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# INTEGRATING KENYA'S SMALL FIRMS INTO LEATHER, TEXTILES AND GARMENTS VALUE CHAINS

Creating jobs under Kenya's Big Four agenda

Background paper

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## ACRONYMS

ABU	Absolute business unit
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
BMO	Business membership organisation
BSCI	Business Social Compliance Initiative
CBK	Central Bank of Kenya
CEO	Chief executive officer
CTM	Cut-make-trim
DoFC	Directorate of Fibre Crops
EAC	East African Community
EIC	Ethiopian Investment Commission
EPZ	Export processing zone
EPZA	Export Processing Zone Authority
FDI	Foreign direct investment
FMO	Dutch development bank (Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.)
FOB	Free on board
GDP	Gross domestic product
GoK	Government of Kenya
ICT	Information communication technology
IFC	International Finance Corporation
KAM	Kenya Association of Manufacturers
KARLO	Kenyan Agriculture and Livestock Research Organization
KEBS	Kenya Bureau of Standards
KEPSA	Kenya Private Sector Alliance
KITP	Kenya Industrial Transformation Programme
KIRDI	Kenya Industrial Research and Development Institute
KLDC	Kenya Leather Development Council
KNBS	Kenya National Bureau of Statistics
KNCCI	Kenya National Chamber of Commerce
LIK	Leather Industries of Kenya
MoIED	Ministry of Industrialization and Enterprise Development
MoITC	Ministry of Industry, Trade and Cooperatives
MSE	Micro and small enterprise
MSEA	Micro and Small Enterprise Authority
MSI	Department of Micro and Small Industries
MSME	Micro-, small- and medium-sized enterprise
PDU	Party of Democratic Unity
SEZ	Special economic zone
SEZA	Special Economic Zone Authority
SGR	Standard gauge railway
SME	Small- and medium-sized enterprise
TVET	Technical and vocational education and training

## EXECUTIVE SUMMARY

The Government of Kenya has developed a range of policies, strategies and measures to promote industrialisation as part of President Kenyatta's 'Big Four' agenda. However, this risks missing the opportunity for broad-based economic transformation if implementation of the strategies occurs without more focus on the role of small, local firms in the manufacturing sector. While past strategies led by the Kenyan government, such as Vision 2030 and the Kenya Industrial Transformation Programme (KITP), have shown strengths, they have also suffered from implementation failures, which have then hampered growth in micro, small and medium-sized enterprises (MSMEs). The Big Four agenda – coordinated by the Presidency and implemented by a range of ministries such as the Ministry of Industry, Trade and Cooperatives (MOITC) – aims to achieve industrialisation through a range of actions, including the expansion and creation of economic zones and industrial clusters. Successful integration of value chains and economic zones (such as industrial parks, export processing zones (EPZs) and special economic zones (SEZs)) with the local economy (specifically MSMEs) will be crucial to ensure zones help transform the whole economy, rather than becoming standalone enclaves.

This study aims to support Kenya's Executive Office of the President by suggesting ways to better integrate leather, textiles and garments MSMEs into value chains, economic zones and industrial parks. The research draws on secondary literature and in-depth primary interviews with more than 40 stakeholders across the leather, textiles and garments value chains, especially in Nairobi. These include CEOs and technical officers of MSMEs and large companies, national and county government officials and representatives of business associations, clusters and economic zones and international organisations. We also draw on perspectives obtained at three multi-stakeholder roundtables involving over 200 representatives, which discussed the challenges facing MSMEs in participating in value chains and entering EPZs, along with macro issues linked to industrial policy design, financing and trade barriers. Many stakeholders were nationwide, but in-depth interviewees were mostly from Nairobi, which limits the scope of the analysis and findings. The roundtable in July 2018 was one of the first stakeholder meetings to bring together participants across the value chain.

This executive summary covers the main issues in the report and:

1. discusses the role of MSMEs in Kenyan manufacturing and job creation
2. analyses pathways for integrating MSMEs into value chains and economic zones and strengthening clusters
3. develops a baseline of MSME capabilities, constraints and pathways of participation in leather, textiles and garments value chains and zones, using primary data
4. presents key policy measures crucial for supporting MSMEs and value chains and
5. highlights three practical steps forward.

## MSMEs ARE A KEY FACTOR BEHIND INDUSTRIALISATION AND EMPLOYMENT IN KENYA

### MSMEs in the Kenyan economy

MSMEs are a crucial component of the Kenyan economy. They constitute approximately 80% of Kenyan businesses and together employ close to 14.9 million (78% of the labour force). Approximately 7.4 million MSMEs in Kenya collectively contribute about a third of the country's gross domestic product (GDP), and yet over 85% of them are unlicensed enterprises. Around 400,000 MSMEs fail annually, with almost 90% of start-ups operating for less than two years.

The manufacture of wearing apparel (41.6% of licensed MSMEs or 72,602 firms) and food production form the majority of manufacturing activities undertaken by MSMEs. Only around 1% of MSMEs are involved in leather-related (1,786 firms) and textiles (2,734 firms) manufacture. Almost 90% of firms in textiles, wearing apparel and leather manufacture are categorised as 'micro', and only 10% of leather-producing firms are categorised as medium-sized.

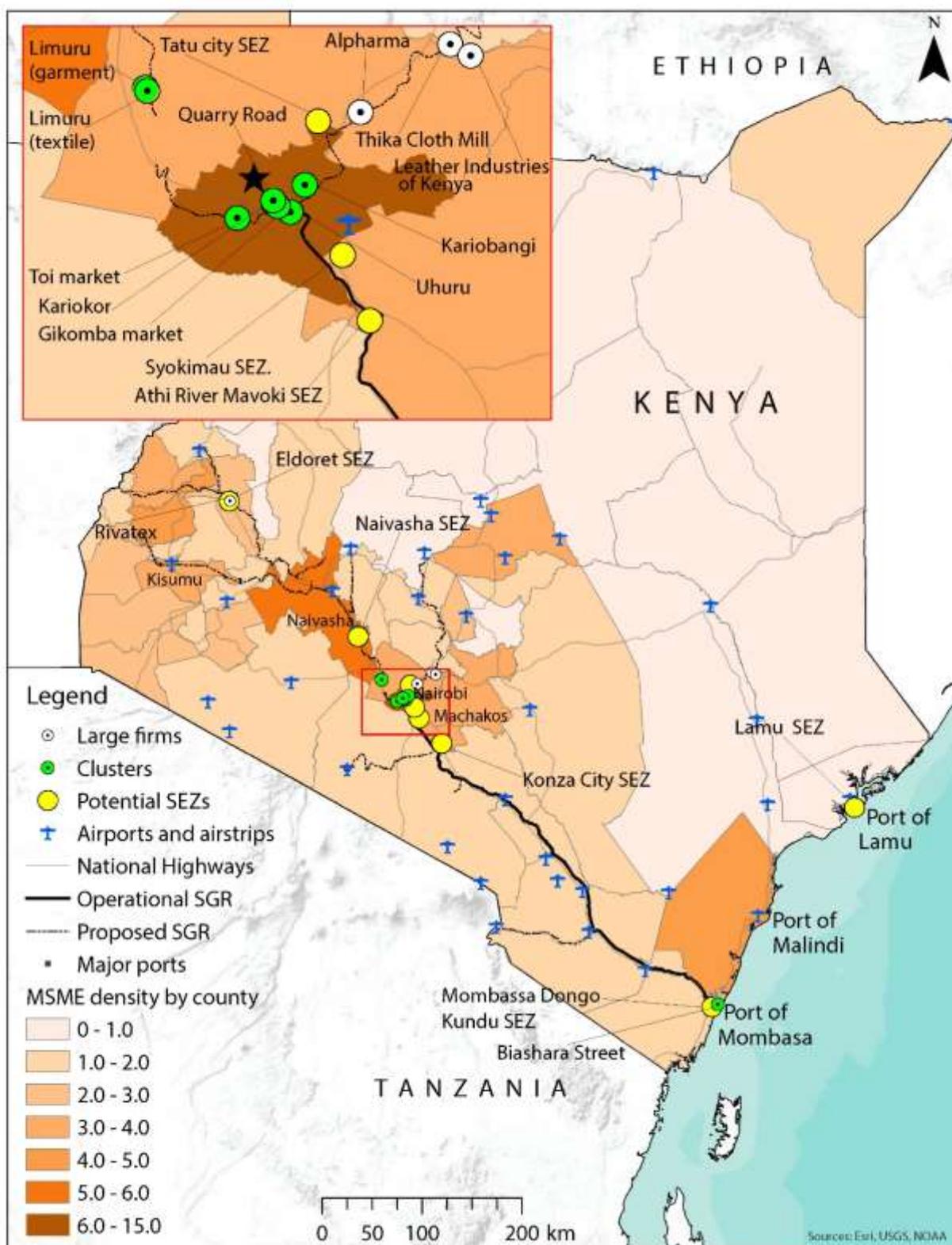
### Jobs and industrialisation challenges in the Big Four agenda

Approximately 3.9 million people will enter the labour market in the East African Community each year between 2015 and 2030, requiring an additional 2.6 million jobs annually, or 7,000 jobs each day. At the current rate of population and employment growth, 14 million people in Kenya may be unemployed by 2030. The aim of the manufacturing pillar of the Big Four agenda is to create at least 50,000 new jobs by 2022 and to generate revenues of \$3.5 billion through the development of these zones and parks.

International experience from Ireland and East Asian economies such as Singapore (Jurong), Malaysia (Penang) and especially China suggests governments can promote local industrial capabilities over time by building linkages between clusters and local firms. These governments have fostered inclusive industrial clusters by concentrating investments in high-quality institutions, social services and infrastructure in a limited geographical area, such as an SEZ, and through a deliberate strategy of promoting close linkages between within-zone firms and local firms through active linkage programmes, supplier development programmes and skills development.

Figure 1 presents a map of potential SEZs; leather and garment clusters (e.g. Kariokor, Uhuru, Limuru); selected large leather, textiles and garments firms in Kenya; density of MSMEs by county; and infrastructural facilities (standard gauge railways (SGR), national highways, airports, ports). Not surprisingly, the hub of development is around the capital Nairobi and its periphery, with MSMEs located in this region possibly having much more access to large firms and more opportunities to relocate into SEZs close by. The location of MSMEs further away (e.g. Kisumu) implies less access.

Figure ES1: Map of economic zones, MSMEs and leather and garment clusters in Kenya



Source: Authors

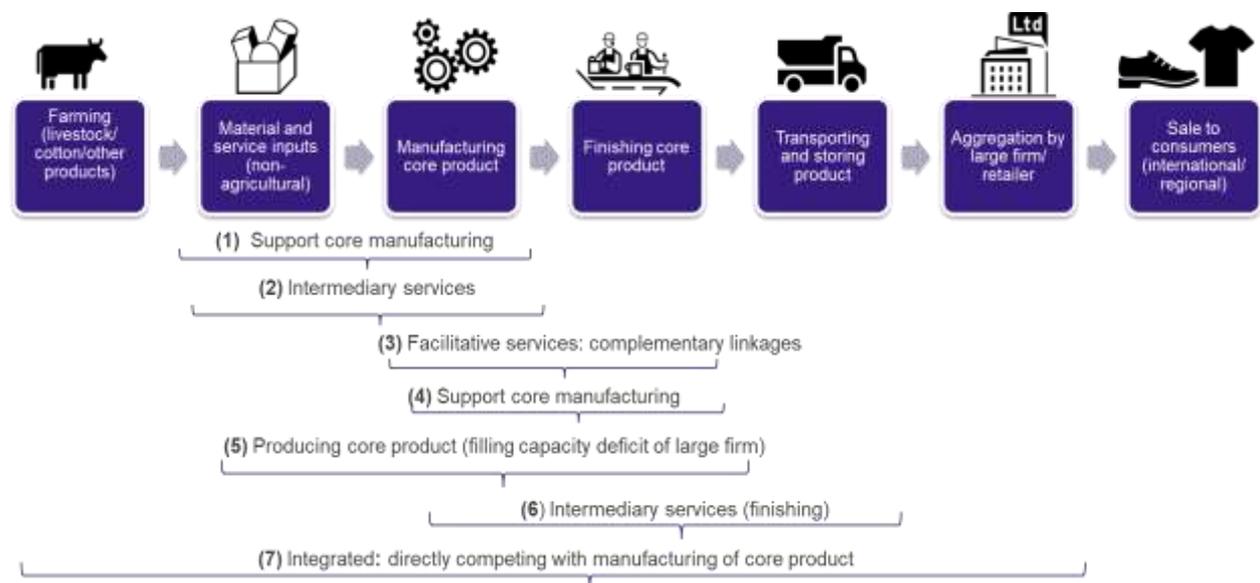
## PATHWAYS FOR INTEGRATING MSMEs INTO VALUE CHAINS

There are seven conceptual pathways through which MSMEs can link into value chains:

- *backward linkages* (supporting manufacturing of core parts required for intermediary products (1); providing intermediary services (2))
- *complementary linkages* (facilitating services not directly linked to manufacture of the product (3))
- *forward and logistical linkages* (manufacturing part of the final product (4); producing the core product (5); offering finishing services (6))
- *integrated linkages* (where MSMEs have relatively integrated backward and forward linkages and compete with large firms (7)).

Figure ES2 provides illustrative examples of these pathways.

Figure ES2: Pathways for MSME linkages into value chains



Sources: Authors' interviews and analysis

A review of the current capacity in value chains shows MSMEs in leather value chains participate through Pathways 1, 2, 3 and 6. These are generally low value-addition, require low- and semi-skilled technical capabilities, need low levels of mechanisation and are not complex tasks. Similarly, MSMEs in textile value chains participate through Pathways 1, 2 and 3, suggesting they are able to perform only peripheral tasks, as they have either old or none of the machinery required for performing high value-added tasks. MSMEs have greater opportunities to grow in garment value chains, as they perform tasks such as design, and to some extent branding or market services (Pathway 6), which increase the value capture of the product, and often subcontracting (Pathway 7). However, most MSMEs in garment value chains participate in pathways that do not require high skills. Table ES1 summarises the main pathways of MSMEs in value chains.

Table ES1: Characteristics and existing pathways of MSMEs in value chains

Value chain	Characteristics of MSMEs in the value chain	Pathways of MSMEs in value chains
<b>Leather</b>	Most of the MSME capabilities range from low to medium as the focus is on backward linkages; tasks are not very complex and there are low levels of mechanisation.	<ul style="list-style-type: none"> <li>1: Slaughtering and skinning</li> <li>1: Tanning raw hides</li> <li>2: Livestock brokers and agents for wet-blue</li> <li>3: Performing cleaning services and providing food</li> <li>4: Producing upper soles for shoes and stitching of shoes, and other accessories</li> <li>6: Fast fashion design capabilities, for local, regional and international markets</li> <li>7: Competition (e.g. with Kariokor cluster)</li> <li>7: Producing and exporting leather</li> </ul>
<b>Textiles</b>	MSMEs perform relatively low value-added and low-complexity work, and lack capacity to be subcontractors. They primarily perform tasks such as intermediary services (brokers, transport) and basic finishing work.	<ul style="list-style-type: none"> <li>1: Cotton farming and coffee husk for boilers</li> <li>1: Cotton input providers, such as of pesticides, seeds</li> <li>2: Cotton brokers</li> <li>2: Road transport and water supply services</li> <li>3: Cleaning the factory floor and amenities</li> <li>4: Dyes, chemicals for fabric finishing</li> <li>4: Handlooms and embroidery</li> <li>6: Supplying road transport</li> </ul>
<b>Garments</b>	Tasks are low-capability and low-complexity, as MSMEs have limited capacity to design and brand products where more value-addition is possible.	<ul style="list-style-type: none"> <li>2: Fabric import services</li> <li>3: Cleaning the factory floor and amenities</li> <li>4: Manufacturing local accessories</li> <li>5: Subcontracting</li> <li>6: Designing and branding for artisanal goods</li> <li>6: Supplying road transport</li> <li>7: Competition</li> </ul>

Sources: Authors' interviews and analysis

## CONSTRAINTS TO MSME INTEGRATION: EVIDENCE FROM INTERVIEWS WITH MSMEs IN THE LEATHER, TEXTILES AND GARMENTS SECTOR

A crucial part of this study included interviewing various stakeholders and MSMEs within the leather, textiles and garments value chain and clusters/zones, predominantly in Nairobi county. The findings suggest there are a range of general constraints relating to MSME development and linkages. For instance, interviewees frequently cited lack of information, MSME support systems and finance as being the most challenging issues faced across all MSMEs. The constraints specific to value chains in the leather sector include poor quality of hides and skins, informality and lack of hygiene in slaughterhouses, high cost of power, low quality of raw products in tanneries, high import tariffs and dependence on old technology. For the textiles sector, they were low yields of cotton production, improper agronomic practices leading to environmental degradation, lack of irrigation and use of obsolete technologies in spinning and yarn formation. Finally, for the garments sector, the key constraints were the rise of cheap and illegal imports, lack of technology to carry out routine tasks such as cutting, lack of local capacity and skills to perform higher value-added work and an uneven playing field that supports the growth of large players while simultaneously disadvantaging MSME participation in garment manufacturing.

In addition, our analysis also suggests there are constraints specific to how economic zones are designed, including lack of understanding across stakeholders on the terminology or key facets of an economic zone; insufficient coordination across governmental agencies; and the deployment of a top-down approach to strategic zone development and implementation, which reduces the scope for involvement of county governments and local knowledge diffusion. Box

ES1 describes examples of major pathways through which MSMEs have integrated into value chains and EPZs.

### Box ES1: MSMEs in leather, textiles and garments value chains – insights from interviews

Interviews for this report uncovered a number of cases illustrating how MSMEs can be successfully integrated into value chains. For example, MSMEs perform slaughterhouse functions in leather value chains. The Dagoretti slaughterhouses are three MSMEs that directly employ approximately 250 employees and indirectly employ 60,000. They supply large volumes of raw leather and hides to larger enterprises, although, owing to a lack of extension services (health and safety, training in skinning), they are unable to increase productivity. In another part of the leather value chain, Preca, in Limiru cluster, is a three-year-old MSME with around 15–20 employees that has successfully developed backward linkages with the major shoe manufacturer Bata. Preca provides Bata with high-quality leather produced using mechanisation, allowing Bata to craft high-quality upper soles for shoes that meet the requisite international standards. Finally, Stealth Hides and Tanneries, located in Nairobi's Industrial Area, participates across the leather value chain. While Stealth has core competence in tanning and supplying semi-processed leather, the firm has expanded into manufacturing car upholstery, which is sold to local automobile manufacturers and also exported to Egypt.

Thika Textile and Rivatex are Kenya's two largest milling companies in the textiles value chain. These mills are important as they purchase cotton gin, dyes, chemicals and embroidery services from MSMEs, while also selling their final product to other MSMEs in garment manufacturing. However, these mills are not operating at full capacity, primarily because of lack of orders and high-quality cotton available to them from ginneries. Finally, the Uhuru Market textile and garment cluster has a membership of about 180 individuals and specialises in the development of thread and fabric for uniforms, which are currently in shortage across Kenya. If supported better, this cluster could substitute for imports of textiles, thereby reducing overall transaction costs for garments firms and increasing their competitiveness.

