



Small Businesses in Kenya: Transition from Informal to Formal Enterprises*

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Abstract: The Kenyan economy is broadly characterized by two parallel sectors: the formal comprised of registered businesses and the informal defined by the economic activities of non-registered businesses. Despite the several advantages of registering a business, only a minority of businesses in Kenya are registered. This paper addresses the question of why a large number of small businesses in Kenya opt to operate informally. The findings show that firm age, size of business, owner's experience, business sector, gender of owner and type of business premise influence the choice to register a business. The paper recommends that the government simplify registration and link it to licensing, decentralize and automate registration, and enforce registration without directly linking it to tax obligations.

Keywords: Small businesses, Registration, Informal sector

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Economies can be broadly characterized by formal and informal sectors. The formal sector includes businesses that have legal registration documents and statutory business licenses required by the regulatory authorities. On the other hand, the informal sector includes enterprises that are not registered and do not comply with legal obligations concerning safety, taxes and labor laws (Bigsten et al. 2000).

There are several advantages of increasing the number of registered businesses in an economy. In terms of governance, a large informal economy impedes economic planning and the provision of infrastructure. Registration of businesses provides reliable information and data for planning and policy making. Similarly, because of the diverse nature of the informal sector, the operational costs of regulating its activities are substantial. Formalization also reduces corruption (McCulloch et al. 2010) and makes businesses contribute tax payments and other statutory levies.

At the firm level, it is generally less risky to conduct business with a registered enterprise as it is easier to access relevant information. Similarly, the enforcement of contracts envisages legal recognition of participating parties. These issues are particularly relevant to banks and other financial institutions, which generally withhold credit from unregistered businesses. So registered businesses receive important benefits that their unregistered counterparts do not: the equity financing to enable them to expand, while limited liability gives it and its employees the freedom to innovate and experiment without excessive fear of failure (World Bank 2004).

In a nutshell, registered businesses receive more coordinated macro support and have better access to finance, links and referrals. A well functioning regulatory environment should therefore encourage business registration.

Nevertheless, many developing countries continue to be characterized by large informal sectors. Many businesses in less developed countries face heavy regulatory burdens, and the excessive transaction costs associated with the administrative procedures required

discourage entrepreneurs from formalizing their business. Most businesses that opt to remain informal therefore do so due to the high registration cost and complex registration procedures they face (Djankov et al. 2002; Auriol & Warlters 2005; Antunes & de V. Cavalcanti 2007; Ulyssea 2010). The World Bank (2012) estimates that this makes it around two times harder for a developing-country entrepreneur to start and operate a formal business compared to the situation in industrialized economies. This is consistent with Loayza's (1997) finding that the size of the informal sector is positively related to the tax burden and labor restrictions. Nkya (2007) points out that in Tanzania, the high cost of doing business formally—which entails the difficulties involved in sustaining formalization as well as initial registration—also encourages informality. Some businesses choose to remain informal to avoid detection by relevant government institutions (Ishengoma & Kappel 2006). Believing that the benefits of informality outweigh the costs, enterprises therefore opt to operate informally to avoid the costs of paying taxes and trade levies, and abiding by labor laws, and environmental and health and safety regulations (Ingram et al. 2007).

The picture is further complicated by the fact that the choice to remain informal is also influenced by factors beyond the regulatory and administrative environment. The characteristics of the enterprise and the business owner influence the choice to register a business. In a study on credit constraints that face manufacturing enterprises in Africa, Bigsten et al. (2000) found that informal enterprises were younger, pay less wages to skilled labor, are less capital-intensive and have limited access to financial services. The study also observed that the education level of a business owner positively influences the choice to register a business. Further, entrepreneurs with professional degrees were found to have higher incidences of registering a business as compared with those with fewer qualifications. In a study on rural Indonesia, McCulloch et al. (2010) observed that the size of the business, the sector the business operates in, ethnicity, level of education and gender of owners/ managers are positively and significantly correlated with formality.

Moreover, some businesses choose to operate informally for a period of time before they make the transition to formal status (Bannock et al. 2002). De Beer et al. (2013) find that businesses generally transit gradually from informal to formal status, and in fact, some carry out informal and formal activities at the same time.

