Viffa Consult
Unlocking Africa's Entrepreneurship Spirit

REVIVING **COTTAGE INDUSTRIES**

Navigating the Challenges of a Developing Economy:

What the local Fundi needs to thrive

Kenya is on a path to transform into an industrializing middle-income economy by 2030, as per the aims of the Kenya Vision 2030. As a lower-middle-income economy with a GNI per capita of USD 2,080, the country is striving to emulate the likes of Brazil and Türkiye, which are classified as upper-middle-income economies. However, this goal cannot be achieved without the growth and development of Micro, Small, and Medium Enterprises (MSMEs).

The creation of Kariobangi Light Industries in the late 1980s, the enactment of the Micro and Small Enterprises Act in 2012, and the establishment of the Micro and Small Enterprises Authority a year later are clear indicators of the country's commitment to promoting entrepreneurship. The Kenya Kwanza government's Bottom-up Economic Transformation Agenda (BETA) framework emphasizes programs, policies, and reforms that enable MSMEs to play a more significant role in domestic and cross-border value chains. However, for MSMEs to thrive, they need a favourable business environment.

There has been progress

Previous administrations focused on trade infrastructure development to support entrepreneurship. The modernization of transport infrastructure, including the construction of a new railway line, expansion of existing roads, creation of expressways, and expansion of air and sea ports, eased the movement of people, goods, and services across the country and the East African Community (EAC) region.

Additionally, previous reforms aimed at reducing the time and cost of starting and running a business in the country. The process of registering a business was simplified, and it became possible to complete the process online within 24 hours. These efforts made it easier for entrepreneurs to start and operate businesses in the country.

Growth Opportunities for MSME

The Kenya Kwanza government has identified the growth of MSME industries as a key factor in boosting the country's manufacturing sector, and a key path to industrialization competitiveness. The production of leather, garments, and textiles has the potential to supply unformed services and schools with local products, while construction projects like the affordable housing scheme could be a source of exponential growth for the building products industry. However, the growth of these industries may be stifled by emerging regulations and fees.

Areas where interventions are needed

1. Business formalization

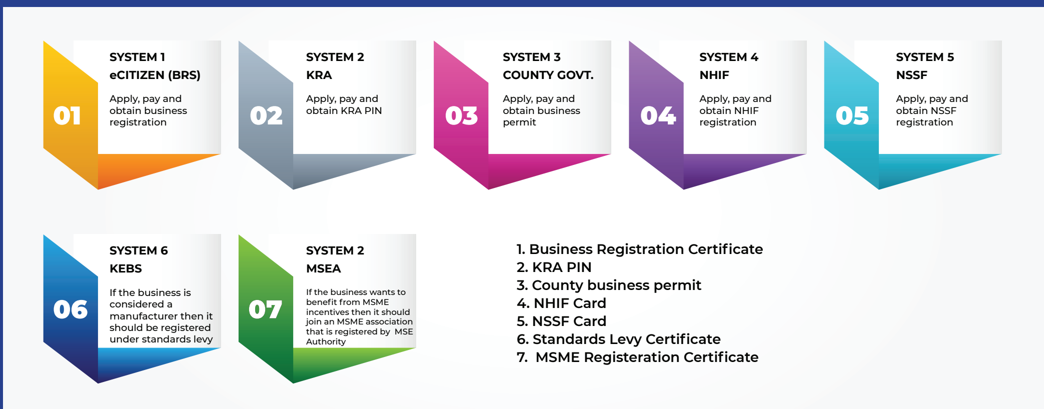
The KNBS MSE survey that was conducted in 2016 revealed that 79% of small businesses are informal. Many reports and our previous surveys agree that it is much easier to support formal businesses and which explains the government's drive to register businesses. The registration is happening through various fronts:

a) MSE Authority is actively registering MSMEs through MSE Associations with the promise of flowing MSME incentives through the formed engagement structures. The key for cottage industries is the promise of the formation of incubation centres at every TVET institution.

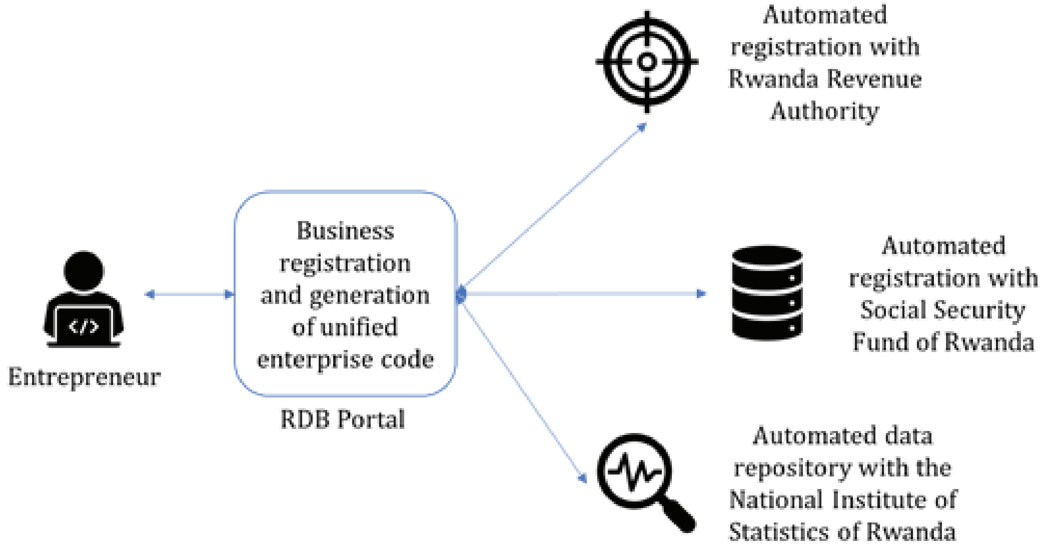
b) Access to Hustler Fund for business loans requires one to have registered the business and acquired a KRA PIN that is linked to the business.

