A Review of the **Draft 2023 Budget Policy Statement**

What is in store for MSMEs

Viffa Consult
Unlocking Africa's Entrepreneurship Spirit

Acknowledgment

Deepest gratitude to the Viffa team that worked tirelessly to bring the report to fruition.

About Viffa Consult

Viffa Consult is a Kenyan-based management consultancy that is dedicated to developing Small and Medium Enterprises (SMEs) and start-ups in Africa. We believe that African businesses can transform their socio-economic status through profitable trade and business engagement.

Since our inception, we have had a positive impact on the Kenyan entrepreneurial ecosystem through our policy and strategic opinion pieces, SME policy advocacy at local and international levels, and consultancy services. We have supported over 500 SMEs in Sub-Saharan Africa and are committed to helping alleviate the challenges faced by these businesses.

Our approach combines granular research with practical support, including corporate engagement, market intelligence, and direct support. Our goal is to build a knowledge base that can inform SME and start-up policies and help these businesses succeed.

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Introduction

The Kenya government's Economic Recovery Agenda aims to increase investments in five sectors that have the largest impact on the economy and household welfare. These include Agriculture, Micro, Small and Medium Enterprises (MSMEs), Housing and Settlement, Healthcare, and Digital Superhighway and Creative Industry.

The goal is to stimulate economic recovery and increase employment, income distribution, and foreign exchange earnings.

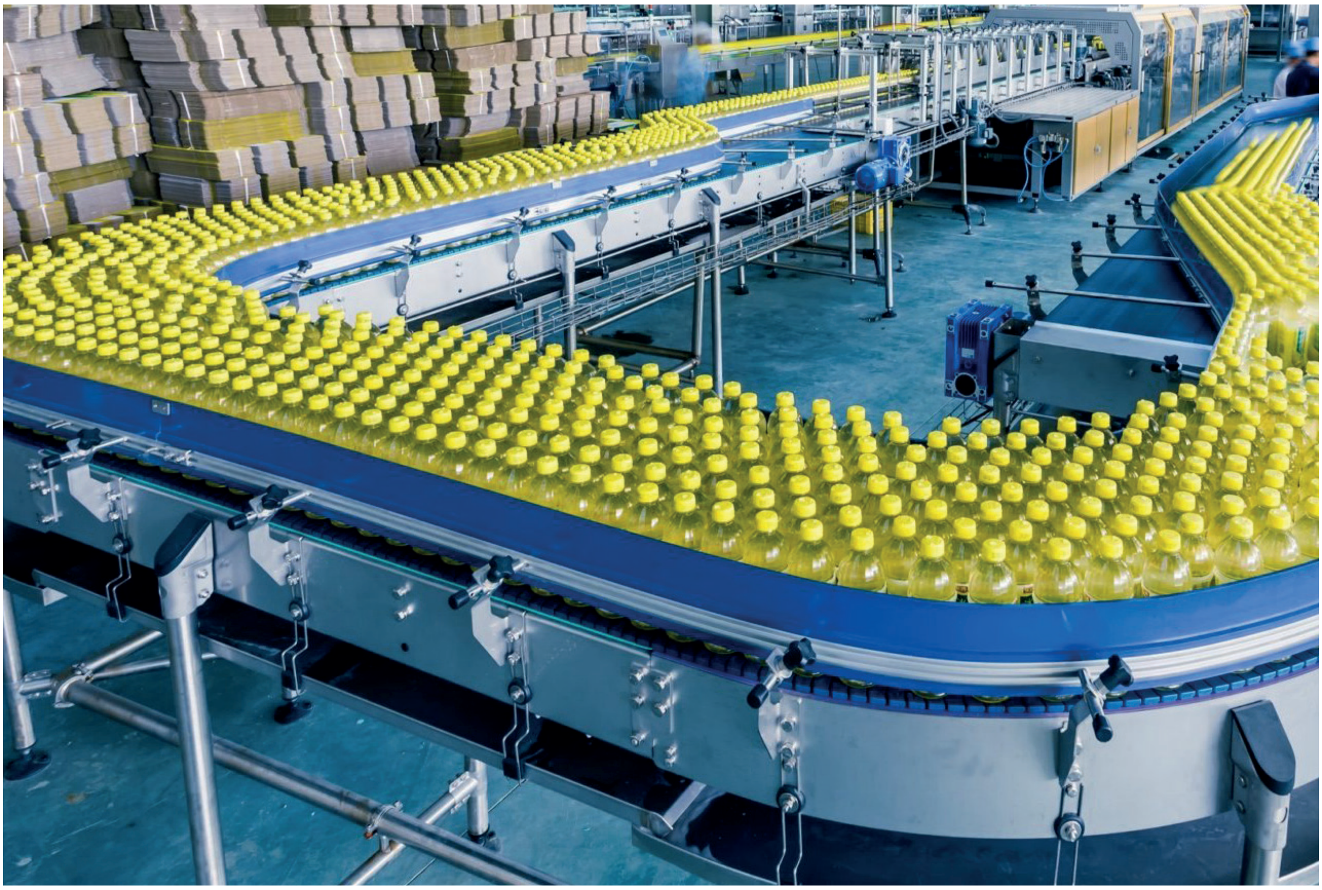
The government has split its priority programs into two categories: Core Pillars and Enablers.