Like those of most other developing countries, the Kenyan economy is broadly characterized by a large informal sector. This informal sector is largely comprised of micro and small enterprises (hereafter referred to simply as small businesses), as very few small businesses in Kenya are registered (CBS et al. 1999; Ingram et al. 2007).

These small, unregistered businesses play an important role in Kenya's economy. In the 1950s and 1960s, it was widely assumed that the informal sector would gradually disappear with the emergence of a modern sector (ILO 2002). However, the informal sector in Kenya has continued to expand. In the first two decades after independence in 1963, Kenya's population grew at higher rate than the economy, resulting in the initial unemployment challenges. Market liberalization and structural adjustment programs of 1980s and 1990s worsened the unemployment problem. Over time, the informal sector has grown rapidly as the formal sector was unable to absorb the expanding labor force (Bigsten et al. 2004).

Now, over 67 percent of businesses in Kenya are micro and small enterprises (KNBS 2012). The small business-dominated domestic trade and repairs sub-sectors alone contribute 10 percent of GDP. Furthermore, of the 742,000 new jobs the Kenyan economy generated in 2013, 84 percent were in informal small businesses (KNBS 2014).

In Kenya, it is now widely recognized that the promotion of the informal small business sector is a viable and dynamic strategy for achieving national goals, including creation of employment and poverty alleviation (GOK 2007). Despite its steady growth over the years, the informal sector faces unique challenges that hinder its growth, prompting the government to plan for various interventions. The Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth gave

explicit recognition of the informal sector's role in economic growth and development. Its recommendations led to the publication of Sessional Paper No. 2 of 1992 on Small Enterprises and Jua Kali Development in Kenya, which provided a more comprehensive policy framework for promoting the sector. Further, the Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises and the Economic Recovery Strategy for Wealth and Employment Creation (2003-2007) advocated for a business environment that will facilitate the graduation of small businesses into medium sized enterprises for high quality products and creation of employment opportunities. The most recent development plan, the Kenya Vision 2030, also places emphasis on the sector, this time focusing on the establishment of small and medium sized business parks as a key initiative to increase the contribution made by the manufacturing sector.

The Kenyan government's focus on small businesses accords with a significant body of literature on the role of small businesses on employment creation and income-generation in an economy (Fafchamps 1994; Lall 1995; IPAR 2002). Development of small businesses is important in accelerating the achievement of wider economic and socio-economic objectives (Cook & Nixon 2000). Unlike in developed countries, where small businesses are associated with human-resource management, creativity and innovation, in developing countries they are usually promoted as a means of generating employment and alleviating poverty (Bigsten & Gebreeyesus 2007). Small businesses are a seedbed for rapid industrial transformation. They provide a training ground for the acquisition of managerial and technical skills required for industrial processes. Hence, small businesses nurture entrepreneurship, which is a driving force that can push developing economies out of the low-growth trap. The labor intensity of small businesses not only promotes equitable income distribution but also alleviates the burden of poverty prevalent in many developing countries, as a majority of the urban poor derive their livelihood by engaging in small-scale industrial and commercial activities. Small businesses are engines of growth

(Beyene 2002). They have ease of entry, initial low capital requirements and minimal technological inputs. Hence, they can be established within a short time span. Further, small businesses promote industrial decentralization and provide relatively less-expensive goods and services (Green et al. 2004; Söderbom 2012). Small businesses tend to be labor intensive, relatively use local resources, are flexible and have high potential for feedbacks effects with the other sectors of the economy.

Small business therefore has the potential to form the foundation of a strong national industrial base and domestic production structure that are central to achieving a middle income economy in Kenya. However, to increase the success of the Kenyan governments policies promoting small business, information on business registration (and factors that influence it), is important to allow for proper spatial and economic planning.

Accordingly, this study investigates the registration of small businesses in Kenya. It employs a qualitative response model that describes the stochastic relationship between the choice to register a business and the enterprise and entrepreneur characteristics. Data is drawn from the Micro, Small and Medium Enterprises (MSMEs) Baseline Survey conducted by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) and consulting firm Ernst & Young in 2007. The findings show that firm age, size of business, owner's experience, business sector, gender of owner and type of business premise influence the choice to register a business. The paper recommends that the government, simplify registration and link it to licensing, decentralize and automate registration, and enforce registration without directly linking it to tax obligations.

