A Good Start to Shaping Start-Ups in Kenya; A review of the Startup Bill, 2021

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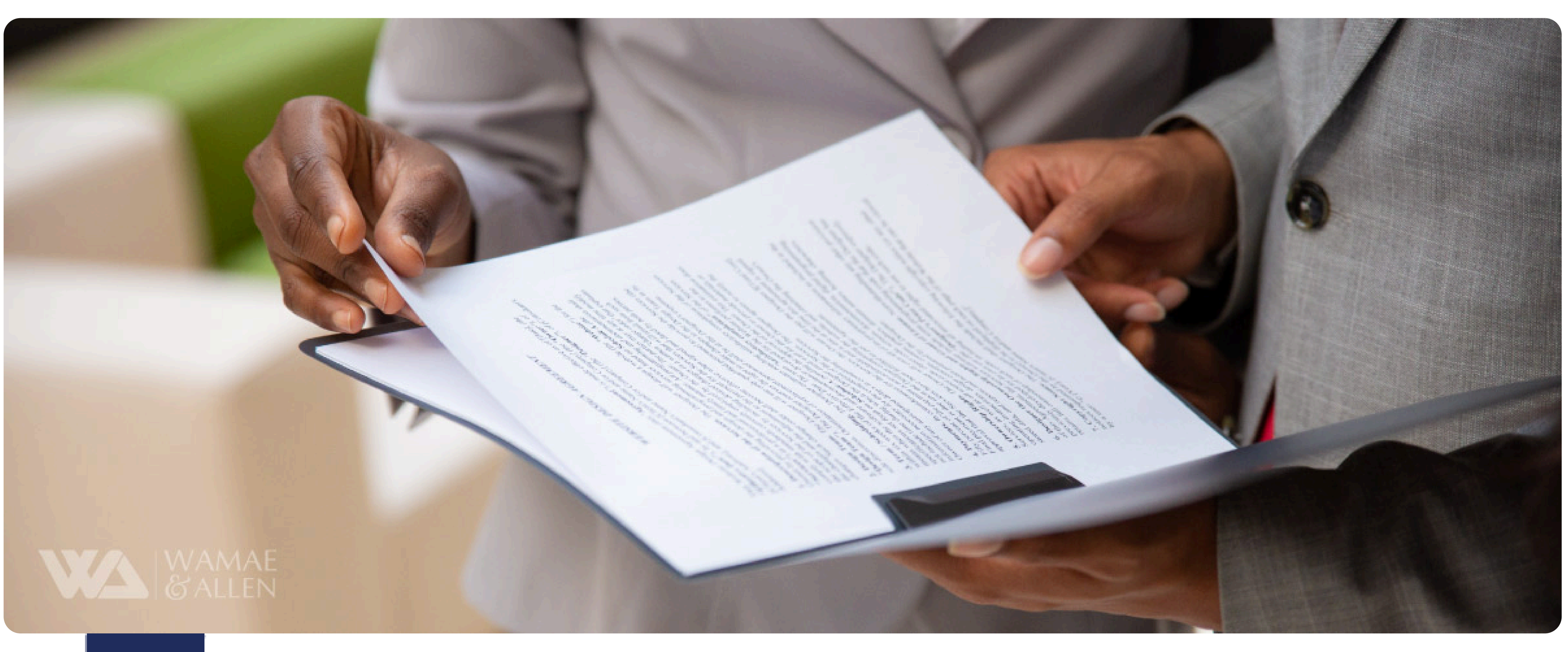

WAMAE & ALLEN

> One problem we face in policy making is the danger of having technology develop faster than the legal and regulatory system can react, potentially risking safety as well as efficient development and testing
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1.0. Introduction and Background

According to data by Statista, Kenya is home to over 80 startups as of 2021. Kenya is one of the top startup countries in Africa. Statista has proven that by 2021, over $292 million was raised by tech startups in Kenya.

Google intends to open its first Africa product development centre in Nairobi to, inter alia focus on innovations. In the same light, Microsoft has already set up a development and research centre in Nairobi. Visa also announced the set-up of an innovation centre that focuses on e-payment solutions. This among many ventures contributing to Nairobi being a Global hub for FinTech Innovation.

