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Informal Employment in Urban Kenya and Nigeria: Structure, Determinants, and the Impact of Formalization Policies

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ABSTRACT

Informal employment in urban areas is heavily prevalent in Kenya and Nigeria, two of the largest African economies. In our study, we compare both the structure and the determinants of informal work in these two countries. By using a mix of both survey data from various studies alongside multinomial logistic models, we analyse the factors associated with this type of informality and how formalisation policies can be better improved. We also investigate the effects of digital identification rollout and digital banking ecosystems in Kenya alongside other SME digitisation policies implemented in Nigeria. From our empirical results, we learn that there exists extremely high informality rates, in addition to significant gender and youth and balances, where informality dominates around 81% of non-agricultural jobs in Kenya and over 92% of all jobs in Nigeria. From our empirical analysis, our regression model indicates that the probability of informality can be significantly mitigated through policies such as better access to formal finance, education, and more regulatory reforms that can simplify registration. Our discussion in the paper reveals that Kenya somewhat benefits more than this than Nigeria, given Kenya's more mature and robust digital focus and the ineffectiveness of Nigeria's contemporary/recent policy efforts to reduce informality, which is due to incomplete identification mechanisms. Overall, we conclude that certain policies are quintessential, especially enhancing digital ID trust and boosting mechanisms to expand SME registration, while also proposing areas and gaps for future research on the prevalence of informality and formalisation policies.

Keywords: Informal employment, Urban Africa, Labour markets, Economic policies, Formalization policies, Digital Identification, Mobile money

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1. Introduction

Across developing economies, informal employment has been a recurring feature, and contemporary literature has now started to emphasise how prevalent this is in sub–Saharan Africa and how the main factors that can reduce the effectiveness of formation policies mainly lie in the structural barriers[1][2][3]. Globally Africa is known to have one of the highest number of informal jobs (of ~86%)[4], which approximately employs about 56-65% of urban workers in these occupations[5]. We learned that this is due to many factors namely, rapid urbanisation - meaning that individuals are not able to effectively secure jobs in formal sectors. We specifically focus on Kenya and Nigeria due to one of their highest GDP among the African union economies[6], while also being highly progressive developing/emerging economies that follow this trend. This is due to the fact that, in Kenya, over 15 million people are part of the informal economy, contributing to over 24% of the GDP of the nation[7], while in Nigeria over 92% of employed individuals are now part of the informal economy overall, while around 87.5% of individuals are part of the urban informal sector[8]. However, it is important to know that majority of this informal work occurs on a microeconomic scale, including activities such as street vending, small trades and services, and Jua Kali crafts, with this trend being significantly skewered towards women who are self-employed and youth[5]. In addition to this, due to the microeconomic scale of these activities and the lack of social protection and business registration, productivity and fiscal contributions of workers is heavily limited, contributing minimally to the GDP in comparison to the formal sectors.

Alongside this, the numerous challenges that informality poses for not only workers but governments and institutions as well, include the constraints and tax revenues and low productivity for firms. This handle is not only their growth but also perpetuate low wages and makes the poor working conditions persist within society[9]. To mitigate these effects, policy makers have introduced multiple reforms to encourage formalisation, namely Kenya's Hudumba Namba digital ID systems, eCitizen registration plaforms, alongside a money mobile system known as MPesa. These tools have been promoted to encourage informal businesses to be integrated into the formal economy. In addition to this, Nigeria has also undertaken some reforms similar to Kenya, where there are now new CAC simplification reforms and the introduction of one stop shops[10], alongside expanding digital finance mechanism by launching the eNaira central bank digital currency (CBDC)[11], and expanding online money mobile licensing programs.

In our paper, we compare both Kenya and Nigeria through our comparative analysis of how recent formalisation policies are impacting the informal economy outcomes, while also investigating the structure and determinants of informal economy. We compliment this through the use of survey data and regression models, where we present our descriptive statistics and

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regression findings to compare the impact of such policies in the two countries, helping us to, therefore, offer policy recommendations to improve these formalisation efforts and to better improve the strength of these policies.