To start, it outlines the process of business registration in Kenya. Next, it provides details on the theoretical framework of the study, the model applied and the data source. This is followed by a discussion of the results and findings. This section first presents the descriptive statistics. Second, it discusses the determinants of the choice to register a business based on the logistic regression results. The final section concludes and

offers policy recommendations.

The Process of Business Registration in Kenya

In Kenya, a business registers its identity and activities either as a sole proprietorship, partnership or a company with the Registrar of Companies. This is provided in relevant statutes that include the Registration of Business Names Act (CAP 499 Laws of Kenya), the Partnership Act No 16 of 2012, Limited Liability Partnership Act No 42 of 2011, and the Company's Act (CAP 486 Laws of Kenya). The registered business is recognized as a legal entity and can engage in legitimate business activity.

There are several procedures to be followed depending on for which registration status the business owner opts. For instance, registering a company requires a business name search, memorandum of articles, articles of association and a statement of nominal capital. Such businesses are also required to obtain tax certification and meet other statutory requirements (labor and social security) from the relevant institutions. All businesses, whether registered or not, must obtain the annual Single Business Permit (SBP) to be allowed to operate in any part of the country. The SBP fees are paid to the relevant counties and the fees vary depending on the respective county laws.

Except for an annual single business permit, business registration is not enforced in Kenya. This undoubtedly influences many businesses to choose to operate without having to register with the Registrar of Companies.

Theoretical Framework

Registration is part and parcel of regulation since it provides the mechanism through which the state interacts with industry. The rationale for economic regulation is basically based on two theories which attempt to provide insights into why regulations exist (Posner 1974). The theory

of public interest contends that regulation is instituted for purposes of protection and benefits of the public at large (Stigler 1971). The case for regulation arises if there is market failure in the form of externalities, imperfect information, fixed costs (indivisibilities) or monopolies. Market failure results in the production of goods and services that do not generate an outcome that is consistent with broader goals of social justice or environmental sustainability. But regulation should not restrict choice or introduce inflexibility that can stifle innovation. Regulation generally implies application of legal instruments to enforce a mode of conduct for individuals or businesses so as to achieve generally-acceptable goals in society (den Hertog 1999). Regulation facilitates the well-functioning of markets so that private sector's role in generating growth and incomes is sustained.

The other theory, the theory of public choice, has two strands. The first is that regulation is pursued for the benefit of politicians and bureaucrats who use the regulation to create and collect rents through granting permits and licenses (Daron & Verdier 2000). The second strand is that regulation is acquired by the industry and is primarily designed and operated for its benefits (Stigler 1971).

It is not clear which of the two theories account for the registration behavior of businesses in Kenya. The low level of registration, particularly among small businesses, suggests that either businesses deliberately refuse to register to avoid high operational costs associated with registration (public choice theory) or the existing registration requirements are excessive for emerging small businesses despite the potential benefits of registration (theory of public interest). However, for both theories, being registered is a decision businesses have to make.

Whatever regulatory framework a business faces, this choice is self-selected. A business owner may have a negative or positive perception of registration, depending on what he/she regards as its potential economic costs and benefits. The choice to register therefore depends on a range of factors. These include administrative requirements and the financial and non-financial costs of business registration. Beyond

these registration considerations, the characteristics of the business and the attributes of business owners are important. It is the business owner who interprets to what extent registration dynamics will impact on business profits if the business is registered. Thus, both enterprise and entrepreneurial characteristics influence the decision to register a business. For this reason, the explanatory variables for business registration are specific to enterprise and/or business owner characteristics. This theoretical proposition rides on recent work by Becker (2014), who argues that the business informality choice is dependent on whether it is facing market-, firm- or product-level regulation which a business chooses to comply with or evade.

