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BUILDING THE CAPABILITIES OF MSMES IN MANUFACTURING TO SUPPORT KENYA'S BIG FOUR AGENDA

Event report

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On 18 July 2018, the SET programme, in partnership Kenya's Executive Office of the Presidency, convened government representatives, manufacturing firms, funders and industry leads in special economic zones (SEZs) and export-processing zones to discuss the importance of SEZ building for the 'Big Four' agenda and the role of micro-, small-and medium-sized enterprises (MSMEs) within this.

With manufacturing forming a core part of the industrialisation 'pillar' of the Big Four agenda, SEZs can be an important tool for addressing constraints to growth in the sector, such as infrastructure and energy supply. MSMEs are crucial agents of growth in manufacturing, and overall, represent 90% of Kenyan employment. However, they face considerable challenges in expanding and integrating into value chains.

This event brought together senior policymakers, MSMEs and industry experts to examine these challenges and build trust and relationships between firms and government as the policy implementation process for the Big Four agenda develops.

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SUMMARY

- On 18 July 2018, the SET programme at the ODI, in partnership Kenya's Executive Office of the Presidency, convened Government representatives, manufacturing firms, funders and industry leads in special economic zones (SEZs) and export-processing zones (EPZs) to discuss the importance of SEZ building for the 'Big Four' agenda and the role of micro-, small- and medium-sized enterprises (MSMEs) within these plans.
- With manufacturing forming a core part of the industrialisation 'pillar' of the Big Four agenda, SEZs can be an important tool for addressing constraints to growth in the sector, such as infrastructure and energy supply.
- MSMEs are crucial agents of growth in manufacturing, and overall, represent 90% of Kenyan employment.
- However, MSMEs face considerable challenges in expanding and integrating into value chains. Some cited by firms include poor linkages between existing EPZs and the local industry surrounding them, a lack of access to low-cost energy, lack of capital for machinery upgrading and increased competition from imports of new and second-hand clothing.
- ODI research has identified eight pathways by which MSMEs in textiles and leather can become more integrated into larger clusters and SEZs, and an 'MSME-readiness tool' to identify which firms are ready for integration into value chains, based on: (i) company structure and economic criteria; (ii) capabilities and tech-readiness; and (iii) dynamism and resilience.
- The research, when finalised, will recommend Government-supported accelerator and incubator programmes for MSMEs, selected based on the readiness-tool.
- Government representatives welcomed the voice of MSMEs in these discussions and put forward plans for promoting MSMEs, to include:
  - Supporting businesses to understand changes in regulation in real-time
  - Training businesses
  - Supporting facilitation of market linkages between businesses
  - Facilitating access to credit
  - Improving information-sharing.
- Closing comments emphasised the need for improved lines of communication between the domestic private sector and Government, informally and through fora such as these, as the Big Four agenda on industrialisation is implemented.

WELCOME AND OPENING PRESENTATIONS

WELCOME FROM RUTH KAGIA, EXECUTIVE OFFICE OF THE PRESIDENCY

Ruth Kagia (Senior Advisor, Office of the President) began by thanking the ODI delegation and Anzetse Were for convening the group and working on the agenda of MSMEs in SEZs. Ms Kagia posited that it was the first time the government, small businesses, donors, business associations and civil society bodies had come together to have a participatory dialogue.

President Kenyatta's 'Big Four' agenda focuses around how Kenya can use its untapped potential, and manufacturing must be a key part of this. MSMEs are important agents of growth, but their resilience has limits - they must be supported with a business-friendly ecosystem. The task is to drive growth in manufacturing, so it forms 20% of the economy instead of 9%.

COMMENTS FROM BETTY MAINA, MINISTRY OF INDUSTRY, TRADE AND COOPERATIVES

Betty Maina (Principal Secretary, State Department of Investment and Industry) began by emphasising that manufacturing forms a prominent part of the Big Four agenda and is the only truly sustainable way to create jobs and achieve economic transformation. Leather and textiles are key sub-sectors, with great potential for supporting MSME upgrading. The building of SEZs and industrial parks is an important for supporting the ecosystem for MSMEs, as will be identifying interventions and key entry points for Government to support their inclusion into value chains.

Ms Maina laid out elements of the Government's work to support MSMEs, over and above focusing on 'Ease of Doing Business' indicators. Government initiatives include:

- **Tracking changes in business regulations** to give guidance to businesses in real time
- **Training businesses** – to date, 147,000 businesses have been trained by one agency
- **Supporting the facilitation of market linkages** between businesses
- **Facilitating access to credit** for small business
- **Improving information-sharing** between businesses.

COMMENTS FROM DR DIRK WILLEM TE VELDE, ODI

SET programme research indicates that the challenge facing East African is to create 7,000 additional jobs each day until 2030, just to keep up with demographic change and new labour market entrants. Thus, labour-intensive manufacturing will be a key sector.

Despite some movement towards re-shoring in developed economies, rising wages in Asia mean manufacturers are looking to other regions for low-cost manufacturing opportunities. It is important to note, however, that increasingly, digitalisation may create difficulty and interrupt jobs growth.

