REGULATORY FRAMEWORK POLICY BRIEF

2020

Addressing Ease of Doing Business in Kenya: Leveraging on Regulatory Framework

Summary Statement

Legal, regulatory and institutional frameworks are important determinants of a country's level of competitiveness. Whilst effective regulation is important for the proper functioning of businesses, especially where there are many micro, small or medium-size enterprises (MSMEs), regulations can become burdensome and hinder enterprise growth. Regulations become troublesome when they are numerous, in turn, increase the cost of compliance. Additionally, they are difficult to administer and to comply with,especially when similar regulations are administered by more than one agency.

In addition to many regulatory agencies, there is a duplication of roles and mandates of the implementing institutions, leading to numerous visits to enterprises by public officials from these institutions. At times, this discourages firms from complying with the same, providing an avenue for extortion of bribes by public officials. Manufacturing firms in Kenya, like in many developing countries, are required to obtain multiple licenses and pay various fees among meeting other business regulatory requirements. While the need for regulations is appreciated, the nature in which these regulations are administered may lead to onerous regulatory regimes, which could discourage investors due to increased cost of doing business.

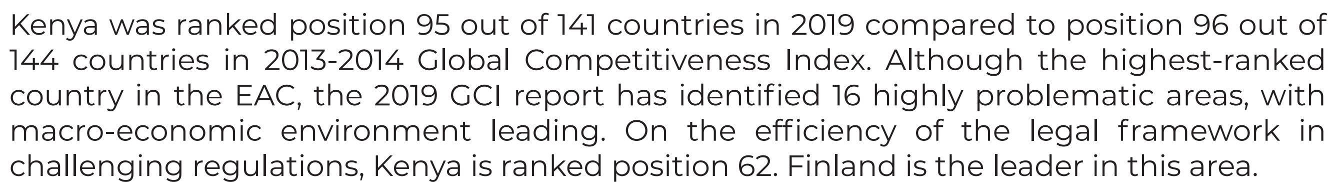
Introduction

Kenya aims to have a robust, diversified and competitive manufacturing sector to transform the country into a middle-income economy by 2030. The sector plays a key role in the country's economic growth and development by facilitating employment creation, attracting investments and wealth creation as outlined in the Kenya Vision 2030 and the "Big Four" initiatives. In the medium term, the goal of the sector is to increase its contribution to the GDP from 7.5% (2019) to 15% by 2022; create additional one million jobs yearly; increase the level of foreign direct investments to $2 billion; and improve ease of doing business ranking from 56 in 2019 to 45 by 2022.

A high ranking in the ease of doing business is an indication that the regulatory environment is more conducive to starting and operating a local firm. According to World Bank's 2018 Ease of Doing Business Report, Kenya's ranking improved significantly from position 129 in 2013 to position 80 out of 189 countries in 2017 and further to position 57 in 2019,and currently at position 50, however, this is still below the country's policy target of a ranking of 45 by the year 2022. Closer home, Rwanda and Morocco are ahead of Kenya in the ease of doing business ranking.

Rwanda is doing better than Kenya in most of the ranking indicators: starting a business, dealing with permits, registering property, protection of minority investors and trading across borders. Globally, New Zealand, Singapore and Denmark have been ranked favourably over time. In general, these countries are ranked among thetop 10 in most of the key indicators of ease of doing business.

On the other hand, Global Competitive Index (GCI) tracks performance on 12 pillars namely: institutions, infrastructure, macro-economic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation. Based on 2019 competitiveness report, Singapore is the most highly ranked country. The country ranks first in terms of infrastructure, health, labour market functioning and financial system. East Asia and the Pacific region are the most competitive in the world, followed by Europe and North America. Led by Mauritius (52nd), sub-Saharan Africa is the least competitive region.



Kenya was ranked position 95 out of 141 countries in 2019 compared to position 96 out of 144 countries in 2013-2014 Global Competitiveness Index. Although the highest-ranked country in the EAC, the 2019 GCI report has identified 16 highly problematic areas, with macro-economic environment leading. On the efficiency of the legal framework in challenging regulations, Kenya is ranked position 62. Finland is the leader in this area.

According to UNIDO's 2018 Competitive Industrial Performance Report, Kenya is among the countries that have performed strongly in the manufacturing sector between 1990 and 2016. Others include Botswana, Ethiopia, Mozambique and Rwanda. Kenya is ranked position 105 globally. Overall, the report brings to fore the fact that in Kenya, like in other developing countries, manufacturing is represented by small firms that are often characterized by lower levels of productivity due to internal inefficiencies and an unsupportive business environment, coupled by an ineffective regulatory environment.