The Model

The choice to register a business is a qualitative choice variable. Thus, a binary response model is used in this study, with the choice to register a business indicated as 0 and to not register as 1. In discrete choice models, the aim is to determine the probability of one making a given choice given the existence of some underlying factor(s) that influence that choice. Borrowing from the discussion above, the choice to register a business is influenced by business characteristics (size, age, sector, number of employees, type of business premise) and entrepreneurial attributes (gender status, business experience and level of education). The qualitative response model that describes this stochastic relationship between the choice to register a business and the enterprise and entrepreneur characteristics is therefore specified as follows:

$$Y_i = \beta_0 + \beta_1 FA + \beta_2 NE + \beta_3 LE + \beta_4 SB + \beta_5 GO + \beta_6 EO + \beta_7 TBP + \varepsilon_i \quad (1)$$

Variable Y is *binary*, taking only two possible outcomes denoted as 1 if a business chooses to register and 0 otherwise.

The variables considered for analysis are detailed in Table 1 below:

Table 1.
Variables Definition and Measurements

Variables	Abbreviation	Measurement
Firm age	FA	The number of years the firm has been in operation
Number of employees	NE	The number of employees engaged when the business commenced operation
Gender of owner	GO	Whether male owned, female owned or owned jointly by male and female
Sector of Business*	SB	Business sector of operation
Level of education of owner**	LE	The highest level of education achieved by the owner-manager
Type of business premises***	TBP	The type of building/structure and site of the business
Experience of owner	EO	The number of years the owner has been in business

* Sectors: Food/Beverages; Garments/Textiles; Car parts and engineering; Machinery and equipment; Chemicals; Electronics; Wood, wood products and furniture; Metal and metal products; Other manufacturing; Commercial agriculture; Retail; Wholesale; Repair of motor vehicles/ household goods; Information technology; Construction; Transport; Hotels and restaurants; Education/training

**Level of education of owner: No formal education; Started but did not complete primary school; Primary school; Started but did not complete secondary school; Secondary school; Vocational/diploma/certificate level training; Graduate degree and Post graduate degree

*** Nature of business premises Permanent - commercial premises; Permanent - Residential house (Home); Semi Permanent - Market stall; Semi Permanent - Kiosk; Semi Permanent - Traditional market day; Semi Permanent - Jua Kali sheds; Temporary - No structure/open ground; Temporary - Roof only; Temporary - Mobile/Hawker; Temporary - Industrial site; Temporary - Roadside; Other

However, as much as we expect entrepreneur and enterprise characteristics to influence the choice to register, data on these characteristics is not sufficient to predict the choice made by the firm with certainty. What could be reasonable is to expect the explanatory factors to influence the likelihood of a firm choosing to register or not. Thus, the model (1) above can be interpreted as the probability of making a choice (and not the observed choice itself). The probability is the conditional expectation of choice to register, given specific entrepreneur

and enterprise characteristics.

$$P_i = P(Y = 1 / X_i) = \beta_0 + \beta_1 FA + \beta_2 NE + \beta_3 LE + \beta_4 SB + \beta_5 GO + \beta_6 EO + \beta_7 TBP + \varepsilon_i \quad (2)$$

Where X are the regressors on the right side of the equation, which are assumed to influence the outcome Y .

The regression coefficients in equation 2 give us the marginal effects of the accounting factors on the likelihood of choosing to register a firm. However, due to an assumption of linearity (i.e. P_i increases linearly with X), the predicted probability of choosing a given information source may lie outside the 0–1 interval, contrary to an acceptable definition of a probability. To overcome the linearity limitation, it is necessary to use the cumulative logistic distribution function:

$$P_i = P(Y = 1 / X_i) = 1 / (1 + e^{-z_i}) \quad (3)$$

Where $Z_i = \beta_0 + \beta_1 FA + \beta_2 NE + \beta_3 LE + \beta_4 SB + \beta_5 GO + \beta_6 EO + \beta_7 TBP + \varepsilon_i$

Whereas in equation 3, P_i is nonlinearly related to X_i and ranges between 0 and 1, use of OLS becomes a challenge because P_i is also nonlinearly related to the parameters.