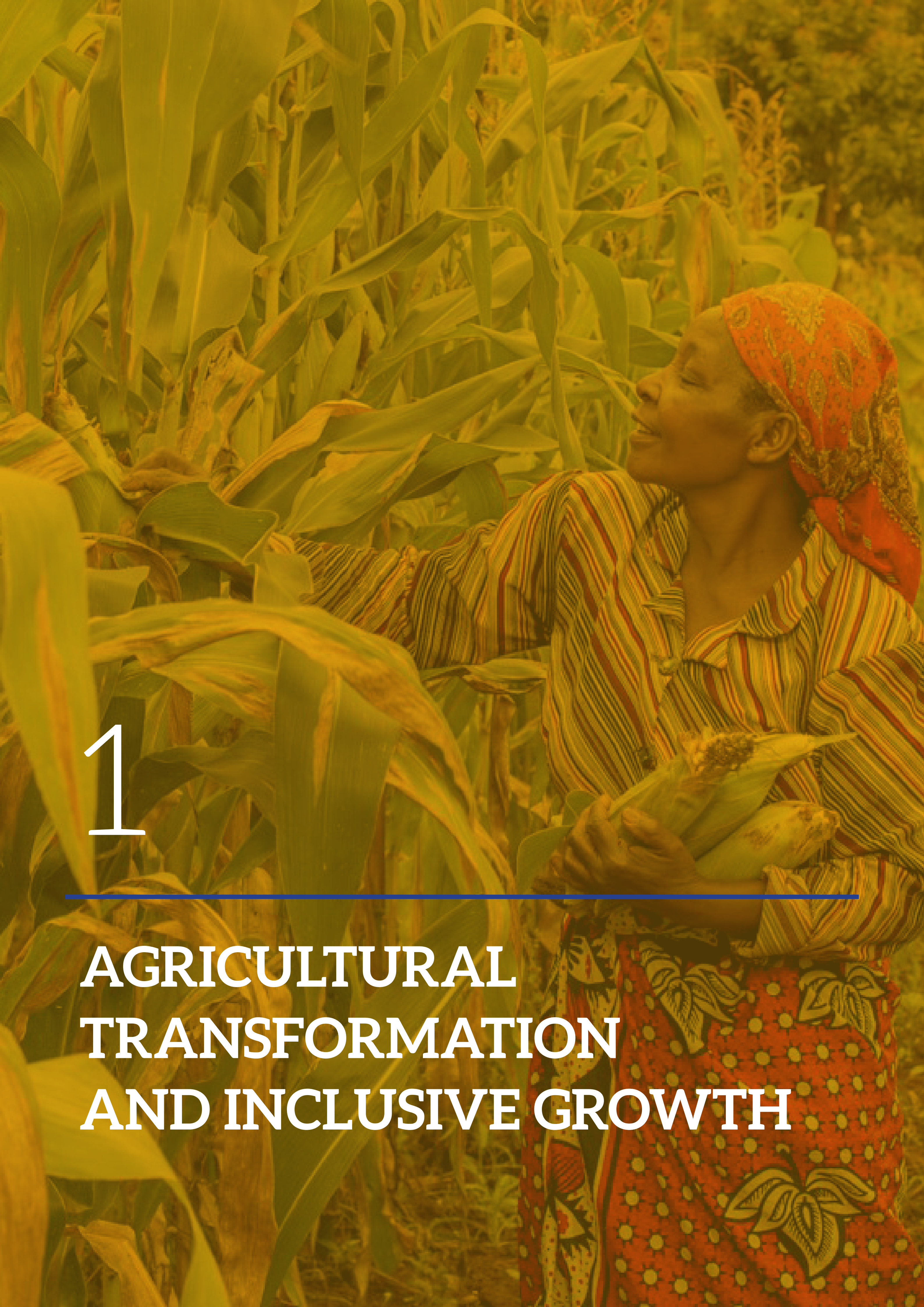
Core Pillars	Enablers
Objective: Increase investments in five sectors envisaged to have the biggest impact on the economy as well as on household welfare	**Objective:** Create a conducive business environment for socio-economic transformation.
Agriculture Micro, Small and Medium Enterprise (MSME) Housing and Settlement Healthcare Digital Superhighway and Creative Industry	Infrastructure Manufacturing Blue Economy Services Economy, Environment and Climate Change Education and Training Women Agenda Social Protection Sports, Culture and Arts Governance.

