SME POLICY IN KENYA: ISSUES AND EFFORTS IN PROGRESS

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Introduction

SME Policy

Small and Medium Enterprises (SMEs) have been known to contribute greatly in economic growth of both developed and developing countries. According to a report published in the **journal of Economic Literature** in the year 2000 about the manufacturing firms in developing countries, the share of SMEs in employment tends to be higher in developing countries, which are typically more focused on small-scale production. As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potentials in contributing towards economic growth.

In Kenya for instance, SME operation cut across almost all sectors of the economy and sustain majority of households. This was well recognized by the 2003, National Budget. David Mwriraria, the then Minister for Finance noted that "SME activities form a breeding ground for businesses and Employees, and provide one of the most prolific sources of employment. Their operations are more labourintensive than the larger manufacturers." As such, policy provisions would mean boosting not only the operations of these enterprises but the country's economy as well.

The development of the private sector varies greatly throughout Africa. According to an article which appeared in a UN based booklet '*handbook for local investors': '* SMEs are flourishing variedly well in various countries in Africa. In **South Africa**, **Mauritius** and **North Africa**, these enterprises are doing well. This could be attributed to fairly modern financial systems and clear government policies in favor of private enterprise.'

While this is commendable, in other countries, the rise of a medium sized enterprises with a considerable swing in the middle class has been hindered by political instability or overdependence on raw materials as the main engine of economic advancement. The article observes that in the Democratic Republic of Congo, most SMEs went bankrupt in the 1990s as a result of the looting in 1993 and 1996 during the civil war. In Congo, Equatorial Guinea, Gabon and Chad, the dominance of oil has slowed the emergence of non-oil businesses.

Between these two extremes, Senegal and Kenya have created conditions for private-sector growth but are still held back by an inadequate financial system and lack of sound policy provisions.

In Kenya, SMEs have continued to face challenges related to accessing credit. Commercial banks are still bargaining with the issue of collateral. Due to limited land ownership status in Kenya (Property Rights in Kenya), entrepreneurs are unable to provide the necessary collateral needed for loan requests. According to ILO report published in 2008: 'Factors affecting Women Entrepreneurs in Micro and Small Enterprises in Kenya,' women make up nearly half of all Small and Medium Enterprises owners and 40 percent of smallholder farm managers, yet they have less than 10 percent of the available credit and less than 1 percent of agricultural credit. Despite the fact that some provisions have been made towards gender mainstreaming, there is much more that could be put in place.

The journey towards SME policy formulation by the Kenyan government has been long. The government's commitment to foster the growth of Micro and Small Enterprises (MSEs) emerged as one of the key strategies in the 1986 report: Economic Management for Renewed Growth. It was reinforced as a priority in the 1989 report, The Strategy for Small Enterprise Development in Kenya: Towards the Year 2000. This report set out the mechanisms for removing constraints to growth of the MSE sector. In 1992, the government published the MSE policy report, *Sessional Paper No. 2 Small Enterprises and Jua Kali Development in Kenya*. The report was reviewed in 2002, leading to a new policy framework that provides a balanced focus to SME development in line with the national goals of fostering growth, employment creation, income generation, poverty reduction and industrialization.

However, though these efforts are commendable, these are but perhaps baby steps compared to the task that lies ahead, namely unlocking the full potential of the SME sector to spur and sustain economic growth. For there to be long lasting changes, it is imperative for there to be concerted efforts starting at the policy level especially when it comes to issue identification and solution architecture. This is because, like in many developing countries, there have been considerable mountains of policy publications, data and research yet the problems still remain.

Realizing that the present grinding poverty does not give would be entrepreneurs the capacity to focus and upscale their enterprises since they are concerned with meeting their very basic needs - food, shelter and sustenance, reducing the divergence of policy proposals and the reality on the ground then, is perhaps the remaining policy challenge that stands in the way of Kenya reaping the full benefits other countries such as India and Brazil are currently enjoying as a result of a robust SME sector.

The Policy Challenge

Kenya has had a long history of economic leadership in East Africa as one of its largest and most advanced economies. However, inconsistent efforts during the structural reforms era coupled with **poor economic policies** and state complicit **corruption** syndicates over the past decades have hemorrhaged development and growth significantly eroding the leadership at a time when other countries in the region have made significant strides.

The dichotomous policy perception of formal and informal business entities has also contributed to ineffective policies on the SME economy as merely-*jua kali*. It was not until the beginning of 2003 that there was deliberate Government debate on the need to integrate the two sectors. At the time, analysis of the SME sector revealed that development and integration of both the informal and formal sectors has to a large extend been constrained by regulatory requirements. Most of these requirements date back to the colonial period and have no relevance in independent Kenya.

There is not doubt that Small and medium-sized firms are the drivers of the Kenyan economy. They employ about **7.5 million Kenyans** or **80 per cent** of the country's total employment outside the small-scale agriculture. But little has been understood about their operations, ownership, source of capital and the key challenges that they face as they propel growth of the Kenyan economy. This could be the reason why they should be supported to graduate from their current state. Perhaps we should ask: are there certain efforts in progress? For one, lack of insight on the sector has left policy makers, key support players such as financial institutions and others groping in the dark on how best to implement SME policies. However, all is not gone, there is still light at the end of the 'SME policy tunnel.'

