

Governance at the Bottom of the Pyramid:  
Regulating Profit & Corporate Purpose  
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Model: *Jacqueline Waihenya*

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## **Governance at The Bottom of the Pyramid: Regulating Profit & Corporate Purpose in The Kenyan Bottom-Up Economic Model**

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### ***Abstract***

*Academic scholarship of corporate governance in Kenya has evolved into an examination of a landscape defined to include the public and private sectors and to a lesser extent the not-for-profit sectors.*

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*Governance regulation for its part has primarily focused on the public sector with the Mwongozo Code as well as public listed companies and public companies incorporated under the Companies Act. Micro-Small & Medium Sized Enterprises (MSMEs) which form the engine of the economy have historically largely been absent in this conversation primarily justified on the grounds of expense and they have been left to flounder around without form and void. That is, until the Kenya Kwanza Government was elected on a platform described as “Bottom-Up Economic Pyramid Model” bringing into sharp focus an amorphous group baptized “the hustlers” defined loosely to inhabit the bottom of the economic pyramid. Scholarship on the Bottom-Up Economic Transformation Agenda (BETA) remains in the embryonic stage and as it is heavily politically nuanced it bears repeating that the United Nations Sustainable Development Goals Nos.1 and 8 heavily underline inclusive and sustainable growth, employment and decent work for all particularly in the current realities of climate change amid the Post Covid economic global crises. This paper, therefore, seeks to capture the place of key Governance issues that may or may not impact uniquely upon MSMEs, particularly within the emerging dynamic focus on the bottom of the so-called pyramid.*

## **1.0 Introduction:**

It is now widely accepted that good corporate governance practices are a necessary foundation for any institution to engender trust, transparency and accountability which in turn fosters greater confidence for purposes of attracting capital, investment and otherwise signaling long term sustainability.<sup>1</sup>

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<sup>1</sup> OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris. Available at [https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015\\_9789264236882-en](https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en) [Last accessed on 22 June 23]

In Kenya, the study and practice of corporate governance has primarily revolved around the *Mwongozo Code*<sup>2</sup> and the *Capital Markets Authority Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015*<sup>3</sup> both touted to number amongst the most progressive in Africa.<sup>4</sup> These codes being the most prevalent and visible have further been adopted as sources of best practice by institutions and enterprises desirous of voluntarily applying good corporate governance practices.

### 1.1 The Classic Conceptualization of Corporate Governance:

Since the seminal articulation of corporate governance declared in the Cadbury's Report to be *the system by which companies are directed and controlled*<sup>5</sup> the concept has been subjected to various interpretations but is yet to achieve a canonical definition. Whilst in essence corporate governance refers to anything and everything that influences the way in which an institution is run and includes external influences, the preponderance of study and discourse has

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<sup>2</sup> MWONGOZO. *The Code of Governance for State Corporations*. Issued jointly by: Public Service Commission (PSC). State Corporations Advisory Committee (SCAC). Available at <https://www.scac.go.ke/2015-02-16-09-34-58/mwongozo> [Last accessed on 19 June 2023]

<sup>3</sup> Capital Markets Authority, *The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015*. Available at <https://www.cma.or.ke/index.php/regulatory-frame-work/corporate-governance-for-issuers?download=79:code-of-corporate-governance-practices-for-issuers-of-securities-to-the-public-2015> [Last accessed on 19 June 2023]

<sup>4</sup> Scribe Services, *An open letter to Regulators & Boards of Directors* (June 2021) <https://scriberegistrars.com/an-open-letter-to-regulators-and-boards-of-directors/> [Last accessed on 19 June 2023]

<sup>5</sup> Cadbury, A. (1992). *Report of the Committee on the Financial Aspects of Corporate Governance*. London: Gee & Co. Available at [https://www.frc.org.uk/getattachment/9c19ea6f-bcc7-434c-b481-f2e29c1c271a/The-Financial-Aspects-of-Corporate-Governance-\(the-Cadbury-Code\).pdf](https://www.frc.org.uk/getattachment/9c19ea6f-bcc7-434c-b481-f2e29c1c271a/The-Financial-Aspects-of-Corporate-Governance-(the-Cadbury-Code).pdf) [Last accessed on 22 June 2023]

been directed towards the mechanics of internal governance particularly the relationship between the managers, directors and shareholders.<sup>6</sup> This can be attributed to the fact that predominantly the corporate governance machinery has been invoked at various times in response to corporate crises and failure leading to economic hardship.<sup>7</sup>