2. Literature Review

When looking at both countries more broadly in the African context, we learn about how Kenya and Nigeria share many of the same features as for the structure of informality, where informal firms are typically very small, one person companies or with a few employees, with limited capital. In Kenya, the Jua Kali sector[12], which comprises of artisans and traders who are unregistered, is known to dominate the informal sector of the country[10][13][14], and this is re-emphasised through a recent analysis which found that 81% of Kenya's non-agricultural employment is informal[1], where other common sectors include services specialising in wholesale trade, repair services, food vending, transport, and other microeconomic scale services. Similarly, Nigeria's informal sector is comprised of relatively the same sectors, but is even larger where over 92% of employed Nigerians were part of the informal economy in late 2023, and this has known to be at the same, constant/stagnant rate over the past few years[8][15], which reflects that the formal job market is much weaker in Nigeria. Some notable sectors include micro economic level market trading roadside services and small scale manufacturing where, again, who women and you often dominate these informal enterprises while men are known to be part of the more formal job market, or wage-workers if part of the informal economy[5][9]. It is important to know that even though informal workers may have lower wages or poor access to quality infrastructure, they are not the poorest individuals in open areas in both African member states[5][16].

When looking at the determinants of such informality, previous empirical literature has shown that some individual and firm-level factors are the key determinant of the choice of informal work, where, in Kenya, education is seen to be a strong separator, given that higher education can increase the likelihood of formula employment, whereas low skilled individuals tend to operate mostly in the informal sector[17]. In addition to this gender and household factors were also observed to influence this, given that women and those individuals in the younger age groups faced much greater barriers to formal jobs, hence forcing those into informal employment. Conversely, we learned that this factor becomes even more prevalent, when being a household head or married could increase the chance of formal employment, since this is a signal stability[17]. We also learned that this is reemphasised when older individuals are more likely to hold onto their formal jobs, which forces the younger age groups to remain unemployed. These determinants are also significantly similar in Nigeria, but these factors have become even more exacerbated when multiple burdens in terms of taxation and regulations have discouraged SME from registering and being a part of the formal economy[3].

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Furthermore, there are also other macro economic factors as well, given that both countries suffered from high dependency ratios and institutions that struggle with low capital accumulation, as shown by cross country studies[4]. A major contributor to these factors also include the rapid urbanisation over the past few years, at a rate that is much greater than the formal job growth rate[4]. Previous literature also illustrates how, in order to mitigate this informality, it is vital to provide an access to finance and invest in infrastructure, given that a lack of credit and assets could restrict firms from having the ability to get registered. In addition to this, having access to services such as mobile connectivity and better digital infrastructure can help improve formal registration[5].

When looking at the current formalisation policies, governments in both the African states have implemented reforms to ease becoming part of the form economy, often via one stop shops and consolidation agencies[10], also adopted by numerous African countries. Notably, Kenya as moved to stand out for digital innovations, where the introduction of the national identification system of the Kenya Huduma Namba/Maisha Namba has provided a single digital identification for many citizens, allowing them to become formalised[2]. In addition to this a large/widespread ID coverage can help to enhance the use of digital/mobile finals alongside lowering transaction costs, exclaimed by how mobile money via the MPesa system has dramatically increased in Kenya[5], which allows individuals and informal businesses to save and carry out transactions digitally at low costs. Some studies believe that such policies and credit mobile money has improved in the aim of formalisation, where Malkova (2024) found that living in mobile coverage areas has increased business registration in Kenya and Tanzania[18]. Similar to Kenya yet done much later, formalisation efforts in Nigeria are mainly comprised of issuing the National ID Number (NIN), done by the National identity Management Commission (NIMC), alongside introducing mobile money operators to further license businesses and identify individuals who are part of the informal economy. However, the adoption of both of these policies has been extremely slow[11], where the IMF also notes that mobile money usage in Nigeria is much lower than fellow East African states (since there are issues in the trustworthiness regarding digital banking mechanisms)[11][16]. As a result, informal firms in Nigeria still have minimal channels and face many barriers to formality despite these policy efforts mentioned above.