Tulip specialises in overalls, dust coats and t-shirts, and is an interesting example of a garment manufacturing SME that has successfully relocated to an EPZ. The firm has 200 sewing machines and employs 60 staff, and has successfully upgraded and improved the overall quality of its garments through technology transfer from Sri Lanka.

## POLICY MEASURES CRUCIAL FOR SUPPORTING MSMES AND VALUE CHAINS

We review current policies towards MSMEs (such as Vision 2030, KITP and the Big Four agenda, which will guide government strategy from 2018 to 2022), the MSE Act and MSEA, the SEZ Act, Biashara Bank and other initiatives.

After taking stock of existing initiatives and agencies, including those implemented by MOITC such as KIE (see the main or summary paper for further discussions), and assessing the needs of MSMEs that have not yet participated in existing initiatives, the main report discusses a range of policies that can help MSMEs integrate into value chains. These can be summarised as follows:

- provision of information along the value chain (business advisory, knowledge management support)
- strengthening clusters through improving access to finance, technology, business management skills and technical skills, by encouraging partnerships with incubator and accelerator programmes that better integrate them into value chains and economic zones
- safeguards against illicit trade
- provision of economic fundamentals such as infrastructure, skills and finance (e.g. through incubator and accelerator services, Biashara Bank-proposed support and others)
- promotion of market access
- enhancement of existing dedicated institutions such as KIE and MSEA

We suggest that MOITC remain responsible for implementation of the policy suggestions and the Executive Office of the President support the coordination of inter-ministerial activity to drive the cross-cutting interventions in MSME development, including supporting MOITC’s priority areas of intervention to avoid duplication of roles and enhance collaboration.

The short-term (Table ES2) and long-term (Table ES3) policy measures we propose for increasing MSMEs’ participation in value chains and designing inclusive clusters and zones are explained below. The Presidency can play a useful coordinating role in ensuring these measure are implemented with a collaborative approach. MOITC will be the lead implementer, and during the course of the research provided a range of important ideas and examples of policy actions, many of which are reflected in the tables (some others are available upon request).

**Table ES2: Short-term policy suggestions to integrate MSMEs with value chains**

<b>Value chain</b>	<b>Key policy required</b>	<b>Key benefits</b>	<b>Main actors to involve</b>
<b>Leather</b>	Provision of info on sector along the value chain: livestock census; quality and quantity of hides collected; environmental compliance of tanneries; trade information on the African Growth and Opportunity Act and countries with demand for leather goods	Comprehensive data and analysis of the entire value chain that are regularly updated and that inspire policy and strategy for government and non-state actors	Ministry of Livestock; MOITC; Kenya Leather Development Council; Ministry of Environment; relevant SMSE associations; Kenya Private Sector Alliance (KEPSA) Kenya Association of Manufacturers (KAM); Kenya National Chamber of Commerce and Industry (KNCCI); county governments
	Development of common manufacturing facilities for leather goods subsector MSMEs	High-quality leather goods and productivity for MSMEs	MOITC; MSME leather associations; fashion associations
<b>Textiles</b>	Provision of info on the sector along the value chain: updated data on cotton production, ginning activity and MSMEs active in textile manufacturing and weaving	Comprehensive data and analysis of the entire value chain that are regularly updated and that inspire policy and strategy for government and non-state actors	MOITC; Ministry of Agriculture;; Cotton Development Authority; relevant SMSE associations; KAM; county governments
	Commercialisation of seed varieties that have better yield to improve cotton production	Higher cotton yields for textile production	MOITC; Ministry of Agriculture; Cotton Development Authority
	Development of a strategy for the fashion subsector under the Creative Sector Policy	Stronger functional linkages between textiles production and fashion subsector	MOITC; KAM; KEPSA; KNCCI; fashion associations; handloom associations
	Development of a branding and marketing strategy for textiles and garments subsectors	Stronger investor and market interest in investment in and purchases from the subsectors	MOITC; KAM; KEPSA; KNCCI; fashion associations; handloom associations
<b>Garments</b>	Provision of information on MSME garment manufacturers and the fashion subsector	Comprehensive data and analysis of the entire value chain that are regularly	MOITC; relevant MSME associations; KEPSA; KAM; KNCCI; county governments

Value chain	Key policy required	Key benefits	Main actors to involve
		updated and that inspire policy and strategy for government and non-state actors	
	Linking EPZ companies with local manufacturers to support growth of MSMEs (e.g. using VAT exemptions)	Stronger functional linkages between EPZs and MSMEs	MOITC; EPZA; relevant MSME associations; KEPSA; KAM; KNCCI; county governments
	Development of common manufacturing facilities for fashion subsector MSMEs	High-quality garments and productivity for MSMEs	MOITC; MSME garment cluster associations; fashion associations; handloom associations
	Development of market access opportunities for MSMEs to local, region and international markets	Increased market access for MSMEs	MOITC; Export Promotion Council; county governments; annual fashion event organisers
<b>General:</b>  <b>Economic zone design, development and implementation</b>	Inform the task force concerned with economic zone development on the definition and legislation, ensuring a level playing field and opportunities for MSMEs	Clear definition, legislation and practices of economic zones that provide opportunities to MSMEs and SEZ development	MOITC (leather, textile and SME desks); economic zone development bodies (EPZA, SEZA); relevant MSME associations; all county governments, to develop a policy framework/strategy on industrialisation
	Coordinate economic zone design, development and implementation	Better government coordination of economic zone design, development and implementation internally and with non-state actors	MOITC; Economic Zone Task Force/Development Coordination Unit coordinated in the Presidency that supports MOITC economic zone financing and implementation of activities (work with and enhance SEZA)
	Enhance private sector participation, from both large companies and MSMEs	Private sector buy-in on zone design and development	MOITC; EPZA; SEZA; KAM; Kenya Private Sector Alliance; relevant MSME associations
<b>General</b>	Provision of info on value chains, e.g. KIE, MSEA and county-level government; and funding opportunities for MSMEs through Biashara Bank and private equity support	Accurate and updated info on MSME sector to better inform policy and strategy; MSMEs able to better leverage funding opportunities	Kenya National Bureau of Statistics (KBS); MOITC, especially MSEA
	Creation of an MSME readiness tool that assesses MSME readiness for financing and economic zone integration	MSMEs ready for financing and economic zone integration	MOITC; Ministry of Livestock; Ministry of Agriculture; EPZA and SEZA
	Finance vehicles by Biashara Bank and selected banks that target MSMEs	Increased access to finance for MSMEs	MOITC; Biashara Bank and banks with an MSME focus
	Establish an MSME Credit Guarantee Scheme and	Increased access of financing for MSMEs	Various

Value chain	Key policy required	Key benefits	Main actors to involve
	operationalise the MSE fund		
	Coordinate MSME development	Better government coordination of MSME development internally and with non-state actors	MSME Development Coordination/Oversight Unit in Presidency, with clear links to implementers such as MOITC
	Implement counterfeit legislation building on recent successful activities (create awareness and uptake of intellectual property)	MSMEs protected from imports of illegal and substandard goods	MOITC; Multi-agency Taskforce on Illicit Trade; Kenya Anti-Counterfeit Agency; KBS

Table ES3: Long-term suggestions to integrate MSMEs with value chains

Value chain	Key policy required	Key benefits	Main actors to involve
<b>Leather</b>	Value chain interventions for animal herders; abattoirs and slaughterhouses; hides and skins traders; tanneries and leather goods producers	Better-quality leather and leather goods	Ministry of Livestock; MOITC; Kenya Leather Development Council; relevant MSME associations; KAM
<b>Textiles</b>	Value chain interventions for cotton producers; ginneries; textile manufacturers	Better cotton production and textile manufacture	Ministry of Agriculture; MOITC; Cotton Development Authority; relevant MSME associations; KAM
<b>Garments</b>	Value chain interventions focused on MSME garment producers	Higher profitability for MSME garment producers	
	Develop an investment policy for economic zones with a focus on manufacturers of accessories, (trims, threads, zippers, buttons and lace)	Better garment input ecosystem for value-addition by MSMEs	MOITC; KenInvest; KAM; KEPSA; KNCCI
<b>Economic zone coordination and implementation</b>	Physical infrastructure development	Economic zone facilities that attract private sector and investors	Economic Zone Development Coordination Unit/Task Force
	Social infrastructure development	Facilities that attract and retain appropriate labour for economic zones	Economic Zone Development Coordination Unit/Task Force
<b>General</b>	Incubator for micro and small enterprises; accelerator programme for medium enterprises, drawing on those developed by KIE for example	Development of MSMEs ready for financing and economic zone integration	MOITC; MSEA, MSME associations
	Development of a united MSME body	United MSME representation led by MSMEs for coordination of sector	Relevant MSME associations
	Restructure and support MSEA	An MSEA that is supported by MSEs and is active and	MOITC; relevant MSME associations

Value chain	Key policy required	Key benefits	Main actors to involve
		engaged in activities focused on MSMEs	
	Cheap, reliable and accessible electricity	Affordable and high-quality electricity for MSMEs	Ministry of Energy; MOITC
	Skills development	Better-skilled, productive and profitable MSMEs	MOITC; Ministry of Education; Technical and Vocational Education and Training Authority

## WHAT NEXT?

We suggest three priority actions for the Executive Office of the President:

1. *Restructure MSME support structures such as MSEA by feeding into current reviews by the Government of Kenya:* Institutions supporting MSME development are fragmented on both the public and the private sides, leading to the neglect of MSMEs' interests. The Executive Office of the President can coordinate government actions towards MSMEs, promote a change in the governance of MSEA, increase the transparency of MSME integration and create a hotline for MSMEs. There is some value in central coordination, but clearly any restructuring needs to take into account existing reviews and, when appropriate, enhance the activities already implemented by line ministries such as MOITC.
2. *Introduce more and better-dedicated incubator and accelerator programmes:* Many MSMEs are not ready for linkages, but some are, or can be prepared with support. An incubator programme could start with promising MSMEs such as those in the Kariokor leather cluster and Uhuru garment cluster. It will be important to be informed by and/or support existing government structures in this area, such as incubator and accelerator programmes provided by KIE.
3. *Involve county governments:* Develop a framework for engagement with and by county governments in coordination with MOITC and private sector actors.

# 1 INTRODUCTION

The Kenyan government has developed a range of policies, strategies and measures such as Vision 2030<sup>1</sup> to promote industrialisation. However, these strategies will miss important opportunities for broad-based economic transformation without more focused attention on the role of smaller and local firms. The overarching goal of the strategies is for Kenya to become a middle-income country by 2030. Micro, small and medium-sized enterprises (MSMEs) are integrated across each of the Vision 2030 pillars of economic, social and political development, with a provision to establish small and medium-sized enterprise (SME) parks, common manufacturing facilities at county level and centres of excellence to promote technology transfer, and to provide capacity-building and marketing support (Ministry of Devolution and Planning, 2013). The Kenya Industrial Transformation Programme (KITP) (MoED, 2015) aims to create 1 million jobs, to grow domestic and foreign direct investment (FDI) fivefold and to increase the contribution of manufacturing to 15% of gross domestic product (GDP) by exploiting already existing opportunities (ODI and KAM, 2017). The KITP identifies that the main mechanisms to achieve these goals is to support rising stars amongst Kenyan SMEs and to build capabilities with model factories (KAM, 2017), but this requires more focused attention.

Despite the formulation of good strategies, both Vision 2030 and the KITP have suffered from implementation and inclusivity failures, which have hampered growth in MSMEs. In terms of implementation, the Ministry of Industry, Trade and Cooperatives (MoITC) did not develop a strategy to deploy the required infrastructural or financial support or to create phased plans to integrate MSMEs within value chains. In terms of inclusivity, not all stakeholders (e.g. MSMEs, county governments) were consulted, which has led to poor uptake and dispersed political commitment.

Within manufacturing, textile and leather are Kenya's largest sub-sectors, exporting a combined sum of \$431 million in 2017 and employing more than 2.5 million people, of whom 2.1 million are employed in MSMEs (ITC, 2016). Even though there has been a significant push towards manufacturing in recent years, it has grown at a slower rate than the rest of the economy, which implies that the share of manufacturing in national output has fallen. Indeed, there is an imminent need to overcome implementation barriers to industrialisation to create jobs – ODI (2018) estimates that 3.9 million people of working age will enter the East Africa Community (EAC) each year between 2015 and 2030, which requires an additional 2.6 million jobs annually or 7,000 jobs a day. At the current rate of population growth in Kenya, 14 million people may be unemployed by 2030 (Koh, 2018).

In 2017, President Uhuru Kenyatta announced that the focus of the current administration would be on the 'Big Four', namely food and nutrition security, universal health coverage, affordable housing and manufacturing, thus aligning its aims with Vision 2030 and the KITP. The Big Four agenda aims to achieve industrialisation through the expansion and creation of special economic zones (SEZs) and industrial clusters (parks, free trade zones, SME parks), and delineates an increase in manufacturing from 8.4% to 15% of GDP by 2022. The aim is to create at least 50,000 new jobs by this time and earn revenues of \$3.5 billion through the development of SEZs and parks (KIPPRRA, 2018; Mutahi, 2018). The key targets highlighted under the Big Four agenda are displayed in Table 1.

The Supporting Economic Transformation (SET) programme is supporting the Office of the President by examining the mechanisms and policies that may enable integration of textile, apparel and leather MSMEs into SEZs and industrial parks.

<sup>1</sup> [www.vision2030.go.ke](http://www.vision2030.go.ke)

Table 1: Big Four agenda targets for manufacturing

Value chain	Detailed targets by 2022	Priority 2018 specific initiatives
<b>Textile</b>	<ul style="list-style-type: none"> <li>• 500,000 new jobs in cotton</li> <li>• &gt; 200,000 ha of Bt-cotton</li> </ul>	<ul style="list-style-type: none"> <li>• 200,000 ha of Bt-cotton</li> </ul>
<b>Apparel</b>	<ul style="list-style-type: none"> <li>• Achieving a \$2.6 billion sales target</li> <li>• 100,000 new jobs</li> <li>• New investments of \$1.4 billion</li> </ul>	<ul style="list-style-type: none"> <li>• 5 million square feet of industrial sheds</li> <li>• Train 50,000 youth and women</li> </ul>
<b>Leather</b>	<ul style="list-style-type: none"> <li>• Achieving a \$500 million sales target</li> <li>• 50,000 new jobs</li> <li>• 20 million shoes made</li> <li>• New investments of \$30 million</li> </ul>	<ul style="list-style-type: none"> <li>• Train and set up 5,000 cottage industries</li> <li>• Complete Machakos leather park</li> <li>• Change policies, especially in stopping imports</li> <li>• Identify three other parks</li> </ul>
<b>MSMEs</b>	<ul style="list-style-type: none"> <li>• Create an additional 1,000 SMEs in manufacturing</li> </ul>	<ul style="list-style-type: none"> <li>• Policy change finalised alongside the United States' Small Business Administration Act and national policies</li> <li>• Enhance SMEs' development funds by \$500 million with guarantee schemes</li> <li>• Merge various government funds to form Biashara bank</li> </ul>

Source: KIPPRA (2018); Mutahi (2018).

In this report we tackle two separate challenges. The first challenge is the integration and upgrade of MSMEs to enable participation in global and regional value chains. The second relates to the specific challenges that MSMEs face in the global market due to their inability to enter clusters or SEZs more generally. While there has been some attention recently to the development of large firms in Kenya (key informant interviews), less attention has been paid to the position of MSMEs and how they link into EZs.<sup>2</sup> To address this, we need a systematic analysis of the different linkages of MSMEs in value chains and EZs, the capability deficits and constraints that exist, what the business case is for integrating them into value chains and EZs, and the policies and private sector-supported institutional configurations that might enable MSME integration into these value chains.

With this in mind, the paper examines four questions:

1. What are the current and possible linkages for MSMEs to integrate in value chains (with a focus on textiles, garments and leather)?
2. What are the pathways for MSMEs to connect with EZs (and can we learn from current export processing zones (EPZs) and other related examples)?
3. What are the practical policies and strategies for integrating MSMEs into value chains and future EZs?
4. What considerations need to be taken on board with future EZ design to better integrate MSMEs?

Section 2 of this report describes the conceptual framework and identifies a number of different 'pathways' through which MSMEs can link to large firms in global and regional value chains, including using economic zones (EZs) for industrialisation. Section 3 maps the textile, garments

<sup>2</sup> ODI convened and funded a workshop on 20 July 2018 on 'Integrating leather, textile and apparel MSMEs into value chains and SEZs'. More than 40 individuals from across MSMEs, large firms, government and associations participated in three roundtable sessions that brought MSMEs to the forefront of discussions with the ministry of Industry for the first time.

and leather value chains and highlights the modes through which MSMEs participate presently. Section 4 provides evidence on how MSMEs are currently linked into value chains using the conceptual framework described in section 2, and discusses the various constraints faced by MSMEs to upgrading to new 'potential pathways' for integration into value chains. Section 4 also discusses how MSMEs can be inserted into EZ design to promote inclusive industrialisation, while section 5 puts forward policy suggestions to foster potential pathways for MSMEs to link into value chains, including potential incubator and accelerator programmes. Section 6 summarises the policy actions and outlines a range of short- and long-term policy measures.

This report is based on secondary literature (articles, grey literature and reports, including previous SET reports) and primary interviews with more than 40 stakeholders in the value chain (e.g. chief executive officers (CEOs) and technical officers of SMEs, cluster associations, business associations, national and county government officials and international organisations) (see Appendix A). Fieldwork was conducted between May and July 2018, during which period SET also organised three multi-stakeholder roundtables that involved more than 200 participants to discuss the role of MSMEs in EZs, financing and trade more broadly. A list of interviewees and details of the roundtables are available from the authors upon request.

## 2 CONCEPTUAL FRAMEWORK FOR INTEGRATING MSMEs INTO VALUE CHAINS AND ECONOMIC ZONES

This section provides a conceptual framework to understand the pathways through which MSMEs can integrate into value chains and SEZs, and the factors that support integration. We begin by highlighting the importance of MSMEs for the Kenyan economy (section 2.1), before describing the various pathways through which MSMEs can integrate into value chains (section 2.2). Section 2.3 discusses the importance of SEZs as tools for transformation, and finally, Section 2.4 explores how MSMEs can be effectively linked into the plans and implementation of SEZs.

### 2.1 MSMEs and their importance to the Kenyan economy

#### Box 1: Summary – the importance of MSMEs in Kenya

- MSMEs constitute more than 80% of all businesses in Kenya and collectively employ close to 14.9 million people, comprising 78% of the country's entire labour force.
- There are about 7.41 million MSMEs in Kenya that collectively contribute about 34% of the country's GDP.
- The majority of MSMEs (around 60%) are in the services sector, with most of these operating in wholesale and retail trade, repair of motor vehicles and motor cycles.
- Despite this, the MSME sub-sector is built on very shaky foundations. More than 85% of MSMEs in Kenya are unlicensed businesses, with the vast majority of these categorised as 'micro' enterprises.
- Medium enterprises, employing 50-99 employees, only account for 0.7% of total licensed enterprises in the country.
- Around 400,000 MSMEs fail each year with almost 90% of all start-ups not surviving beyond two years.
- Close to half of all MSMEs in Kenya are located in Nairobi County and within 100 km of the capital.