The preceding developments and programmes pick the mind on the role of the Kenyan government and laws in relation to the growth and development of promising innovations within the Republic. Dominantly, the **Science, Technology and Innovation Act No. 28 of 2013** was enacted to regulate and promote innovation while entrenching the development of science and technology. However, the Science, Technology and Innovation Act do not have provision that creates an environment to skyrocket new innovations from their inceptions. Hitherto, new entrants in the technological and innovation sphere are still faced with a myriad of regulations, fiscal and non-fiscal challenges, and other challenges dragging their abilities to easily sprout.

Senator Johnson A. Sakaja came up with a **Startup Bill of 2021 (the "Bill")** that aims to create a framework to encourages the growth, development, innovation, technological advancement and creation of a more favorable environment for innovative entities with growth potential and a disruptive technology.

2.0. Key Provisos of the Startup Bill, 2021

The Bill is purposed at fostering innovative culture, development of startups, startup investments facilitation, creation of meaningful co-operations, establishment of startups incubation facilities, and monitoring of startup developments.

The notable advancements forged by the Bill are as follows:

2.1. Incubation Programmes

Part II of the Bill provides for **incubation programmes**. Incubation means a programme established **to create a favorable environmental condition to facilitate the birth, growth, maintenance of enabling environmental conditions for the purpose of facilitating the growth and development of infant technology ideas and creations.**

The Bill has mandated the County and National Governments, in conjunction with the Kenya National Innovation Agency established under the Science, Technology and Innovation Act to set up an incubation policy framework, foster partnerships, create enabling environments, and even keep a reregister of startups and incubators.

2.2. Incubators

The Bill has defined an incubator to mean an establishment whose object is to support the birth and development of startups in a controlled environment.

Incubators must be establishments duly registered solely to incubation of startups and must apply to be registered as such. A certification is thereafter issued under Part IV of the Bill. A duly registered incubator thereafter facilitates technological innovations and developments of startups.

Moreover, the national and county governments shall be given powers to develop fiscal and non-fiscal support mechanisms for the incubators.

2.3. Eligibility for admission into the Incubation programme

For startups to be placed under the programme, they must be an establishment registered in Kenya, have innovative products and/or services, at least one third Kenyan ownership, has a branch or headquarters in Kenya, and at least fifteen percent of the entity's expenses to be attributed to research and development activities. After the preceding conditions in the Bill have been fulfilled, the startup applies either to the Ministry or Agency or even the County government for startups managed by the county to be registered.

Where the startup has fulfilled all the requirements, it is issued with a certificate showing its absorption into the incubation programme.

2.4. Incentives to the startups

The Bill under part V, in its bid to support startups, has provided a number of incentives. The Bill aims at subsidizing the regulatory formalities for startups, facilitation of intellectual property development by startups, fiscal and non-fiscal support, research support, and even a credit guarantee scheme.

The Agency has also been mandated to put forward training and capacity building programmes for startups, establish a database for mentors, available training programmes, projects under existing incubation programmes, and available fiscal and non-fiscal programmes. The Agency will also help the startups in the registration of their intellectual property even on international levels.

The Cabinet Secretary responsible for science, technology and innovation has been empowered to make regulations towards the operationalization of the Bill if passed, including regulations on exemption of startups from registration fees, development, partnering, advertising and marketing, protection of Intellectual Property rights, deregistration of startups, and incentives to invest in innovative startups.

3.0. Analysis and Critiques of the Startup Bill, 2021

3.1. Placement into regulatory sandboxes

An idea has been thought of, that before placing the startups into incubation programmes, the Agency in conjunction with other relevant stakeholders, the county and/or national government, should first place them into a regulatory sandbox like the one created by the Capital Markets Authority.

The **regulatory sandbox is a controlled environment to conduct live test of the innovative startup's product or service, but on a limited scale**. This tests then provide an evidence-based approach and tool for nurturing development before the startup finally enjoys the benefits that comes with incubation programmes. This also allows the agency and the relevant stakeholders to remain vigilant on the possible successes or otherwise, investor protection, and integrity risks.