Accordingly, for instance, the collapse of Maxwell and BCCI lent a great boost to the Cadbury's Report, the Enron Scandal birthed the *Sarbanes-Oxley Act of 2002*<sup>8</sup> and the financial crisis of 2008 paved the way for the *Dodd-Frank Act of 2010*.<sup>9</sup> More recently corporate governance has been expanded to address (1) rising inequality; (2) gender inequity; and (3) human rights and environmental protection<sup>10</sup> providing a response mechanism that has given rise to environmental, social and governance reporting.<sup>11</sup>

The evolution of corporate governance which initially emerged to temper corporate power for the benefit of the public evolved into a conceptualization of shareholder primacy with directors and

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<sup>6</sup> Mariana Pargendler, *The Corporate Governance Obsession* (2016) 42 J Corp L 359 Available on Heinonline [last accessed on 22 Jun 23]

<sup>7</sup> Ibid

<sup>8</sup> Congress.gov. "Text - H.R.3763 - 107th Congress (2001-2002): *Sarbanes-Oxley Act of 2002*." July 30, 2002. Available at <https://www.congress.gov/bill/107th-congress/house-bill/3763/text>. [Last accessed on 22 June 23]

<sup>9</sup> Congress.gov. *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Public Law 203, U.S. Statutes at Large 124 (2010): 1376-2223. Available at <https://www.congress.gov/bill/111th-congress/house-bill/4173/text> [Last accessed on 22 June 23]

<sup>10</sup> Mariana Pargendier Supra Ibid

<sup>11</sup> Satyajit Bose, Guo Dong, Anne Simpson, *The Financial Ecosystem: The Role of Finance in achieving Sustainability* (2019) Palgrave McMillian

managers serving in agency to the owners. Given the scale at which these considerations have been studied and discussed the corporate governance machinery has advanced and expanded to comprise (1) law, regulations, guidelines, policies as well as judicial precedent at the domestic and international planes; (2) government including the legislature and executive particularly regulatory authorities; (3) market institutions and intermediaries; and (4) culture.<sup>12</sup> Naturally, corporate governance has therefore developed into a complex field revolving around public listed entities and government owned entities comprising a plethora of experts from distinct disciplines which number of players have contributed to the significant expense.

## **1.2 The Evolving & Emerging Need to Reconceptualize Corporate Governance for Micro-Small & Medium Enterprises:**

In large part due to the ever-evolving complexity the focus of corporate governance on big business has continued to permeate notwithstanding the fact that in actual fact Micro-Small & Medium-sized Enterprises (MSMEs) are the prevalent model for engaging in business and are in essence the heart and thrust of not only the Kenyan but the global economy.<sup>13</sup>

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<sup>12</sup> Dorothy S. Lund and Elizabeth Pollman, Elizabeth, *The Corporate Governance Machine* (2021). Faculty Scholarship at Penn Carey Law. 2775. Available at [https://scholarship.law.upenn.edu/faculty\\_scholarship/2775](https://scholarship.law.upenn.edu/faculty_scholarship/2775) [Last accessed on 22 June 23]

<sup>13</sup> Joshua Yindenaba Abor & Charles Komla Delali Adjasi, *Corporate Governance and the Small & Medium Sized Enterprises Sector: Theory & Implications* (April 2007) Corporate Governance International Journal of Business Society. Available at DOI: 10.1108/14720700710739769 [Last accessed on 23 June 2023]



The dominant justification for exempting MSMEs from the rigours of corporate governance is the premise that it is “an unnecessary cost” which small institutions ought not to be burdened with.<sup>14</sup>

However, when we recall the OECD articulation of good corporate governance to be to the effect that this comprises the framework governing the relationship of owners, managers and stakeholders of a corporation that contribute to growth, financial stability and integrity as well as economic efficiency<sup>15</sup> coupled with the renewed emphasis on sustainability and resilience in the 2023 revision<sup>16</sup> that was prompted by the Covid 19 Pandemic and its aftershocks on big and small business and the global economic system then a rethink of this premise becomes inevitable.