Source: KNCCI (2018).

SMEs contribute more than 78% of jobs in many sub-Saharan African economies (KNCCI, 2018), which is a significant proportion of employment opportunities in a growing economy. Failure to include SMEs in a country's industrialisation process could lead to social and economic exclusion, missed economic opportunities and a widening of the gap between the winners and losers of globalisation. The importance of SMEs' participation in industrialisation is recognised in Goal 9 of the United Nations 2030 Agenda, which aims to 'increase the access of small-scale industrial and other enterprises ... to financial services ... and their integration into value chains and markets' (UN, 2015: 24, target 9.3). Likewise, Goal 8, target 8.3 highlights the importance of promoting 'policies that ... encourage the formalization and growth of micro-, small- and medium-sized enterprises' (ibid.: 23).

In Kenya the Micro and Small Enterprises Act 2012<sup>3</sup> defines MSMEs as the following:

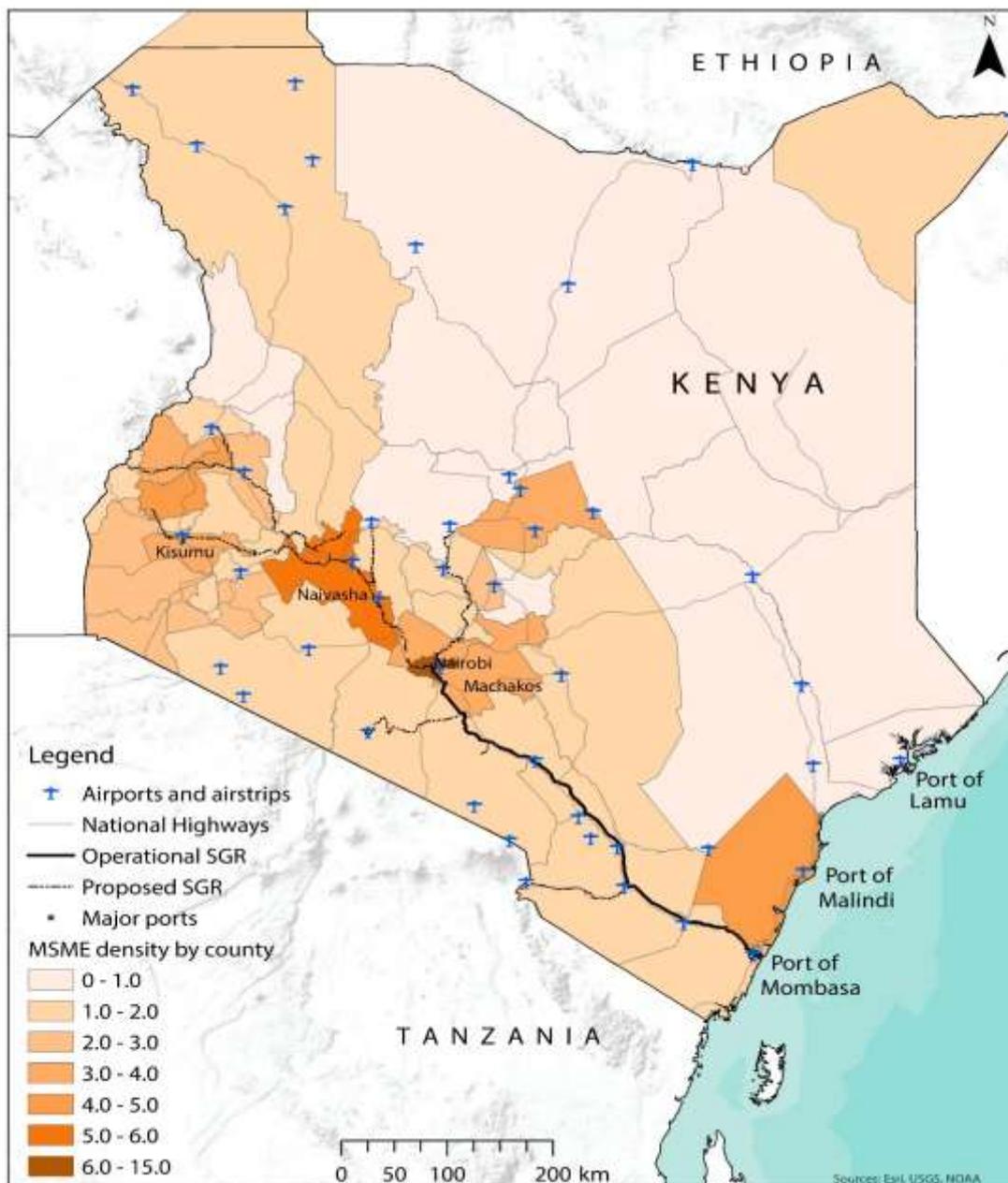
- **Micro** – annual turnover does not exceed **500,000 Kenyan shillings** (KSh) and employing **fewer than 10 people**.

<sup>3</sup>[www.kenyalaw.org/lex/rest/db/kenyalaw/Kenya/Legislation/English/Acts%20and%20Regulations/M/Micro%20and%20Small%20Enterprises%20Act%20No.%2055%20of%202012/docs/Micro%20and%20Small%20Enterprises%20Act%20No.%2055%20of%202012.pdf](http://www.kenyalaw.org/lex/rest/db/kenyalaw/Kenya/Legislation/English/Acts%20and%20Regulations/M/Micro%20and%20Small%20Enterprises%20Act%20No.%2055%20of%202012/docs/Micro%20and%20Small%20Enterprises%20Act%20No.%2055%20of%202012.pdf)

- **Small** – annual turnover ranges between **KSh 500,000 and KSh 5 million** and employing between **10 and 50 people**.
- **Medium** – annual turnover ranges between **KSh 5 million to KSh 800 million** and employing between **50 and 99 employees**.

In terms of the distribution of MSMEs, approximately 12% (0.9 million) of the 7.4 million SMEs surveyed by the Kenya National Bureau of Statistics in 2016 were manufacturing firms (KNBS, 2017). Only 20% of these firms were licensed, and the remaining 80% were unlicensed and form part of what is commonly described in Kenya as the *jua kali* or informal sector. Figure 1 presents the density (%) of licensed and unlicensed MSMEs by county using the KNBS survey data from 2016 (ibid.). The map clearly highlights that Nairobi, Mombasa and Naivasha, and areas around their borders, have the highest density of MSMEs.

Figure 1: Density of MSMEs



Notes: % MSME density by county is calculated as total licensed + unlicensed MSMEs in a county divided by the total number of MSMEs in the country (based on data from KNBS, 2017)

Source: authors.

Apparel manufacturing (41.6% of licensed MSMEs or 72,602 enterprises) and food production form the majority of manufacturing activities undertaken by MSMEs in the country (KNBS, 2017). Only about 1% of MSMEs were involved in leather-related (1,786 identified firms) and textile (2,734) manufacture. Table 2 highlights that almost 90% of firms involved in the manufacture of textile, apparel and leather are categorised as ‘micro’, and only 10% of leather product firms are categorised as medium-sized. This breakdown is critical when formulating policy, and necessitates that the characteristics of each type of firm are distinguished from one another instead of grouping MSMEs under a one-policy-fits-all approach. Accordingly, at times this paper distinguishes between micro and small enterprises (MSEs) and small and medium-sized enterprises (SMEs), as the two categories face slightly different dynamics and challenges.

Table 2: Distribution of licensed MSMEs

Manufacturing activity	Number of firms	Micro (%)	Small (%)	Medium (%)
Textiles	2,734	90.9	9.1	0.0
Apparel	72,602	97.1	2.4	0.5
Leather and related products	1,786	89.4	0.0	10.6

Source: KNBS (2017).

The Micro and Small Enterprise Act 2012 began to set up the relevant institutional mechanisms to operationalise MSMEs. The MSE Act provides legal frameworks, new rules and institutions to support micro and small businesses, which include the Office of the Registrar of MSE Associations (to formalise and register MSEs), the MSE tribunal (for conflict resolution) and the MSE fund (to address issues of financing) (UNDP, 2015). One of the key institutional reforms emerging from this Act was the establishment of the Micro and Small Enterprise Authority (MSEA) within the Ministry of Industrialization and Enterprise Development (MoIED).

The core functions of the MSEA are to support MSMEs to grow, by providing conducive work environments and market access, setting out proper management and mobilisation of financial resources, coordinating sector players and facilitating integration of programmes and activities relating to MSEs (MSEA, n.d.), facilitating formalisation and upgrading of informal MSEs, promoting information communication technology (ICT) in all sectors, and improving entrepreneurial and technical skills in the MSE sector. There are several ‘governance deficits’ within the MSEA, however, specifically relating to its inability to create cohesion between various MSME clusters (leather, textile, motorcycles (*boda-boda*)), which has prevented MSMEs from forming associations. This failure to form associations or cohesive groups has inhibited the ability of MSEs to interact with national government or to garner any bargaining power.

Within the MoITC – an arm of the State Department for Investment and Industry – is the Department of Micro and Small Industries (MSI) (MoITC, n.d.a). Several aims of the MSI overlap with the MSEA, however much of the funding within the MSI comes from development partners. There also exists a Directorate of Enterprise Development within the MoITC, which deals with SMEs, as well as designated leather, textile and garment and SME advisers who attempt to coordinate actions for developing the sector. While there are various authorities and departments that look at MSMEs at a national level, there is not a comprehensive plan on the coordination of pro-MSME growth activities.

## 2.2 Conceptualising possible pathways to integrate MSMEs into value chains

Here, we present a conceptual framework that covers a range of linkages between MSMEs and large tier 1 or tier 2 firms that may sell to international, regional and local buyers of leather, textile and apparel. Tier 1 firms are those that supply directly to the original equipment manufacturer or the international retailer; tier 2 firms supply to tier 1 firms and are usually limited to specific geographical coverage. Table 3 presents a typology of pathways, including the key actors involved and their roles, and, together with Figure 2, shows the different ways in which MSMEs can integrate into value chains.

A pathway is defined as the structure of transactions between MSMEs and large buyers (which could be tier 1 or 2 firms). We identify seven pathways that enable MSMEs to participate in global, regional or national value chains through a specific role, which are divided into three categories. The first category is **backward linkages**, where the focus is on the inputs (domestic and foreign) used in production, along with research and development (R&D) at the production stage. The second category is **complementary**, which covers support services not within the immediate remit of core activities of the buyer or exporting firm, but which play a key role in supporting and complementing the goods/services for the buying firms. The third category relates to **forward and logistical linkages**. Backward and forward linkages are associated with core requirements for manufacturing a final product, while complementary linkages relate to those which ‘enable’ or ‘support’ the core requirements.

Table 3: Conceptualising pathways for MSMEs to integrate into value chains

Actors involved	Category of pathway	Role of MSME in the pathway	Examples of MSME activities in each pathway	Pathway
MSME with lead/large firms (tier 1 or 2 firms)	Backward	Support core (vertical) manufacturing – parts of main product	e.g. chemicals, elastics, buttons, dye, soles	1
MSME with lead/large firms (tier 1 or 2 firms)	Backward	Intermediary services	e.g. brokers for livestock, removing animal skin	2
MSME with large firms (tier 1 or lead firms)	Complementary	Facilitative services and manufacturing – supporting main product development	e.g. cleaning, food supply	3
MSME with large firms (tier 1 or lead firms)	Forward	Support core (vertical) manufacturing – parts of main product	e.g. finishing chemicals	4

<b>MSME with large firms (tier 1 or lead firms)</b>	Forward	Producing core product – filling capacity deficit of large firm	e.g. subcontracting	5
<b>MSME with large firms (tier 1 or lead firms)</b>	Forward and logistical	Intermediary services (finishing)	e.g. design, advertising, transporting goods, brokers	6
<b>MSME stand alone</b>	Competition to large enterprises and integrated chain	Directly competing with manufacturing of core product; has full product from backward to forward	Own export markets and local connections	7

Source: authors.

**Pathway 1 refers to backward linkages**, where MSMEs can supply firms with inputs used directly in producing intermediary leather, apparel or textiles products. Examples include supply of chemicals, elastics, buttons or dye used in the production of goods that will undergo further stages of processing and value addition before sale.

**Pathway 2 refers to intermediary services.** These relate to the provision of services required for the production of intermediary products, for example, in leather value chains MSMEs clean and remove skin from livestock; or broker between firms and farmers for cotton and livestock. Such intermediary services are required as inputs and form part of the backward linkage tasks. These are critical to production of final goods, but do not involve any manufacturing support.

**Pathway 3 consists of complementary linkages or support services** to large enterprises (buyers). These services facilitate the smooth functioning of other pathways and improve efficiency in the manufacturing process. For example, cleaning services of factory floors, catering to factory workers, health and safety support staff etc. Complementary linkages mostly occur amongst indirectly integrated MSMEs – i.e. where they do not contribute directly to the manufacturing of the product.

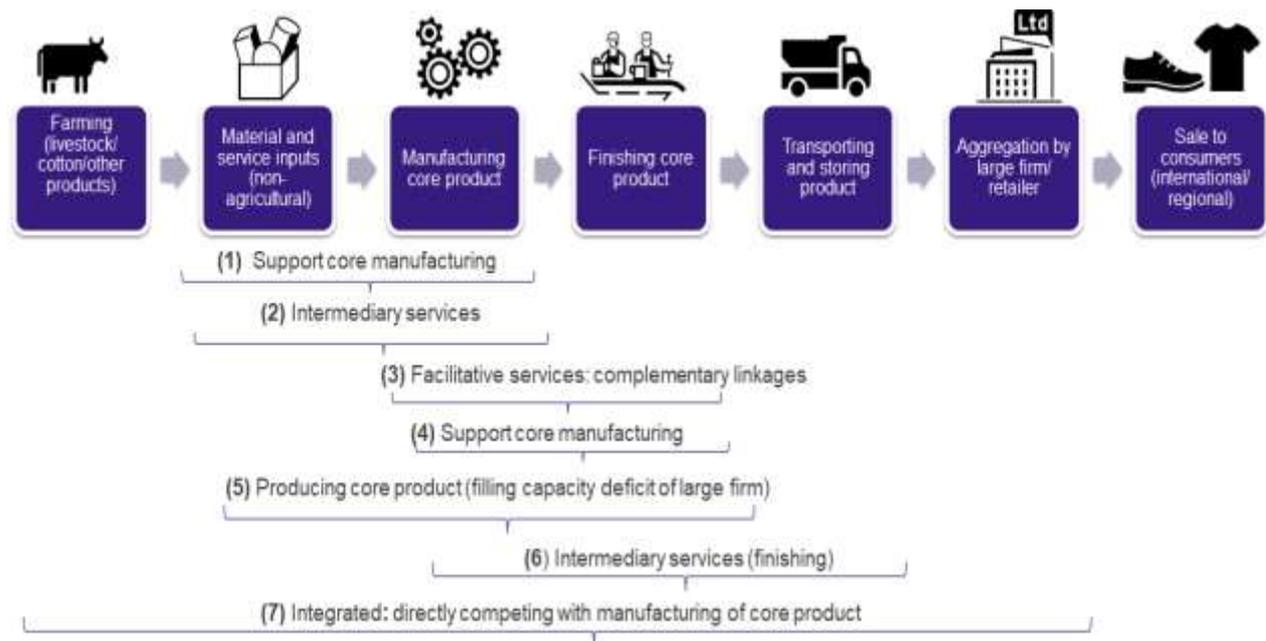
**Pathway 4 is forward and logistical.** This occurs when MSMEs perform manufacturing activities that support production of a final product. For instance, within leather value chains, MSMEs can finish hides using chrome washings to give a wet-blue finish, which are then sold to large enterprises in Kenya and exported. Or MSMEs can make buttons for men’s shirts, which are used by large enterprises in the production of the shirts before export.

**Pathway 5 is when MSMEs are ‘subcontracted’.** These MSMEs have the capabilities to produce the full product required by a buyer, which requires them to have well developed backward and forward linkages. Large firms frequently outsource final products from MSMEs when there are shocks, like a sudden increase in the volume of international orders.

**Pathway 6 links to services required to facilitate the functioning of forward and logistical linkages.** For example, MSMEs can perform finishing services (such as design, advertising, marketing), which are often services that support brand development. These can also link to brokering services, such as micro entrepreneurs connecting large firms to MSMEs. Some logistical services include road transport services offered by MSMEs.

**Pathway 7 concerns MSMEs that have managed to develop integrated value chains by deepening forward and backward linkages.** They are able to compete directly with large enterprises for various markets, these are firms who not only subcontract, but also have their own marketing and branding departments for sale.

Figure 2: Possible pathways for how MSMEs can link to value chains



Source: The authors.

### 2.2.1 Characteristics of a pathway

Each pathway varies in the level of complexity of tasks involved and the capital and industrial capabilities required. These include:

- *Capabilities required for the pathway*: the possession of managerial skills and technical capabilities to perform low- or high-skill tasks relevant to a particular pathway. This also includes a component of learning such as direct transfer, imitation and learning-by-doing.
- *Complexity of the task*: the degree to which complex information and knowledge is transmitted between buyers and MSMEs to perform tasks within each type of linkage pathway.
- *Asset specificity requirements*: whether MSMEs have made the necessary asset-specific investments, be it in physical assets, human assets or sites to help them participate in a linkage pathway.
- *Social networks*: the strength of the ties MSMEs have with buyers and other actors within the value chain (county and national government, business associations, other MSMEs) determines the support they will receive to participate in a linkage pathway.

For example, using chemicals to finish fabric can be characterised as highly complex and requiring high capabilities. As specialised skill (knowledge) is necessary, it will also require high asset specificity as there is a need for mechanisation. Social networks are not particularly important. Section 3 unpacks these characteristics for each pathway in order to describe the ‘current status’ of MSME capacity in the country. We map each of the four characteristics on a (relative) scale of low, medium and high, based on perceptions gathered through interview data. A ‘low’ rating implies that participating in the specific pathway requires low levels of managerial and technical capabilities; or that the pathway requires simple tasks with low asset-specific requirements. A ‘high’ rating entails the opposite, wherein participating in the pathway demands a high level of capabilities, the tasks are complex and significant investment is required in mechanisation (high asset specificity). A ‘medium’ rating occurs between the two extremes.

## 2.2.2 Potential pathways

While we use this conceptual framework to analyse the *current status* of MSMEs in section 3, it can also be used as a *foresight tool to assess the potential pathways* that could support industrialisation and improve opportunities for participation within EZs.