3.2. Trademarks not registered in Kenya

The wording of clause 9(2)(b)(i) of the Bill seems to lock out startups whose trademarks are not registered in Kenya. This might be a direct bottleneck for startups that have already registered their trademarks in other jurisdictions that they consider more favorable in terms of IP protection. Such action may hinder growth of the start-up sector locally, as companies may opt out of the safeguards and benefits of local registration in favour of preservation of their IP rights.

3.3. 'A third' local rule

The choice for external investors plays a crucial role to the strategy of a business. Clause 8 (e) of the Kenyan Bill removes startups that have less than a third local ownership from its operation. Criticisms have been put that this may stifle the intention of outside investors, who want to convert their debts into ownership after investing into a startup. However, it must be noted that a balance needs to be created so that all startups within the country have a local-ownership connotation so that we do not end up dealing with a total foreign-owned startup.

The rule presents a challenge to seed funding for a start-up, as many companies require this funding as a resource for their growth. In limiting ownership, this may also limit the availability of funding, which mainly allows the investor to secure their investment in ownership rights.

3.4. A 360-degree incentive for the startups, entrepreneurs and even investors

Unlike the Kenyan Bill, the Tunisian Startup Act has provided a definite all-round incentive for entrepreneurs, startups and even investors. The entrepreneurs have the advantage of startup leaves, startup stipend/allowance, assisted and free patenting process, professional programmes, and even good failure in case of liquidation. A one-year startup scholarship has also been set for Tunisian entrepreneurs who aren't employees to start off their projects.

The investors have tax reliefs, tax exemptions on capital gains, valuation of contributions in kind, and even a guarantee programme that protects their investments thereby promoting the concept of good failure. For startups, they have been exempted from corporate income tax, social charges, and they can open accounts in foreign currencies at their inception. Additionally, the startups are considered authorized economic operators and thereby given a 'technology card' exempting them from homologation on their exports and imports. The Kenyan Bill just mentions that incentives will be provided later. It is however important to include the above-mentioned incentives as they are primarily pertinent to the growth of startups.

3.5. Startup stipends, leave, and amicable liquidation

Borrowing from the Tunisian Startup Act, the Kenyan Bill should have included a startup leave, startup stipend, and even an amicable liquidation process for startups, noting that there isn't a liquidation process for startups in the Bill as the same has been left to the regulation of the Cabinet Secretary or by default the rigorous process in the Companies Act shall apply.

Employees who wish to found a startup are entitled to a one-year startup leave from their employers. The leave is only given to employees with at least three years' experience with their employers. This leave, with justifiable cause, can be extended by a further one year.

Moreover, up to a maximum of three founders per a startup are entitled to a stipend. The stipend shall be computed based on the previous median income as employees and a fixed allowance for those who are unemployed at that time.

Lastly, the Tunisian Act guarantees good failure of startups. It promotes amicable liquidation procedures for startups through a combination of measures including but not limited to corporate tax exemption and the guarantee fund. The Kenyan Bill, apart from the guarantee fund it creates, it does not have other measures to promote the simplicity of a good failure for the startups, for instance exemption from corporate tax and State support for salary costs and employers.

The foregoing measures can be enjoined into the Bill as they are primarily pertinent to the evolution of startups instead of leaving their regulation to the Cabinet Secretary.

3.6. Access to public procurement preferential regime

The Senegalese startup Act of 2020 gives startups an upper hand when bidding. Through this incentive, the startups have priority when accessing public and/or private procurement opportunities. This can be inculcated into the Kenyan Bill by giving the Cabinet Secretary together with the Agency powers to make regulations for the same.

4.0. Conclusion

All in all, regulation is vital. Regulation can be an enabler or inhibitor to the growth of startups. Nonetheless, regulations should be all-rounded and developed in such a manner that they do not become bottlenecks stifling technological/startup conception and advancement. Laws should be flexible and all-encompassing.

The criticisms leveled against the Bill are pertinent. However, they can still be implemented in the regulations that will operationalize the Bill. To address the issue, we presented a Memorandum to National Assembly (view document) and are hopeful that our Memorandum will be considered by Parliament in addressing the pertinent issues raised.

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