The prudent approach therefore becomes to work from the premise that good governance is a long journey which SMEs ought to commence adopting from early stages to reap real benefits particularly since there are undeniable benefits.<sup>17</sup> Research further supports the position that poor governance lead directly to poor business performance, fraud and catastrophic failures.<sup>18</sup> The 2 sides of this coin therefore create a rationale and business case to invest in good governance particularly when considering accessibility to credit

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<sup>14</sup> Ibid

<sup>15</sup> OECD Principles of Corporate Governance Supra Ibid

<sup>16</sup> OECD, *Recommendation of the Council on Principles of Corporate Governance*, OECD/LEGAL/0413 (2023) Available at <https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0413> [Last accessed on 22 June 23]

<sup>17</sup> International Finance Corporation, *SME Governance Guidebook* (2019) Available at <https://documents1.worldbank.org/curated/en/594351582262788634/pdf/SME-Governance-Guidebook.pdf> [Last accessed on 22 June 23]

<sup>18</sup> Ibid

and investors arising from enhanced performance, risk management and stakeholder confidence.<sup>19</sup>

## **2.0 Micro-Small & Medium Enterprises:**

Micro, Small & Medium Enterprises (MSMEs) comprise 24% of the Kenya's gross domestic product (GDP) represent over 90% of the private sector enterprises and 93% of the total labour force.<sup>20</sup> This compares with global statistics which per the World Bank<sup>21</sup> and United Nations<sup>22</sup> MSMEs comprise the majority of business worldwide representing 90% of formal global businesses which provide 60% to 70% of employment and 50% of the world's GDP.<sup>23</sup> These numbers increase significantly when informal MSMEs are included.<sup>24</sup> Instructively for our purposes the *United Nations Sustainable Development Goal (SDGs)*<sup>25</sup> which are *a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity*<sup>26</sup> by the year 2030 whose very first goal is the

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<sup>19</sup> Ibid

<sup>20</sup> Micro & Small Enterprises Authority, *Policy Interventions Geared Towards the Growth and Development of the Micro & Small Enterprise Sector in Kenya* (2022). Available at <https://msea.go.ke/wp-content/uploads/2022/03/MSES-HISTORICAL-POLICY-INTERVENTIONS.pdf> <Accessed on 17 May 23>

<sup>21</sup> The World Bank, *Small and Medium Enterprises (SMEs) Finance Improving SMEs' access to finance and finding innovative: solutions to unlock sources of capital* (2023) Available at <https://www.worldbank.org/en/topic/sme/finance> [Last accessed on 18 June 2023]

<sup>22</sup> United Nations, *Micro-Small & Medium Businesses Day June 27* (2023) Available at <https://www.un.org/en/observances/micro-small-medium-businesses-day> [Last accessed on 18 June 2023]

<sup>23</sup> Ibid

<sup>24</sup> The World Bank Supra Ibid

<sup>25</sup> UN General Assembly, *Transforming our world: the 2030 Agenda for Sustainable Development*, 21 October 2015, A/RES/70/1, available at: <https://www.refworld.org/docid/57b6e3e44.html> [Last accessed on 19 June 2023]

<sup>26</sup> Ibid



eradication of extreme poverty in all its forms everywhere<sup>27</sup> whilst Goal 8 promoting inclusive and sustainable economic growth, employment and decent work for all.<sup>28</sup>

## 2.1 A Snapshot History of MSMEs in Kenya:

Policy articulations on MSMEs in Kenya can be traced back to *Sessional Paper No.10 of 1965*<sup>29</sup> entitled the 'African Socialism and its Application to Planning in Kenya' which entrenched Democratic African Socialism championing local indigenous ownership of enterprise. Since then, successive policy articulations such as *Sessional Paper No. 1 of 1986*<sup>30</sup> on Economic Management for Renewed Growth, *Sessional Paper No. 2 of 2005*<sup>31</sup> on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction, *Private Sector Development Strategy Kenya*<sup>32</sup> and the country's development

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<sup>27</sup> Ibid

<sup>28</sup> Ibid

<sup>29</sup> Available at

<https://repository.kippira.or.ke/bitstream/handle/123456789/2345/AFRICAN-SOCIALISM-AND-ITS-APPLICATION-TO-PLANNING-IN-KENYA.pdf?sequence=6&isAllowed=y> [Last accessed on 21 June 23]

<sup>30</sup> Available at

<https://repository.kippira.or.ke/bitstream/handle/123456789/2679/Sessional%20Paper%20no%20of%201986%20Economic%20Management%20for%20Renewed%20Growth.pdf?sequence=1&isAllowed=y> [Last accessed on 21 June 23]