Legal, regulatory and institutional framework are important determinants of a country's level of competitiveness. Competitiveness is important for the growth of enterprises and the general economic development of any country. Although effective regulation is important for the proper functioning of businesses, especially where there are many small or medium-sized enterprises, regulations can become burdensome and hinder enterprise growth. Regulations become burdensome when they are many, difficult to administer and to comply with, and when similar regulations are administered by more than one agency.

In addition to many regulatory agencies, there is a duplication of roles and mandates by the implementing institutions, leading to numerous visits to enterprises by public officials from these institutions. This discourages firms from complying with the same, providing an avenue for extortion of bribes by public officials. Manufacturing firms in Kenya, like in many developing countries, are required to obtain licenses and pay various fees among meeting other business regulatory requirements, including Environmental Impact Assessment (EIA). While the need for regulations is appreciated, the nature in which these regulations are administered may lead to onerous regulatory regimes, in turn, discourage investors due to the increased cost of doing business.

Among the major levies charged to manufacturers by the county governments include the Single Business Permit (SBP), environmental assessment/audit and workplace registration (also charged by the Directorate of Occupational Safety and Health (DOSH). Additional levies include water supply and sewerage/effluent discharge, despite them being part of an enabling environment for investment.

Licensing businesses is among the main contributors to county annual Own Source Revenue (OSR). An estimate of county OSR collection potential for Kenya indicates that business licensing is the second-largest potential revenue base for counties after property taxes.

The Context

Experience from elsewhere has shown that a properly anchored regulatory framework is key in not only protecting minority investors but also creating an enabling environment for all players. For instance, streamlining and harmonizing licenses in other countries such as Egypt and Rwanda has proven to be time and cost-saving. Although Kenya has been implementing regulatory reforms since 2005, regulations continue to pose challenges to its business sector. Domestic regulations and administrative procedures are among the major challenges affecting Kenya's manufacturing sector. Apart from discouraging investments, regulations also provide an opportunity for massive corruption practices. In many instances, manufacturers and other stakeholders have to part with huge amounts of money, as bribes, to save time and avoid cumbersome regulations.

Efforts have been made towards addressing the issue of regulation in Kenya through business regulation reforms, with strong advocacy from the private sector, particularly Kenya Association of Manufacturers (KAM). A report by the Department of Business Reforms and Transformation (in the State Department for East African Community) on the Ease of Doing Business in Kenya shows that Kenya has made tremendous strides since 2014. The report examined procedures, time and cost involved in doing business in the country. The report appreciates that a lot had been done to make the business environment conducive and is in agreement that there is still a lot to be done.

However, the key challenge of business regulations in Kenya is that they are still many. Additionally, similar regulations are administered by more than one regulatory agency. This leads to delays and higher costs of doing business, ultimately reducing businesses competitiveness.

This study was conceptualized to gain a deeper understanding of the regulatory environment in Kenya with respect to regulations, institutions and duplicity/multiplicity of roles by regulatory institutions, to offer recommendations on rationalizing them to improve the ease of doing business in the country. More specifically, it sought to identify regulatory institutions dealing with the manufacturing sector in Kenya; examine their roles, mandates, legislative instruments, licensing regime and funding mechanisms of the identified institutions as it relates to manufacturing sector; identify overlapping roles of regulatory institutions and their impact on the manufacturing sector; identify the challenges faced by Kenya Association of Manufacturers (KAM) members when dealing with these regulatory institutions; and propose ways of addressing overlapping roles.

The study is a follow up to the last regulatory report prepared in 2008 and subsequently in 2012. The two (2) reports bought to fore salient issues as pertains regulatory framework in Kenya. Key among these was the need for the review of the mandates of institutions involved in regulating the manufacturing sector in Kenya and the enforcement of legal directives. It should be noted that these reports were done before devolution took effect and only concentrated on national government Ministries, Departments and Agencies (MDAs).

The study used a combination of secondary and primary data gathered from manufacturing sub-sectors under KAM membership.