Suppose we consider the probability of not registering a business $1 - P_i$:

$$1 - P_i = 1 / (1 + e^{z_i})$$

A ratio of probability of registering a business to that of not registering a business is:

$P_i / (1 - P_i) = (1 + e^{-z_i}) / (1 + e^{z_i})$ is the odds ratio in favor of registering a business. Taking the natural logarithms of the odds ratio we have:

$$L_i = \ln(P_i / (1 - P_i)) = Z_i$$

$$Z_i = \beta_0 + \beta_1 FA + \beta_2 NE + \beta_3 LE + \beta_4 SB + \beta_5 GO + \beta_6 EO + \beta_7 TBP + \varepsilon_i \quad (4)$$

Equation 4 is a logit model where L_i is itself linearly related with parameters β even though P_i is not. The parameters β are typically estimated by maximum likelihood.

Data

This study uses data from the Micro, Small and Medium Enterprises (MSMEs) Baseline Survey conducted by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) and consulting firm Ernst & Young in 2007 as part of the World Bank-funded “Micro, Small, and Medium Enterprise Competitiveness Project.”¹ This five year project focused on the competitiveness of MSMEs through three mutually reinforcing components: access to finance, strengthening enterprise skills and market linkages, and improving the business environment. The MSME baseline survey targeted about 2800 firms. The definition of MSMEs was drawn from relevant statutes, with micro, small and medium enterprises constituting businesses with less than 10, 10-49 and 50-100 employees respectively.² From the overall sample, the study determined that 5, 12 and 83 percent of the firms to be medium, small and micro sized firms respectively.³

¹ Information is available at

<http://www.worldbank.org/projects/P085007/micro-small-medium-enterprise-competitiveness-project?lang=en>

² The Public Procurement and Disposal Act (2005) and the Micro and Small Enterprises Act (2012) define micro enterprise as “a business undertaking with an initial (a) staff establishment of not more than ten employees, and (b) annual turnover or investment not exceeding Kenya Shillings five hundred thousand”; and small enterprises as “a business undertaking with (a) staff establishment of not less than eleven and not more than fifty employees, and (b) annual turnover or investment not exceeding five million Kenya Shillings.”

³ The ratio between small versus micro firms is roughly based on the 1999 National MSEs Baseline Survey that shows that MSEs constitute 99.3%

Sampling of the firms proceeded as follows. The local authorities' lists of licensed firms were used to construct a sampling frame of existing enterprises. The study covered all eight administrative regions in Kenya with an average of three counties per region. In total, one city, seven municipalities, fifteen county councils and eleven town councils were included in the sample. In selecting firms within sampled municipalities and town councils, consideration was given to the pattern of existing firms within known commercial and industrial zones. A preliminary stratification was carried out to identify enterprise characteristics that define the existing clusters. Within a given cluster of firms, the businesses were chosen on the basis of a stratified random sampling, to take cognizance of the number of firms in different size categories and sectoral distribution. The sampling of firms within county councils was guided by the location setting of enterprises within the major market centers together with information reflected in the sampling frame. The size of the market centers in relation to the number of enterprises and the logistical convenience in terms of distance from the district headquarters were critical issues that the research team took into account in identifying market centers that were sampled.

Results and Findings

Descriptive statistics

As indicated in the Table 2, only 28 percent of small businesses are registered in Kenya (limited companies (9%), sole-proprietors (15%) and partnerships (4%)). There is a higher level of registration among male-owned businesses (30%) compared to female-owned (14%). Further, small businesses operate in about 19 different sectors and business registration varied across these sectors. Registration is relatively high in construction (90%), education/training (78.5%),

micro and 0.7% small enterprises.

machinery and equipment (65.4%) and chemicals (63.3%), but relatively low in sectors such as food and beverages (28.1%), garments/textiles (14.1%), wood, wood products and furniture (14.2%) and retail (18.7%). A possible explanation for sector variance in registration is that for some sectors like construction and education, there are legal requirements that the business must be registered before it starts operations. On average, most of sampled firms were seven years old and had about four employees. For the firms that are registered, the main motivation identified for registering a business was to have legal recognition. However, less than half of businesses have a clear understanding of what business registration involves.

