

Improving Productivity of Informal Manufacturing Enterprises through Better Business Environment

By Florine Mwiti and James Kimunge

Introduction

A favourable business environment makes it easy for both domestic enterprises and multinationals to enter and exit from the markets, provides opportunities for low cost of doing business, increases productivity and consequently job creation. Concerted efforts by the Government to improve the business environment in Kenya has seen ease of doing business ranking improve from position 129 in 2014 down to position 56 in 2019 with a doing business score of 73 (Doing Business Report 2020). This improvement can be attributed to improvements in dealing with construction permits, accessing electricity, accessing credit, protecting minority investors, ease of paying taxes and resolving insolvencies. Nevertheless, the country still performed poorly in registering property (scored 53.8) and enforcing contracts (scored 58.3).

Despite the improvement in ranking, businesses in Kenya still face an unfavourable environment. According to the executive opinion survey conducted by the World Economic Forum, business leaders rated corruption, financing, taxation rates, infrastructure and inflation as the most problematic factors affecting the business environment in Kenya. Other factors that followed were crime and theft, inefficient government bureaucracy, tax regulations, policy instability, insufficient ability to innovate, poor work ethic in the national labour force, foreign currency regulations and poor public health (Global Competitive Index Report, 2017-2018).

Literature has proven that inefficiencies in the business environment lead to distortions in the allocation of resources at the firm level and are responsible for the country differences in the level of output and total factor productivity (TFP) growth. To date, there is scanty evidence on how this business environment influences productivity of enterprises, especially the ones operating in the informal sector. Specifically, it is necessary to understand the effect of the business environment on total factor productivity (TFP) of informal manufacturing enterprises in Kenya.

Key Findings

The effect of business environment on productivity of businesses varies from one sector to another. For instance, access to electricity was found to be an important determinant of the productivity of enterprises in food products and wearing apparel sub-sectors. Specifically, firms that had access to electricity in the manufacture of food products had a 0.53 higher productivity than those without access to electricity. Similarly, firms with access to electricity in the wearing apparel sub-sector had a 0.18 higher productivity than those without access to electricity.

Access to water was another determinant of productivity in wearing apparel and wood and wood products sub-sectors. This implies that firms with access to piped water were more productive than those that did not. Specifically, a firm in the manufacture of wearing apparel sector with access to piped water had a 0.79 higher productivity than firms in the same sector without access to this utility.

Training was also found to be an important determinant of productivity of enterprises in the informal manufacturing sector. Firms whose employees had received training in the last three years in the manufacture of fabricated materials sub-sector had a 0.63 higher productivity compared to those in the same sector that had not trained their employees. Moreover, education was found to be an important factor influencing productivity in wood and wood product sub-sectors. The contribution of education to productivity increased as the education level increased. Specifically, those with primary, secondary and post-secondary education had 0.82, 0.85 and 0.88 productivity higher, respectively, than those without any education.

Another key result was that expenditure on research and development was positively influencing productivity in the manufacture of fabricated materials, manufacture of food products, manufacture of wearing apparel and manufacture of wood and wood products sub-sectors. This indicates that research and development is important in improving productivity, but firms spend a minimal amount on it.

The sex of the owner(s) of businesses was also a key determinant of the productivity of enterprises in the sector. The sex variable was positive and significant in the manufacture of wearing apparel sub-sector. Businesses owned by men had a 0.18 higher productivity compared to those owned by women in the same sector. Most authors attribute this observation to the fact that male workers have a higher probability of being in employment, lower probability of being laid off due to longer tenure, have relatively more human capital investment compared to women, and that they are the main providers to household income hence likely to be in employment activities.

Use of computers was also found to affect productivity positively. Firms with access to computers in the food products sub-sector had 1.23 higher productivity than similar firms without access to computers. Similarly, firms in the manufacture of wood and wood products (except furniture), which had access to a computer had a productivity of 2.76 higher than those without access to these services.

Market outlet was another factor that was found to be important in determining the productivity of firms in the manufacture of wood and wood products sub-sectors. Firms that sold to individual consumers were found to have a 1.98 lower productivity than firms that sell to Micro, Small and Medium Enterprises (MSMEs).

Finally, the age of the firm, which is a measure of how long a business has been in operation, was found to have a positive influence on productivity for enterprises in the manufacture of fabricated materials sub-sector. This implies that older firms in this sub-sector were more productive than the younger ones. An increase in firm's age by one year in this sector was found to increase productivity by 0.03.

Policy Recommendations

- **Enhance access to electricity:** There is need for increased distribution of electricity especially for access by the informal sector businesses. This will allow many businesses to use the utility and increase their productivity.

- **Enhance access to water:** There should be more concerted efforts to ensure reliable supply of water to firms where water is an important intermediate input. These include the wearing apparel and wood and wood products sub-sectors. Some of the efforts that can help ensure this include water subsidization and better water management practices such as water recycling and harvesting.
- **Market diversification:** Firms should be encouraged to diversify to target large markets and not just selling to individual consumers. These other sources of market would include other MSMEs, government and export markets.
- **Offer training opportunities:** There is need for policy makers to come up with a framework for training entrepreneurs in the informal sector and to encourage firms to train their workers. This can be done, for example, by decentralizing training centres in different regions in the country. Business owners should be trained on a variety of business skills to enhance better use of their resources.
- **Efforts to bridge gender gap in productivity:** It is necessary for both National and County Governments to come up with policies that promote the productivity of female workers. These can include measures that will encourage women to participate in trainings to improve their skills, for instance subsidizing training for those who cannot afford to pay for it. Also, it is important to provide for child care services to reduce the amount of time women take to care for their children. This will ensure that women have more time devoted to paid work just like their male counterparts.
- **Spend more on research and development:** Businesses should set aside some funds for research and development. Alternatively, the government can develop a kitty and provide intellectual property rights (IPRs) to innovators to encourage the businesses to make new or improved products. This will see the productivity of the informal sector rise.

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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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For More Information Contact:

Kenya Institute for Public Policy Research and Analysis
Bishops Road, Bishops Garden Towers
P.O. Box 56445-00200, Nairobi
Tel: 2719933/4
Cell: 0736712724, 0724256078
Email: admin@kippra.or.ke

Website: <http://www.kippra.org>
Twitter: @kipprakenya