Gaps in the Prevailing Policy Framework

Various Executive Orders and Acts of Parliament have led to the establishment of government institutions to regulate various sectors of the economy. Key institutions include government Ministries, Departments and Agencies. Further, since the adoption of Kenya's Constitution in 2010, the country has embarked on an ambitious devolution agenda, shifting multiple powers and responsibilities from the national government to 47 county administrations. Counties started setting up new institutions and systems to deliver services, formerly assumed by the central government. To avoid overlaps and duplication, the functions of the two tiers of government have to be carefully coordinated.

Devolution seeks to enhance accountability and improve service delivery at the local level, thus addressing important limitations to past economic growth and poverty reduction efforts. However, Kenya's low level of productivity, especially in its informal sector, continues to constrain firms' ability to grow and generate more employment.

National and county governments and business operators are the main stakeholders in shaping the business environment. Both governments have the larger responsibility of: providing adequate physical infrastructure and services, to enable business operation and their sustainability; developing and enforcing laws and policies that promote fairness, competitiveness, and sustainability for businesses; as well as revenue collection and compliance enforcement. At the county level, businesses are the major sources of Own Source Revenue (OSR) for county governments through licensing and taxation. They also create employment opportunities and platforms for innovation, as well as attract new investment into counties. They are the key drivers of the counties' economy.

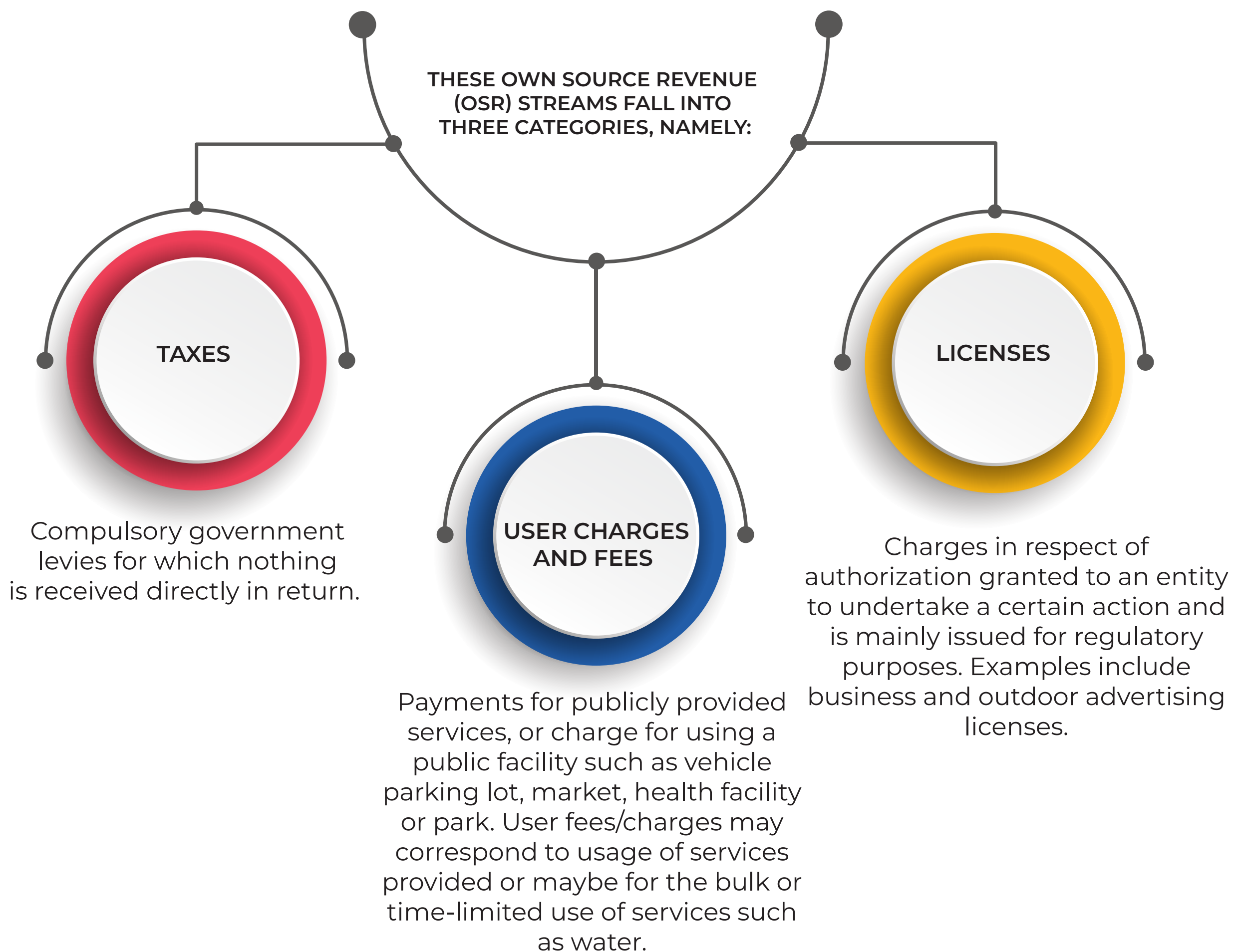
Towards improving the ease of doing business in Kenya, the national government and counties have embarked on a bold investment climate reform programme that has transformed the regulatory landscape. Implementing the reforms in the country, coordinating across the different levels of government and building capacity to ensure efficient and quality service delivery are the main challenges ahead.