Table 2.
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Business registration	2547	0.00	1.00	0.2764	.44731
Firm age (FA)	2538	1.00	81.00	6.9153	7.23187
Number of employees (NE)	2547	0.00	100.00	3.8657	6.93478
Sector of the business (SB)	2547	1.00	19.00	11.82	6.280
Gender of owner	2547	1.00	3.00	1.5638	.75943
Level of education of owner (LE)	2547	1.00	8.00	5.18	1.516
Type of Business Premise (TBP)	2547	1.00	12.00	2.48	2.744
Experience of owner (EO)	2496	1.00	57.00	7.4637	7.10736

Source: Authors' calculation from MSMEs Baseline Survey 2007.

Irrespective of their registration status, most businesses indicated that the main obstacles to registration are tax burden (31.8%), financial costs of registration (30.4%) and administrative burden of complying with all tax laws for registered firms (28%).

Determinants of choice to register a business

The logit regression results in Table 3 highlight the influences an entrepreneur's decision to register a business. In terms of overall model

robustness, the Hosmer and Lemeshow goodness-of-fit test had a p-value of 0.579 implying failure to reject the null hypothesis that there is no difference between the observed and predicted values of the dependent variables. This suggests the model's estimates fit the data at an acceptable level. Except for semi-permanent nature of market stall and diploma level of education all other variables were found to be statistically significant in influencing choice to register at 1% level of significance. However, as explained below, the significance level for the sector of the business, level of education and the type of business premise varies, depending on how specific attributes or characteristics compare with the standard used as a reference.

Firm age

Firm age was found to be positively and highly significant (at 1%) in influencing choice to register a business. This is consistent with previous findings that enterprises that operate informally are relatively younger (Bannock et al. 2002; de Beer et al. 2013). This may stem partly from the fact that most businesses normally delay registration for an average period of four years after inception for varied reasons. In addition, as discussed next, firm size is crucial factor in a business' decision to register. The size and the age of the firm are potentially correlated due to the time profile of business growth.

Number of employees

Using the number of employees as a proxy for firm size, the study findings show that not only does firm size matter in choice to register a business, the possibility of registration increases with the size of the firm. The possible reasons why firm size matters in business registration are the ability for relatively large businesses to meet financial requirements for registration and the inability of large businesses to remain unregistered without attracting administrative attention from the government.

Business owner's experience

The findings show that more experienced entrepreneurs are more likely to seek business registration compared to emerging entrepreneurs. This observation accords with the intuition that seasoned businesses have more enhanced organizational learning (firm-specific capacity to use knowledge) and have more channels of information flow related with benefits that accrue to registered businesses in terms of public contracts, positive referrals and networks.

Business sector

Comparing the likelihood of registration across different business sectors, the regression results are consistent with findings in the descriptive summary, which showed higher registration among some sectors than in others. There is more likelihood for businesses to register in machinery and equipment, transport, education, car parts and engineering, wholesale, chemicals and construction when compared to the food and beverages sector. There are two possible reasons for this observation. First, it is probable that there is more enforcement for registration in some sectors than in others. Second, it is again likely that the nature of operations and transaction involving these sectors require them to be registered. For instance, some sectors require relatively high starting capital and/or use capital intensive technology. The external sourcing of credit may require that such businesses be registered.

Gender of business owner

Female owners are found to be less likely to register their business. The odds of female owners registering their business compared to male owners decreases by 0.55 times. The element of joint ownership does not significantly influence the choice to register a business. A conclusive inference on this observation requires information on their marital status. In the Kenyan context, businesses are mostly interpreted as jointly

owned where they are run by married women.

Level of education of business owner

Contrary to expectations, the choice to register a business is negatively influenced by the level of education irrespective of the education level. However, the odds of registering a business declines as the level of education reduces.

Type of business premise

The type of business premises influences the choice to register a business. Likelihood of choosing to register a business increases as the business moves from temporary structures to permanent commercial premises. Most businesses are located in semi-permanent market stalls, temporary open ground and roadside premises (mainly food kiosks and Jua Kali artisans) were found to be more likely to operate informally. Operating out of such structures is likely to limit the small business's access to utilities such as electricity and water, as well as reduce protection from the weather and road access.

Table 3.

