

Informal Sector's Response to Shocks: Lessons from Kenya

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The informal sector enterprises are affected by diverse shocks that substantially affect their operations. Most of these shocks tend to have drastic negative impact on the affected enterprises, leading to business closure, losses, sluggish recovery and low returns on investment.

Some of the shocks that affect enterprises include: crime-related shocks, abrupt government policy changes (allocation of new work spaces), harassment by government officials and power outages.



Hawkers Running (Source: Standard newspaper)

To survive through the effects of shocks or reduce the effect of such shocks, enterprises design or take up different shock coping mechanisms. Coping mechanisms for informal enterprises can be self-initiated or initiated by external actors such as the government and development partners.

Why address shocks in the informal sector?

The informal sector contributes immensely to Kenya's economy. The Kenya National Bureau of Statistics 2019 Economic Survey indicated that the 14.9 million persons employed in the sector in 2018 accounted for 83.6 per cent of the total employment, which was a rise of 5.4 per cent compared to 2017. In addition, out of 840,600 new jobs created, 90.7 per cent were in the informal sector (762,100 new jobs). This is attributable to a growing population in need of jobs that do not match the jobs created in the formal sector.

Return on investments during periods of shocks

Returns on investment are relatively lower in the informal sector enterprises compared to formal businesses due to differences in obtaining inputs, shocks and diversity in the scale of production. During unanticipated negative eventualities, business operations are either halted or minimized. Shocks such as crime, demolitions of worksites and harassment by government officials sometimes lead to loss of stocks and revenue. In Kenya, crimes related shocks annually account for losses of almost 50 per cent of sales in the informal enterprises. In such events, return on investments of the informal sector enterprises is affected substantially. These eventualities are aggravated by lack of proper spatial plans and unresponsive policies.

Key Findings

The study found that enterprise characteristics, business owner characteristics, sector and location of the business influenced the shocks and shock coping strategies adopted by informal enterprises.

This study identified three major shocks; losses due to crime, harassment by government officials or police and power outages.

Losses due to crime

About 7 per cent of informal enterprises experienced losses due to crime. Out of the affected enterprises, 39 per cent adopted paying for security as a coping

The analysis

The researchers used the World Bank's Informal Enterprise 2013 survey data. The survey covered urban-based enterprises in Nairobi, Mombasa, Central, Nyanza, and Nakuru towns. There were 533 interviewed enterprises. The total sample had 522 (98%) businesses which had not registered their activities with the Kenya Revenue Authority (KRA) hence considered informal. Using an econometric approach, the researchers investigated the response of informal enterprises to shocks affecting their businesses.

mechanism. Half of the firms that experienced this shock were in the manufacturing sector. The region within which an enterprise was located influenced the likelihood of facing crime. For example, enterprises in Nairobi faced more crime incidences than those located in Central Kenya. Contrary to expectation, an informal enterprise that had a business location or workspace had a higher probability of incurring losses due to crime. This indicates that the enterprises could have been operating in generally insecure areas that were prone to crime.

The probability of an informal enterprise that owned a location or a workspace paying for security was higher relative to those that did not own a workspace. Similarly, male-owned enterprises had a higher probability of paying for security than female-owned enterprises.

Harassment

About 20 per cent of informal enterprises were harassed by government officials. This includes physical harassment and coercion to pay bribes. Enterprises located in Central, Nyanza and Nakuru were less likely to be harassed compared to those in Nairobi. Additionally, informal enterprises that owned a workspace were more likely to be harassed than those that did not have workspaces. This could be an indication of unfair harassment by government officials who tried to extort money in form of bribes from informal enterprises who own workspaces, given they were less likely to re-locate.

Results show that most of the harassed enterprises (68%) considered formalizing their business as a coping strategy to avoid being harassed by government officials. Despite enterprises in the service sector being the least harassed, they indicated greater intentions to formalize, probably because of other factors such as the nature of their industry that requires more trust from customers for good business. Harassed enterprises substantially recorded lower returns per unit of capital invested. This is a clear indicator that harassment reduced the returns of informal enterprises.

Power outages

Most of the informal enterprises (83%) faced power outages. However, only 3 per cent of the affected enterprises used generators as a coping strategy. This could be an indication that using generators was an expensive venture for informal enterprises. To some extent, level of education of the business owner influenced the use of generators. The study noted that all enterprises affected by power outages and were owned

by people with university training used generators. Enterprises that had a physical location were more likely to use generators compared to those that did not have a physical location. Similarly, enterprises located in Nairobi, relative to other regions, and those in the service sector relative to other sectors were more likely to use generators.

Policy Recommendations:

Mitigating losses due to crime

- The Government could consider beefing up security around business sites to ensure that enterprises run their businesses smoothly.
- To complement the Government security provision efforts, owners of informal enterprises in a given locality could consider having pooled private security at a lower cost.
- To further complement hiring private security, informal enterprises could consider using technology such as Closed Circuit TV (CCTV) cameras in their working premises to record incidences of crime.

Mitigating harassment by government officials

- To minimize cases of harassment by Government officials, informal enterprises could consider formalization and complying with requirements that make them vulnerable to harassment.
- There is need for an elaborate and reliable framework for reporting and dealing with genuine cases of harassment at both National and County Government levels.

Mitigating power outages shock

- The Government could work closely with developing partners to encourage informal enterprises to take up cheaper renewable sources of energy such as solar panels for lighting. A case example is partnering with Safaricom which is already offering solar powered equipment in rural areas (*M-kopa solar*).
- Overall, informal businesses should be sensitized on risk and risk mitigating measures to enhance their ability to cope with shocks. This can be done by both private and public sector actors seeking to enhance the quality of jobs and returns for people employed in the informal sector, such as Micro and Small Enterprise Authority (MSEA) and Kenya National Alliance of Street Vendors and Informal Traders (KENASVIT).

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KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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