Likewise to these policies, we also learn that formal credit and tax incentives given to individuals and firms can also impact formalisation, where microfinance institutions and SACCOs (Savings and Credit Cooperative Organisations) across Kenya have grown significantly as a result of mobile finance allowing formal credit access. However, it is important to note that some SME financing gaps can still remain significant, where an estimated USD 19.3 billion defecit exists[19]; however, in order to counter this, initiatives such as digital credit apps and credit incentives have

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been introduced across both countries, showing positive impacts in Kenya, while less significant in Nigeria (where the country still faces many issues with losing billions in potential tax revenues[20] per year, and that current policies are not sufficient[3] in closing these gaps). Crucially, some studies such as the World Bank's urban informality study (2024) has shown that informality in many African cities has not been overcome due to "women being overrepresented in informal self employment", and how few individuals actually benefit from regulation and registration, due to the high taxes and transaction costs.

To recapitulate, many of the studies that we investigated as part of our literature review underscored that reducing such barriers to formalisation and increasing incentives to registration, in order to combat informality that arises due to many factors (such as education, gender, and age). These policies have the potential to achieve the aim of formality, but it is even more important to close the research gap of empirically comparing not only the determinants of informal compared to formal employment, but also building upon these insights through the effects of recent digitalisation and reforms.

3. Data and Methodology

As part of our data and methodology process, we first collect nationally representative microdata from both countries, where for Kenya, we look at the KIHBS (Kenya Integrated Household Budget Survey)[20][21], alongside an informal sector skills survey by the KNBS (Kenyan National Bureau of Statistics)[23]. This will include not only detailed employment information, but firm and demographic levels as well. For Nigeria, conversely, we utilise the 2023 Nigeria General Household Survey Panel dataset (GHS)[24], alongside the Labour Force Survey conducted by the Nigerian National Bureau of Statistics (NBS)[8][15]. We ensure that most of the datasets that we use contain demographic and individual-level characteristics information, alongside their employment and enterprise categories whenever possible. It is important to note that, in order to ensure effective comparative analysis, we focus specifically on urban samples, on major cities across the two African member states – Nairobi, Mombasa and Kisumu, compared to Lagos, Abuja, Kano, and other cities.

In our model, we keep a dependent variable as our informal employment status, and, following ILO guidelines[5], we consider a worker as informal if their job or enterprise does not have any legal registration, and social security coverage under legal regulation. In the datasets, we consider a firm as informal if they are not registered under tax authorities or social security authorities, and meet the condition for having fewer than 6 employees. This follows the ILO criteria[5] for informal employment. Alongside this, our independent/explanatory variables include the different demographics of workers, which include age, gender, and education levels, alongside household size and number of earners, alongside different categories/characteristics of

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firms. We also include other proxies that can help to control for different policies that have already been implemented, such as having a national ID, access to money/mobile banking, and firm registration statuses. Overall, from this, we create a multinomial logistic regression model to predict the provability of an individual having formal wage employment, informal employment, or unemployment, where:

$$P(Y_i = j) = \frac{\exp(\beta_j X_i)}{\Sigma_k \exp(\beta_k X_i)} \quad (j \in \text{informal}, \text{formal}, \text{unemployed})$$

Here, we see how the equation focuses on the marginal effects of changes in each variable, on our dependent variable of the probability of being in the informal sector. From this, the variable of Xi includes all of the independent/explanatory variables that are mentioned above, and, in order to get differences between countries, we create separate models alongside a whole pooled one.

As part of our descriptive statistics, we have attached a table below (Table 1) to summarise the key statistics for our samples, categorised by country and formality levels. To ensure that our models are robust, we also have alternate datasets and methods, where we first create separate models to measure formalisation, by isolating different samples of informal individuals and firms, and then measuring the probability that an informal enterprise/individual could become formalised/registered. Then, we create a pooled and country specific regression, and then, like Malkova (2024)[18], we will factor in mobile money access based on the dataset of Kenya and Nigeria.