Efforts in Progress

The Government as the sole regulator and licensor plays a crucial role in SME development through different ministries, departments and state corporations. Key organs of government such as cabinet office, Parliament and Local Authorities concerned with policymaking have to grasp the role of government in SME advancement, and be aware of the impact new policies and laws impose on the operations of small enterprises. In doing this, the government establishes the institutional framework for business - rules of the game and ensures that promising enterprises receive appropriate incentives to facilitate efficient performance. Such interventions have potential for mainstreaming the informal economy alongside larger formal enterprises.

In the journey towards revitalizing a well oiled SME sector, the Kenya Local Government Reform Programme (KLGRP) has been particularly relevant. This was spurred 1999 with a deliberate policy priority focusing on reducing poverty and unemployment going hand in hand with accelerating economic growth.

The KLGRP reforms had three components: improving local service delivery; enhancing economic governance; and alleviating poverty. These objectives were to be achieved through increasing efficiency, accountability, transparency and citizen ownership and on the practical side, removal of unnecessary regulatory barriers and the reduction in costs of doing business. In particular, the government initiated two nation-wide reform efforts, namely: the Single Business Permit (SBP) and The Local Authority Transfer Fund (LATF). The SBP was a response to business licensing problems faced by SMEs in the start up phase as they had to get multiple licenses before opening shop draining the initial business inertia

Alongside Government led efforts of change, there has also been international support towards the SME sub-sector. For instance the International Finance Corporation (IFC) along with the

Central Bank and the ministry of Finance have been working hand in hand to establish a credit reference bureau that should benefit SME entrepreneurs (mostly women). This reform could enable Non-land Assets to be acceptable as collateral.

According to a 2007 Kenya Women Finance Trust (KWFT) report 'Improving Access to Finance for SME: International Good Experiences,' removing the obstacles to financial access for SMEs requires that commercial banks, micro-credit institutions, community groups and Business Development Service (BDS) institutions work closely together. Pushing for agreements between financial bodies and BDS suppliers can help make up for lack of capacity and reduce costs by more efficient division of labor.

The BDS supplier makes the initial choice of projects on a purely technical basis and the credit institution looks at financial viability. Making loans to intermediaries (NGOs and federations of SMEs) with the job of allotting funds to members can also help cut administration costs.

Solidarity between banks, especially setting up inter-bank financing to pool money to be invested in SMEs should also be considered as a viable option in reducing the extra risk of lending to SMEs. This will address simultaneously the twin issues of accelerating access to finance and reaching the unbanked.

An interesting case study in the banking sector has been Equity Bank. There is no doubt that the bank is one that has stood the test of time in aiding the sub-sector. The recent announcement by the bank to support SMEs in the country following a shilling 4 billion loan from China serves to solidify its commitment revolutionizing the SME sector.

This loan facility will be available to SME clients at interest rates of between 7 and 9 percent for periods of 3 to 7 years, making it the cheapest source of funding for the sector in the country. Perhaps this is a wake up call to other financial institutions to develop the courage beyond the shores and launch out in to the sea too.

Government efforts have also bee unwavering. The proposal by the government to set up a revolving fund to provide low interest loans to Small and Medium enterprises is another red signal to commercial banks to lend on easier terms. Looking at the 2010/2011 budget that hit Ksh 1 trillion markreveals some of the intended projects. Under the theme ‘‘towards inclusive and Sustainability Rapid Economic Development’’ the 2010 Budget set an ambitious target of spurring growth in every part of the country. The move by the government to support growth in SMEs sector is a new re-awaking based on what can be viewed as a gradual realization of the inherent potentials in the sector in spurring economic growth. The budget incorporated SME factor as a move towards revitalizing the sector – having been allotted a Sh3.8 billion credit line. By all means, this amount is small to cater for the needs of all players in the massive SME sub-sector.

Conclusion

As if to fill the much-felt SME gaps, the government has also initiated other programmes to support the sub-sector. For instance, through Jitihada Business Plan Competition, the government undertook a training programme for entrepreneurs under the Micro, Small and Medium Enterprises competitive project in the Ministry of Industrialization. Implemented by the Kenya Institute of Management, Jomo Kenyatta University of Agriculture and Technology and TechnoServe, the plan seeks to identify growth oriented and innovative business ideas that can be nurtured into vibrant and sustainable business enterprises. It is also meant to provide participants with innovative ideas, expert coaching and individual mentorship to help them develop and refine their business plans.

Therefore, more policy initiatives definitions towards revitalizing the SME sub-sector should not only be government engineered, but also enjoy the input of all stakeholders in all sectors of development. The effort from both private and public sector towards reinforcing the existent SME policy provisions is highly recommended based on the fact that all appear to recognize the SMEs’ critical role in spurring not only self sustenance but also the country’s economic boom.

Citation

Wanjohi,A.M.(2010). *Sme Policy In Kenya: Issues And Efforts In Progress.*

KENPRO Publications. Available online at http://www.kenpro.org/papers/sme-policy-in-kenya.htm

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