c) Farmers are being registered country-wide using county administration structures, with a promise of delivery of incentives to those who comply.

The business formalization processes are tedious. For MSMEs to achieve full compliance with government regulations they need to interact with at least seven (7) different portals or offices. It is noteworthy that the Kenya Bureau of Standards (KEBS) applies a broad definition for manufacturers which includes tailors, carpenters, equipment installers and basket weavers.



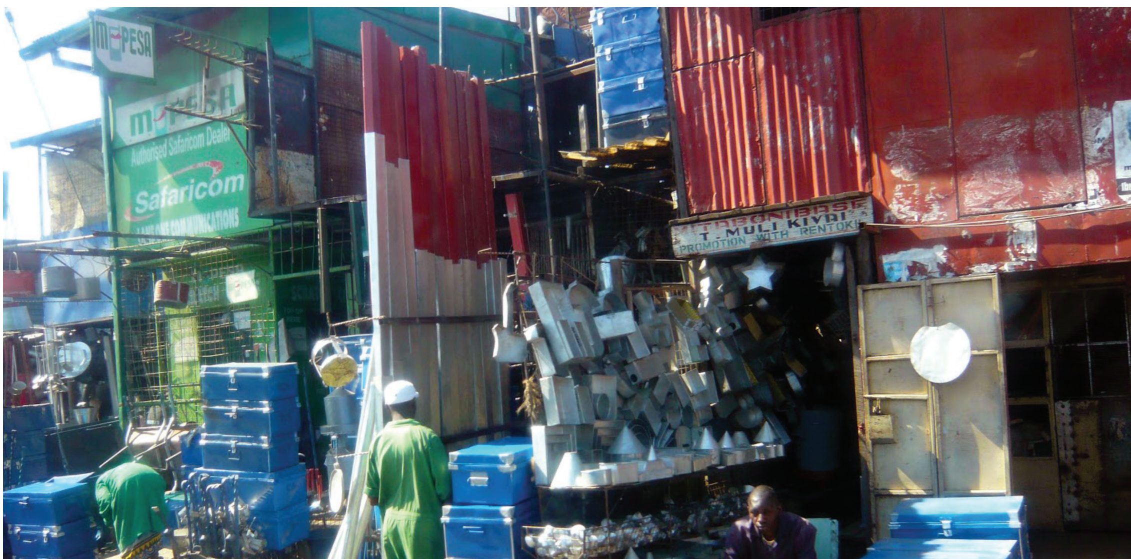
In contrast, the Rwanda Development Board, which is mandated with the registration of businesses in Rwanda, has one online portal that facilitates all licenses and permits that a business may need. The portal aggregates all relevant information .



2. Business license fees

Business registration fees in Kenya range from KES 950 to KES 25,000, depending on the type of company. Small businesses usually register as business names or private limited companies.

- Registration of Business Name	KES 950
- Limited Liability Partnership	KES 25,000
- Private Limited Company	KES 10,650
- Public Limited Company	KES 10,650
- Unlimited Companies	KES 20,050
- Company Limited by guarantee	KES 10,000



Small businesses are concerned about the annual permits issued by county governments. The process of obtaining these permits can be confusing, as the final costs are not easily understood. Small businesses must apply for a permit and receive an invoice after the county government assesses what they should pay. Additionally, there are different license categories based on location, size of operation, and activities.

The Standards Levy (Amendment) Order of 1999 lists small businesses such as tailoring, leatherwork, and carpenters as manufacturers. If this is followed by county governments, then such businesses would be licensed as "industrial plants", which can result in higher permit costs. This is especially true for those who sell directly to the retail market. For example, in Nakuru County, a small trader permit costs around KES 6,500, while a small industrial plant permit costs KES 50,000. In Laikipia, the permit for a small trader shop is KES 3,000, and KES 50,000 for a small industrial plant. As a result, tailors and carpenters may choose to identify as "traders" instead of "manufacturers" to save on license fees, even though this may not accurately reflect their business.

To promote the registration of micro-industries and support the growth of these businesses, it would be beneficial for both the county and these industries to maintain a clear licensing regime that promotes business classification. This will help map potential opportunities based on the Kenya Kwanza BETA framework.