Linking EZs, value chains and MSMEs through the above pathways could lead to a range of win-win benefits (Schmitz, 1995; Te Velde, 2001; Pietrobelli and Rabelotti, 2006). These include:

- productivity increases that can occur due to increases in the volume of present output with minimal change to costs of factors of production; or through a reduction in transaction costs (e.g. cheaper costs for the procurement of inputs, higher efficiency in using inputs)
- technological progress and knowledge acquisition/accumulation. MSMEs can acquire new forms of high-tech to improve their technical capabilities, for instance for better quality textiles and digital skills for sewing and design
- functional upgrading that can occur when MSMEs move to new pathway linkages, by participating in new product lines or branding strategies such as 'Buy Kenya Build Kenya' to support own brand manufacturing
- economies of scale, as better integration could support collective efficiency. MSMEs are better able to evolve and grow over time in a cluster setting
- regional development and improved livelihood security by creating significant positive spill-overs for regional and local markets.

There are two categories of 'potential pathways' to achieve win-win benefits (which are explored in greater detail in section 4).

- 'Incremental' pathways do not need considerable new investment or acquisition of new forms of capabilities. These pathways are relatively well developed and require minimal or relatively little investment to enable MSMEs to upgrade. Thus, the incremental category would involve looking at MSMEs that already have considerable experience in specific pathways and enjoy competitive advantage (i.e. have existing strengths). These pathways are not necessarily high value, or complex, but can perform significantly better with small investment, targeted technical skills, marginal improvement in managerial skills and acquisition of additional machinery.
- 'Substantive' pathways require more investment and new knowledge and capabilities to functionally upgrade into new pathways or significantly improve the performance of the MSME in the pathway (e.g. by increasing productivity significantly). This is a long-term strategy as it involves large investments and time.

Section 4 expands on these potential pathways by providing examples of how MSMEs in each value chain can 'incrementally' and 'substantively' upgrade and create win-win benefits for large enterprises and themselves.

## 2.3 Economic zones clusters and industrial parks: theory and current practice in Kenya

Current industrialisation policy in Kenya relies heavily on developing SEZs but what we discuss can also be applied to economic zones generally. This section discusses under what circumstances SEZs can be good for industrialisation and wider development goals. Integration into the local economy (and hence with MSMEs) is a core reason why these zones can help to transform the whole economy, rather than becoming enclaves.

### 2.3.1 The theory of SEZs and industrialisation

Governments can foster industrial clusters by concentrating investments in high-quality institutions, social services and infrastructure in a limited geographical area such as SEZs (Farole, 2011). Outward-oriented SEZs have been an important policy element in the structural transformation in a range of East Asian economies, most notably in China (Dinh et al., 2013). Kingombe and te Velde (2015) discuss how SEZs could play a role in addressing Africa's twin challenge of structural transformation and employment creation.

Effective SEZs are those that: (a) respond to the latest global developments (for example, increased demand for natural resource-rich products, offshored services); (b) are regarded as tools in a wider growth strategy which incorporate good quality policies and support for institutions; and (c) follow a set of best practices such as emphasising the clustering properties of SEZs. All of this requires significant state capacity with a consistent and coherent approach.

The evidence on SEZ development suggests that some zones (especially in Asia) have worked while many others (especially in Africa) have failed. Nonetheless, some zones in sub-Saharan Africa have attracted significant employment (for example in Madagascar, Mauritius, Lesotho and now Ethiopia), although the wider transformational aspects have been largely absent (with exceptions such as Mauritius). SEZs that have emphasised (industrial) clustering tend to be more successful. Significant and sustained employment generation only occurs when there is a strategy for the zone to contribute to innovation and structural transformation, because zones without such a strategy will not succeed in the long run and are vulnerable. A sustainable SEZ strategy needs to ensure that zones are not established and managed as enclaves, but involve significant linkages between zone firms and local firms, and use economic and social standards that are similar to the rest of the economy.

Ethiopia is successfully developing SEZs, although it still has to build stronger linkages to the local economy (see Box 2).

## Box 2: Hawassa Industrial Park in Ethiopia

Hawassa Industrial Park is the flagship SEZ of the Ethiopian Industrial Parks Development Corporation (IPDC). The park has more than 400,000 m<sup>2</sup> of factory floor space, and is expected to generate 60,000 jobs and \$1 billion in exports by the end of 2018, and is widely seen as an example of a successful African SEZ. It already employs some 20,000 workers.

There are 52 factory sheds in Hawassa, used by 18 companies including investors from Hong Kong, China, India, Bangladesh, Indonesia, Spain and the United States. From an initial 37 sheds, another 15 were built in response to high demand. Prospective new investors are selected by the Ethiopian Investment Commission (EIC). Hawassa Industrial Park is made up of four main elements which are carefully planned and integrated with 50 km of underground piping: factories, housing units for expats, a water treatment plant and a textile mill (currently the largest in Ethiopia) which will eventually supply all the textile needs for the park's incumbent companies. The latter is a key aspect of the government's plans for vertical integration and will benefit the country's textile industry overall. The demonstration effect is strong in Hawassa – the presence of American luxury apparel company PVH signals to other investors that this park is capable of supporting high-quality light manufacturing. The park was operational in just nine months.

International investors are attracted to Ethiopia due to cheap labour costs and modern technological resources, which are needed to produce low-cost, high-quality garments and textiles competitively for export. More importantly, they are attracted by Ethiopia's strong institutions, as well as financial incentives. These include simpler processes for setting up operations and a one-stop institutional service with the EIC supporting new companies with banking, visa and immigration facilities, import/export licences, work permits and customs clearance, all of which helps to speed up decision-making and can reduce set-up costs.

Challenges do exist and include having a reliable energy supply (which is a common problem across African SEZs), as well as issues specific to Hawassa such as quality of labour (high absenteeism is reported, and factory owners have little say in who they employ), sourcing supplies locally and cost of transport to the nearest port in Djibouti. Despite challenges, Hawassa offers important lessons on how to set up successful SEZs: namely that financial incentives alone are not enough to attract investors – coordination of various aspects on both practical and institutional levels by a government committed to a broader vision of industrialisation and manufacturing growth is key. The case of Hawassa demonstrates that coordination and the presence of a long-term vision are important ingredients for building high-quality SEZs quickly. These, in turn, can create high numbers of transformational jobs, while also generating crucial positive spill-over effects to benefit the local economy.

Source: Hoque (2017).

### 2.3.2 Current practice of SEZs and EPZs in Kenya

SEZs are considered instrumental in delivering the manufacturing agenda in Kenya, which forms one of the government's 'Big Four' priorities. The SEZ Act<sup>4</sup> came into force on 15 December 2015. In addition to the two licensed SEZs – Tatu City and Africa Economic Zones – there are further plans for Naivasha (1500 acres) and Dongo Kundu SEZ, and others such as Konza City are under construction.

Key issues emerging from the consultations include: (i) the clear lack of a common understanding of the term SEZ; (ii) the lack of common knowledge on the status of SEZ plans; and (iii) lack of progress on SEZ development. At the moment there is interchangeable use of the terms and

4

<http://www.kenyalaw.org/lex/rest/db/kenyalaw/Kenya/Legislation/English/Acts%20and%20Regulations/S/Special%20Economic%20Zones%20Act%20No.%2016%20of%202015/docs/SpecialEconomicZonesActNo16of2015.pdf>

related attributes of EPZs, industrial parks and SEZ (see Appendix B for a list of EPZs and Appendix C for a map of leather-, textile- and apparel-related EPZs).<sup>5</sup> The law delineates SEZs from industrial parks and EPZs and this has considerable implications on their governance structure, related institutions and therefore their development trajectory. But the largest challenge is the extent to which SEZ plans actually become parks: sometimes there is nothing more than designated land for SEZs (see Table 4). We map potential SEZs in relation to the SGR, national highways, ports and airports in Figure 3 to get a sense of their location in relation to key infrastructure.

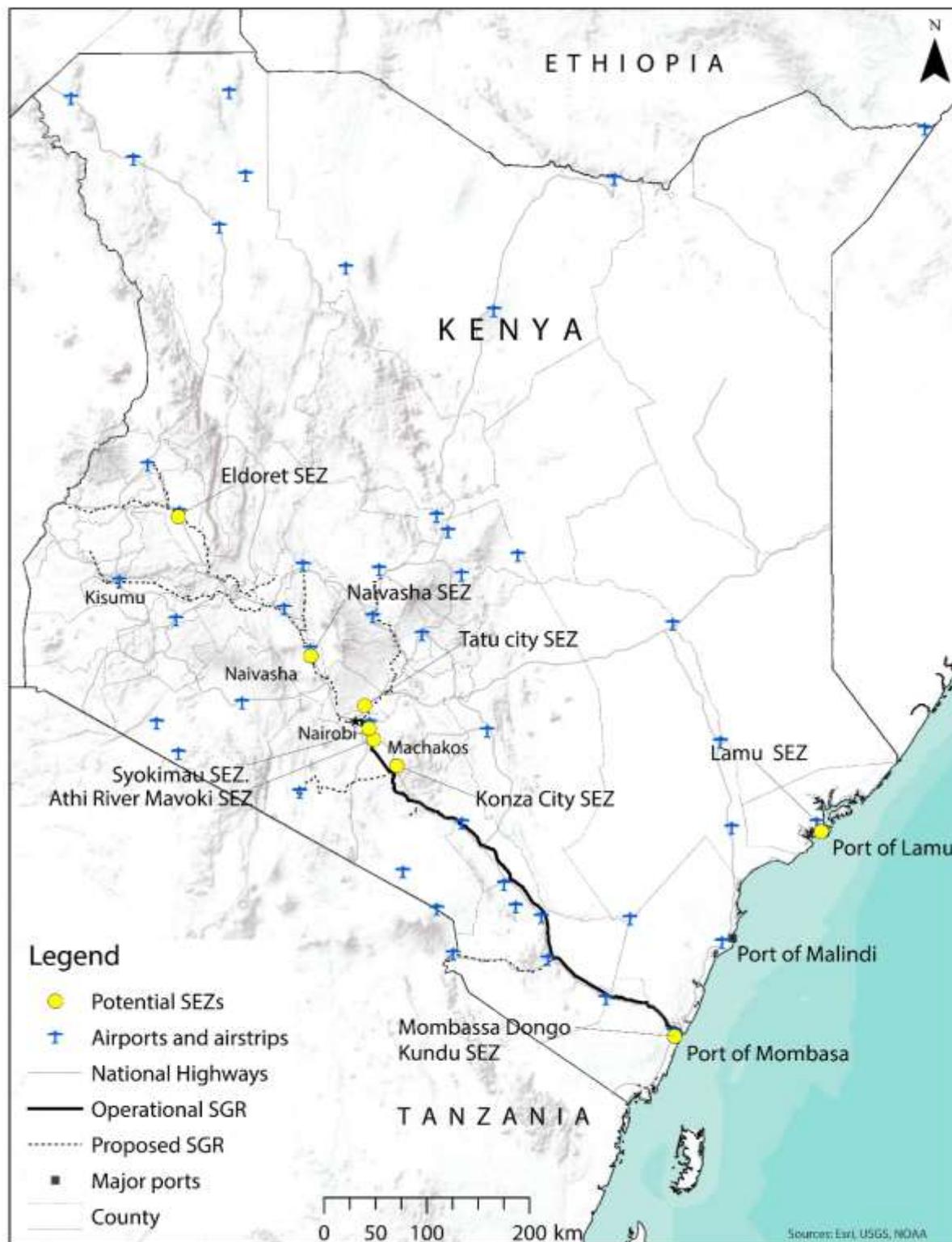
Table 4: Existing and planned SEZs and industrial parks in Kenya

Name and location of industrial park / economic zone	Public or private SEZ	Details on operational plans
<b>Eldoret SEZ</b> (‘African Economic Zone’)	Private (licensed by GoK)	3,000 acres  China and Kenya signed KSh 200 billion to build an industrial park at the Eldoret Special Economic Zone <sup>a</sup>
<b>Tatu City SEZ</b>	Private (licensed by GoK)	2,271 acres licensed <sup>b</sup>
<b>Athi River Mavoki SEZ</b>	Private	4,000 acres, Machakos leather park, training 5,000 cottage industries <sup>c</sup>  Also discussion on upgrading current Athi River EPZ
<b>Konza City SEZ</b>	Public	5,000 acres, planned ICT/business processing outsourcing (BPO) now under construction, 250,000 jobs by 2030 <sup>d</sup>
<b>Mombassa Dongo Kundu SEZ</b>	Public	3,000 acres, issues with squatters making it hard to acquire land  Logistics hub, agro-processing, Japan taking lead in developing zone and attracting Honda as anchor investor
<b>Lamu SEZ</b>	Public	LAPSET, Northern Corridor
<b>Syokimau SEZ</b>	Public	
<b>Homabay – Victory Farms industrial park</b>	Private	Fisheries (coastal waters), running as industrial park but not yet SEZ
<b>Homabay – Jokis industrial park</b>	Private	Fisheries, running as industrial park but not yet SEZ
<b>Lamu Resort City \$970 million; Isiolo Resort City \$200 million; and Turkana Resort City \$42 million</b>	Public	
<b>Naivasha industrial park</b>	Public–private	30,000 acres, textiles and garments  Public only procuring land, geological issues

Sources: Based on discussions with the Export Processing Zone Authority (EPZA), MoITC and media reports, and a) *Daily Nation* (2017); b) Anjarwalla & Khanna (2017); c) Mykenyananusu (2018); d) Kajilwa (2016) and Muiruri (2018).

<sup>5</sup> SEZs and EPZs are sometimes used interchangeably, but EPZs are used to relate to incentive schemes (e.g. EPZ firms pop up around the country, missing out on the clustering benefits) rather than parks (although EPZs, such as Athi River EPZ in Kenya, are also clusters in practice).

Figure 3: Planned and ongoing SEZs in Kenya



Source: authors.

## 2.4 Conceptualising the integration of MSMEs in the design of economic zones

The first aim of our conceptual framework was to identify how MSMEs can integrate into value chains, through discussing seven possible pathways. This was associated with a range of win-

win benefits. The second aim was to understand how MSMEs could be inserted into SEZs, or economic zones more generally, (through design and implementation) to benefit all actors involved. There are two ways for MSMEs to integrate into the design and implementation of an SEZ:

1. *Directly integrated*: MSMEs are located within the zone and benefit from SEZ incentives. Within the SEZ, MSMEs complement large firms through the seven pathways described above.
2. *Indirectly integrated*: MSMEs are located outside the SEZ and supply to firms within the zone. For instance, MSMEs that are part of clusters or operate as standalone entities and are subcontracted by SEZ firms.

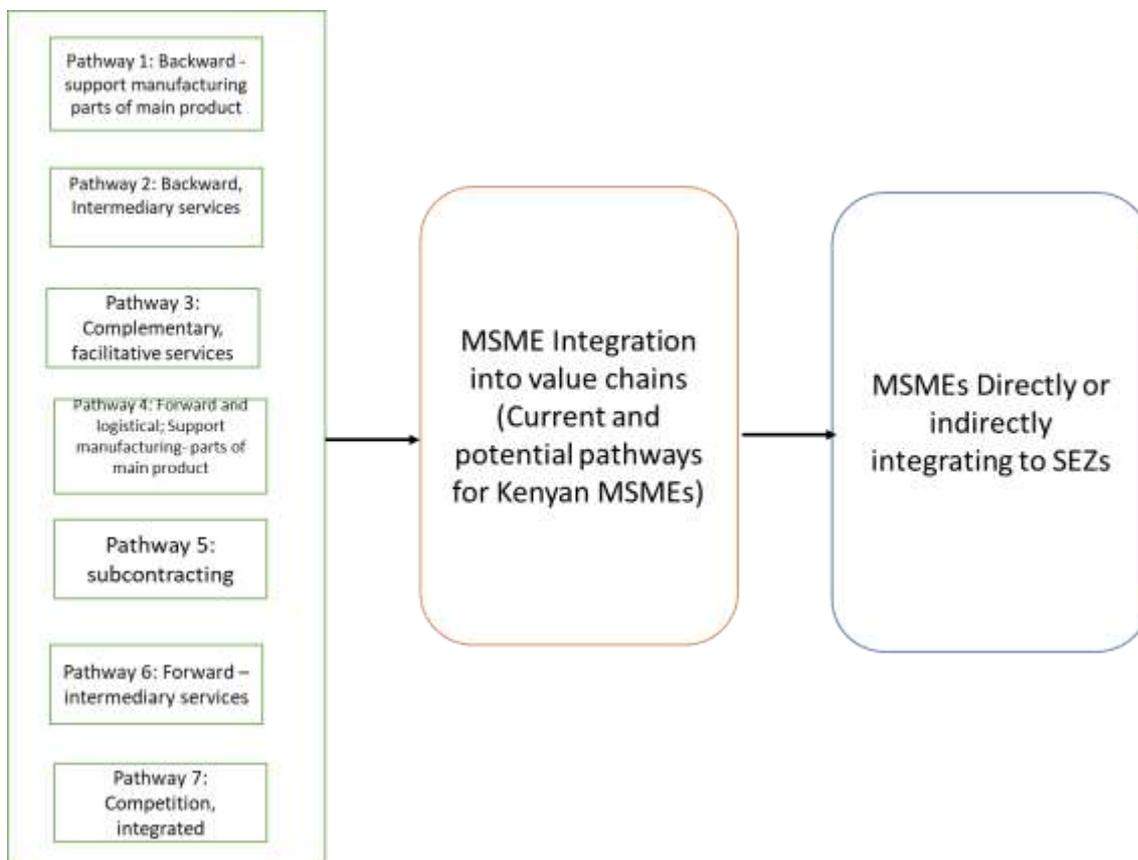
SEZ firms can benefit in numerous ways from integrating better with MSMEs, including:

- a reduction in overall transaction costs of large enterprises
- access to tacit and local knowledge from firms in SEZs
- access to local specialist skills
- access to social networks in the country
- the opportunity to diversify into local and regional markets.

If MSMEs are located outside the SEZ and are organised in clusters, collective efficiency gains will reduce overall transaction costs for larger enterprises that source from these clusters and individual MSMEs. Furthermore, large enterprises can derive benefits through access to specialist skills and by developing social networks outside the SEZ.

Figure 4 recaps the seven pathways of the conceptual framework, which is then used in section 3 to map out on which pathway most MSMEs sit.

Figure 4: Framework for integrating MSMEs into the design of economic zones



Source: authors' construction.

## 3 THE CURRENT ROLE OF MSMEs IN TEXTILE, GARMENT AND LEATHER VALUE CHAINS IN KENYA

This section discusses the current state for leather, textile and garment value chains in Kenya and the role of MSMEs within these.

### 3.1 Leather value chains and MSME links

Africa accounts for more than 21% of the global livestock population, supplying 14% of the world's raw hides but contributing to less than 4% of the total value of leather and leather goods trading (Mwinyihija and Quiesenberry, 2013). Kenya is a minor exporter of leather and leather products, with exports totalling about \$140 million in 2016. Market liberalisation, along with the low purchasing power of the local population, has allowed traders in second-hand footwear (*mitumba*) from Europe, the United States and Asia to prosper and, in many cases, to outperform local producers. In an effort to curb raw hide exports, the Kenyan government introduced an export tariff of 20% on the value of raw skins and hides in 2006, which was increased to 80% in 2012. This boosted the processing industry by increasing income generation, the number of tanneries and employment (Curtis, 2018), but this does not give the full picture.