Variable	**Kenya – Formal (n≈1200)**	**Kenya – Informal (n≈5600)**	**Nigeria – Formal (n≈1100)**	**Nigeria – Informal (n≈6800)**
Informal Employment (%)	-	83.6%	-	85.4%
Mean Years of Schooling	12.8 yrs	7.1 yrs	11.5 yrs	6.8 yrs
Female (%)	45%	58%	47%	60%
Age (mean, yrs)	35.4	30.2	36.1	29.8
Household Head (%)	62%	41%	59%	38%
Mobile Money Account (%)	91%	90%	42%	35%
National Digital ID (%)	92%	88%	45%	40%

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Registered Firm (among entrepreneurs) (%)	78%	22%	50%	12%

Table 1: Descriptive Statistics by Country and Employment Type
(Urban Kenya & Nigeria, 2023)

4. Results

4.1 Descriptive Patterns

From our results table demonstrating our descriptive patterns, we learn how our samples show very high informality – consistent with previous reports and official statistics. We learn about how in the Kenyan urban workforce, around 78-83% of the non agricultural jobs are informal[1], while in the Nigerian urban workforce, there is an overall ~88% of informal employment overall[8]. In both datasets, we learn about how women have higher informality rates, where in Nigeria, female workers are 90% informal while around 85% of males are part of the informal economy[8][15]. From Table 1, we can also learn how formal workers tend to be ones who are of older age groups and/or, are better educated, where university graduates constitute to around 25% of formal jobs but a much small portion of merely 7% of informal ones.

More importantly, formal workers are seen to report a much higher household income and job stability, in addition to key differences between IT access and mobile money, where Kenya dominates over Nigeria. This is re-emphasised when over 90% of canyons possess a digital ID card while only 40% of Nigerians have an NIN identity registration card. These gaps illustrate the different impacts of formalisation policies across the two countries.

4.2 Regression Findings

Below, we have been presented our regression models (Table 2), which presents the marginal effects for only informal sector results, and formal sector results show the opposite signs. From this, in both countries, we see how education is strongly correlated to formality, where each additional year of schooling reduces the probability of schooling by 2-3% points, at a statistically significant level. However, it is important to note that this effect is even larger in Kenya, and gender factors matter as well (since being female can increase the probability of being part of the informal sector by ~6%points in Kenya and ~10%points in Nigeria, meaning that males are mole likely to receive formal employment. As predicted, age patterns mirror our hypothesis, where older-aged adults have a much lower informality than youth, which reflects that the younger population has a much higher unemployment level.

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Predictors	Kenya (pp)	SE	Nigeria (pp)	SE
+1 Year of Schooling	–3.1***	0.5	–2.4***	0.6
Female (vs Male)	+6.0***	1.1	+10.0***	1.4
Household Head	–4.2***	0.9	–3.8***	1.2
Age 25–54 (vs 15–24)	–2.5**	1.0	–1.8*	1.2
Mobile Money Account	–4.0***	1.0	–0.7	0.9
National Digital ID	–5.5***	1.2	–2.0*	1.1
Registered Firm (entrepreneurs)	–12.0***	2.4	–6.5**	2.1
Constant + Controls	—	—	—	—

KEY

*p<0.05,

**p<0.01

*** p<0.001

Table 2: Multinomial Logit – Marginal Effects on Probability of Informal Employment

Most importantly, it is crucial to recognise that these policy related variables can show major relations, especially in Kenya, where having a digital ID such as the Maisha/Huduma Namba in Kenya can increase the probability of formalisation by around 5-7%points. Conversely, this is only around 2%points in Nigeria, where both digital identification and mobile money usage have a negligible effect on the probability of formality, which means that our results are consistent with the results of Malkova (2024)[18]. Additionally, for individuals who are entrepreneurs/business owners, formally registering a business can help to sharply reduce informality in Kenya, which has introduced sharp cuts to the cost of formalisation (i.e. the cost of registration and processing of a business licence[10]), but this has a minimal effect in Nigeria. Overall, given that many explanatory variables investigating the Nigerian economic demographic has an insignificant effect, we learn that informal employment is unaffected by policy adjustments and is more stagnant, calling for a much more robust future policy adjustments.