4. Business costs

The local business environment is faced with several cost-related challenges that impede the growth of micro, small and medium-sized enterprises (MSMEs). One of the biggest concerns for entrepreneurs is the high cost of fuel and electricity, which are largely determined by global markets. However, government levies charged at the last mile also play a significant role in increasing the overall cost burden for businesses. Reports indicate that at least 50% of the cost of fuel and electricity to end users comprises levies and taxes imposed by the government.

Additionally, county governments require businesses to obtain multiple permits and licenses to operate, with business permit fees ranging from KES 3,000 to KES 50,000 per outlet. These fees are further compounded by additional levies such as fire and health permits, which could attract an additional KES 3,000 to KES 30,000 per outlet. It is concerning that the artisan sub-sector, which is often small and struggling, is required to pay higher fees compared to general traders. This puts them at a disadvantage, especially when competing with cheap imported goods flooding the market.

The recent decision by KEBS to enforce the Standards Levy regulation could further exacerbate the challenges faced by MSMEs. Under this regulation, all local manufacturers are required to pay 0.2% of the ex-factory price of each item sold, regardless of the size of their operation. This comes at a time when small tailoring, woodwork, leatherwork and metalwork outfits are already struggling to compete with cheap imported goods that are flooding the market, some of which are even used items.

Furthermore, businesses that choose to sell their products or services through online platforms are also subjected to Digital Service Tax, which is 1.5% of turnover. Once the business hits an annual turnover of KES 1,000,000, they become liable for a 1% turnover tax. This means that MSMEs that opt for more efficient online channels could end up paying as much as 2.5% of their turnover in taxes.

Case in point

Perhaps to bring home the gravity of the issue at hand, let's take the example of school uniforms.

Some of the uniform articles are generic in colour and design, making it easy for parents to purchase from a wide range of sources. However, the local tailoring industry is constantly under pressure from imports and needs intervention to have an edge over them.

A measure taken by the government is to review the levies paid by importers of used clothes, popularly known as mitumba. Previously, the Kenya Revenue Authority collected a levy of KES 24.35 per KG of clothes. The new tariff is KES 108.30 per KG. Used clothes are packaged in bales. A bale of shirts would contain about 160 pieces and weigh 45 kg. Change in cost to importers is therefore as follows:

	Bale (160 shirts; 45 KG)	**Resulting levy per shirt**
Old tariff	KES 1,095.75	KES 6.85
New tariff	KES 4,873.50	KES 30.46

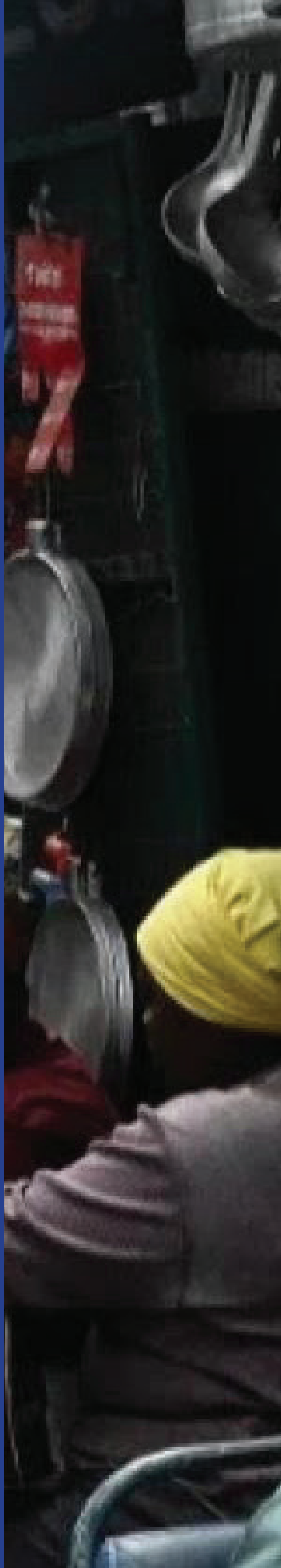
Though the 345% increase in tariff is significant, it is not enough to protect the local industry. Should the importers choose to pass on the additional cost to consumers (without additional mark-ups to it), they will still have headroom to be price competitive. It is noteworthy that used clothes reach consumers via a distribution chain that sees margins shared between importers, wholesalers and retailers. Local tailors based in market centres do not incur distribution costs, yet their prices are significantly higher than used clothes.

Comparison of cost of school uniforms to consumers (before new levies)

	Local tailors (e.g. Market Centre)	Locally manufactured, stocked in shopping mall	Used clothes market (mitumba)
Shirt/Blouse	400	800	250
Short	600	850	250
Skirt	600	850	250
Sweater	600	1,100	400
Socks	150	300	100
Shoes	N/A	2,000	1,200

Parting shot

In conclusion, the government must address the high-cost burden faced by local businesses, especially MSMEs, if they are to thrive and contribute to the growth of the economy. This includes a review of the licensing and permit fees charged by county governments, as well as the introduction of measures that support the growth and competitiveness of the local fundi.



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