Viffa Consult
Unlocking Africa's Entrepreneurship Spirit

Kenya SME PERFORMANCE INDEX 2022

Changing Tide?

Contents

Study Methodology

Viffa Consult conducted its 6th annual SME index survey between 4th October to 5th November 2022.

Specific study objectives were:

1. Establish effectiveness of SME interventions by Government of Kenya
2. Establish SME Revenue performance
3. Establish SME financing
4. Establish preferred Intervention Gaps

• Sampling

Study tool	**Online & Telephone survey**
Sample Size	**127**
Sample Design	**Purposive (Counties; Nairobi, Kisumu, Machakos, Kiambu, Eldoret, Mombasa, Nakuru)** **Random (Within counties)**

Acknowledgment

Deepest gratitude to the Viffa team that worked tirelessly to bring the report to fruition. A big thank you to all entrepreneurs in all the target counties who participated in the survey as well as key experts who shared their expertise.

Acronyms

CBK	-	Central Bank of Kenya
CMA	-	Capital markets authority
CRB	-	Credit reference bureau
ESO	-	Enterprise Support Organizations
GDP	-	Gross Domestic Product
IRA	-	Insurance regulatory authority
KAM	-	Kenya Association of manufacturers
KEPSA	-	Kenya Private Sector Alliance
KNBS	-	Kenya national bureau of statistics
KNCCI	-	Kenya National Chamber of Commerce and Industry
KNFJKA	-	Kenya National Federation of Jua Kali Associations
MSME	-	Micro Small Medium Enterprise
NGO	-	Non-Governmental Organisation
RBA	-	Retirements benefits authority
SACCO	-	Savings and Credit Co-Operative Society
SASRA	-	SACCO Societies Regulatory Authority

Introduction

The year 2022 was a challenging one for SMEs. SME performance was impacted by a prolonged electioneering period, despite the fact that it was peaceful. Further, rising living costs, drought, and rising oil prices are reducing disposable income for customers. It has been two years of dwindling fortunes instead of rapid growth that had been projected following the launch of various interventions.

The year 2020 had previously been projected to be the turning point for SMEs on the back of several initiatives that were espoused to change the fortunes of entrepreneurs including; the repeal of interest rate cap, the establishment of a credit guarantee scheme, payment of pending bills owed to SMEs, setting up of SME fund together with supporting policy and Biashara centres, SME loaning through STAWI, financing opportunities through African Development Bank among others. Instead, SMEs have continued to suffer dwindling fortunes.

The first set-back to the SME plans was the outbreak on COVID-19 during the first quarter of 2020. The pandemic caused unprecedented havoc for the Kenyan economy with SMEs bearing the brunt of it. The government took measures under the COVID-19 stimulus program to support SMEs by providing liquidity relief through various tax and non-tax measures, such as reducing turnover taxes from 3 to 1%, reducing corporate tax from 30-25%, and reducing VAT from 16% to 14%.

In 2021, the government of Kenya through a budget policy statement established a post-COVID-19 recovery strategy. This was to help with economic recovery driven by the private sector, specifically SMEs. Proposed interventions towards SMEs under the strategy were the MSME credit guarantee scheme, capacity building, and MSME ICT platforms to improve productivity and competitiveness.

Thus 2022 is a continuation of what has transpired in the last couple of years coupled with ineffective policy interventions.