Introduction

The government plans indeed touches on sectors that are key to the development of MSMEs in the country. However, it is our considered view that Manufacturing should be mainstreamed as a core pillar as it has the potential to further entrepreneurship opportunities – given the role of the Jua Kali sector in the MSME ecosystem. We also view Housing and Settlement, and Healthcare as enablers. While programmes under them may create jobs, they touch more on social protection. In the same breath, we consider Digital Superhighway to be separate and distinct from the Creative Industry.

Our review focuses on the core pillars of Agriculture, MSMEs, Manufacturing, and Creative Industry, as well as specific enablers that have the greatest impact on MSMEs.





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AGRICULTURAL TRANSFORMATION AND INCLUSIVE GROWTH

The agriculture sector in Kenya is a major contributor to the economy, making up 25% of the GDP, 65% of total exports, and providing the highest employment. However, productivity has been declining due to prolonged drought and high global fertiliser prices, leading to food shortages. The government aims to improve this by:

i) Supporting farmers to access quality inputs and extension services

ii) Increasing irrigation from 670,000 acres to 3 million acres

iii) Restarting the milk coolers program to support dairy farmers

iv) Working with research institutions to scale up seed multiplication and improve value addition

v) Enhancing market access and supporting agricultural insurance.

While these steps are commendable, long-term solutions are needed to address the challenges of smallholder farmers, dependence on rain-fed agriculture, and lack of strategies for arid and semi-arid regions.

a) The Cooperative Movement

The cooperative movement in Kenya could be strengthened to better serve smallholder farmers by focusing on specific value chains that align with their individual circumstances, such as access to markets, climate, and topography. The government could also consider zoning production based on domestic and export market potentials and empowering local cooperatives to drive this agenda. Additionally, value addition through cooperative structures could diversify sources of income for farmers and provide an example of the potential of aggregating smallholders.

One example of this is the Kenya Tea Development Agency (KTDA), where small scale tea farmers are shareholders in factory companies, which are then corporate shareholders of KTDA Holdings Limited. The income from these subsidiaries is then channelled back to farmers, providing them with additional revenue streams.

b) Irrigation Programme

The government's plan to increase land under irrigation is a positive step as it will increase resources available for farming and shift towards market-based cultivation. Season-based cultivation leads to sharp price variations, which can negatively impact processing value chains. Market-based cultivation will promote investment into value chains to meet evolving market needs. This includes expanding varieties of a crop and preparation of foods to a certain level, such as pre-cut potato chips for the Hotels, Restaurants, and Cafeterias (HORECA) segment as a value addition.