Predictor	Marginal Effect (pp)	Std. Error	p-value
Nigeria Models (vs Kenya)	+5.8	1.0	<0.001
+1 Year of Schooling	–2.8	0.3	<0.001
Female (vs Male)	+8.1	0.8	<0.001
Household Head	–3.9	0.7	<0.001
Age 25–54 (vs 15–24)	–2.1	0.6	<0.01
Mobile Money Account	–2.5	0.6	<0.001
National Digital ID	–3.1	0.7	<0.001

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Registered Firm (entrepreneur subset)	–8.7	1.5	<0.001
Constant + City & Survey Year FE	—	—	—

Table 3: Pooled Multinomial Logit – Marginal Effects on Informal Employment (Kenya & Nigeria)

As seen in Table 3 (above), we have ensured that our model is even more robust, since we have re-estimated our models separated by country and pooled overall (Table 2 compared to Table 3). From this, we see how there exist multiple country differences in both the Kenyan demographic and Nigerian demographic, which confirms that formalisation policies and the need for digital infrastructure can have impacts in both economies, but probabilities of being formalised could differ between the two economies, which reveals that there may be deeper structural differences that should be accounted for.

5. Discussion

As seen from our results, our findings demonstrate that there exist key contrasts between Kenya and Nigeria, where Kenya's combination of widespread digital infrastructure and advanced mobile money banking systems have facilitated the transition from informality of workers into the formal sector, while Nigeria's formalisation environment is weak but still developing. For Kenya, our regression results mirror the findings of other studies as well, where the ubiquitous use of MPesa and mobile money regulation has stimulated formalisation[11], and this high connectivity digitally has allowed small business owners (SME owners) to be able to accept cashless payments and open accounts, further boosting their revenues and hence, improving their standards of living. In addition to this, the new Maisha Namba System introduced in Kenya could potentially build upon a pre-existing ubiquitousness of ID utilisation[2], demonstrating how informal workers and businesses can value IDs as a prerequisite to formality[2].

In contrast to this, the 2023 IMF report on Nigeria notes that, due to large gaps in infrastructure and a string cash preference, mobile money account utilisation has been limited, which translates into limited benefits for informal firms and entrepreneurs, as shown by our analysis. The lack of trust around IDs has led to the failure of even basic enrolment, which is why we recommend the use of aggressive ID registration campaigns, mirroring the advice of the IMF[11]. It is important to note that despite initiating one-stop shops for MSME registration[25], our data suggests that the uptake is low and a vast number of enterprises are still unregistered[3], which is partly due to the fact that the perceived costs outweigh the benefits[18].

Overall, in terms of looking at the outcomes, informal sectors dominate both of the African economies, and as Cunningham et al. (2024) argue, any future policies employed for

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formalisation must consider the multifaceted nature of informal sector workers – and how there are numerous factors that make specific and tailored policies essential[5]. For instance, encouraging formalisation could help to boost tax revenues and business growth, yet the policies required may differ – since Kenya may require investing more in current digital platforms but Nigeria may need to work on building financial and literacy trust first[11].

6. Policy Recommendations

Based on our analysis, the following policy measures are advised to improve formalization:

6.1. Enhance Digital ID Enrollment:

Nigeria should boost mobile banking usage and NIN registration (ID registration) through mobile drive programmes and subsiding businesses, and by integrating state issued ID cards, it could lead to universal coverage like in Kenya. Boosting ID systems can help to build trust, which in turn leads to greater digital finance uptake and can simplify formalisation further.

6.2. Expand Mobile Finance Access:

Both Kenya and Nigeria should support mobile money/banking platforms, where Nigeria could promote agent networks and could reduce network fees[11], and Kenya can participate in more partnerships (like the previous Kenya Agent Banking), which can serve underserved. In addition to this, both countries should include a financial literacy programme targeted at women and youth to boost digital trust and utilisation.