In the third Medium Term Plan (MTP III), the government commits to continue implementing public sector and governance reforms in the areas of administration of justice, law and order to improve the ease of doing business and sustain a conducive business environment that will promote investment, growth, and employment creation. The MTP has recognized the need to reduce administrative and regulatory impediments to starting and growing businesses in the country and across the counties.

However, since the advent of devolution, formulation and implementation of various policies and legislation has been done haphazardly across counties. Further to this, county governments and their agencies, and other national government agencies have designed and implemented various levies and licenses across various sectors of the economy. This has partly been occasioned by the urgent need to upscale county own revenue collection given the current county revenue allocation formula. This notwithstanding, it has greatly impacted the ease of doing business across counties, and by extension, the country, hence negating the aspirations of MTP III and the Big Four Agenda.

The need for county governments to have reliable revenue is a key principle of Kenya's devolution, contained in Article 175(b) of the Constitution. The 47 County Governments budget for devolved functions and generate revenue from local sources. The Constitution defines County Governments' funding sources to include: Equitable share of at least 15% of most-recently audited revenue raised nationally; additional conditional grants from the National Government's share of revenue; equalization fund based on half of one per cent of revenue raised nationally; local revenues in the form of taxes, charges and fees; and loans and grants.

The Constitution allows counties to impose: property rates; entertainment taxes; charges for services they provide; and, any other tax or licensing fee authorized by an Act of Parliament.



Supported by this, counties have imposed hefty charges and levies to businesses. Currently, close to 45.8% of all charges go to the county government of which, most are not properly anchored in policy and legal framework. These should be guided by a sound policy and legal regulatory framework. To date, however, no County Government has developed a Tariff and Pricing Policy to guide imposition of fees and charges, which is a legal requirement under section 120 of the County Governments Act, 2012.

Important to note, the County Licensing (Uniform Procedures) Bill, 2019 has been formulated and is at the Senate. The Bill aims to harmonise the county licensing processes.

The findings suggest that:

1. There are various overlapping charges and levies by various quasi institutions. Some of these include water and sewerage services; effluent discharge; movement of goods taxes and levies at the national and county levels; dust measurements, noise survey and air receiver; and occupational and health certifications, among others. A review and alignment of overlapping mandates and roles will reduce the cost of doing business for the manufacturing sector by 28.9%.

2. These overlapping regulatory roles affect the operations of Kenya's manufacturing sector as they do not only increase the cost of doing business, thus reducing the country's competitiveness, but they also consume a lot of time due to their multiplicity and at times, create loopholes for abuse by those mandated to administer them.

3. Government Ministries, Departments and Agencies, and county governments have been increasing charges and levies significantly. This has been occasioned partly by the need to mobilize A-I-A for MDAs and enhance Own Source Revenue (OSR) for county governments.

4. Even with the reforms, the number of procedures and time taken for approvals has gone up due to new requirements in some instances. For example, procedures required to obtain a construction permit increased from 9 to 16 because of new requirements to submit a survey plan and register the project with NCA. The time required to obtain a construction permit increased by over 25% from 125 days (2014) to 159 days (2020). It is also important to note that some of the proposed reforms, such as the need for the reduction of physical visits to departments, have not been implemented.

5. At the devolved level, most county levies and fees are determined haphazardly as counties are yet to formulate tariffs and pricing policy to guide imposition of fees and charges. This is a key legal document required under section 120 of the County Governments Act, 2012.