SEZs will be a key tool, as they tackle challenges in the manufacturing sector by:

I. **promoting clustering** and thus productivity spillovers
II. **helping tackle logistical issues** through policy in a targeted area, such as energy supply
III. **allowing countries to grow, trial and learn** at a smaller scale.

In practice, in some SEZs problems have emerged due to the design of incentives, location, and a lack of coordination. SEZs work best when they are **inclusive**, have **strong linkages to the local economy, respond to global developments**, **fit in with a country's overall growth strategy**, and **implemented with purpose.**

PANEL DISCUSSION: TAKING STOCK OF EPZS AND SEZS

Chair: Anzetse Were (consultant economist).
Panellists from: Export Processing Zones Authority (EPZA), Thika Cloth Mill, Kenya Tanneries Association, Kenya National Federation of Jua Kali Associations.

A selection of comments and discussion points are included here, without attribution to any individual panellists or audience members.

- SEZs, EPZs and clusters are often conflated but they are distinct. EPZs are designated areas under customs control, to promote (i) manufacturing (ii) services and (iii) commercial activities. 80% of what is processed in EPZs goes to export, with only 20% retained for the local market.
- SEZs are broader, large industrial parks. SEZs can integrate within the local economy very well and connect well to SMEs, so the impact on social and economic development can be very positive.
- There is a sense of unfairness around EPZs and SEZ where they have not made linkages with local firms, such as around taxation and energy prices. Implementation must be done in a way that does not disadvantage firms who choose not to relocate to zones. Incentives for firms to relocate must be clear, fair, and industry-driven.
- Energy prices are a concern for firms. How can we develop a policy to make it affordable, and continue to use renewal sources, e.g. solar, geothermal?

- It creates a challenge for government when businesses can't expand in their existing space, but they don't want to move. It is inevitable that not everything government implements will work for every firm. Policy change is about the whole manufacturing sector, the whole country, and not a bespoke solution for every firm or factory.

Panel chair Anzetse Were (left) and panellists.

SECOND SESSION AND PRESENTATIONS

OPENING COMMENTS FROM ANNE MUTAHI, EXECUTIVE OFFICE OF THE PRESIDENCY

Ms Mutahi began by stating that more needs to be more done on improving communication between the Government and local firms on the ground. The Government should, and does, view MSMEs as a great asset. They should not be on the fringe of these sorts of discussions.

Government plans for new SEZs are in progress, but in the short term, firms can still improve productivity. More can be done to support existing MSMEs and small clusters where they are.

PRESENTATION OF INITIAL FINDINGS FROM MSMES STUDY FROM DR AARTI KRISHNAN, ODI, AND ANZETSE WERE, CONSULTANT ECONOMIST

Ms Were opened the presentation by stating that MSMEs employ approximately 90% of the Kenyan workforce. ODI's research looks to explore pathways by which MSMEs can be further integrated into larger clusters and formal SEZs. This will help address the coming jobs crisis.

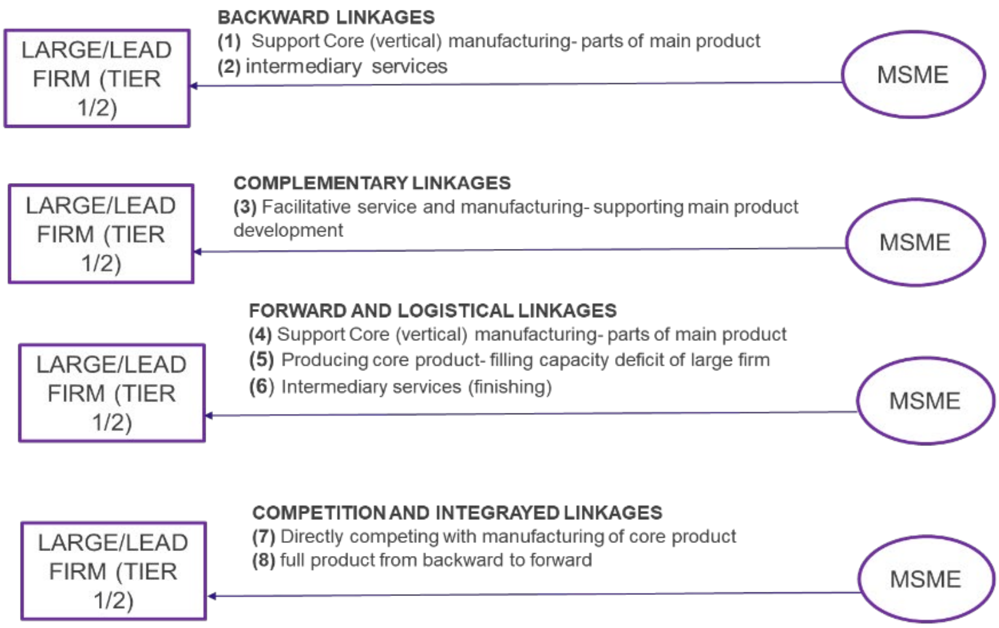
Dr Krishnan explained the eight possible pathways identified in the research by which MSMEs can become involved in value chains, in Figure 1.