6.3. Make SME Registration Streamlined:

Boost the number and scale of one stop shops and portals for e-registration, where Nigeria's Federal Government One-Stop Shops (FOSS) should be distributed to local county-level authorities to further integrate permits into the formalisation process, while in Kenya, continuing to reduce the fees and automating the renewal of licences, alongside incentives can help to further motivate formalisation.

6.4. Promote and Utilise Formalization Benefits:

Governments should be transparent, where they not only clearly communicate the benefits of the formal status, but also enforce it, through Kenya's growth of SACCO loans and pension schemes requiring a Maisha Namba to boost formalisation, and Nigeria's integration of bonuses and special tax rates for newly formalised MSMEs[3].

6.5. Improve Infrastructure and Services:

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Given that informal businesses need utility and transport resources, providing affordable workspace and utility rate cuts (eg. electricity and water rate cuts) to urban MSMEs could reduce the costs of formalisation. For instance, pre-existing programs of designated trading zones in Kenya[10] could be expanded to an even larger range, and this could be implemented in Nigeria as well.

6.6. Gender and Youth Focus:

Given that women and youth make up the majority of the informal labour force, offering business training and startup subsidies/grants specifically for female entrepreneurs could boost formalisation. Since digital platforms should cater towards the younger/youth population, which has a generally low financial literacy, ensure that digital platforms are kept user-friendly.

7. Study Limitations

In our study, we realised that there were some limitations that could be mitigated/avoided in future research. For instance, we relied on cross-sectional surveys which could be impacted by potential reporting bias, given that such data is self-reported, hence a larger panel data on the entry and exits of firms could help to better understand transitions in formalisation. Additionally, the fact that the definitions for informality vary by source, with the ILO-source being different from those followed by other countries, we curated one that combined both of these sources. However, in doing so, these definitions may not perfectly match. For instance, in Nigeria, some MSMEs may register under the CAC but could still be considered as informal if they do not register/file for taxes, which invalidates some cases from the dataset.

By having to treat cases consistently against a set matrix to avoid bias, we are inadvertently adding another inconsistency. Moreover, formalisation policies that we analyse in the study could sometimes overall between countries, and getting the causal effect of one single policy is extremely challenging, given that unobserved influences remain despite our regression models controlling for many factors. Despite these limitations, it is important to note that these limitations are only minor, and the fact that we used the large dataset with an effective comparative approach, we have full confidence in our conclusions about the policy implications and conclusions drawn about the economic demographics of Kenya and Nigeria.

8. Future Research & Conclusion

To build upon our insights, we recommend that future studies should track workers or firms over time, in order to reveal the true dynamics of transitioning into formality, and this could be done through entries into a formal register such as digital IDs or tax sheets, to any past informal status documents. In addition to this, an in-depth analysis of different industries and the specific

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structural barriers, complemented by qualitative sources of data such as interviews, could further enhance the tailored/specific approach of policy recommendations to each economy.

Moreover, future studies could also evaluate particular programs and their effectiveness, through the analysis of the quantified effects on firm registration and individual incomes. By addressing the various areas available for research, the sparse amounts of research present on informality across the African Union could be overcome, by closing the research gap with more robust and larger sets of data – helping to design more effective interventions tailored to each economy. To recapitulate, informal employment in both, Kenya and Nigeria is multifaceted and is a result of countless structural factors. Through our comparative study, we have shown that current/contemporary formalisation policies have some success in Kenya (characterised by a strong digital infrastructure), but remains limited in Nigeria due to lower digital uptake. Using our empirical analysis, we suggest that strategies that utilise technology should persist and grow, but should also be accompanied bu other incentives and campaigns to boost trust in such growing systems. Ultimately, it is important to note that the time taken to formalising the extremely large and vast informal economy will not be short, but will benefit millions not only in Sub-Saharan Africa, but globally as well.

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