<sup>31</sup> Available at

<https://repository.kippira.or.ke/bitstream/handle/123456789/1360/Sessional%20Paper%20no%20of%202005%20Development%20of%20Micro%20and%20Small%20Enterprises%20for%20Wealth%20and%20Employment%20Creation%20for%20Poverty%20reduction%201%29.pdf?sequence=3&isAllowed=y> [Last accessed on 21 June 23]

<sup>32</sup> Department for International Development, *Private Sector Development Strategy – Prosperity for all: Making Markets Work* (2008) Available at <https://www.enterprise-development.org/wp-content/uploads/DFID-Private-Sector-development-strategy.pdf>

blueprint *Kenya Vision 2030*<sup>33</sup> have continued to advocate the rationalization of MSMEs in Kenya.<sup>34</sup>

## **2.2 MSMEs in the Bottom-Up Economic Transformation Agenda:**

A significant development that has reengineered discourse in the Kenyan legal and economic space is the recent election of the Kenya Kwanza Government on a platform popularized as the Bottom-Up Economic Model resting on the pillars of (1) Agriculture, (2) MSME Economy, (3) Housing and Settlement, (4) Healthcare, (5) Digital and (6) Creative Economy.<sup>35</sup> The Government remodeled this into the Bottom-Up Economic Transformation Agenda (BETA)<sup>36</sup> whose main objective is the improvement of livelihoods and the welfare of Kenyans<sup>37</sup> reiterating the intention to implement policies and

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<sup>33</sup> Supra Ibid

<sup>34</sup> Kenya National Bureau of Statistics, *Micro, Small & Medium Establishments Survey: Basic Report 2016* (September 2016) Available at <https://www.knbs.or.ke/download/2016-msme-basic-report/> [Last accessed on 21 June 2023]

<sup>35</sup> Parliamentary Budget Office, *Assessment of the Cost Implications of the Bottom Up Economic Transformation Plan 2022-2027*, (2022) Available at <http://parliament.go.ke/sites/default/files/2022-11/ASSESSMENT%20OF%20THE%20COST%20IMPLICATIONS%20OF%20THE%20BOTTOM-UP%20ECONOMIC%20TRANSFORMATION%20PLAN%202022-2027.pdf> [Last accessed on 19 June 23]

<sup>36</sup> Njuguna Ndung'u, *Keynote Address by Njuguna Ndung'u CBS Cabinet Secretary for the National Treasury and Economic Planning, During the Sensitization Workshop For Counties on Aligning County Integrated Development Plans 2023-2027 (CIDPs) to the Bottom-Up Economic Transformation (BETA) & Medium-Term Plan IV 2023-2027* Held at PrideInn Paradise Beach Resort, Mombasa (13<sup>th</sup> – 14<sup>th</sup> March 2023). Available at <https://www.planning.go.ke/wp-content/uploads/2023/03/CS-SPEECH-CIDPs-BOTTOM-UP-AGENDA.pdf> [Last accessed on 19 Jun 23]

<sup>37</sup> Ibid

structural reforms in respect of the aforesaid pillars<sup>38</sup> via the County Integrated Development Plans 2023-2027<sup>39</sup> which ought to inform the Fourth Medium Term Plan 2023-2027<sup>40</sup> of the *Kenya Vision 2030*.<sup>41</sup>

Though the fiscal policy on the BETA remains in its early stages, the Concept Note for the Fourth Medium Term Plan identifies MSMEs as having been adversely affected by the Covid Pandemic<sup>42</sup> which slowed down economic performance or outrightly had the effect of closing down businesses.<sup>43</sup> The remedial path that has been identified is *the promotion of MSMEs, addressing of the skills mismatch between demand and supply, and improved linkage between industry and training institutions*.<sup>44</sup> For its part the 2023 Budget Policy Statement<sup>45</sup> themed The Bottom Up Economic Transformation Agenda For Inclusive Growth canvasses the correction of market and institutional failure affecting MSMEs by promoting access to affordable credit to the

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<sup>38</sup> Ibid

<sup>39</sup> Ibid

<sup>40</sup> Ibid

<sup>41</sup> Government of Kenya (2008) *Kenya Vision 2030 A Globally Competitive and Prosperous Kenya* (2008) National Economic and Social Council (NESC), Nairobi. Available at [https://www.planning.go.ke/wp-content/uploads/2020/11/Vision\\_2030\\_-\\_2007.pdf](https://www.planning.go.ke/wp-content/uploads/2020/11/Vision_2030_-_2007.pdf) [Last accessed on 20 June 23]