c) ASAL Region

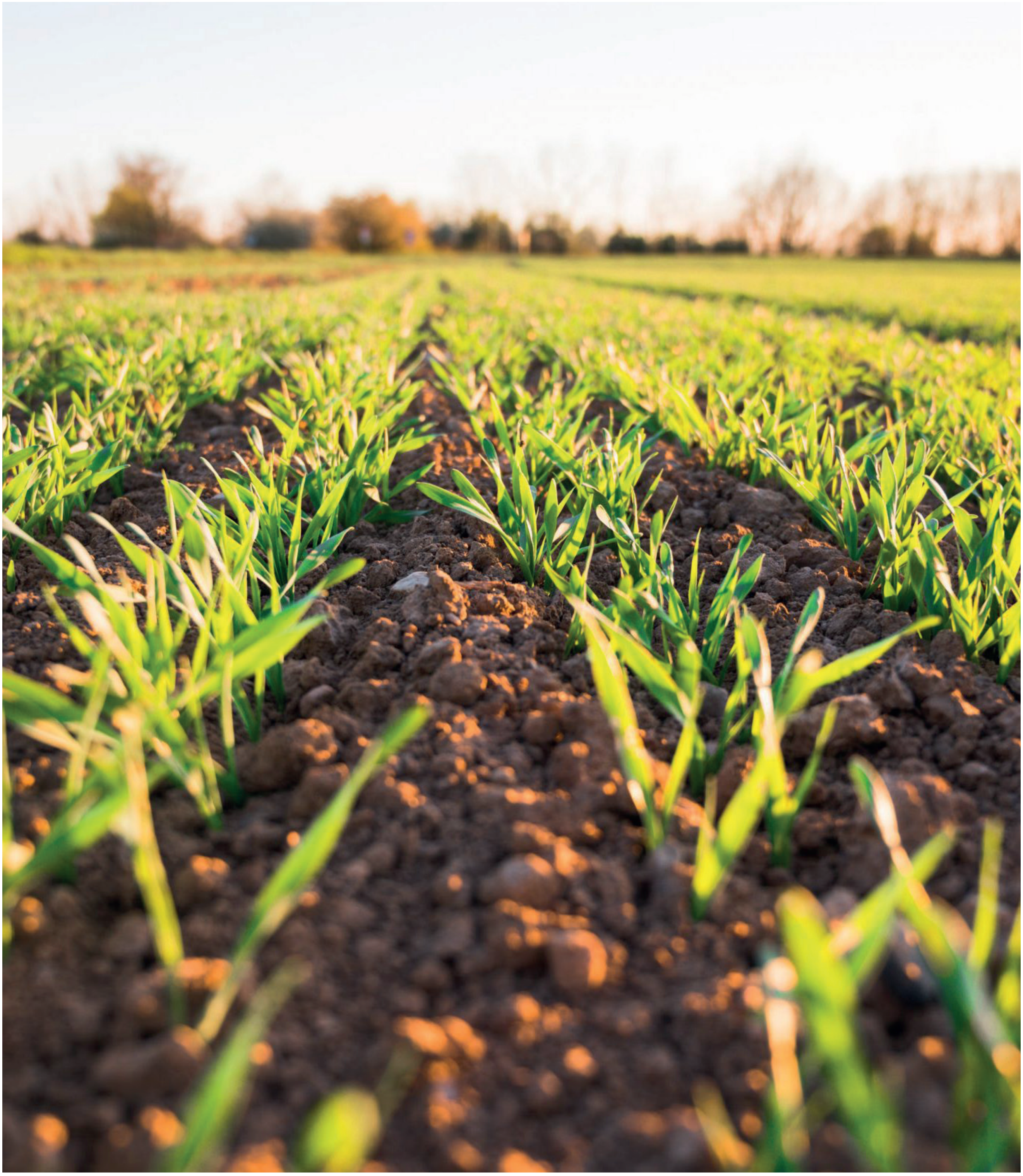
Arid and Semi-Arid Land (ASAL) communities should be empowered to either produce food profitably or purchase food. They should not be dependent on food aid.

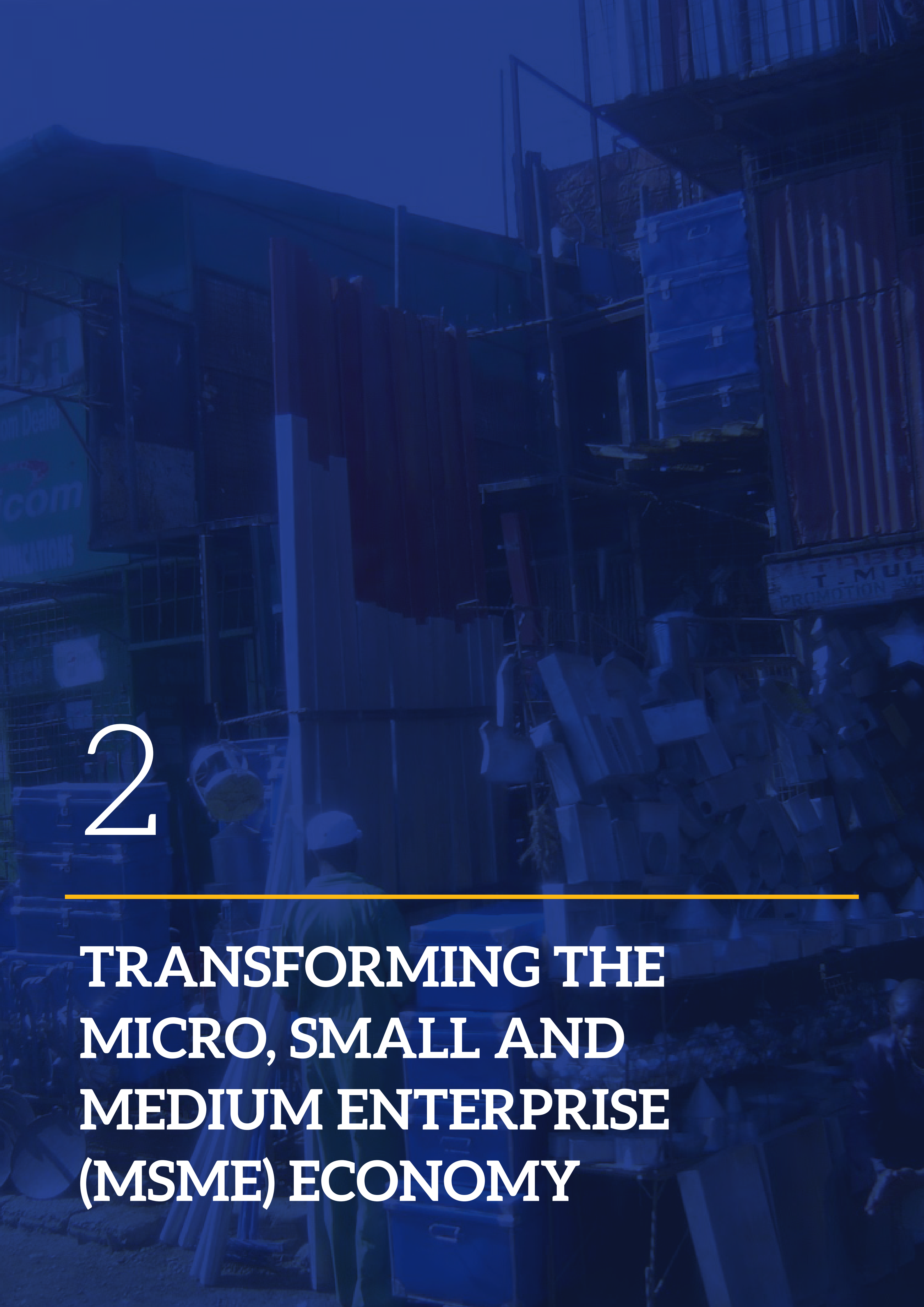
The irrigation agenda should also include ASAL pastoralists, as they lose livestock to drought each year due to lack of pasture. This loss is estimated to be worth billions of shillings in some counties. Research institutions and other stakeholders should be mobilized to find means of developing sustainable pasturelands in ASAL areas.