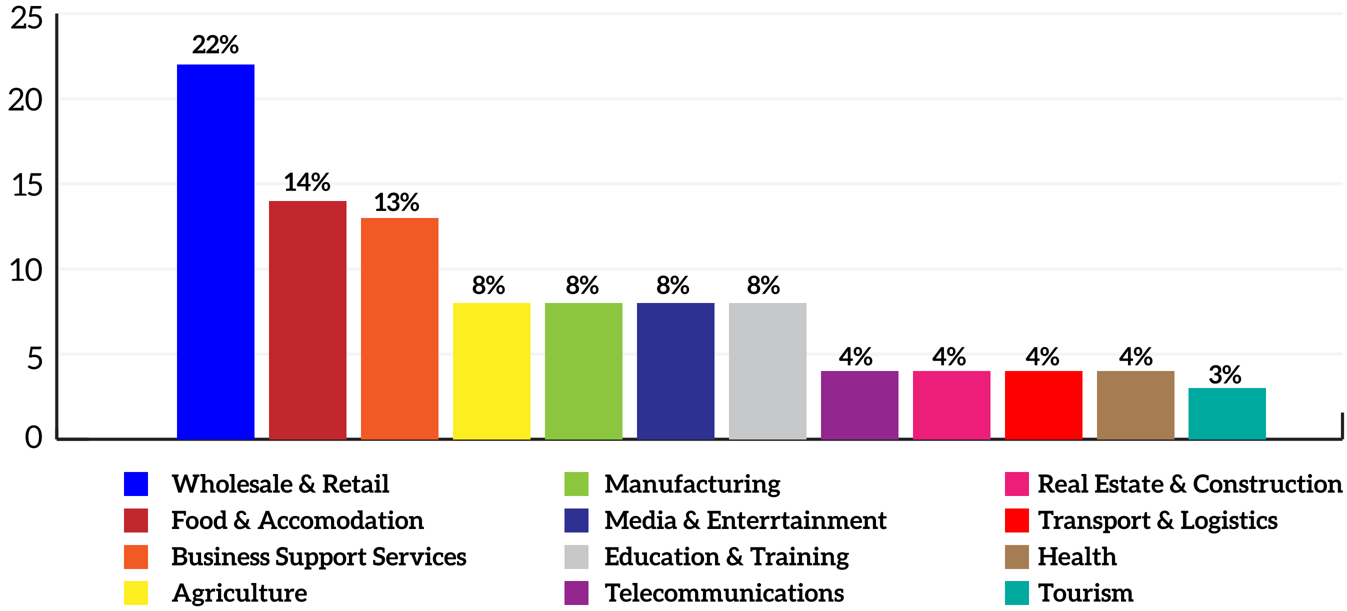
It was therefore no surprise that the plight of small businesses took centre-stage in the run up to the 2022 General Elections. The newly installed administration carried the day on the basis of their agenda for SMEs – particularly plans for access to credit and markets. Delivery on the plans is now vested in the newly created Ministry of Cooperatives and MSME Development and the most anticipated programme is the Hustler Fund - a proposed government-sponsored SME loan scheme. The Hustler Fund is supposed to provide start-ups and growth-oriented SMEs with Kshs. 50 Billion a year in affordable financing through saccos, venture capital, equity funds and long-term debt.

The government had good plans for the SME sector in 2020. Implementation failed due to factors that were outside of the government's direct control (such as COVID-19) and systemic challenges considering the political environment ahead of the 2022 General Elections. Though disruptive, the Elections presented an opportunity to reset plans for the SME sector. The market therefore remains optimistic that 2023 shall be a better year for SMEs.

Results

Survey data was analysed to establish the performance of SMEs in Kenya based on critical success factors of access to financial markets, policies, support services and effectiveness of SME interventions by the Government of Kenya among others.

• Sector Distribution



49% of the surveyed SMEs are in trade, catering and professional services sectors. This aligns with the fact that SME entrepreneurs have traditionally focused on providing last-mile delivery services to industry value chains. Three factors contribute to this trend:

→ The capital and statutory requirements for starting and developing trade, catering or professional services businesses are relatively low compared to commercial agriculture, manufacturing, education, transport and other industries. Unlike the rest, one could start a trade, catering or business support business as an informal micro-enterprise with start-up capital that does not exceed Kshs. 50,000.

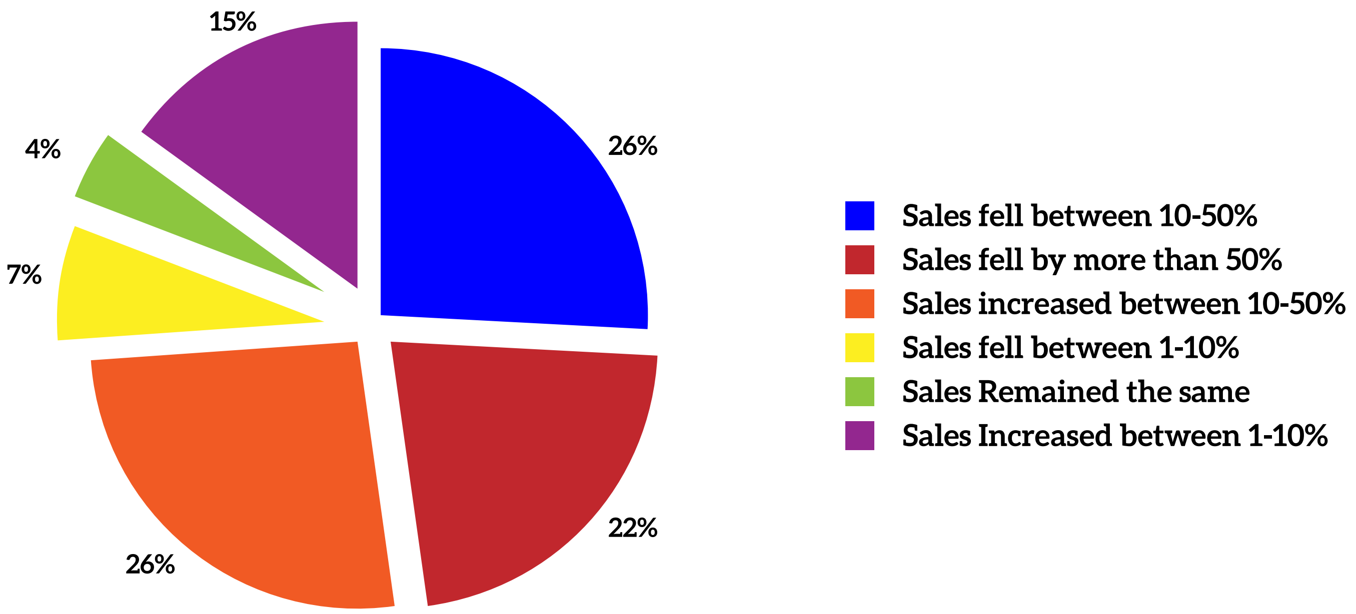
→ Opportunities outside of retail and wholesale trade are not widely understood. Many SME entrepreneurs start ventures using information handed to them by those already in the business of interest. Our previous studies already revealed limited efforts by Enterprise Support Organizations (ESO) in disseminating information on emerging sectors – resulting in low uptake of new opportunities.