6. Although a Single Business Permit (SBP) was introduced in the year 2000 as a reform measure to replace multiple local authority licenses, numerous licenses have continued alongside the single business permit. Other multiple permits by county governments have led to increased costs, man working hours and administrative requirements.

7. County governments continue to charge cess although it should not be levied on the transportation of produce since it has already been paid for by the producer.

8. There exist weak customer support channels to eliminate the need for in-person visits, when services are delayed or lacking. Further, accessibility and availability of services (such as water and sewerage) are not in any way commensurate to chargeable fees and levies. For instance, a majority of businesses are not connected to water and sewer lines, which are essential inputs to their operations.

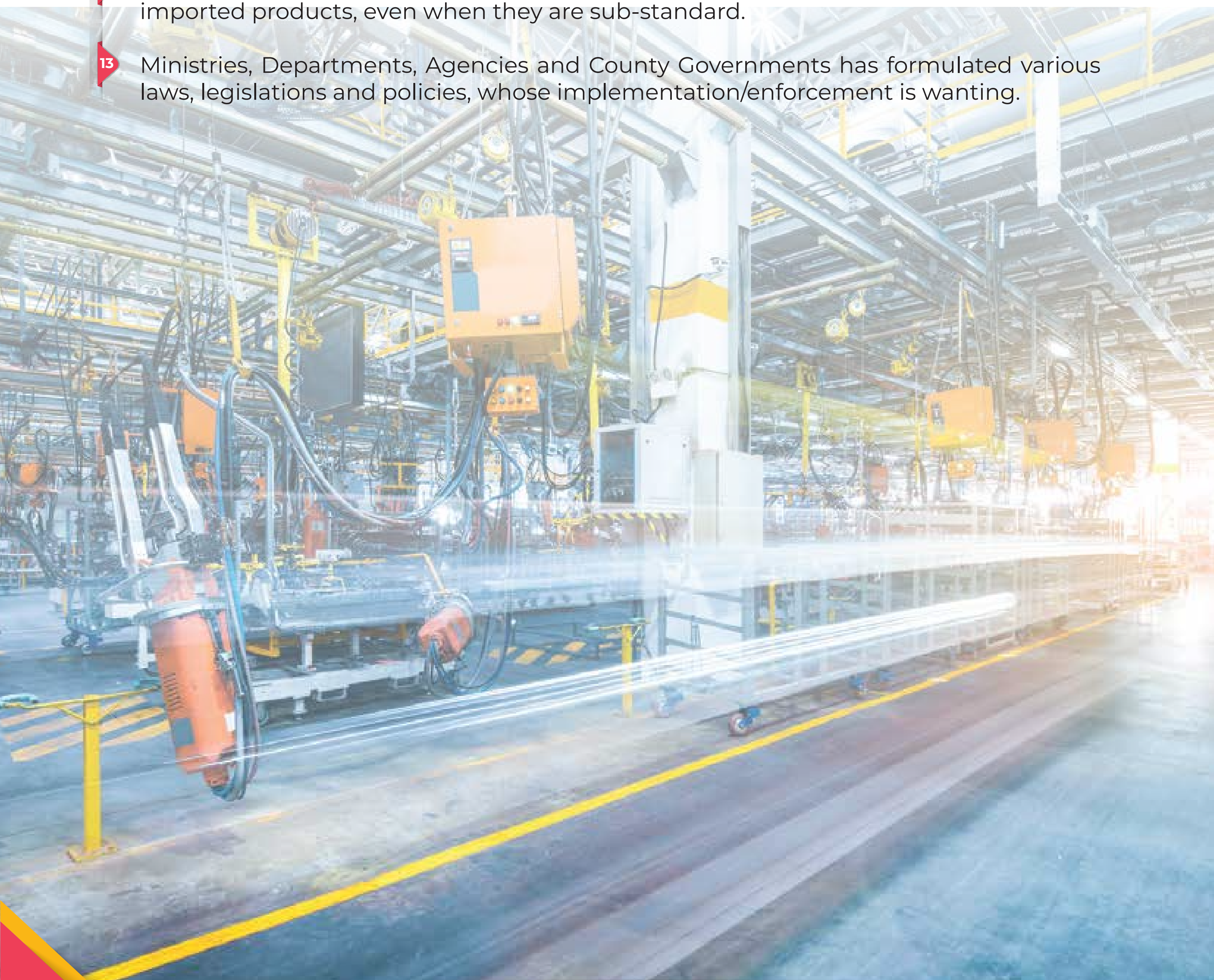
9. Movement of goods across counties is exorbitantly regulated. Distribution licenses are expensive, vary across counties and are mandatory before goods are allowed to transit. This contravenes Article 209 (5) of the Constitution which requires that taxation and other revenue-raising powers of a county shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour.