The government has already earmarked the development of leather industry clusters in certain areas, and the livestock sector in ASAL can also be organized into cooperatives for value chain activities, linkages, and technical support to secure domestic and export markets.

Non-food hardy crops like sisal can also be presented as an option for ASAL regions, which can then be used in the Creative Industry for production of items like baskets. The income generated from this can be used to purchase food from areas that can support food production.

In summary, the development of agriculture (including livestock) has to be looked at in conjunction with manufacturing (as the anchor for value addition) and the cooperative movement (to aggregate production for improved market performance and profitability).





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TRANSFORMING THE MICRO, SMALL AND MEDIUM ENTERPRISE (MSME) ECONOMY

The Micro, Small and Medium Enterprise (MSME) Economy contribute very significantly to the economy, employing about 85 percent of non-farm jobs.

The MSMEs plans should address the four pillars that drive development of MSMEs in Kenya:

a) Access to support

MSMEs find it difficult to access support due to the high costs and unclear process of obtaining business registration/licensing. The government has committed to enacting a right to work law to make trading licenses more affordable and provide a trading location entity to every citizen/MSME who applies. However, concerns may arise about the impact of taxation on formalized businesses. To increase compliance, the government should focus on delivering benefits to compliant taxpayers rather than relying on penalties.

b) Access to credit

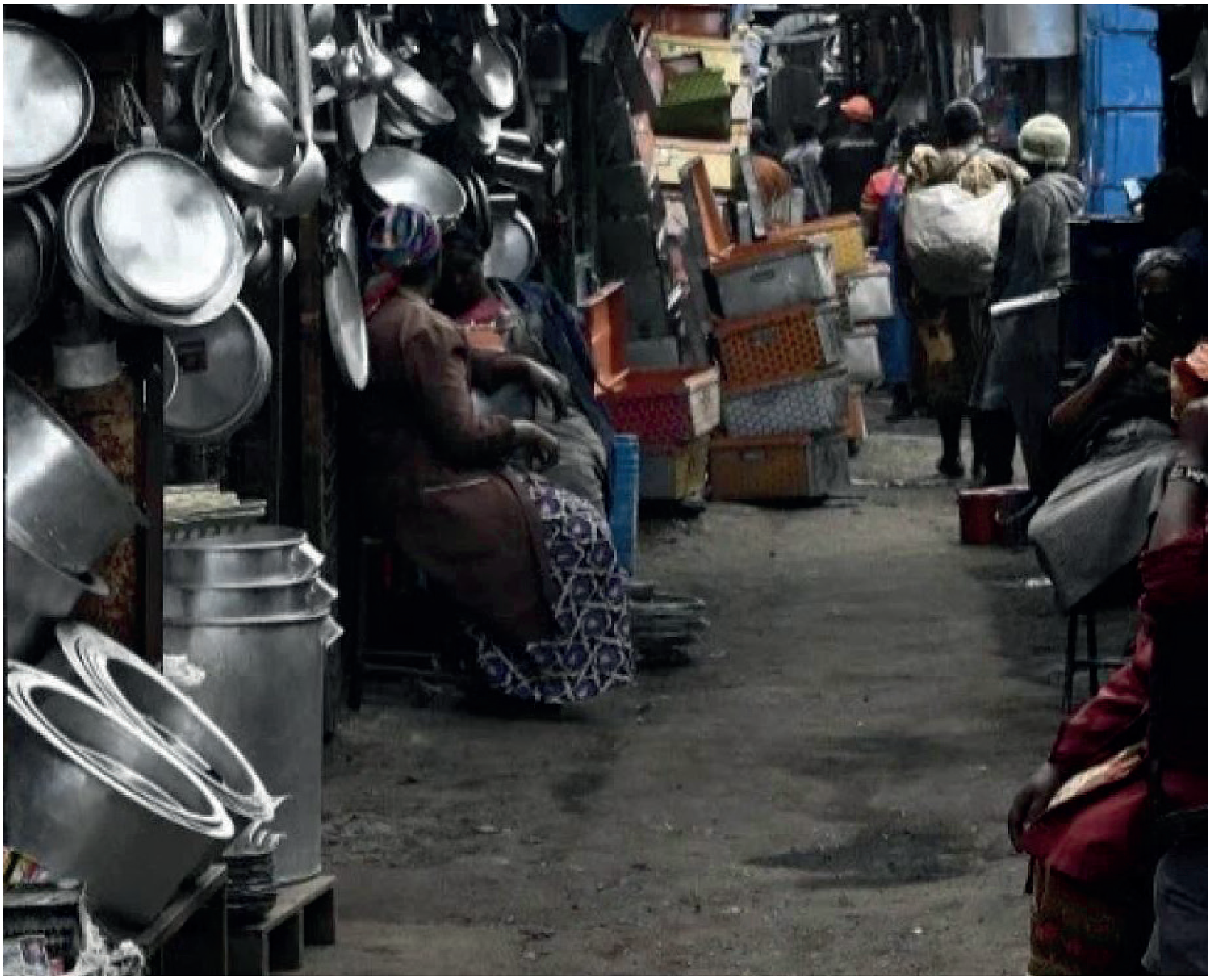
Small businesses find it difficult to access funding from mainstream financial institutions. The government's Hustler Fund, launched in November 2022, has attracted over 10 million borrowers, but the current phase is only suitable for domestic consumption and not for business. A separate program will be required for start-up and growth-oriented SMEs, and the loan structure should be adapted to the production-to-sales cycles of sectors like Manufacturing and Agriculture.