→ With the advancement of online market places, local entrepreneurs now have to contend with global competition. Those in manufacturing and creative industries have to step-up product research and development in order to participate in the market effectively. However, the Kenya National Bureau of Statistics (KNBS) has previously reported a significant gap in formal education for SME entrepreneurs. KNBS states that 61% of licensed business owners reported have not studied beyond secondary of education.

Ease of doing business and training are SME sector development imperatives. Entrepreneurs should be motivated to participate in other sectors lest the few easy industries be choked with over-participation to the detriment to individual business revenues.

• Sales Performance in 2022 Compared to 2021

There was no middle ground for the majority of the businesses in sales performance over 2022. Sales, in comparison with previous year, either dramatically fell or rose.



Supply chains were significantly impacted by the COVID-19 pandemic. Extended periods of national lockdowns meant that consumer goods manufacturers had to seek alternative means of ensuring last mile delivery to consumers. This had a direct impact on SMEs – particularly those in retail and wholesale trade. SMEs that pivoted to include online service delivery found opportunities to grow sales and win customers from those who remained static. The growth momentum for those who went online was maintained throughout 2022.

Another possibility, that requires further investigations, would be the impact of layoffs that happened between 2021 and 2022 as larger businesses either ceased operations or reduced staff. Typically, released staff use their severance pay to start a business.

→ Well positioned new enterprises will typically record significant growth during the formative years.

→ Where new businesses enter an already crowded market, existing businesses within the market will typically record declines in sales. This is especially the case when it is difficult for entrepreneurs to differentiate final delivery to consumers.

• Primary Source of Finance in 2022

Respondents to our survey indicated the following as their primary source of finance:

1. Mobile Credit
2. SACCO
3. Family and Friends
4. Savings
5. Chama Group
6. Profit
7. Bank
8. Micro Finance
9. Money-lenders
10. Industry Association
11. NGO

Respondents further indicated the following as their primary uses of finance:

1. Pay Utilities
2. Purchase stock
3. Marketing
4. Purchase assets eg machine
5. New product development

Mobile credit, Sacco and Family and friends formed the top three primary source of business finance in 2022 , this is similar to FSD FinAccess 2021 where mobile credit and family-friends were also top three.

