 2013

**Table 4.5: Paying taxes**

	<b>Indicator Measure</b>	<b>Mauritius</b>	<b>Rwanda</b>	<b>South Africa</b>	<b>Kenya</b>	<b>South Korea</b>
1.	Tax payments for a manufacturing company in 2011 (number per year adjusted for electronic or joint filing and payment)	7	17	9	41	10
2.	Time required to comply with 3 major taxes (hours per year)	161	134	200	340	207
3.	Total tax (% of profit before all taxes)	28.5	31.3	33.3	44.4	29.8

*Source: World Bank and International Finance Corporation, 2013*

The total number of taxes and contributions paid including consumption taxes (VAT, sales tax or good or service tax) in Kenya by a manufacturing company in Kenya is 41 compared to 7, 17, and 9 for Mauritius, Rwanda and South Africa (Table 4.5). Likewise, time taken to collect information and compute the tax payable, complete tax return forms, and arrange for payments or withholding tax is highest in Kenya compared to the other countries. The total tax (% of profit before all taxes) is also higher in Kenya than in the four comparator countries.

## **5. Conclusions and Policy Recommendations**

### **5.1 Introduction**

This section concludes the study and provides policy recommendations.

### **5.2 Conclusions**

This study sought to analyze institutional and regulatory environment in the wholesale and retail trade in Kenya. This is based on the recognition that the business environment is dynamic and not static, implying that constant review is essential to identify areas that require further reforms. The study relied on expert opinion discussions and comparative analysis to realize its objectives and the following conclusions can be drawn.

- There is no specific institution in Kenya which deals specifically with the wholesale and retail trade. Instead, there are Ministries and quasi-government organizations offering legislation and policy direction.
- The institutions relevant to the wholesale and retail trade include KEBS, KEPHIS, KNTC, ACA, Competition Authority, JLB, and BRRU among others. These institutions have achieved limited success in promoting and regulating wholesale and retail trade because of various constraints ranging from lack of personnel to limited funding.
- There exists multiple licenses and fees which reduce the investment in this sector. These include the registration of the company, registration for PIN and VAT with KRA, single business license, NHIF and NSSF contribution among others.
- The study results have demonstrated that despite the reforms so far undertaken by the government to make the business environment friendlier, starting a business remains problematic to most business operators. There are many time consuming procedures of business registration. This serves to increase the cost of doing business for traders.
- From the comparative analysis using the doing business reports, tax related measures are a major bottleneck for businesses and add into the cost of doing business in Kenya. This is as a result of the numerous tax payments to be made per year, which consume substantial amount of time.

### **5.3 Policy Recommendations**

Based on the results, the study proposes the following:

- There is need to establish a single institution to give direction and regulation to the wholesale and retail trade in Kenya. Given that most businesses face credit constraint, the JLB scheme should be strengthened by increasing the amount disbursed, reducing the time taken before loans are disbursed, and increasing the number of staff managing the loan facility.
- A balance between the use of business licensing as a tool to regulate business activity or a tool to generate revenue is required. If the aim is to regulate businesses, then the fees levied should be limited to the costs of administering and enforcing licensing system. Even where fees are low and meant for regulation, the tax administrations system need to be efficient to avoid rent-seeking. The SBP charges should be harmonized across counties.
- The Constitution of Kenya separates the functions of national and county governments without providing a clear mandate of who takes care of inter-county trade. Although the National Trade Development Bill 2012 proposes the establishment of the Domestic Trade Directorate to formulate and implement policies for domestic trade, it is not clear who shall coordinate inter-county trade. This study proposes that the national government coordinates inter-county trade.
- Improve on the infrastructure and distribution channels in the country should be prioritized in order to promote the inter-county trade. In particular, fast-tracking the construction of retail and wholesale hubs as proposed in Vision 2030 by allocating more funding.
- More reforms will be required to reduce the number of procedures, time and cost related to business registration. In addition, tax payments and related procedures by KRA will require simplification.

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