Evidence suggests that most MSMEs are on low value-add pathways in textiles, apparel or leather industries. Most only perform complementary and intermediary services, rather than participate in core manufacturing activities that will enable them to move to higher value-add pathways. The ultimate aim is for MSMEs to complement and support large firms as well as expand and upgrade, rather than compete with large firms directly.

Neither the textile nor the leather sector is an integrated value chain; both have major limitations and challenges, including: (i) skills – they do training in-house which is not benchmarked to global standards, deploying their own finance; (ii) the lack of financing prevents MSMEs from hiring capable workers and paying wages to the existing workforce; (iii) import prices – for example, it's cheaper to import the whole shoe rather than import the leather and add value.

Anzetse Were, left, and Dr Aarti Krishnan.

FIGURE 1: TYPOLOGY OF PATHWAYS FOR MSMES TO LINK INTO VALUE CHAINS



Supporting MSMEs to integrate into value chains will help create specialist enterprises with finishing skills that can increase value capture, along with providing tactical knowledge of the region.

So how can the Government support MSMEs? ODI has created an 'MSMEs readiness tool' to identify which firms can fit into which pathways, and how prepared they are. Three measures: (i) company structure and economic criteria; (ii) capabilities and tech-readiness; and (iii) dynamism and resilience.

SMEs and MSEs should be supported through incubator and accelerator programmes to support particular pathways. Depending on their MSME readiness tool scoring, we'd hope they'd be put into incubator (for small and micro) and accelerator (medium) programmes.

PANEL DISCUSSION: HOW TO CREATE WIN-WIN OPPORTUNITIES FOR MSMES AND LARGE FIRMS IN VALUE CHAINS

Chair: Anzetse Were.
Panellists from: Tulips Collection, Limuru Leather Association, Uhuru Textiles Association Cluster and Kenya National Federation of Jua Kali Associations.

A selection of comments and discussion points are included here, without attribution to any individual panellists or audience members.

- Some firms struggle to retain competitiveness, due to the cost of upgrading machinery.
- MSMEs who have succeeded in integrating into clusters and zones have had a difficult path in producing enough to satisfy large clients, while remaining competitive.
- Other issues facing firms include a lack of production methods, short lifespan for products, lack of finishing machinery, poorly skilled workers and lack of standardisation.
- The Ministry of Education should be involved in these discussions because skills are so crucial. There used to be a Kenyan Institute of Industrial Training; this could be revived.
- There is a lack of coordination in the value chain between local and national government. County governments are left behind in the conversations.
- Quality of products is impacted because quality accessories are not available locally, so manufacturers have to import at a higher price.
- Innovation is needed, and greater technological capacity, as there may be better, newer ways of producing that are not happening in Kenya.
- There are not sufficient data on the demand side – it is not known how many companies there are in Kenya. Businesses do not even have data on their own companies. There must be proper identification of SMEs (formal) vs. general economic activity (informal).
- There must be proper incentives for informal firms to become formal (they would need to do this to be in an SEZ). Taxation is an issue – firms stay informal to stay under the radar.

COMMENTS FROM MINISTRY OF INDUSTRY AND OFFICE OF THE PRESIDENCY

Two points regarding the study:

1. It would be beneficial to have a time-plan based on short, medium and long-term changes.
2. On diagnostics, the handloom sector is missing. For example, in Tirupur in India, local handlooms were formalised by the government and grew into a cluster. If a similar model can be replicated of clustering a value chain, it needs to be in this report.

An inclusive approach to developing an ecosystem for MSMEs is needed. It has been very fragmented. We will map what is happening on the ground, supporting MSMEs, to work out what programmes have and have not been successful. This will then influence our reforms for the sector.

Potential areas for Government action include:
- Categorising MSMEs both by size and type
- Reforming credit systems
- Developing better, clearer standards

- Upgrading of training facilities – what Kenya has is highly underutilised
- Making linkages between national and county
- Greater general support for MSMEs: mentorship, linkages to markets, hand-holding.

There is a desire to build capacity in industries, but if we do not see the value in leather and textiles, we will not encourage young labour market entrants into them. *Mitumba* is not our competitor – we need to replicate the quality of what is coming into the market. To ensure quality and productivity is high, we plan to roll out a national programme of production and services centres with machinery.

Anne Mutahi, SME Advisor, Executive Office of the Presidency.

CLOSING COMMENTS FROM RUTH KAGIA, EXECUTIVE OFFICE OF THE PRESIDENCY

Ms Kagia closed the event with three observations:

1. There are islands of excellence in the MSME sector and in the Ministry of Industry. These successes are not communicated sufficiently. We also need to be more targeted and specific about what kind of MSME we are developing policies for.
2. We should do more case studies of success from Kenya. We have cultural and societal idiosyncrasies that can render foreign case studies irrelevant.
3. At the same time, we need to better understand what others are doing, such as Rwanda. How have others addressed finance, and integrating firms into clusters?

Key takeaways for Government are: that we need to tackle the issue of imports from China and elsewhere and that we need to think more about easier ways to upgrade skills and make firms and workforces more agile,

Finally, we, as Government and the private sector, must work together, not against each other. The Government is open to feedback and ideas from private sector as we move forward.