<sup>42</sup> State Department for National Planning, *Concept Note: Fourth Medium Term Plan 2023-2027* (February 2023) The National Treasury & Planning. Available at <https://www.planning.go.ke/wp-content/uploads/2022/02/Final-MTP-2023-2027-Concept-Note-1-Final.pdf> [Last accessed on 20 June 23]

<sup>43</sup> Ibid

<sup>44</sup> Ibid

<sup>45</sup> National Treasury & Economic Planning, *2023 Budget Policy Statement, Themed The Bottom-Up Economic Transformation Agenda For Inclusive Growth* (February 2023). Available at <https://www.treasury.go.ke/wp-content/uploads/2023/02/2023-Budget-Policy-Statement.pdf> [Last accessed on 20 June 23]

bottom of the pyramid.<sup>46</sup> This being done via the Hustler Fund, the Youth Enterprise Development Fund, Women Enterprise Fund and provision of financing to SMEs in the manufacturing sector.<sup>47</sup> The Budget 2023<sup>48</sup> further contemplates easing access to opportunities and the cost of doing business under the (1) Access to Government Procurement Opportunities (AGPO) for women, youth and persons living with disabilities led MSMEs within the public procurement space; (2) the Capital Markets (Public Offers and Disclosures) Regulations, 2023 and Capital Markets (Investment Based Crowdfunding) Regulations, 2022 providing local and global financing and funding opportunities; and (3) Competition and Consumer Protection exemptions.

### **2.3 The Alternative Paradigm of Development from Below:**

There does not appear to be any consensus on the definition of the concept of bottom-up approach other than that it is an alternative paradigm to the traditional conventional economic development model.<sup>49</sup> Descriptors such as bottom-up, development from below, grassroots development started to emerge with dissatisfaction with the dominant development paradigm also denoted as the top-down/trickle-down approach<sup>50</sup> which focuses on industrialization

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<sup>46</sup> Ibid

<sup>47</sup> Ibid

<sup>48</sup> National Treasury & Economic Planning, *Budget Statement 2023* (June 2023). Available at <https://www.treasury.go.ke/wp-content/uploads/2023/06/Budget-Statement-for-the-FY-2023-24.pdf> [Last accessed on 20 June 2023]

<sup>49</sup> Bishwapriya Sanyal, *The Myth of Development from Below*, (2020) Massachusetts Institute of Technology. Available at <http://web.mit.edu/sanyal/www/articles/Myth%20of%20Dev.pdf> [Last accessed on 21 June 23]

<sup>50</sup> Ibid

and economic growth. The alternative paradigm for its part is geared towards achieving self-governance and economic self-sufficiency.<sup>51</sup> Prerequisites for bottom-up models to generate employment include (1) a supportive legal framework allowing for private production, entrepreneurship as well as the protection of property rights; (2) a stable macro-economic environment; and (3) a critical mass of capable persons and business entities imbued with a robust entrepreneurial spirit.<sup>52</sup>

#### **2.4 Defining Micro, Small & Medium Enterprises:**

The *Micro & Small Enterprises Act*<sup>53</sup> enacted to promote, develop and regulate micro & small enterprises and otherwise establish the Micro Small Enterprises Authority defines an enterprise to be any formal or informal business concern engaged in the production of goods or provision of services.<sup>54</sup> The Act further proceeds to provide 2 separate definitions for micro-enterprises and small enterprises respectively to be (1) Micro-enterprises<sup>55</sup> - a business whose turnover does not exceed Kshs.500,000.00 per annum,<sup>56</sup> that employs less than 10 persons,<sup>57</sup> whose plant and machinery is not valued at more than Kshs.10 million (manufacturing)<sup>58</sup> or Kshs.5 million (services);<sup>59</sup> and (2) Small enterprises - a business whose turnover is between

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<sup>51</sup> Ibid

<sup>52</sup> Horst Brezinski & Michael Fritsch, *Bottom-Up Transformation: Prerequisites, Scope & Impediments* (1996) *International Journal of Social Economics*, Vol. 23 No. 10/11, 1996, pp. 297-310. © MCB University Press, 0306-8293

<sup>53</sup> Act No.15 of 2022

<sup>54</sup> Section 2 – Micro & Small Enterprises Act, Act No.15 of 2022

<sup>55</sup> Section 2

<sup>56</sup> Section 2 Micro-enterprises (a)

<sup>57</sup> Section 2 Micro-enterprises (b)

<sup>58</sup> Section 2 Micro-enterprises (c)