10. Issuance of permits by regulatory bodies takes a long time to process. Response time by regulators is either not embedded in Service Charters/Service Level Agreements or adhered to. Businesses have to pay huge amounts of money in the form of bribes to save time and avoid cumbersome regulations and lengthy, time-consuming legal actions.

11. Standardization mark and fortification permit are issued separately by Kenya Bureau of Standards (KEBS), yet standardization permit cannot be considered and issued without having fortification permit.

12. Locally manufactured products face stringent regulatory requirements compared to imported products, even when they are sub-standard.

13. Ministries, Departments, Agencies and County Governments has formulated various laws, legislations and policies, whose implementation/enforcement is wanting.



Policy Recommendations

Considering the various constraints and opportunities underscored in the preceding sections, the following policy interventions are recommended:

1. Reduction in the cost of obtaining export permits will make Kenya's exports globally competitive.
2. Streamline approval procedures and protocols between national and county government agencies and communicate this to stakeholders to clarify roles.
3. Merge regulatory bodies that have almost similar or duplicative roles as well as fast-tracking the enactment of the Government Owned Entities Bill. The establishment of government quasi agencies and their funding mechanisms should be clear and realistic from the onset. The need to raise A-I-A and OSR review disadvantages the private sector.
4. Implement a one-stop-shop approach to obtain permits from national and county government agencies. Review fees and regulatory roles of institutions with duplicative roles. These permits should be consolidated into one permit and to be issued by one (1) regulator as opposed to several regulators.
5. Enhance customer support channels to eliminate the need for in-person visits. Chargeable fees and levies should be linked to accessibility and availability of services (such as water and sewerage).
6. Publish a detailed list of requirements for obtaining a permit online to enable manufacturers to submit complete and accurate applications.
7. Consolidation of levy filing, payments and reporting into a unified return.
8. Most county levies and fees are determined haphazardly. Hence, there is need for county governments to formulate tariffs and pricing policy to guide imposition of fees and charges, which is a legal requirement under section 120 of the County Governments Act, 2012.
9. Counties have very different regulations, causing difficulties when it comes to doing business consistently across the country. Kenya needs to further streamline competitiveness, and service operations at the county level to benefit local businesses and to help all counties attract more investment. Fast track completion of the County Licensing (Uniform Procedures) Bill, 2019, which aims to harmonize county licensing processes.
10. Both the national and county governments should prioritize the involvement of manufacturers while formulating laws, regulations and policies. This will ensure realistic charges, levies and user fees.

11. Review goods distribution fees to enhance transportation and reduce logistics cost at the county level. Cess and distribution levies should be charged at the source. In addition to inter-county transportation levies, national government institutions impose charges such as fuel levies, railway development levy and Cess. Cess levied by Kenya Forest Service and Kenya Roads Board should be abolished.

12. County trade permits should be merged to have one business license with all the requirements. Charges for services catered for the Single Business Permit should not be levied and should be scrapped.

13. Reduce the time taken to issue permits. As such, response time by regulators should be embedded in Service Charters/Service Level Agreements, and monitored and adhered to.

14. There is need to merge permits for the standardization mark and fortification permit. This will ensure reduction of costs/fee paid and issuance of only one general permit for products that have mandatory fortification requirements. The standardization permit cannot be considered and issued without having fortification permit.

15. A clear process of documentation and verification of officials by public regulators is required to ensure that all entries into businesses are documented and available publicly.

16. Review regulatory requirements on imports and exports to spur local production. Locally manufactured products face stringent regulatory requirements compared to imported products, even when they are sub-standard. This affects the competitiveness of Kenyan products.

17. Businesses are required to submit reports to different agencies which adds administrative costs. Government agencies should create sharing platforms and work in unity to facilitate compliance and reduce costs for businesses.

18. Enforce compliance with formulated various laws, legislation and policies.

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15 Mwanzi Road opp West Gate Mall,
Westlands, Nairobi, Kenya
E: info[@]kam.co.ke
M: +254 (0) 722201368, 734646004/5
T: +254 (020) 232481