#### Box 3: Snapshot of the Kenyan leather sector

- Kenya is the third largest livestock holder in Africa, especially of cattle, goats and sheep.
- Around 15 functioning tanneries were in operation in 2016, down from more than 100 pre-liberalisation. Thirteen tanneries process raw hides and skins to wet blue, and eight tanneries process raw hides to crust (dried and dyed) and finished leather (KAM, 2018).
- Employment in Kenya's leather industry was estimated at 22,000 individuals in 2016, with 12 companies directly employing 14,000 people and indirectly employing 10,000 according to KAM estimates (ibid.). The informal sector is responsible for the largest share, accounting for 15,000 workers.<sup>6</sup>
- The leather sector accounted for only 2% of formal manufacturing employment in 2016 (KAM 2018).
- Leather exports consist of semi-processed tanned 'wet blue' leather (89%); raw hides and skins (5%); finished leather (2%); and leather footwear and handbags, travel ware and other leather products (4%).<sup>7</sup>
- Major export markets include India, Pakistan, China and Italy. Major regional markets include East Africa and Southern Africa.

Source: Mwinyihija and Quiesenberry (2013); Mwinyihija (2014); World Bank (2015a); Krishnan et al. (2018).

Leather processing involves a long value chain, beginning with breeding livestock, slaughtering, tanning of raw hides/skins and then the manufacture of various finished and semi-processed products (e.g. footwear, accessories and other leather goods). Figure 5 highlights the numerous nodes that make up a leather value chain, including those that currently account for MSME participation, which are discussed in turn in the following sub-section.

<sup>6</sup> According to KFMA, there are more than 500 footwear producers in the country, 200 of which are located in Kariokor Market. The vast majority of footwear entrepreneurs operate in the informal economy, with little or no machinery. The main types of footwear produced are office shoes, military and safari boots, school shoes and sandals (Pasquali, 2018).

<sup>7</sup> The sustainability of the sector is in question. The current comparative cost advantage of Kenya's tanneries in the production and export of semi-finished wet-blue leather derives from the fact that North American, South American, European Union and, most recently, Chinese governments are unwilling to continue to absorb externalities in the sector, including those associated with environmental clean-up. As a result, these governments are attempting to 'export' these costs to nations such as Kenya that are willing to absorb them in exchange for artificially depressed production cost structures. Over the long term, these deferred costs may re-emerge in various forms including, for instance, increased medical costs and significantly increased costs associated with water purification. Sustainable production should thus be a high priority for government policy.

Figure 5: The leather value chain



Source: Authors

### 3.1.1 Livestock breeding

Livestock breeding nodes consist of pastoralist animal herders, diversified farmers (the primary producers of livestock), and livestock traders who aggregate livestock and sell to the abattoirs. Inputs into livestock production include animal husbandry specialists such as vets, medicine suppliers, extension officers and feed suppliers. Most of the extension support is provided through the Kenyan Agriculture and Livestock Research Organization (KARLO), Kenya Industrial Research and Development Institute (KIRDI), Kenya Leather Development Council (KLDC), Kenya Bureau of Standards (KEBS), county officers and technical universities. More recently, farmer-based apps such as I-Cow have been introduced which provide husbandry support to farmers and pastoralists.

The animal herding sector is largely informal and includes a significant number of pastoralist communities, according to KNBS (2013). The Rift Valley supplies more than 35% of Kenya's cattle (which give the highest per capita yield of hide and skin) and indigenous cattle, followed by the North-East of Kenya. About 80% of the medical and feed suppliers are micro- and small-scale shops that double as extension officers in several cases (key informant interviews). A large number of intermediaries or livestock brokers strike deals between tanneries and small business owners (especially in and around the Kariokor and Nairobi clusters), taking an average cut of about 4-10% of the total sale price from pastoralists and farmers (key informant interviews). In sum, the livestock node is dominated by MSMEs in production and sale to larger players often located at slaughterhouses, which is usually the point of sale of livestock.

### 3.1.2 Hides and skin

Hides and skin nodes consist of slaughterhouses, abattoirs and tanneries. There is no up-to-date information on the number of slaughterhouses and livestock slaughters per unit, however some older figures<sup>8</sup> suggest that there are approximately 65 operational units in Kenya, of which only two, Hurlingham and Farmer's Choice, involve export-quality products;<sup>9</sup> the others mostly deal with local and regional sales. The quality of hides varies significantly, especially because the skin/hide is considered only a by-product in slaughtering, with the focus on meat, so more than 85% of skins are damaged or lost during the slaughter process. This is compounded by the fact that Kenyan cows are slaughtered at the young age of four years. For good quality hides, slaughter should occur between six and eight years only. The quality of this young leather is not always as good as some East African counterparts (such as Ethiopia), and tanners pay lower premiums for it (key informant interviews).

The curing process (the treatment of raw hides and skins after flaying to retard bacterial action) is of relatively poor quality in Kenya, as most slaughterhouses do not have hygienic or

<sup>8</sup> <https://informationcradle.com/kenya/slaughterhouses/>

<sup>9</sup> Other certified ones are Kakuzi Ltd (beef) in Thika, Kenchic Ltd (poultry) in Nairobi, Dagoretti Slaughterhouse (beef and sheep) in Kikuyu and OI Pejeta Ranching Ltd (beef and sheep) in Nanyuki.

temperature-controlled warehouses. About 50% of slaughterhouses (32 of the 65) are privately owned and 90% of them are SMEs. The remainder are run by local authorities.

### 3.1.3 Tanning

Only a few tanneries process finished leather for sale on the domestic Kenyan market. Raw skin is tanned using a chrome agent that leaves the leather with a bluish-tint, thus called 'wet blue'. At this stage the leather is not dried, dyed or finished. The next stage is known as 'crust leather' when it is dried and dyed, which involves a host of other activities including thinning (shaving off fibres), conditioning (adding water), re-tanning, softening, buffing and so on, all of which are capital-intensive processes and thus beyond the remit of most MSMEs. Currently, tanneries in Kenya have installed capacities standing at 60% for wet blue, 25% for crust leather and 15% for finished leather.

The finished leather market is tightly controlled and often resembles a seller's market. Kenya's largest and most modern tannery, Alpharama,<sup>10</sup> dominates the production of leather (MoITC, 2017). Other tanneries include Bata, Leather Industries of Kenya (LIK), Aziz, Sagana and smaller tanneries such as Dogbone, which provides wet blue leather to Alpharama. Tanneries are divided into hide and skin storage and beam house operations; tannery operations; post-tanning operations; and finishing operations. The transformation of hides and skins into leather is costly and requires high-tech processes and expertise. Some operators perform only part of the production process (semi-processed), whereas others are involved in the entire process of transforming raw hides into finished leather (Memedovic and Mattila, 2008). For the tanning sub-sector of the leather value chain, the relatively high cost of raw materials and chemicals in Kenya (owing in part to a 25% import duty on inputs) and the costs of new technical equipment represent the most significant challenges to competitiveness. Both these areas have very minimal input from MSMEs, with a handful of MSMEs producing only specialised chemicals and chemical accessories such as chemical-resistant gloves for the leather market.

### 3.1.4 Leather goods

The leather goods node consists of formal and informal leather suppliers (tanneries, large-scale producers of goods, wholesalers, independent MSMEs producing goods), and clusters of MSMEs, accessories providers and design houses. Appendix D includes a map of clusters in Kenya including infrastructural facilities (SGR, airports, ports, highways).

*Wholesale producers* buy leather in large bundles from tanneries such as Alpharama and sell it to various players in the industry. Other wholesalers include Dismas, Balozzi and Dimu Leather Shop.

*Large-scale producers*, such as LIK (Aga Khan), Bata, United Footwear, Sandstorm and Leather Master, have relatively integrated chains as a few have their own tanneries and slaughterhouses, as well links to international markets. These large companies are able to source leather bundles from tanneries that are of higher quality than those sold to MSMEs (World Bank, 2015a).

A third type of leather supplier are *independent MSMEs*. These mostly consist of unregistered firms in the informal market, but not selling in Kariokor. They manufacture items such as shoes, belt and handicrafts. They are often located outside the city centre and sell their goods at small shops or stands, some even have special shops that customise shoes and leather accessories for fashion-conscious customers (Mwinyihija and Quiesenberry, 2013).

One of the biggest leather goods manufacturers and suppliers in Kenya is the Kariokor cluster, located in Nairobi. The market has approximately 350 stores and, of that, 200 are within the walled

<sup>10</sup> Alpharama is the only tannery in Africa that is certified under the environmental sustainability certification regime advanced by the British Leather Corporation. It sells crusted leather to China, Italy, Turkey and Malaysia; and semi-finished leather to a supplier of cell phone cases to Samsung.

boundary and about 150 are located outside in the open-air space. At peak times, such as before school starts or at the end of the rainy seasons, shops can hire as many as 30 to 40 employees, with each employee specialising in making different parts for shoes (school shoes, dress shoes, safari boots, security boots etc.). The most labour-intensive work is making beads for sandals. According to the MoITC, on average, a small shop with six employees produces about 40 to 50 pairs per day, each costing about KSh 600 (World Bank, 2015a).

Kariokor currently does not have a standardised output due to a lack of mechanisation and formal training. The KEBS does not enforce leather standards and is unable to benchmark mass production, but instead is able to perform ‘flexible specialisation’ or the manufacture of specialised goods by means of general purpose resources (Sabel, 1984). Due to the proximity of a large number of small firms, a network of entrepreneurs with a similar cultural background are able to collaborate. However, our interviews suggest that there is a lack of cohesion and low levels of trust between entrepreneurs within the cluster, which prevents the purchase of large leather bundles and therefore increases the overall costs to the MSME owner and the tannery. In several cases, this has forced tanneries to sell poor quality crusted leather to the cluster. A 25% import duty on Chinese leather further increases overall costs (key informant interviews).

Kenya is considered to be a low-cost producer of undifferentiated, low-end shoes and boots, with production estimated at 3.3 million pairs of leather footwear per year, mostly for the domestic market<sup>11</sup> and with 83% of products coming from the Kariokor cluster. Lamuru, Kariobangi and industrial estates in the Nairobi footwear industry host 12% of the overall market (Okello, n.d). The Kariokor cluster has its own design capabilities, from African boots and now the fashionable beaded sandals popularly known as the ‘African Ndula’.

Another actor within the leather goods node are *leather component manufacturers*, which provide pieces and accessories such as buckles, soles, thread and glue. Most of the larger players source these from China, India, Italy and Germany, direct from the supplier, while independent MSMEs either tend to go to small retail stores in town or to intermediaries around the Kariokor cluster to purchase these items. Many of the MSMEs within Kariokor import from China, but the 25% import duty makes it very expensive and the low quality of leather, along with non-homogenised finishing, affects the overall value of the leather product.

*Design houses* are an important value-added function. On average, new designs make up about 20% of the overall value of the product (excluding brand value) (key informant interviews). MSMEs can play a significant role in the design of handbags, belts, sandals and wallets as these types of products are relatively labour-intensive. For example, Adelphi and Sanabora are designers that own small-scale workshops. They produce designs for their own brand but at times receive orders from small designers locally and internationally, to whom they sell unlabelled products. The design of high-end products, such as sports shoes and dress shoes, is more complicated and requires specialist machines for stitching, pattern-making (controlled drag knife cutter), toe box and heel contouring, and pressing to compress the sides of the shoe.

### 3.1.5 Governing bodies in leather manufacturing

Key governing institutions operate within each node of the leather value chain, including business associations, universities and government authorities. These include:

- KLDC: a coordinating board, uniting private and public stakeholders.<sup>12</sup> It was set up in 2010, with four strategic goals – value addition and quality assurance, market development,

<sup>11</sup>

[http://erepository.uonbi.ac.ke/bitstream/handle/11295/99775/Okello\\_Revival%20Of%20Production%20In%20The%20Footwear%20Industry%20In%20Kenya%20The%20Case%20Of%20Kariokor%20In%20Nairobi.pdf?sequence=1&isAllowed=y](http://erepository.uonbi.ac.ke/bitstream/handle/11295/99775/Okello_Revival%20Of%20Production%20In%20The%20Footwear%20Industry%20In%20Kenya%20The%20Case%20Of%20Kariokor%20In%20Nairobi.pdf?sequence=1&isAllowed=y)

<sup>12</sup> Representation is drawn from the Kenya Livestock Marketing Council, the Slaughter Houses Association, hides and skins traders, tanners, footwear manufacturers, informal leather manufacturers, and established academics in the sub-sector and the environment.

research and development, and resources and infrastructure development. KLDC partnered with the East Africa Trade and Investment (EATI) Hub in 2016 to address the glaring skills gap in Kenya's leather production, footwear and leather goods sector.

- KIRDI: within KIRDI, the Leather Development Centre (LDC) is a specialised semi-commercial unit offering products development, capacity-building and business support services. The centre is meant to offer MSMEs a variety of contract services in tanning, re-tanning, finishing, machine operations and product development trials.
- KARLO: one of Kenya's premier universities with a mandate to promote, streamline, coordinate and regulate Kenyan research in livestock and animal diseases, and to facilitate equitable access to research information, resources and technology.
- KEBS: set up with the aim to develop standards relating to products, measurements, materials and processes; to support certification of industrial products; to provide assistance in the production of quality goods; to perform quality inspection of imports at ports of entry; and to disseminate information relating to standards of leather. There are specific committees set up to develop leather-related standards in hides and skins, footwear and other accessories, but none have been operationalised at the time of writing.
- Leather Articles Entrepreneurs Association: an association of leather entrepreneurs and experts.
- KAM: the representative organisation for manufacturing industries in Kenya. KAM provides an essential link for cooperation, dialogue and understanding with the government by representing the views and concerns of its members to the relevant authorities.
- Animal Health and Industry Training Institute: created by the Food and Agriculture Organization of the UN in 1965, it offers two-year certificate courses in leather manufacture and leather craft.

### 3.1.6 Current pathways of MSMEs in leather value chains

MSMEs already play a significant role in advancing the leather sector within Kenya and will have a greater role to play in the future. Presently, MSMEs seem to be primarily participate in the livestock and breeding and leather goods nodes. Interviews with large players suggested that MSMEs were indeed key to the production and consumption of leather, with Certain MSMEs selling raw hides and livestock to firms. More than 70% of the hides are sourced from within a large firms' network, and 90% of the leather they produce is procured by small-scale traders and artisans who mainly make school shoes and supply these to the regional market (LIK, part of Aga Khan Industries). However, even large firms in Kenya face limited opportunities to upgrade and add value, because their products are not competitive due to poor design facilities and low levels of mechanisation for producing at mass scale.

Table 5 highlights a number of examples of how MSMEs integrate with larger players based on interviews, and draws on the conceptual framework presented in section 2.2. Notable examples of certain pathways are further discussed in boxes 3 to 5.

The pathways are ordered starting with the most commonly occurring pathway to the most uncommon, giving a clear picture of where Kenyan MSMEs stand within the value chain.

Table 5: Pathways of MSMEs in leather value chains: selected examples

Pathway	Overall situation in Kenya for each pathway	Selected examples
1: Backward – support core (vertical) manufacturing – parts of main product	65 slaughter houses, employing more than 4.5 million people directly and indirectly  Tanning raw hides and skin	Dagoretti Slaughterhouse cluster of three SMEs  Stealth Tanneries <sup>a</sup>
2: Backward, intermediary services	3,000 livestock brokers across Nairobi, Rift and North-Eastern Valley  10-20 leather agents buying crust and finished leather directly from tanneries or leather wholesalers and selling it to footwear/leather goods producers	Livestock brokers and agents for wet blue
3: Complementary, facilitative services and manufacturing – supporting main product development		Substantial number of MSEs performing cleaning services and catering to workers
4: Forward and logistical – support core (vertical) manufacturing – parts of main product	Producing upper soles for shoes and stitching of shoes, and other accessories (belts, wallets, car seats)	Stealth Tanneries (Nairobi industrial park)  Preca Pvt. (Limuru leather cluster)  Few independent MSMEs manufacturing accessories such as buckles or laces
6: Forward and logistical, intermediary services (finishing)	Fast fashion design capabilities for local, regional and international markets	Specialised design houses, Karikor independent MSMEs
7: Competition, integrated – directly competing with manufacturing of core product	More than 80% of leather goods produced in Kenya emanate from the Kariokor MSMEs, producing all types of leather goods  Exporting finished leather goods (e.g. car seat covers)	Kariokor cluster  Stealth Tanneries

Note: a) Other medium-scale tanneries producing wet-salted hides or wet blue include: Sagana Tanneries Ltd. (200 tonnes per month), Nakuru Tanneries Ltd (200 tonnes per month), Nairobi Tanneries Ltd (50 tonnes per month), Faaso Import and Export (100 tonnes per month), Athi River Tanneries (250 tonnes per month), Ondiri Tannery.

### Box 3: MSMEs linking with value chains through backwards linkages (pathway 1) – the case of Dagoretti slaughterhouse

Located in Dagoretti sub-county, there are three slaughterhouses owned by SMEs that employ about 250 employees directly (formal employment) and about 15,000 informal workers. The slaughterhouses in turn provide a livelihood for 40,000 workers in butcheries and shops across the country, 10,000 livestock farmers, and 10,000 transporters.

The slaughterhouses service big orders through the Dagoretti association, but mainly operate as individual businesses when servicing normal orders. Restaurants and butcheries are the main market for the meat while the hides and skins are sold to tanneries and brokers. The prime players here are brokers, who buy the hides at cheap prices (sometimes 1 kg of hide for as little as \$0.50 to \$1) and resell them at higher prices (about \$1.50 to \$2 per kg), thus exploiting the slaughterhouses. Large tanneries like Alpharma pay a premium for the hide if quality is maintained.

### Box 4: Preca Pvt. Ltd supplying Bata (pathway 4)

Preca is a three-year-old MSME with around 15 to 20 employees. It is located in the Limuru cluster, which consists of seven absolute business units (ABUs) that supply Bata Kenya with shoe uppers for the local and export market. Bata gives them the raw materials (inputs) and the designs which they process and send back to Bata Kenya, which completes the shoe production.

Preca have the technical capabilities to produce uppers, as they have had training support from Bata, but they lack the equipment in terms of needle sewing machines, skiving machines, binding and taping machines. Preca is able to support Bata by manufacturing part of the complete shoe. In terms of value added, the sourcing of materials and stitching the uppers allows them to earn about 15% to 20% of the value of the full shoe. The lack of physical machinery prevents them from meeting Bata's volume requirement of 1,800 shoe uppers per day; instead they currently produce 500 due to capacity constraints.