<sup>59</sup> Section 2 Micro-enterprises (d)

Kshs.500,000.00 to Kshs.5 million per annum,<sup>60</sup> that employs less than 10 – 50 persons,<sup>61</sup> whose plant and machinery is not valued at more than Kshs.10 million to Kshs.50million (manufacturing)<sup>62</sup> or Kshs.5 million to Kshs.20 million (services).<sup>63</sup> Medium enterprises for their part are defined in the *Public Finance Management (Amendment) (No.2) Act, 2020* to be a business whose turnover is between Kshs.5 million and Kshs.100 million per annum,<sup>64</sup> that employs less than 51 – 250 persons,<sup>65</sup> whose plant and machinery is not valued at more than Kshs.250million (manufacturing)<sup>66</sup> or Kshs.125 million (services).<sup>67</sup> The *Public Finance Management (Financial Inclusion Regulations), 2022*<sup>68</sup> popularly known as “**the Hustler Fund**” Regulations further define the “bottom of the pyramid” to mean a socio-economic group of persons with low disposable income<sup>69</sup> and these regulations adopt the definitions of both micro & small enterprises to be as per the *Micro & Small Enterprises Act*.<sup>70</sup>

The foregoing definitions belie the challenges of attempts to stratify MSMEs as (1) they are represented in practically all sectors of the economy and are therefore subject to different dynamics; (2) they operate both formally and informally; (3) they are located in both business locations, markets and households whilst some are highly

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<sup>60</sup> Section 2 Small-enterprises (a)

<sup>61</sup> Section 2 Small-enterprises (b)

<sup>62</sup> Section 2 Small-enterprises (c)

<sup>63</sup> Section 2 Small-enterprises (d)

<sup>64</sup> Section 2 PFM Amendment Act (a)

<sup>65</sup> Section 2 PFM Amendment Act (b)

<sup>66</sup> Section 2 PFM Amendment Act (c)(i)

<sup>67</sup> Section 2 PFM Amendment Act (c)(ii)

<sup>68</sup> Legal Notice No.213 of 23<sup>rd</sup> November 2022

<sup>69</sup> Section 2 – Public Finance Management Act 2012

<sup>70</sup> Act No.15 of 2022



mobile; (4) others operate seasonally.<sup>71</sup> It is further important to note that the reference to employment in the policy framework and the *Micro & Small Enterprises Act* <sup>72</sup> is a fairly fluid approach which includes owners, workers, operators, apprentices, casual workers, fully paid employees and even unpaid family members.<sup>73</sup> Also, save in agri-business many MSMEs are engaged in non-primary product activities or businesses.<sup>74</sup>

### **3.0 Corporate Governance Framework For MSMEs in Kenya:**

The predominant theme of this paper is that SME governance in Kenya comprises a veritable black-box whose internal and external workings remain largely hidden and mysterious to the intended users. An attempt to open this gap up for our better understanding can be summarized to reveal the following:

#### **3.1 Registration of MSMEs in Kenya:**

Historically, MSMEs in Kenya have operated formally and informally.<sup>75</sup>

##### **3.1.1 MSMEs in the formal sector:**

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<sup>71</sup> Kenya National Bureau of Statistics, *Micro, Small & Medium Establishments Survey: Basic Report 2016* (September 2016) Available at <https://www.knbs.or.ke/download/2016-msme-basic-report/> [Last accessed on 21 June 2023]

<sup>72</sup> Act No.15 of 2022

<sup>73</sup> Ibid

<sup>74</sup> Ibid

<sup>75</sup> Sessional Paper No.5 of 2020, on *Kenya Micro and Small Enterprises Policy for Promoting Micro and Small Enterprises (MSEs) for Wealth and Employment Creation*. Available at <https://msea.go.ke/wp-content/uploads/2021/07/MSEs-Policy.pdf> [Last accessed on 26 June 2023]

Those MSMEs within the formal sector have tended to be registered as sole proprietorships, partnerships and companies and are regulated under the Registration of Business Names Act,<sup>76</sup> the Partnerships Act,<sup>77</sup> the Limited Liability Partnerships Act,<sup>78</sup> and the Companies Act, 2015<sup>79</sup> respectively.