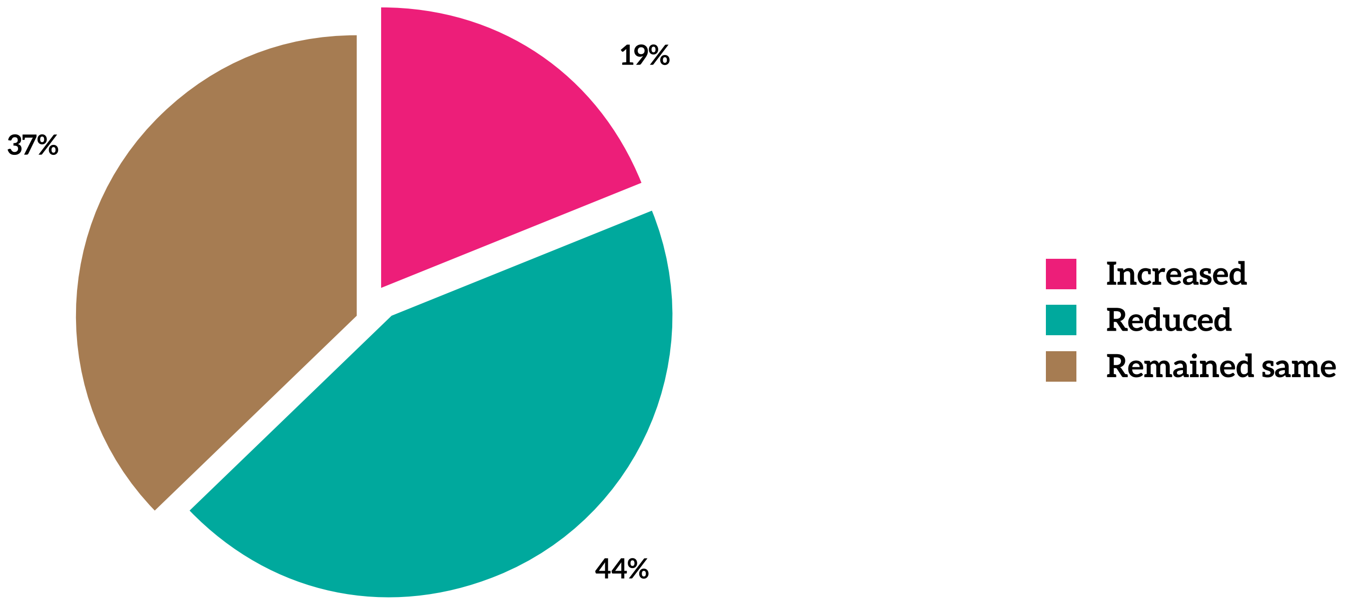
SME FinAccess has come a long way with mobile credit leading the charge in providing SMEs with access to finance. As of 2021 only 2.6 percent of business owners were considered excluded from any form of financial services products (FinAccess 2021).

- FinAcess by livelihood (Owners of Business)

Level of Access	Financial Services
59.7%	Formal Prudential -Financial services and products used through prudentially regulated and supervised financial service providers by an independent statutory Government Agency including CBK, CMA, IRA, RBA and SASRA
33.5%	Formal Non-prudential- Financial services and products accessed and used through financial service providers/ channels that are subject to non-prudential regulation and supervision (oversight) by Government Ministries/Departments with focused legislations.
4.1%	Informal- Financial services offered through different forms not subject to registration and regulation, but have a relatively well–defined organizational structure e.g. money-lenders, employer, credit lines from suppliers etc

Source: FDS FinAcess 2021

• Employee Number in 2022 Compared to 2021



A key contribution of SMEs to the national economy is employment. 81% of our survey respondents either maintained or reduced their staff compliment – with more reducing compared to those who retained.

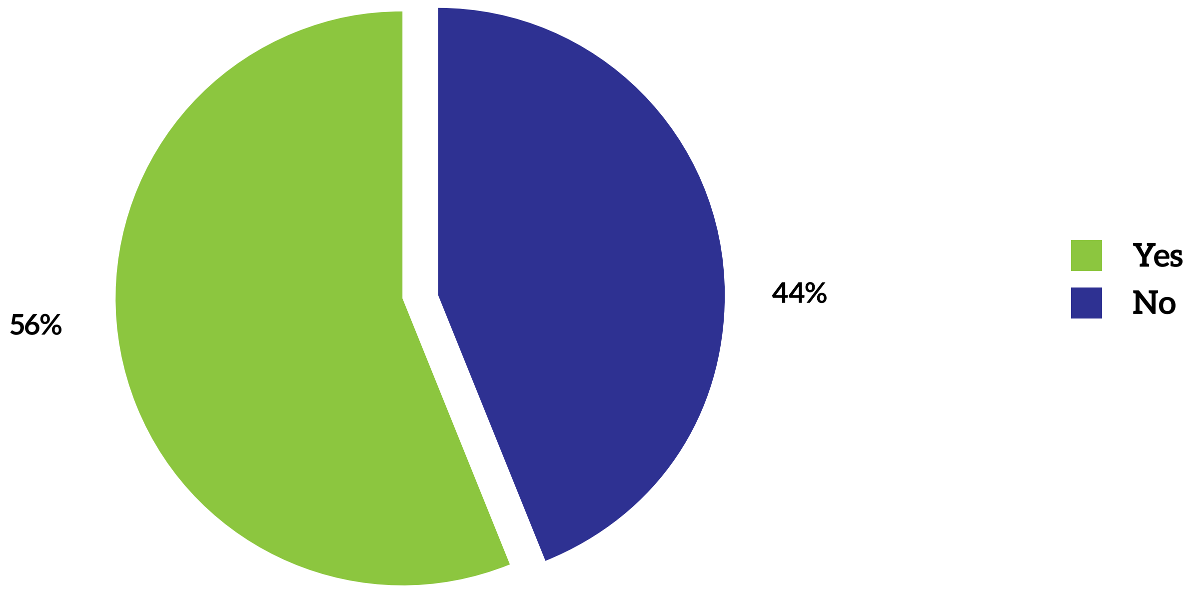
→ Reduced incomes as consumers rationalised their spending in the wake of rising living costs, drought, rising oil prices and job losses is the main cause for the slow-down in employment.