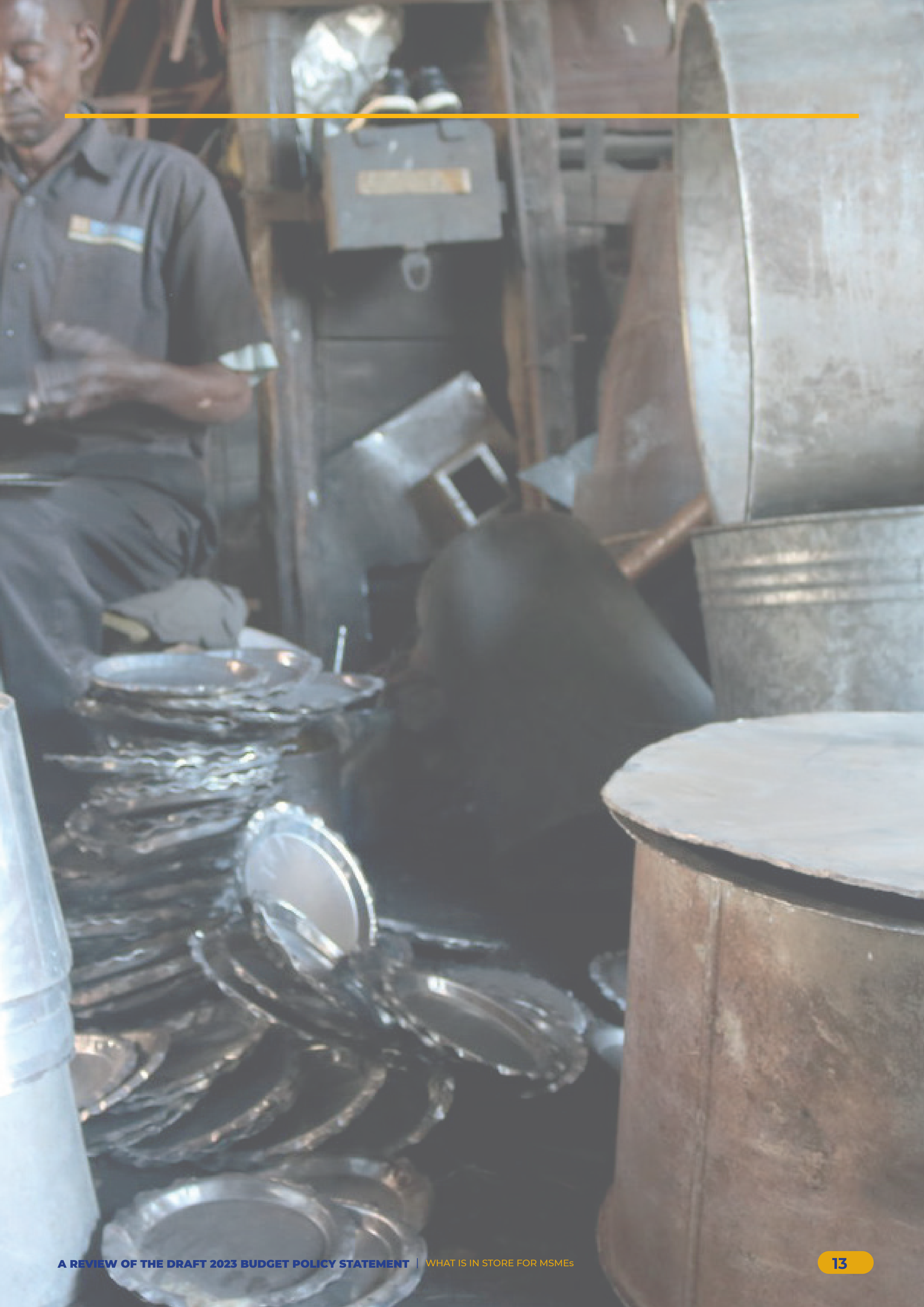
c) Access to markets

Many MSMEs do not actively market their products and services, relying on others to advertise them. The government plans to work with county governments to create frameworks that provide secure trading places in cities and towns, which will open opportunities for promoting MSME businesses. This framework should include certifications and standards workflows, as trade usually requires certification of products to a certain standard.

d) Access to knowledge resources