	2016	2017	2018	2019	2020	2021	2022
Business Names	48,983	60,625	56,763	73,302	101,674	85,592	79,572
Private Companies	31,481	46,256	40,677	44,128	50,932	46,215	52,977
Public Companies	31	70	82	74	179	82	77
Foreign Companies	75	182	171	145	182	196	162
Companies Limited by Guarantee	158	184	227	536	490	490	357
Limited Liability Partnerships	118	380	382	424	448	448	470
Strike Off	-	-	-	-	-	-	1,469
Total entities registered	80,846	107,697	98,302	118,609	133,023	133,023	133,615

*Fig.1 – Extract of Business Registration Services: Summary of Registered Entities<sup>80</sup>*

**3.1.2 MSMEs in the informal sector:**

<sup>76</sup> Chapter 499 of the Laws of Kenya

<sup>77</sup> Chapter 29 of the Laws of Kenya

<sup>78</sup> Act No.42 of 2011

<sup>79</sup> Act No.17 of 2015 (Amended in 2020)

<sup>80</sup> Complete data & statistics Available at <https://brs.go.ke/companies-registry-statistics/> [Last accessed on 23 June 2023]

It is also possible to register a self-help group popularly known as a *Chama* in Kenya's *lingua franca* through the Ministry for Gender<sup>81</sup> now designated the Ministry of Public Service, Youth and Gender Affairs. *Chama*'s have historically been used by women's group for table banking purposes as a social insurance mechanism for small groups of at least 10 members to support each other.<sup>82</sup> In time some *Chama*'s have achieved considerable success by adopting good corporate governance principles growing into impressive investments machines.<sup>83</sup> The new Hustler Fund Regulations define a *Chama* to be a registered group of persons pursuing common objectives by pooling resources together to empower one another economically.<sup>84</sup> Other potential regimes for registration include the *Micro & Small Enterprises Act*.<sup>85</sup> The provisions of this Act are permissive rather than prescriptive and though it promotes the realization of SDG target number 8.3<sup>86</sup> also buttresses the country's fragmented and multiple registration regimes that contribute instead to some MSMEs operating outside of any registration framework provided by Kenyan

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<sup>81</sup> Sophie Oyugi, *How to Register a Group*, (2013) The Standard Group. Available at [Last accessed on 26 June 2023]

<sup>82</sup> Ibid

<sup>83</sup> Florence Bett, *Chamas with Wealth & Influence - Women's investment groups are finally going from merry-go-round meet-ups to savvy money makers* (8 March 2014) Nation Media. Available at <https://nation.africa/kenya/life-and-style/saturday-magazine/chamas-with-wealth-and-influence-958660> [Last accessed on 26 June 2023]

<sup>84</sup> Section 2 – Hustler Fund Regulations

<sup>85</sup> Act No.15 of 2022

<sup>86</sup> United Nations, *Policy Guidelines for the Formalization of Micro-, Small & Medium Sized Enterprises (MSMEs) in Kenya* (12 August 2021) Available at <https://sdgs.un.org/sites/default/files/2022-03/Policy%20guidelines%20for%20the%20formalization%20of%20MSMEs%20in%20Kenya.pdf> [Last accessed on 27 June 23]

laws due to the overlaps that emerge doing little or nothing to incentivize formalization.<sup>87</sup>

These 2 foregoing regimes greatly reduce the applicable formalities though they still require the execution of a constitutive document and the identification documents of the members.<sup>88</sup> The output is a certificate of registration which outlines the name of the group and the period of validity.<sup>89</sup>

The permissive nature of MSME registration is lauded in some quarters for it is said to simplify the processes and procedures that an MSME is required to fulfil before proceeding to engage in entrepreneurship and this may be so for start ups and cottage industries. Nevertheless, such advantage does have the severe limitation of failing to equip such an entity with the power to sue and be sued as well as to borrow in its own name. The immediate exposure for its members is that they are all fully liable for each other's missteps and commitments made by the entity may create future liabilities with claims even attaching upon the members' personal wealth.

### **3.2 Constitutive Documents:**

Other than a sole proprietorship business enterprises such as partnerships, companies, MSEs and Chama's are required to have constitutive documents signed by the members pursuant to each of the Acts that these are registered under. These come in the form of (1)

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<sup>87</sup> Ibid

<sup>88</sup> Section 5 – MSE Act

<sup>89</sup> Section 7 – MSE Act

partnership deeds;<sup>90</sup> (2) memorandum & articles of association;<sup>91</sup> and (3) constitutions.<sup>92</sup> Such documents have become increasingly prescriptive in the respective Acts and the prescribed forms under such Acts set forth requirements as to the name of the enterprise, how to acquire or terminate membership, the cost of maintaining such membership, membership registers and importantly how records and minutes of the entity are prepared and kept. They also set out the office bearers and each of their responsibilities as well as the mechanics for general meetings and the management of the entities funds and how property is held.