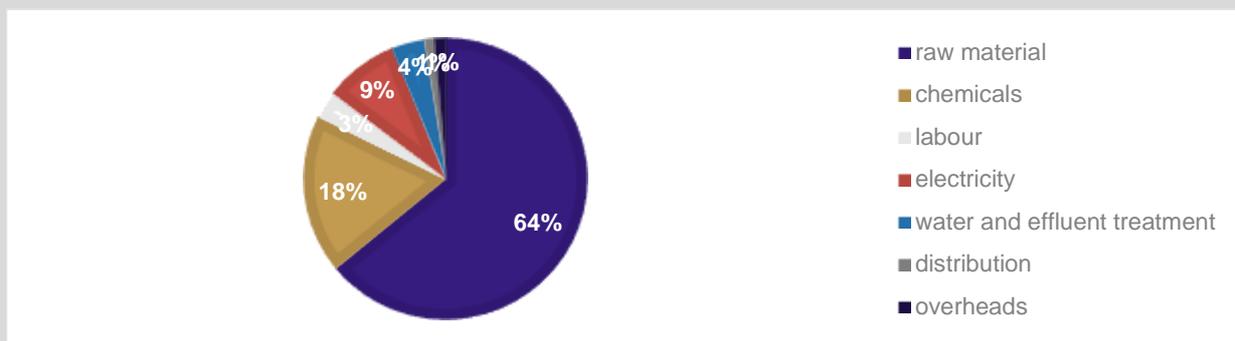
There are other pathways where MSMEs play a key role – for instance, pathway 6 using the MSMEs' design capabilities. MSMEs within Kariokor learn from the *mitumba* (second-hand) market, along with indigenous designs created from feedback from current customers to develop new fashion lines for sandals, handbags, belts and wallets (especially those involving beaded work). Kenyan MSMEs are also at the forefront of innovative design. MSMEs in Limuru cluster have developed belts, which have hidden money pockets within them. These items have been sold at a premium to Tanzania and Uganda, and some go as far as Cameroon and Côte d'Ivoire. MSMEs are yet to develop high-tech capabilities or skills that will help them to enter the international market.

To conclude, there is a mixed outlook for MSME participation in leather value chains. While a significant number of MSMEs participate in value chains through pathways 1 and 3, these are low value-added, with low capabilities and low complexity pathways. There are also a few MSMEs that participate in pathway 7 which is high value-added and high complexity. Drawing on the discussion in section 2 on the characteristics of pathways, we can see that several MSMEs perform complex tasks that require high levels of capabilities and asset-specific requirements. Table 6 summarises the overall characteristics of MSMEs in each pathway.

### Box 5: MSMEs and value chains through backward and forward linkages (pathways 1, 4 and 7) – Stealth Tanneries, Nairobi

Stealth Tanneries is a successful enterprise located in Nairobi’s Industrial Area. It is a good example of a nearly fully integrated value chain that has been able to diversify across leather product categories, by maintaining both backward and forward linkages.

Some 90% of Stealth’s suppliers of hides and skins are small-scale operators consisting mainly of butcheries, slaughterhouses and agents. About 10% of the raw materials are sourced from larger players (e.g. Kenya Meat Commission and Quality Meat Products). Stealth began as a tannery, which was costly as it required electricity, chemicals and 10,000 litres of water per hide. Stealth Tannery’s cost breakdown for processing 1 kg of hide is shown below (in %)



In fact, 98% of this leather is destined for the export market – the wet blue leather goes to Pakistan, India, China and Italy (Pathway 1).

Over the last five years, Stealth has started forward linkages through functional upgrading, and is moving away from purely backward linkages of tanning and producing leather goods towards finished leather products. It is one of the few companies in Kenya to focus on car upholstery, working on 230 cars, some locally but a few going to Peru and Egypt (Pathways 4 and 7).

Source: interviews.

Table 6: Characteristics of MSMEs in leather value chains

Pathways	Capabilities	Complexity of task	Asset specificity requirements	Social networks
<b>1: Slaughtering and skinning</b>	Low to medium (Almost no technical and vocational education and training given to farmers, so poor slaughtering and skinning skills)	Low to medium	Can vary (in Kenya, no mechanisation involved)	Can vary
<b>1: Tanning raw hides</b>	Low to medium (depending on the type of mechanisation owned – the process can vary in technical skill)	Low to medium	Medium (in Kenya the tanning process uses outdated mechanisation and smaller enterprises sometimes perform	Can vary

			the tanning process manually)	
<b>7: Direct competition from Kariokor cluster</b>	Medium (ideally require good technical and managerial capabilities to produce international standard products, but mostly substandard quality produced in Kariokor for local and regional markets)	High	Low	High (word-of-mouth is an important mechanism to increase sales)
<b>3: Performing cleaning services and providing food to the workers</b>	Low	Low	Low	Can vary
<b>2: Livestock brokers and agents for wet blue</b>	Low	Low	Low	High (networks required to aggregate livestock)
<b>4: Producing upper soles for shoes and stitching of shoes, and other accessories</b>	Medium (ideally require good technical and managerial capabilities to produce international standard products, but mostly substandard quality produced for large enterprises)	Low to medium	Medium (requires mechanisation, but most machines are outdated)	Can vary
<b>6: Fast fashion design capabilities, for local, regional and international markets</b>	High (specialised knowledge and training required to design items)	High	Low (in Kenya most are labour-intensive processes that do not use advanced design software, rather they use sewing machines)	Can vary
<b>7: Producing and exporting leather</b>	Medium to high	Medium to high	Medium to high	High

Note: Pathways are ordered by perceived level of importance.

### 3.2 Textile value chains and MSME links

Textiles manufacturing is a long and complex chain that begins with cotton manufacturing and then moves into highly capital-intensive mechanised processes to convert the cotton into finished fabric for garments. Kenya used to have 75 operational textile mills, which expanded under the Import Substitution Scheme (Goughlin and Ikiara, 1991). Most of the textile mills were owned by private investors, many of whom were Kenyans of Asian origin because the technical expertise came from India. Currently, Kenya has 52 textile mills but only 15 are operational and they operate at less than 45% of total capacity (World Bank, 2015b). The dramatic fall in textile manufacturing has been attributed to the fast-paced growth of the *mitumba* market, outdated machinery for producing fabric and the increase in volume and intensity of pests affecting cotton crops (ITC, 2016; *Daily Nation*, 2018a). However, Kenyan firms have the opportunity to capitalise on the

United States’ African Growth and Opportunity Act,<sup>13</sup> and export duty-free and quota-free to that country, and in the process gain substantial competitive advantage over other apparel-exporting countries.

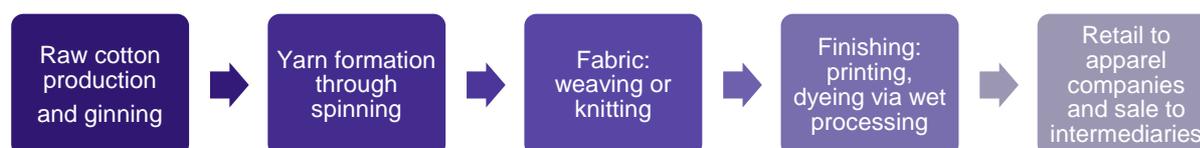
### Box 6: Snapshot of the current textile market in Kenya

- World textile exports (HS code 50-59), including silk, stand at \$220 billion, with Kenya’s exports representing a very small proportion at about \$57 million.
- Kenya has not been able to diversify its export markets beyond the United States. Other major markets are Rwanda, Tanzania, Uganda and Sudan, with a focus on indigenous textiles (Katenge, Kanga, Kikoye and Masai).
- Over 80% of apparel firms in Kenya import more than 90% of their textiles fabric supply from China and India (ITC, 2016).
- In 2013, Kenya imported more than \$70 million worth of cotton, cotton yarns and fabrics compared to a garment export value of \$384 million.
- There are 40 large textile firms operating in Kenya, employing approximately 4,000 people directly and 1 million indirectly. The government invested heavily in firms such as Rift Valley Textiles (Rivatex), Kenya Textile Mills (in Thika) and Mountex (in Nanyuki). Private firms include Raymonds, Yuken, United Textile Mills, Sunflag, Thika clothing Millers.
- The official MSME survey (2016) conducted by the MoITC shows that there are 2,734 MSMEs in textiles, of which 91% are micro and small enterprises.
- Fourteen of the 54 EPZs are linked to apparel and textiles, however only one known company (Rivatex) is within an EPZ.
- A World Bank Survey (2015b) suggested that almost all the required machinery in a textile plant, which includes carding, spinning and wet processing machines, are more than 38 years old, making them less efficient and restricting production to lower-quality yarn and fibre.

Source: World Bank (2015b); ITC trademap (2016).

### 3.2.1 Mapping the textile value chain in Kenya

Figure 6: The textile value chain map



#### *Cotton production and ginning*

Kenya has 385,000 hectares of land suitable for cotton cultivation, but only a small fraction is under cotton cultivation and only about 29,000 hectares are being utilised. The country has the potential to produce 260,000 bales of cotton annually but currently production stands at 28,000 bales, and productivity is only about 572 kg per hectare against a potential of 2,500 kg per hectare (Farmers Trend, 2018). Current production of cotton lint in Kenya is approximately 7,000 tonnes

<sup>13</sup> <https://www.trade.gov/agoa/>

versus a potential production of 200,000 tonnes of lint or 750,000 tonnes of seed cotton (World Bank, 2015b).

Cotton is mainly cultivated in the coastal, eastern, north-eastern, Rift Valley and western parts of the country, under rain-fed conditions. Often poor-quality seeds are used, which results in lower yields (productivity) than in most cotton-growing Asian regions. Despite this, the cotton, textile and apparel industry forms Kenya's second-largest manufacturing sector and supports about 200,000 households (KenInvest, 2016). Most of the cotton is grown by micro enterprises (and farmer households).<sup>14</sup> In an attempt to revive cotton, KARLO and the Directorate of Fibre Crops (DoFC) attempted to introduce Bt-cotton to the country, but growth has been inhibited by the lack of extension services to support the reduction in pests and diseases<sup>15</sup> and by the lack of any internationally benchmarked standard existing within Kenya. Many of the agro-vet shops (for agricultural supplies) are run by SMEs in villages and provide indirect support to farmers. Several of these shops are not registered and it is therefore difficult to gauge accurate numbers. Furthermore, farmers are negatively affected by the sale of substandard or counterfeit agrochemicals, especially pesticides (FAO, 2012).

When cotton is ginned, it produces lint (approximately 35% of the output), cotton seed (55%), and waste (10%) (Cotton Australia, n.d). Kenya had about 24 ginneries operating in 2002 (RATES Center, 2003), reduced to only eight in 2016; and some reports suggest only five were operational in 2018 (Nyanza has one operational ginnery, Eastern has three and Rift Valley has one) (*Daily Nation*, 2018b). According to KAM (2018), utilisation capacity is less than 14% of total capacity. These ginneries use outdated equipment (ITC, 2016), with some reportedly still using the same technology from when ginneries were introduced in the 1930s (RATES Center, 2003). This aged equipment leads to higher inefficiencies, as these ginneries use more energy and have no backup generators and thus left with depending on an unreliable electricity supply. Furthermore, they have a ginning outturn of 33.3% – the lowest in Africa (21% lower than the levels achieved in West and Central African countries of the franc zone), which leads to significantly reduced productivity, thereby inflating processing costs. Additionally, the lack of support of extension services has reduced the volume required by ginners.

At its production peak in the late 1970s and early 1980s, Kenya's cotton farmers produced up to 13,000 tonnes of cotton lint per year. However, between 2013 and 2016, total average production declined to approximately 4,760 tonnes per year (World Bank, 2015b). According to the DoFC, Kenya has a ginning capacity of 140,000 bales, with a production rate of only 28,000, meaning that less than 31% of that capacity is harnessed (World Bank, 2015b).

The removal of the quota restrictions under the World Trade Organization (WTO) 30-year-old Multi-Fibre Agreement (MFA) means that African producers are no longer protected from stiff competition from Asian mass producers (Mugambi, 2005). The low yields and the poor quality of Kenyan cotton make it less competitive than Asian counterparts. Additionally, local ginners face competition from imported lint mainly from Sudan, Uganda and Tanzania (RATES Center, 2003), as well as China and India, which is imported to meet the cotton lint needs of textile mills in Kenya.

MSMEs participate as intermediaries, as they aggregate cotton from farmers, and sell it on to ginneries. Approximately 30% of the total cotton bought by ginneries in Kenya comes through MSMEs (RATES Center, 2003). An overall breakdown of ginning costs suggests that poor quality cotton significantly affects the overall costs of ginning, and several ginners would be happy to pay premiums for good quality cotton.

<sup>14</sup> Kenya also produces fibres like wool and sisal, but in small quantities. MSMEs often provide the raw wool or sisal and transportation services along with this.

<sup>15</sup> Pesticide costs are high, amounting to as much as 51.7% of input costs (Gitonga et al., 2016)

### *Yarn formation*

The first step in creating fabric is when raw materials and fibres such as cotton are processed into yarn and threads. The fibres are spun in an automated process. Good quality yarn formation is a capital-intensive process that involves mechanisation for opening, blending and cleaning the raw material. A slew of machines are required – blending machines (to combine cotton lint), cleaning machines (to loosen the fibre tufts and remove the leaf, sticks, boll parts, bark and seed fragments) and carding machines (to pull fibres into long loose threads) (Cotton Australia, n.d). The spun fibres are collected into a cylindrical object called a bobbin, which is then made into a long strand of thread or yarn.

The 23 yarn-spinning companies in Kenya have a capacity of 140,000 spindles in total, with only 40% to 50% currently being utilised. There are a few standalone yarn-spinning mills that produce cotton yarns, blended yarn, polyester, acrylic and sewing threads. Yarn output is sold in Kenya and exported to Uganda, Rwanda, Tanzania, and Nigeria (World Bank, 2015b).

There are opportunities for MSMEs to participate in yarn-spinning – for example, ‘small batch’ or niche market speciality artisanal products require hand-spun fabric. However, hand-spinning can be tedious and time-consuming. Some textile firms procure hand-spun yarn, which is cost-effective due to relatively low capital investments, but it does not match international quality standards or the volumes necessary for export.

### *Fabric formation*

After the raw materials have been converted into yarn, they enter the second step in the production process, which involves joining these individual threads together to form fabric, through weaving, knitting or crochet.

Knitting is capital-intensive,<sup>16</sup> and creates a fabric that is stretchy such as for t-shirts. Crochet is common for lace production. In weaving, automated looms are used to create different types of weaves for a variety of products. Much of the textiles produced in Kenya are woven, as they can ultimately be used in jeans and men’s shirts (ITC, 2016). Loom weaving can be a source of job creation and business focus for MSMEs.

Handlooms are widely used throughout the world, with MSMEs in Kenya primarily using second-hand handlooms (key informant interviews). Hand-woven textiles have a niche market, which also provides opportunities for MSMEs to sell into bigger mills in Kenya.

<sup>16</sup> Most cotton is knitted on circular machines with needles fixed to the rim of a rotating cylinder. As the cylinder turns, the needles work their way from stitch to stitch producing a tubular fabric (Cotton Australia, n.d).

### Box 7: Breaking down the costs of producing fabric in Kenya

The table below shows the direct costs of making woven or knitted fabric (MoITC, 2017). Clearly most costs are due to importing textiles and the old machinery used to produce yarn. The cost of electricity and also of financing make up more than 80% of the cost of the fabric. In subsequent sections we discuss some of the constraints faced by Kenyan textile firms in greater detail.

#### Cost of production for a large textile firm

Textile production items	% of total cost of the woven or knitted textile in Kenya
Raw cotton procurement	2%
Fibre or yarn <sup>a</sup>	22%
Chemicals	4%
Power	25%
Maintenance of machines, power and other utilities	6%
Workers' salaries and wages	12%
Indirect costs, including overheads, administrative expenses and costs of financing <sup>b</sup>	29%

Notes: a) Costs vary depending on type of fibre – cotton, silk, cotton blended etc.; b) Access to finance is challenging for Kenyan firms due to the high prevailing interest rates – ranging from 15% to 21% depending on creditworthiness – and the short time horizons available for loans, usually less than seven years (MoITC 2017).

Source: Global Development Solutions (2014) cited in World Bank (2015a).

#### *Fabric finishing*

After weaving, knitting or crocheting, the fabric is then finished, ready for sale to local, regional and export markets. A common finishing method is wet process, which is required for the pre-treatment, dyeing, printing and finishing of manufactured fabric. These stages require an aqueous medium, which is created by water. It is estimated that, on average, almost 100 litres of water are used to process just 1 kg of textile (RATES Center, 2003). There are several other types of finishing – for example, embellishing with embroidery work; bleaching to produce an off-white colour; dyeing or printing colour added to the yarn; permanent press to prevent the need for frequent ironing; and water-repellent to ensure water is repelled not absorbed.

Several mills in China and India are integrated mills, that also dye or print their fabrics in addition to spinning and weaving them. However, to our knowledge, only Rivatex mill in Kenya is integrated and has the capacity to manufacture from cotton production through to finished fabric. This is a node in which more than 60% of the 2,734 registered and unregistered MSMEs in Kenya participate – large Kenyan textile firms often subcontract embroidery work, vegetable dye printing and bleaching of unfinished fabric to MSMEs.

The final textile product is sold, primarily to domestic apparel producers ranging from large garment-producing firms to MSMEs such as those in the Uhuru cluster. Key stakeholders in this node include private players (including large textile buyers); the government (the DoFC, which regulates and promotes fibre crops in the country); the Ministries of Agriculture and the MoITC; associations such as KAM, KNCCI, the Cotton Growers Association, MSEA, the Association of Fashion Designers, and Handloom Weavers Marketing; and universities and other TVET providers for textiles, including KARLO, technical schools of design, the Moi University, and the technical development centre.

### 3.2.2 Current status of MSME links to the textile sector

Table 7 and Box 8 illustrate how MSMEs link with larger players in the textiles sector, based on the conceptual framework discussed in section 2. Textiles differs from leather, in that textiles-related MSMEs do not manufacture textiles, but rather only perform certain value additions. They are primarily linked into semi-integrated mills (i.e., large enterprises), such as Thika Cloth Mills and Rivatex.

Table 7: Current pathways for textile MSMEs

Pathway	Kenya situation	Examples of MSMEs
<b>1: Backward – Support core (vertical) manufacturing – parts of main product</b>	Cotton production: Kenya has 385,000 ha of land suitable for cotton cultivation, but only 29,000 ha is used; has the potential to employ at least 200,00 households  35% of the MSMEs surveyed are in the textile category (950 MSMEs)	Cotton farmers  Coffee husk for boilers, making biomass briquettes for fuel  Cotton input providers: agro-vets for pesticides, seeds
<b>2: Backward, intermediary services</b>	No formal survey of number of cotton brokers; they control more than 30% of total cotton supply to ginneries  Transport of cotton, lint, cotton seed; transport of water and procurement of water for ginning	Cotton brokers: intermediaries between ginneries and farmers  Road transport and water supply services
<b>3: Complementary, facilitative services and manufacturing – supporting main product development</b>		Cleaning factory floor and amenities  Water supply for drinking and production (finishing fabric)
<b>4: Forward and logistical, support core (vertical) manufacturing – parts of main product</b>		Dyes, chemicals for finishing fabric: Independent MSMEs  Handlooms: Uhuru cluster
<b>6: Forward and logistical, intermediary services (finishing)</b>		Supplying road transport to shipyard or other destinations for sale  Embroidery: Independent MSMEs, Uhuru cluster

#### Box 8: Uhuru market textiles and the garment cluster (pathways 4 and 6)

Uhuru market is located in Jogoo Market and began in 1971. It has a membership of 180 individuals, who specialise in the development of textile products and apparel including knitting and fabric weaving. Their key products include: thread, fabrics for uniforms, aprons, bags, dustcoats, sweaters, as well as embroidery work on fabric. Their main buyers for textiles are large enterprises located in EPZs and around Nairobi and Nakuru, and local speciality artisans.