Programs designed to support MSMEs are not well cascaded to the grassroots, and MSMEs find it difficult to access knowledge resources that would help them improve their businesses. The government should focus on creating a conducive environment for MSMEs by providing them with access to knowledge resources and training programs that will improve their capacity to innovate, create and manage their businesses.





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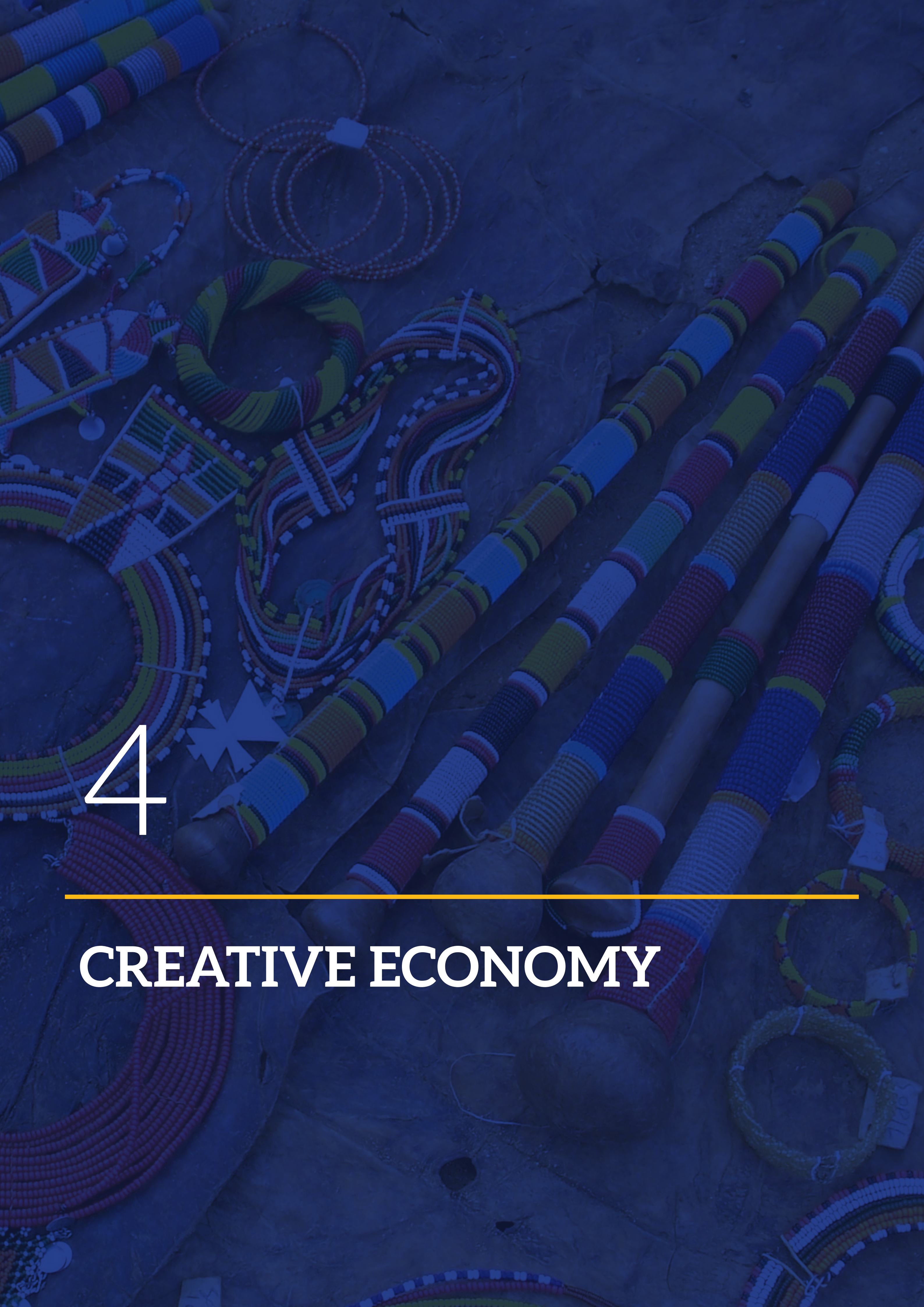
MANUFACTURING