This approach of “one size fits all” is in actual fact counterintuitive and delivers scant benefit to MSMEs. An approach that would bear greater fruits would of necessity distinguish between the key evolutionary stages of growth of an MSME starting with (1) start-ups; (2) active growth; (3) organizational development; and (4) business expansion.<sup>93</sup> Each of these stages requires different systems and processes to be responsive flowing from the typical characteristic of the Key Personnel at the start-up level and evolving through the stages to bring in complementary skills mix to the management of the enterprise usually through representative boards even as the institution approaches strategic oversight at the level where a classic corporate governance framework then becomes imperative.<sup>94</sup>

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<sup>90</sup> Chapter 29 of the Laws of Kenya as well as custom and practice on the establishment of partnerships

<sup>91</sup> Companies Act, Act No.17 of 2015 (Amended in 2020) outlines the requirements in respect of the Memorandum & Articles of Association

<sup>92</sup> Per the provisions of the Micro & Small Enterprises Act, Act No.15 of 2022 as well as the registration of self-help groups in the Ministry of Gender

<sup>93</sup> IFC SME Governance Guidebook Supra Ibid

<sup>94</sup> Ibid

### **3.3 Access to Credit:**

The Hustler Fund Regulations set an eligibility criteria for access to funding at Regulation 19 where an individual requires to provide their identification documents to demonstrate they have attained the age of majority.<sup>95</sup> Enterprises for their part require all members to be above the age of 18 years old and be registered with the relevant government institution.<sup>96</sup> The motivation for repayment being leveraging of creditworthiness through a yet to be named credit scoring model.<sup>97</sup>

Since its launch in November 2022 the first phase of the Fund being access to individuals was reported to have achieved significant success paving way for the next level which will incorporate chamas, self-help groups was launched in June 2023.<sup>98</sup> Considering the progression and evolution of this particular product we can expect that the corporate governance toolkit for such enterprises will require to be more sophisticated than those tools adopted by individuals who patronized the fund at the onset.<sup>99</sup>

### **3.4 Financial Reporting:**

None of the formal registration legislation affecting MSMEs makes provision requiring such entities to maintain financial records and accounts. In actual fact Section 711 of the Companies Act specifically exempts small companies from the mandatory provisions requiring the preparation of audited accounts. Per section 624 a company

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<sup>95</sup> Hustler Regulations - Regulation 19(1)

<sup>96</sup> Hustler Regulations - Regulation 19(2)

<sup>97</sup> Hustler Regulations - Regulation 18(2)

<sup>98</sup> Fridah Naliaka, *President Ruto Launches 2<sup>nd</sup> Product of Hustler Fund* (1 June 2023). Available at <https://www.citizen.digital/news/president-ruto-to-launch-second-product-of-hustler-fund-n320787> [Last accessed 24 June 2023]

<sup>99</sup> IFC SME Governance Guidebook Supra Ibid



qualifies to be a small company where (1) its turnover is not more than Kshs.50million; (2) its balance sheet net assets do not exceed Kshs.20million; and (3) it does not have more than 25 employees. These provisions are completely at variance with the position that effective and efficient organizational systems, appropriate accounting processes and procedures coupled with a robust internal and external financial reporting system are key to the success of a business enterprise.<sup>100</sup>

#### **4.0 Conclusion:**

The foregoing can be described to be the proverbial tip of the iceberg insofar as SME Governance in Kenya is concerned. It is anticipated that this space being in the early stages of scholarship and discourse requires to be studied and brought to the fore. Ultimately, the same will require to be reengineered into a coherent body transfigured to fit the realities of Kenya and the country's emerging and dynamic needs.

In the intervening period it seems safe to conclude that good corporate governance principles are required across the board to signal confidence in big and small business alike and are a legitimate marker for sustainability. However, whilst classic corporate governance continues to be a perfect fit for public listed companies and government owned entities a different approach that contends with the challenges MSMEs face in Kenya requires to be put in place.

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<sup>100</sup> Nohade Nasrallah & R. El Khoury: *Is corporate governance a good predictor of SMEs financial performance? Evidence from developing countries (the case of Lebanon)*, (2021) *Journal of Sustainable Finance & Investment*. Available at <https://doi.org/10.1080/20430795.2021.1874213> [Last accessed on 24 June 2023]

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