### Box 9: Thika Cloth Mills and Rivatex (pathways 1–4 and 6)

Two of Kenya's largest milling companies are Thika Cloth Mills and Rivatex East Africa Ltd.

**Thika Cloth Mills** was established in 1959 and employs 700 people. They process cotton sourced from ginneries in Mpeketoni, Makueni, Voi, Kitui and Nakuru. The Makueni Ginnery alone sources its cotton from about 15,000 farmers. In addition to local production, the company imports cotton from Uganda and Tanzania when local capacity is low and uses 80 tonnes of cotton per month. Thika Cloth Mills Ltd is already operating at less than 60% of its capacity, although it imports most of its raw material from other East African countries. Without imports they would be operating at less than 50%.

Other inputs such as polyester are sourced from China while dyes and chemicals are sourced from Kenyan SMEs and India. The company manufactures textiles from ginned cotton into yarn and final textile development for a range of clients. They currently have 400 customers, including SMEs, corporate companies and EPZ firms. Key corporate clients are Kenyatta National Hospital, Bata, the National Youth Service and security firms.

**Rivatex East Africa Ltd** is a 43-year-old company that is a vertically integrated textile factory converting cotton lint through various processes to finished fabrics. They employ more than 2,000 people, and have established several factory outlets in major cities and towns in Kenya such as Nairobi, Kisumu, Eldoret, Nakuru and Kitale. They supply textile products to independent retailers, schools, universities and large enterprises as well as MSMEs that manufacture garments. Their key export markets are Rwanda, Burundi, Uganda and South Sudan. They currently process about 10 bales of cotton/day but with the support from the Indian government (a KSh 3 billion loan agreement to modernise Rivatex by supplying textile machinery), they will be able to process more than 70 bales/day, more than any East or West African textile mill.

MSMEs play a critical part in both these companies' supply chains. They are a source of inputs such as cotton lint and coffee husk for boilers (pathway 1, backward support manufacturing). Both Thika Cloth Mills and Rivatex purchase about 30% to 40% of their cotton lint from intermediary brokers (pathway 2, backward intermediary services). Both companies stated that they purchased dyes and chemicals from SMEs (pathway 4, forward support manufacturing). But the most important value added, provided by MSMEs to both companies, was finishing fabric through embroidery and crochet work. Also neither company has its own transport fleet and so they frequently use MSMEs for road transportation (pathway 6, forward intermediary design). Thika Cloth Mills also sources very small quantities of handloom fabric (pathway 4) in times where there is low availability of cotton or when they have a high volume of orders. Both large enterprises prefer to use SMEs in their supply chain due to their strong distribution networks and wider customer base, and because they view the development of SMEs as being part of their social responsibility.

In sum, the pathways suggest that MSMEs in textiles perform relatively low value-added and low complexity work, and do not have the capacity to be subcontracted by firms to manufacture products. They primarily perform tasks such as intermediary services (brokers, transport) and basic finishing work. Table 8 summarises the pathway characteristics for MSMEs in textiles.

Table 8: Pathway characteristics of MSMEs in textiles

Pathways	Capabilities	Complexity of task	Asset specificity requirements	Social networks
<b>1: Cotton farming</b> <b>Coffee husk for boilers</b>	Medium to high, (requires explicit knowledge to grow crops)	Medium to high (several stages involved in final cotton crop production)	Low (no mechanisation used in Kenya)	Can vary (extension support)
<b>1: Cotton input providers: agro-vets for pesticides, seeds</b>	Low to medium (managerial capabilities needed to run a shop; and technical knowledge required for sale of pesticides)	Low to medium (need to select the right kind of product for farmers)	High (need to buy or lease shop space)	Can vary
<b>2: Cotton brokers</b>	Low (brokering between buyers and farmers)	Low	Low	High (to help brokers aggregate cotton from farmers)
<b>2: Road transport and water supply services</b>	Low (low skill knowledge for driving)	Low	Low	High (new jobs gained via referrals)
<b>4: Dyes and chemicals for fabric finishing</b>	Low to medium (primarily selling/ applying the dyes, high capabilities are required only when finishing the fabric, which is rare)	Low	Low (when selling but high if applying chemicals to fabric)	Can vary
<b>4: Handlooms and embroidery</b>	Low to medium (specialised skill)	Low to medium	Low to medium (need handlooms and embroidery kits)	Can vary
<b>3: Cleaning of factory floor and amenities</b>	Low	Low	Low	Can vary
<b>6: Supplying road transport</b>	Low	Low	Low	Can vary

Note: The pathways are ordered by perceived level of importance.

### 3.3 Garment value chains and MSME links

#### Box 10: Snapshot of the garment value chain in Kenya

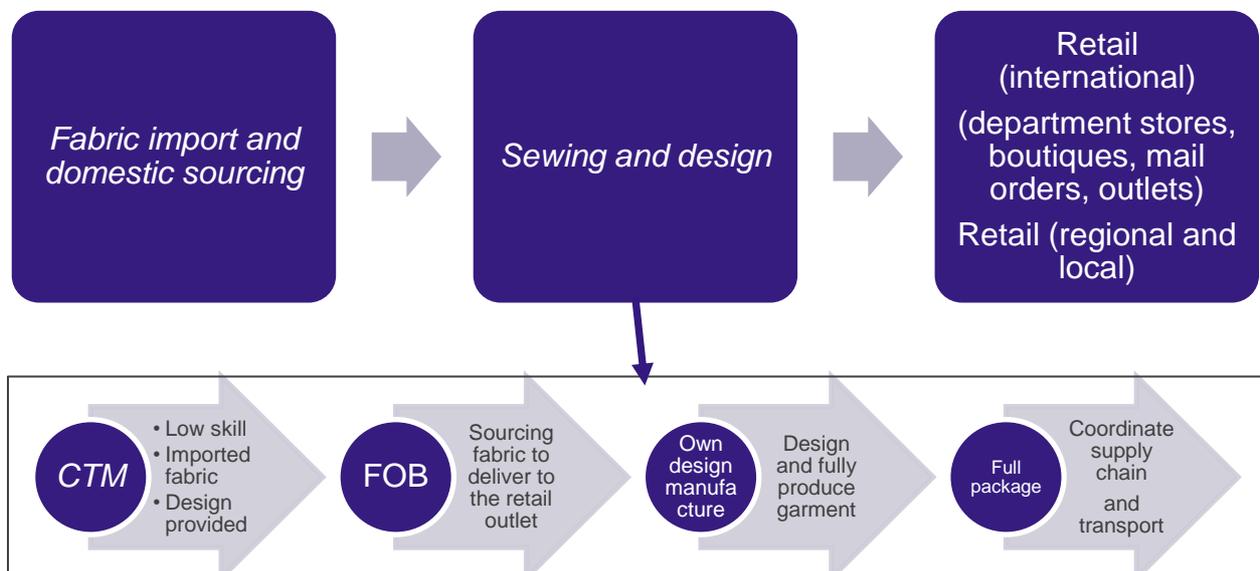
- Thousands of garment companies operate in Kenya. Approximately 170 are medium and large, while upwards of 74,000 are small and micro companies.
- 21 companies operate in the EPZ, employing an average of 1,800 people per company.
- About 90% of all fabrics (both natural and manmade) are imported, due to low volume and quality available locally.
- The second-hand market (*mitumba*) is a key competitor to firms attempting to sell locally. It imports about \$215 million of clothing, chiefly from China, Pakistan, India, the United Kingdom and the United States (more than 75%).
- Kenya nearly doubled its exports to the United States under AGOA from \$225 million in 2010 to \$389 million in 2016.

Source: ITC trademap (2016); World Bank (2015a); AGOA (2018).

The garments sector was valued at about \$360 million in 2017, and mostly involved the export of t-shirts and shorts, followed by knitted and crocheted articles. Most garments are exported to the United States using AGOA preferences, with more than 80% of all garments being exported to northern markets such as the United States, Germany and Canada, as well as regional markets such as Uganda and Tanzania (ITC 2016).

#### 3.3.1. Mapping the garment value chain in Kenya

Figure 7: The garment value chain



Notes: CTM = cut-make-trim; FOB = free on board.  
Source Adapted from Gereffi and Frederick (2010).

#### *Fabric import and domestic sourcing*

Due to low local availability of fabric, Kenya has to import it at a tariff rate averaging about 25% (ITA, 2017). The cost structure of garment companies varies significantly by firm size. The costs of imported material contribute to the majority of the manufacturing cost (approximately 64% of the cost to produce a standard cotton t-shirt), while other costs include electricity (5% of total cost), labour (8%), maintenance (2%) and remaining overheads (managerial labour, service

personnel, quality control staff, tax, rents, depreciation, administrative costs, compliance costs) (about 21% of the total cost) (World Bank 2015b). There are several MSMEs that can participate in the value chain here, both as buyers of imported materials, and also as import-export intermediary companies that supply firms with imported material.

#### *Sewing and design*

Most of Kenya's value-added relates to sewing and design (which in general make up 8% of the total cost of the final product) (MoITC, 2017). The different forms of value addition are described below.

*Cut-make-trim (CTM) manufacturing* involves low or semi-skilled female workers, the need for sufficient factory space and cheap electricity costs to stay competitive. Generally at this stage the buyer will supply the firm with imported fabric to manufacture an item and provide a design. Companies follow international standards, such as the Business Social Compliance Initiative (BSCI) and private codes of conduct of buyers. Most MSMEs participate in CTM manufacturing, but selling mostly to local markets.

In Kenya, this segment consists of non-EPZ firms (small/micro as well as medium and large apparel companies) and firms inside the EPZs, which are divided into foreign investment firms and accessory producers. These firms often work at 100% capacity utilisation, and around 93% of their fabric supply is imported from China, Hong Kong, Taiwan, India and Pakistan, as are the trims, machinery and spare parts used in apparel production. There are significantly more garment companies than textile manufacturers – 170 medium and large companies, 74,576 small and micro companies, 22 foreign firms and 9 accessory producers.

*Free on board (FOB) manufacturing* is similar to CTM, except that the supplier firm is trusted with purchasing their own fabric and shipping the goods, thus they can realise more value. However, very few MSMEs are present here as they are not able to secure lines of credit or loans to enable them to participate.

*Own-design manufacturing* is a step ahead of FOB, as it involves developing an own design, which is one of the most value-adding aspects of the chain and requires specific skills. Kenya has a significant number of MSMEs that are able to design to local states, and small batch or niche markets are often touted as an important way that Kenya can brand for export.

*Full package manufacturing* suggests an integrated mill and garment-manufacturing unit combined. Presently there are not many enterprises in developing countries that provide full package services (Arvind Mills in India is one example), and none of the large firms in Kenya are yet able to provide a full package.

#### *Retail*

There are numerous outlets for Kenyan garment items, with the key market for international retail being the United States and outlets such as GAP, Levis, JC Penny and department stores like Walmart and discount outlets. Kenya also designs fast fashion items for ASOS in the United Kingdom, with a brand 'Made in Kenya' that is available online. Within East Africa, Kenya mostly sells to MSMEs in Uganda and Tanzania that market products through open retail formats and in small shops. Some of these sales are fast fashion, while a significant proportion are indigenous designs. Within Kenya, most of the products sold are indigenous designs that are sold primarily to MSMEs and street hawkers who market in open retail.

### 3.3.2 Current status of MSME links to the garment value chain

Table 9 highlights a number of examples how MSMEs link in with larger players. The garments sector differs from textiles, in that most MSMEs in the former have the capacity to manufacture final products (i.e. specific garments (pathway 5) and some are able to directly compete with

large firms (pathway 7)). Garment MSMEs are less competitive than their larger counterparts, however, due to low capacity and higher costs from the import of accessories and textiles.

Table 9: Current pathways for MSMEs in garment value chains

Pathway	Kenya’s situation	Examples of MSMEs
<b>5: Forward</b> <b>Subcontracting, producing core product, filling capacity deficit of large firm</b>	MSMEs in Kenya have experience in manufacturing apparel, especially uniforms (police, school) for local markets, and also filling orders for larger enterprises	Tulip
<b>6: Forward and logistical</b> <b>Intermediary services (finishing)</b>	Designing and branding for artisanal goods for local and regional markets and special ‘Made in Kenya’ international products	Soko, Uhuru, Masai market
<b>7: Integrated</b> <b>Directly competing with manufacturing of core product; has full product from backward to forward</b>	Due to years of experience, several MSMEs through their own social networks have lists of clients they supply to and input providers	Tulip, Soko
<b>4: Forward and logistical</b> <b>Support core (vertical) manufacturing – parts of main product</b>	Local sourcing of accessories, such as buttons, elastic and beads for garment finishing, as well as ironing and pressing services	Masai and Uhuru cluster
<b>2: Backward</b> <b>Intermediary services</b>	Fabric import services	MSME import–export services, which aggregate and provide accessories to large firms and other MSMEs
<b>3: Complementary</b> <b>Facilitative services and manufacturing – supporting main product development</b>	Health and safety training, transportation of containers, cleaning, security services, catering services	Commonly provided by MSMEs to large enterprises

Note: Pathways are ordered by perceived level of importance.

**Box 11: Tulip Ltd (pathway 5: subcontracting, and 7: relatively integrated)**

Tulip Ltd was incorporated as a partnership in 2011 with a focus on the manufacture workwear such as uniforms, overalls, dust coats and t-shirts. The company has 200 sewing machines and employs 60 staff. The main markets are uniform shops, supermarkets and hotels in Kitale, Laikipia, Kisumu, Kericho, Meru, Nairobi, Eldoret and Lodwar. The company has contractual orders from larger firms based in Rwanda, Uganda and South Sudan.

They primarily produce school and police uniforms for the local market. A large proportion of their inputs come from the Thika Cloth Mill (described in Box 9). With more than 40 years’ experience, Tulip is able to subcontract and produce good quality local wear. As a sign of upgrading, they hired technical officers from Sri Lanka to train in better governance structures, which has helped them to maintain high quality standards and a competitive edge over counterparts.

Source: Key informant interviews.

**Box 12: Soko Kenya (pathway 7: relatively integrated, and 6: design services)**

Soko Kenya is a good example of niche or small batch marketing. It was established in 2009 by Joanna Maiden whose vision was to provide the fashion industry with a manufacturing unit that held social and environmental issues at the heart of its business model. Soko Kenya is one of the few companies that performs own design manufacturing – not only do they do CMT, they also include garment manufacturing, labelling and packing to the client’s specification and manage import and export logistics.

In 2012 Soko Kenya moved into its own purpose-built eco-factory, built from compressed earth, which is a traditional form of construction in Kenya. One of their major customers is ASOS in the United Kingdom, which sells Soko products under a brand name ‘Made in Kenya’. Because Soko does its own designs, it is able to add more value to the exportable product, and also its brand names retail for higher prices in the local market. As such, Soko is perceived to be better quality than other manufacturers.

Source: See <https://www.soko-kenya.com/>

In sum, the pathways suggest that MSMEs in garments perform relatively low value-added work, and have limited capacity to design and brand products where more value-added is possible. Table 10 summarises the pathway characteristics in the garment value chain.

Table 10: Characteristics of MSMEs linking to garment value chains

<b>Pathways</b>	<b>Capabilities</b>	<b>Complexity of task</b>	<b>Asset specificity requirements</b>	<b>Social networks</b>
<b>5: Subcontracting</b>	Medium to high, (requires managerial and technical skills to achieve higher productivity)	Low to medium (the apparel manufactured in Kenya is not complex, e.g. uniforms)	Low to medium (outdated machinery exists, very few small firms use new digital technologies)	Can vary (extension support)
<b>6: Designing and branding for artisanal goods</b>	Medium to high (needs special new forms of training to meet different tastes and preferences of customers and need to adapt designs and marketing strategies)	Medium (relatively complex, needs to fit customer requirements)	Medium (needs design software to support fast fashion)	High (to increase inflow of orders)
<b>7: Competition</b>	Medium to high (requires managerial and technical skills to achieve higher productivity)	Low to medium (the apparel manufactured in Kenya is not complex, e.g. uniforms)	Low to medium (outdated machinery exists, very few small firms use new digital technologies)	Can vary (extension support)
<b>4: Manufacturing local accessories</b>	Low to medium (specialised skill)	Low to medium	Low to medium (need minimal mechanisation to create button moulds. In Kenya the range of accessories and designs are very limited due to low use of digital technology)	Can vary
<b>2: Fabric import services</b>	Low to medium (primarily selling and importing textiles and accessories, need technical skill on import regulations)	Low	Low	Can vary
<b>3: Cleaning factory floor and amenities</b>	Low	Low	Low	Can vary
<b>6: Supplying road transport</b>	Low	Low	Low	Can vary

Source: Authors' construction from interviews.

### 3.4 Summary of MSMEs’ participation in value chains

Table 11 shows that most MSMEs in leather value chains participate in pathways 1, 2 and 6, which are generally low value-addition, requiring low and semi-skilled technical capabilities with low levels of mechanisation to complete relatively simple tasks.

Similarly, MSMEs in textiles essentially operate in pathways 1, 4 and 6, suggesting that they are only able to perform peripheral tasks as they have old or no machines to perform high value-added tasks.

MSMEs have greater opportunities to grow in the garment value chain, as they participate in tasks such as design, and to some extent branding or marketing services, which increases the value capture of the product. However, most MSMEs in the garment value chain currently participate in pathways that do not require high skill capabilities.

Table 11: Current pathways and characteristics of MSMEs in value chains

Value chain	Characteristics	Pathways
<b>Leather</b>	Most of the MSME capabilities range between low to medium as the focus is on backward linkages; tasks are not very complex and there are low levels of mechanisation.	<ul style="list-style-type: none"> <li>1: Slaughtering and skinning</li> <li>1: Tanning raw hides</li> <li>2: Livestock brokers and agents for wet blue</li> <li>3: Performing cleaning services and providing food to workers</li> <li>4: Producing upper soles for shoes and stitching of shoes, and other accessories</li> <li>6: Fast fashion design capabilities for local, regional and international markets</li> <li>7: Competition (e.g. with Kariokor cluster)</li> <li>7: Producing and exporting leather</li> </ul>
<b>Textile</b>	MSMEs perform relatively low value-added and low complexity work, and do not have the capacity to be subcontractors. They primarily perform tasks such as intermediary services (brokers, transport) and basic finishing work.	<ul style="list-style-type: none"> <li>1: Cotton farming and coffee husk for boilers</li> <li>1: Cotton input providers: agro-vets for pesticides, seeds</li> <li>2: Cotton brokers</li> <li>2: Road transport and water supply services</li> <li>4: Dyes, chemicals for fabric finishing</li> <li>4: Handlooms and embroidery</li> <li>3: Cleaning factory floor and amenities</li> <li>6: Supplying road transport</li> </ul>
<b>Garments</b>	Low capability and complexity work, as MSMEs have limited capacity to design and brand products where more value-added is possible.	<ul style="list-style-type: none"> <li>5: Subcontracting</li> <li>6: Designing and branding for artisanal goods</li> <li>7: Competition</li> <li>4: Manufacturing local accessories</li> <li>2: Fabric import services</li> <li>3: Cleaning factory floor and amenities</li> <li>6: Supplying road transport</li> </ul>

Sources: Key informant interviews and authors’ analysis.