Logistic Regression Results

	Coefficient	Significance (P-value)	Odds Ratio
FA (firm age)	.038	.000*	1.039
NEMP (number of employees when the business started)	.110	.000*	1.117
EO (owners experience)	.035	.001*	1.036
Sector (Food and beverages)			
Garments/textiles	.266	.450	1.305
Car parts and engineering	1.531	.000*	4.621
Machinery and equipment	3.000	.000*	20.087
Chemicals	1.522	.000*	4.580
Electronics	.987	.005*	2.682
Wood products	.072	.863	1.074
Metal products	1.217	.002*	3.376

Other manufacturing	.408	.415	1.504
Commercial agriculture	.819	.087	2.267
Retail	.472	.090	1.603
Wholesale	1.458	.000*	4.297
Repair of motor vehicles and household goods	.776	.104	2.172
Information technology	1.237	.001*	3.444
Construction	1.498	.004*	4.473
Transport	1.961	.000*	7.105
Hotels and restaurants	.099	.761	1.104
Education/training	1.650	.000*	5.207
Others	.345	.219	1.413
Gender of owner (male)			
Female	-.599	.000*	.549
Joint ownership (male and female)	.279	.062	1.322
Level of education of owner (postgraduate degree (MBA/MA/MSc))			
No formal education	-21.694	.998	.001
Started but did not complete secondary school	-3.336	.000*	.036
Primary school	-3.067	.000*	.047
Started but did not complete primary school	-3.009	.000*	.049
Secondary school	-1.869	.000*	.154
Vocational/diploma/certificate level training	-1.200	.013**	.301
Graduate degree (BA/BSc etc)	-.323	.520	.724
Type of business premises (Permanent –commercial premise)			
Permanent-residential (home)	-.288	.310	.750
Semi permanent – market stall	-.836	.025**	.433
Semi permanent – kiosk	-1.299	.000*	.273
Semi permanent – traditional market day	-19.702	.999	.001
Semi permanent- <i>Jua Kali</i> shed	-1.332	.000*	.264
Temporary – no structure	-2.643	.006*	.071
Temporary- roof only	-1.302	.053	.272
Temporary - hawkker	-1.335	.244	.263
Temporary – industrial site	-.257	.713	.774
Temporary - roadside	-1.640	.003*	.194
Other	-.293	.558	.746
Constant	-.725	.190	.484
Hosmer and Lemeshow Goodness-of-fit test		Chi-square 6.616 df 8 P-value.579	
Cox & Snell R Square .314		Nagelkerke R Square .454	

Source: Authors' calculation from MSMEs Baseline Survey 2007.

Note. Variables in parenthesis represent the reference group for the discrete variables

* Significance at the 1% level ; ** Significance at the 5% level

Conclusions

Less than a third of small businesses are registered in Kenya. Other than for the annual single business permit, business registration is not enforced in Kenya. Further, more than half of businesses do not have a clear understanding of what business registration involves. Thus, it is possible that all businesses would register if the registration of a business was an inherent component of the single business permit process.

Most of the unregistered businesses indicated that tax burden, financial costs of registration and administrative burden of complying with all tax laws for registered firms were the main factors that hindered business registration. Since owner-managers closely associate business registration with compliance to tax obligations, many businesses may opt not to register if registration predisposes them to the attention of tax authorities.

The firm age, the number of employees, owner's experience, the sector the business operates in, and the type of business premise all positively influence the choice to register a business. Notably, for the sectors where business registration is enforced due the nature of their economic activities, e.g. construction and education/training, registration was found to be relatively high. The choice to operate informally in some sectors is therefore a rational behavior to minimize operational costs in an environment where business registration is not enforced.

Further, the significant association of firm age, better business premises, owners' experience and business size with business registration implies that enterprises opt to register as they grow in size and become well established. However, as previous research indicates, remaining informal pays (through reduced tax obligations) and businesses may have no incentive to grow. Businesses owners may therefore opt to adopt a horizontal growth strategy, where new related enterprises are established to enjoy the economies of being small.

As such, the paper recommends that the government: i) simplify business registration procedures and link registration with licensing

since many businesses are familiar with the latter; and ii), devolve business registration to county authorities within the framework of the existing two-tier governance structure. An automated process on a single access point platform will reduce transaction and bureaucratic costs associated with business registration. Finally iii), institute a mechanism to enforce registration without directly linking it to tax obligation.

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