→ The COVID-19 pandemic forced consumer goods producers to divest from linear supply chains to more integrated networks which favours automation of routine tasks. This had mixed outcomes in terms of employment opportunities. The need for low skill manual labour diminished on one hand as the need for tech-savvy employees increased on the other hand.

→ Employment retention was largely driven by members of staff who were able to pivot their roles (learning new skills) as the business adjusted to the prevailing environment. For instance, if a waiter at an eatery learned how to ride a motorcycle, then such a waiter could be redeployed to food delivery service (where a restaurant opts to go online) and thus retain employment.

• Enterprise Support

A slim majority of respondents subscribe to a chama, cooperative or sacco as per the pie chart below:



NGOs, industry lobby groups (e.g. KEPSA, KNCCI, KAM) and corporate organisations provided bulk of training to SMEs. It is noteworthy that the training provided by the mentioned are usually aimed at passing specific industry concepts or achieving certain corporate goals of the training sponsor. For instance, if Company X is introducing a new product, then they would be motivated to hold an SME training session that delivers business skills in addition to information on the new product.

Government interventions that had the most positive impact on businesses include:

1. Prompt payment of pending bills
2. Fuel stabilisation through fuel subsidy
3. Access to government procurement
4. Credit guarantee scheme
5. Biashara centres
6. Delisting from CRB
7. Kenya Youth Employment project (KEYOP)
8. Business registration automation and automation of regulation and licences
9. Access to finance through household collateral

Support from the government that had an impact on the businesses' cash-flow had the most positive impact on businesses. Payment of pending bills and access to government procurement have had significant impact. A recent report by the Central Bank showed that start-ups and SME growth have improved credit risk profiles among commercial banks. Some commercial banks are even charging SMEs lower interest compared to large corporates.

• Looking Forward

Key aspirations for the businesses over 2023 include:

1. Broader access to capital
2. Venture into new export markets courtesy of bilateral trade agreements and regional trade agreements.
3. Improve on product research and development
4. Diversify to new business venture

In order to achieve 2023 ambitions, the businesses require the following interventions:

1. Access affordable credit
2. Access to cash or in-kind grants
3. Training and capacity building in quality to access market
4. Reduced cost of business permits and licences
5. Unification and automation of business permits and licences
6. Access procurement opportunities (National, County and cooperatives)
7. Access to export market

General 2023 Outlook and SME Anticipation

Africa development bank, Africa economic outlook 2022 report on Kenya economic outlook projects Kenya's economic growth to decelerate to 5.9% in 2022 and 5.7% in 2023, driven on the demand side by a decline in domestic and external demand caused by lower income and by an increase in food and fuel import costs and on the supply side by tepid economic activity across sectors due to cost-push factors. Similarly, World Bank group June 2022 Kenya economic update estimates real GDP to grow by 5.5 percent in 2022 and 5.2 percent on average in 2023–24.

Major business environment risk for SMEs as Kenya moves to 2023 are;

- Impact of the war in Ukraine which continues to impede economic recovery
- Drought which has an effect on food security and livelihoods in parts of the country necessitating increased social spending on food assistance.
- Financing fiscal deficit which has an effect on availability of finance to SMEs are financial sectors continues to prefer government securities which are less risky

Similarly opportunities in 2023 lurk in the following interventions:

- SME access to finance through the hustler fund
- SME access to market through trade agreements such as; The African Continental Free Trade Area is a free trade area (AFCFTA), East Africa community (EAC), AGOA and subsequent US-Kenya Strategic investment partnership among others
- Continued business regulatory environment reforms under the new government especially simplification of licensing regime and review of tax policy to be predictable
- Renewed focus on innovation through supporting policy and legislation such as introduction of startup bill which will have a ripple effect on SME growth as is the case of Twiga foods

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