The manufacturing sector has a lot of potential in Kenya, as there is a ready market for leather, garments, and textiles due to the uniformed services and schools. Additionally, the building products industry has potential for growth due to the government's focus on mega projects such as the affordable housing scheme, road construction, and rail development.

However, the sector faces some challenges such as quality and cost concerns. The quality of locally made products has been a concern as it relates to the quality of raw materials, manufacturing technology applied, and skills. The government plans to address this by providing training and access to technology through Business Centres and TVET institutions.

The cost issue is mainly due to the high cost of energy in the country. Main grid costs are high, and there are limited alternatives available. Additionally, the energy sector is highly regulated, and there are significant entry barriers for firms that want to compete with the national electricity distributor, Kenya Power and Lighting Company.

It's important to note that addressing the cost element is crucial for the growth of the manufacturing sector. Without addressing this, manufacturers will struggle to compete with cheaper imports or with other sectors, and the sector will not reach its potential.



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CREATIVE ECONOMY

The creative economy is a broad concept that encompasses various industries that are based on human creativity and intellectual property. These industries include digital, film, music, and arts, as well as handicrafts.

Handicrafts, in particular, have a significant potential for economic growth and poverty reduction in rural communities. They are an important part of the creative economy and are a way to promote and preserve traditional cultural heritage, skills and techniques. Handicrafts are also a way to create jobs and income for artisans, especially in remote areas where other economic opportunities may be limited.

Handicrafts are also an important part of the tourism sector as they can attract tourists to experience local culture and purchase unique and authentic souvenirs. They also have the potential to increase foreign exchange earnings through exports. The global handicrafts market size is around US$ 752.2 Billion, and it is projected to reach US$ 1,296.6 Billion by 2028. This shows the potential for economic growth and job creation in this sector.

The focus of the government on the digital vertical of the creative economy, as seen in the Draft 2023 BPS, is commendable, but it also important to not ignore other important verticals such as handicrafts. The government should also focus on promoting and supporting the handicrafts sector to unlock its potential for economic growth and poverty reduction. This can be done by providing training and access to markets for artisans, promoting handicrafts as a tourist attraction, and encouraging exports of handicrafts to markets like the USA - which is the highest buyer of handicrafts and has an increasing desire to associate with Africa.

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TAX POLICY

MSMEs in Kenya face high costs and little value from compliance with government regulations and taxes. Many businesses prefer to remain informal due to the complexity of registration and compliance procedures. Previous studies that we have conducted suggest that MSMEs believe that government rules and regulations do not foster business growth and instead exist for government revenues without providing any benefit to entrepreneurs.

The general approach taken by government aims to increase tax collection and compliance among small businesses. The Kenya Revenue Authority is perceived to be focused on penalty-driven compliance enforcement which businesses are uncomfortable with. Our previous studies show that tax penalties have no significant impact on compliance. Instead, tax policy framers should engage with the MSME sector to drive formalization and compliance while providing incentives.

A high rate of non-compliance among MSMEs is often due to a lack of understanding of tax laws, complex tax computation formulae, inconvenient remittance processes, and the use of technical jargon in the legislation. We suggest that tax administrators should focus on the end-to-end process of business licensing and use presumptive tax at the point of purchasing a license as a starting point for data collection. Additionally, including benefits such as pension and health coverage in tax remittances could provide incentives for MSMEs to comply with tax laws.

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