## 4 CONSTRAINTS IN LINKING MSMEs TO VALUE CHAINS AND ECONOMIC ZONES IN KENYA

While there are many opportunities and pathways for MSMEs to take part in value chains and economic zones in Kenya, these are often not realised and a range of general constraints exist that limit the participation of MSMEs.

### 4.1 General constraints of MSME pathways across all value chains

#### 4.1.1 Lack of information

MSMEs find it difficult to access information on: sector and sub-sector performance; financing opportunities (from both government and non-government entities) and the associated application processes; technical support programmes; markets for sourcing inputs and selling products, and new domestic, regional and international markets; changes in legal and regulatory structures that affect them at national and county levels; networking opportunities; and technological innovation that can add value.

Such lack of information often translates into missed opportunities and weak performance. Even when MSMEs are aware of specific pockets of information, they are often unable to access or leverage that information because they lack the expertise or funds required.

Additionally, there is no conclusive information on the economic size of the sector, the contribution to GDP, number of enterprises and focus of activity, and the economic sectors (agriculture, manufacturing and services) to which they contribute. Information is lacking on the scale of funding allocated to the sector (grant, debt, equity and so on), investment opportunities and enterprise funding readiness. There is also no coordinated process through which this information is gathered at regular time intervals. Taken together, such a dearth of data suggests that MSMEs are often not prioritised in policy discussions.

#### 4.1.2 The MSME ecosystem

MSMEs function as part of a whole ecosystem with national, county and sector dimensions.

At the **national** level there are political constraints relating to five-year political cycles. The Institute of Economic Affairs in Kenya states that there is a 60% likelihood of a reduction in economic growth during an election year (IEA, 2017). Out of the 10 elections that Kenya has held, the economy slowed or failed to grow in three of the five multi-party elections and in two of the five single-party elections. The 2017 election was no exception. In addition, the cost of doing business in Kenya is high due to a combination of the high cost of electricity, transport and labour. This negatively affects private sector activity, MSMEs included. Finally, there is a lack of appropriately skilled labour in the country. The Brookings Institution (2014) points out that 62% of Kenyan youth aged 15 to 34 years have below secondary-level education, 34% have secondary education, and only 1% have university education. According to the World Bank's (2013) Enterprise Survey for Kenya, about 30% of firms surveyed stated an inadequately skilled workforce as the most important constraint inhibiting growth.

At the **county** level there are 47 different governments each with their own plans and budgets that are not coordinated. This translates into having uncoordinated county policy instruments and activities, and prevents complementary action aimed at private sector development.

The introduction of fees and levies to boost county government revenue generation has also increased the cost of doing business. While informal businesses and MSMEs make up the bulk

of the private sector at county level, most county governments do not have structures and activities through which MSMEs are supported.

Furthermore, county governments have poor fiscal transparency and accountability, which makes it difficult to track the allocations, efficiency and effectiveness of county government spending. There is also limited private sector-related county-level data such as ease of doing business, investment climate, share of national GDP, comparative advantages, sector features and size, and the number of enterprises in the county. This lack of information often means that government operates in a vacuum.

At the **sector** or manufacturing level the KAM (2018) highlights that the high cost of inputs leads to highly priced and uncompetitive manufactured products domestically. The sector is also constrained by the high cost and poor quality of electricity, poor access to long-term finance, and high transport and logistics costs. Further, trade in illicit, substandard and counterfeit products undermines manufacturing. Indeed, KAM has estimated lost revenue for government at KSh 25.1 billion due to trade in these goods (ibid.). Additionally, many manufacturers use outdated technologies that lower productivity and energy efficiency, and the sector is affected by unstable and unpredictable environmental policy (such as the recent ban on plastic bags) that makes the business context volatile. The lack of coordination between national government ministries relevant to manufacturing and between national and county governments also has an impact at the sector level.

Finally, in terms of the ecosystem, MSMEs are poorly organised and lack unity. There are numerous associations that represent certain sectors and thematic clusters, but these associations are not unified in their priorities, objectives or action. MSMEs are fragmented and work in silos and there is no unified body with which parties interested in MSMEs can engage. There have been previous attempts to create an umbrella organisation (such as the Micro and Small Enterprise Federation (MSEF)) but these have not succeeded. This lack of unity prevents MSEs from advocating effectively for policies or action to be taken by the government, as well as from engaging in independent activity that strengthens their financial position, enterprise activity and funding options. The lack of unity and self-organisation often results in an over-reliance on and expectation that government ought to be the solution to their problems, which limits MSMEs' options in terms of growth and development. The lack of unity further translates into a lack of negotiating power with both state and non-state actors. While some SMEs may be represented by business membership organisations (BMOs), many SMEs are not, which means they can be dominated by the interests of large companies. There is also no high-profile BMO that specifically represents SMEs and their specific issues and interests, and as a result SME issues tend to be swallowed by the priorities of larger players in BMOs.

Overall there is a lack of clarity regarding the role of national and county government with MSMEs. While MSEs have a government body focused on their development in the form of MSEA, the role of county governments is less clear. This lack of clarity is detrimental to MSMEs because they dominate county business activity both in and outside cities and towns. This lack of attention to MSMEs by county governments often relegates them to sub-optimal business activity because issues such as work space, the county business environment and problematic action by county governments (like new levies and fees) are not addressed or highlighted.

#### 4.1.3 Financing constraints

While financing can be seen as part of the MSME ecosystem, we devote a separate section to this because of its importance. We distinguish between the issues faced by MSEs and by SMEs.

##### *MSEs*

According to our interviews and analysis, MSEs are often not extended lines of credit for several reasons.

*MSEs generally operate outside the regulatory and legal systems.* While it is clear that this is because they face numerous factors that impede and discourage formalisation, the fact that MSEs are often not legally functioning units increases the risk associated with extending credit lines to them.

*Most MSEs operate on premises for which they do not hold the title.* MSEs often work on road reserves, unclaimed land and even parking lots. The lack of legal tenure translates into the constant risk of MSEs being evicted and losing their source of income. As a result, creditors are reluctant to extend lines of credit due to the lack of legal tenure on the land where they operate.

*MSEs often lack collateral against which credit can be extended.* In terms of immovable assets, MSEs generally cannot provide title to land as collateral. In terms of moveable assets, MSEs lack equipment of a standard and level such that the asset is deemed commercially viable as collateral. Further, moveable assets can be removed from the business location, which prevents them from being viable collateral items.

*MSEs often lack financial records that are presented in a manner deemed acceptable by creditors.* To be clear, MSEs can have an understanding of the financial performance of their business, but this is not recorded in a manner that lends them creditworthiness.

*The lack of professionalised staff in terms of an organisational structure* that delineates the role of technicians, human resources, finance and marketing personnel lends a fluidity and murkiness to the MSE structure that can be perceived as disorganisation. The lack of an organised business structure again increases the risk associated with MSEs by lenders.

Finally, the *interest rate cap has led to notable risk aversion by banks* because they cannot use increased interest rates to factor in any additional risk that MSMEs may pose to them.

### **SMEs**

A significant constraint for SMEs is the *failure of government at both national and county levels to pay for goods and services rendered.* The Central Bank of Kenya has pointed out that non-performing loans (NPLs) rose from 6.1% of total loans in 2015 to a record high of 12.36% in April 2018, citing delayed bill payments by government as a big issue (Standard Newspaper, 2018). Indeed, the government may be holding up to KSh 200 billion owed to SMEs (Standard Newspaper, 2018). Media reports indicate that the latest report by the Controller of Budget shows the devolved units alone had accumulated debts totalling KSh 100 billion by the end of 2014/15. The lack of payments means that SMEs cannot service loans, resulting in rising defaults and listing by credit reference bureaus. According to the CBK, the delays have resulted in so many defaults that 10% of Kenya's bad loans (worth KSh 28 billion) are as a result of late payments by the government (Standard Newspaper, 2018).

Our interviews revealed that a key concern for creditors is *poor financial practice as SMEs often lack audited accounts.* Many cannot afford the costs of a qualified auditing firm or do not understand the importance of having audited accounts. Further, SMEs' 'official' books often under-report incomes in order to limit tax liabilities. This can make it difficult to understand the true financial position of an SME and also undercuts the loan amounts for which they can qualify. Bankers are forced to question SMEs' financing practices and then exert extra effort to get the true financial picture.

*Financial literacy can also be an issue for SMEs.* They may not have lawyers and auditors to support their financial performance and often have issues with understanding and complying with the tax regime.

As with MSEs, *SMEs tend to lack collateral* and yet, as transactions grow in complexity and size, more collateral is required. Creditors prefer immovable assets such as land and buildings as these tend to appreciate over time. Moveable assets such as machines depreciate and make

them less attractive as collateral items. Further, recovering moveable assets is difficult as by the time creditors have reached the stage where they seek to collect moveable assets, the SME has often cleared out. Additionally, in some cases, regulation makes moveable assets such as machines useless. This is exemplified in the plastic bags ban Kenya implemented which made those related machines commercially worthless.

During interviews, creditors were also of the view that *SMEs are expensive and labour-intensive and require considerable supervision*. As a result, banks have to deploy several staff members to monitor them, which makes SMEs considerably more expensive to lend to when compared to larger companies.

*Poor corporate governance is a further concern* in that SMEs are often family businesses with the owner also being the manager. As a result, decisions do not have checks and balances because decisions are centred on a few people. Further, decisions can also be emotionally driven because the family is heavily invested in the SME and thus fail to fully acknowledge challenges and issues that the SME ought to address. The owner, manager and decision-maker tends to be one person who is often not challenged due to power dynamics; other family members go along with the decision or do not raise their concerns even when they are of the view that it is not correct. In addition, because the owner-manager tends to be the point of focus, if this person dies or falls ill, others do not have a full picture of the SME or the ability to deliver what is required to continue functioning. Nor is there any guarantee that the children of the family will demonstrate interest or competence in running the SME in years to come. Thus, when an SME is centred on an individual, it is not always assured that they will be receptive to the changes that banks seek to make to improve business performance. If the SME becomes successful, there can also be infighting among family members over the company.

Finally, a key challenge is *poor market access* in that SMEs are competent at creating products but not at gaining access to markets. SMEs often do not know how to expand market access because they do not have the infrastructure, funding and networks to establish new markets. Additionally, SMEs are often affected by corruption because they don't have the influence to resist and because of their small size. As well as showing up in their books, corruption eats into their margins and into the funds available to run the business and make loan payments. A further key concern is that when money starts coming in, SMEs often divert this to non-core business-related ventures such as buying land and real estate, rather than investing back in the business.

#### 4.1.4 MSME-specific factors

In addition to lack of information and a weak ecosystem, there are constraints specific to MSMEs or firms that prevent them from better integrating into value chains and creating partnerships with corporate players.

*A key issue is low productivity*. The World Bank (2016) reports that informal firms are much less productive than formal firms, with productivity calculated as value added per employee. In Kenya, formal or registered micro firms show a much higher level of labour productivity than the informal counterparts surveyed, but the gap varies by region: the mean value of labour productivity for micro firms is about 8.4 times that of informal firms surveyed. The corresponding figure for median level of labour productivity is lower, but is still 3.8 times that of informal firms surveyed by the World Bank (ibid.). Additionally, labour productivity for firms surveyed is higher among relatively older firms and firms with more educated managers. Thus, the combination of informality, firm size and education informs productivity. That most MSEs tend to be informal with low levels of education negatively informs their productivity.

During the interview process, large companies consistently cited that their reluctance to integrate MSMEs into their supply chains was due to a *lack of consistency in the quality and quantity of goods provided*. Our evidence points to a lack of standardisation for goods manufactured as well as consistency in timelines among MSMEs, which discourages large companies from outsourcing

to MSMEs. That said, there are some SMEs in particular that have managed to secure contracts with large companies but these are negotiated on a business-to-business basis with positive outliers pulled into large supply chains. An example of this is the Limuru Leather Cluster detailed in Box 13.

A related factor that spreads across MSMEs is the *inability to access relevant technology and equipment* that would enable them to standardise products and increase their ability to produce a certain number of units in a consistent manner.

Interviews also revealed that large companies are concerned that *many MSMEs do not function within the appropriate legal environment or comply with regulations* on tax, labour, wage and safety standards. Thus, if an activity is deemed to be in violation of regulations, the larger company will be held responsible as there is a general understanding tolerated in government that MSMEs in particular operate outside the law. Often larger companies regard MSMEs as high risk and as potentially exposing them to legal action.

In some cases, *SMEs in particular are viewed as competitors by some big players*. There is a sense that large companies actively undermine the growth of MSMEs so that they never grow to a size that would allow them to truly compete with large players.

## 4.2 Value chain-specific constraints and opportunities

We begin by identifying challenges that are specific to value chains, firstly within each node of the leather value chain and then within the textile and garment value chains.

### 4.2.1 Specific constraints in the leather value chain

#### *Animal herders*

Most of Kenya's livestock, and therefore hides and skins, are derived from predominantly pastoralist populations particularly in North-East Kenya. At the animal husbandry stage, the quality of hides and skins has deteriorated over time and tanneries have noticed a notable decline since devolution in Kenya. One of the key functions devolved to county governments was agriculture and livestock. County governments seem reluctant to finance livestock extension services such as animal health and husbandry officers to work with local communities in managing their livestock, mainly because they have limited funds available and the financing of extension officers is seen as a cost that does not generate short-term returns. This is resulting in poor quality hides with tick bites, parasites and skin diseases, and poor nutrition amongst livestock, all of which affect hide quality. Additionally, animal herders tend to brand their livestock, which destroys hides and skins for further use.

#### *Raw hides and skins*

Hides and skins tend to be collected at slaughterhouses and abattoirs and are then sold to local tanneries. Due to steep export tariffs, these are semi-processed domestically by the formal private sector then released for export. The high level of informality in the animal husbandry and abattoir/slaughterhouse segments constrains private sector engagement in these sectors.

At the abattoir and slaughterhouse stage the key constraint is the prevalence of flayers who are not formally trained and do not have the right equipment for high quality flaying of hides and skins. This is largely because this part of the value chain is dominated by MSMEs that are typically poorly financed, which prevents them from accessing training services and buying appropriate equipment. This results in the destruction of hides and skins at flaying stage due to poor handling. In addition, hides and skins are often poorly preserved and stored by hide traders who use inappropriate chemicals such as sea sand and salt to preserve the hide. Hide collectors are not trained in hide curing, chemical use and hide handling, which further lowers the quality of hide.

Because of the poor practices at the animal husbandry and the abattoir/slaughterhouse stages, hides and skins are not a lucrative source of income. Players are therefore not motivated to improve the quality of hides and skins as income sourced from them is negligible. In turn, this prevents players from making improvements in the value chain that would increase hide and skin value, creating a vicious circle.

Another challenge faced by the sector is that the aggregation of hides and skins is quite informal and disorganised due to the lack of a central collection point. The disorganised collection system discourages entry of new investors, who cannot be assured of enough availability of timely raw materials (KAM, 2018)

Under-declaration and under-invoicing of exports in liaison with customs officers and clearing agents also causes corruption in the raw hides and skins trade. While the smuggled value of raw hides and skins is usually fixed at \$0.4 or \$0.5 per kg, the actual export price should be \$1.4 per kg. From this fact, the government loses about Ksh 83 million per month, which translates to about \$100 million per year (KAM, 2018).

#### *Tanneries*

Hides and skins tend to be semi-processed and then exported. The current comparative cost advantage of Kenya's tanneries in the production and export of semi-finished wet blue leather derives from the fact that North American, South American, European Union and, most recently, Chinese governments are unwilling to continue to absorb externalities in the sector, including those associated with environmental clean-up. As a result, they are attempting to 'export' those costs to nations such as Kenya that are willing to absorb them (World Bank, 2015a).

At the tannery stage, a key constraint is the cost and quality of power, which limits firms' ability to produce competitively. One tannery interviewed stated that about 65% of its total costs comprise electricity alone. There are also concerns regarding compliance with environmental standards by tanneries – the lack of adherence to international leather-related environmental standards at the tannery level limits leather exports to high-income markets in particular.

#### *Leather goods producers*

There is limited large-scale value addition in the leather sector. As mentioned, the focus for larger players is on basic value addition to hides and skins for export. The value-addition space is dominated by (often informal) MSMEs, which service local markets particularly in the manufacture of school shoes. No large players operate in the leather value-addition space, and EPZs do not have a single manufacturer of leather goods and products. For example, the informal Kariokor market cluster produces low-cost leather goods for Kenya and the region.

The lack of quality inputs is a key constraint to expanding the domestic production of leather goods. Because most high-quality leather is exported, value addition is defined by the provision of low-quality leather. It is also important to note that once leather reaches the finished stage in its particular colour, texture and pattern, the local market has a limited number of buyers for it. The absence of large players at the value-addition stage is reinforced by the fact that Kenya does not have an ecosystem of leather goods input suppliers that can easily support leather goods producers. Additionally, leather has a fashion element to it that is dynamic and fluid yet there is a lack of readily available accessories locally and thus local players cannot comply with the different design elements such as soles, cutting dyes, cutting dices and moulds needed to meet the fashion demand. Accessories for leather are not locally available and so have to be imported, which is time-intensive and complicates the ability to comply with global export delivery timelines. Further, input accessories are subject to 10% to 25% tariffs and yet finished goods can be imported at a 25% tariff. These tariff structures dis-incentivise the import of accessories for shoe manufacture, for example. Current tannery practices and the chemicals used at the tanning stage present additional challenges in meeting international standards for exports.

As mentioned previously, there is a lack of technology and equipment to support the value-addition process, with MSMEs indicating that they do not have the technological equipment to

enable them to service big orders and increase output. MSEs also make the point that they do not have the financial capacity to buy machines, improve inputs, improve technical skills or source new markets, which tends to relegate them to subsistence-level manufacturing.

The Limuru leather cluster (see Box 13) consists of a group of SMEs active in the production of leather goods, mainly shoes. Their experience highlights how a combination of factors hamper their business activity and growth.

### Box 13: Limuru leather cluster

The Limuru cluster of MSMEs consists of three absolute business units (ABUs) that supply Bata Kenya with shoe uppers for the local and export market. Bata gives them the input materials as well as shoe designs, which they manufacture and then send back to Bata to complete the shoe production. They currently have a capacity of 3,000 sole uppers per day but produce less than the daily total required by Bata.

The cluster faces particular challenges:

- Working space is limited and requires capital to expand.
- Workers are paid fortnightly but due to delays in payment from clients, MSMEs can struggle to meet payment schedules which leads to a high turnover in labour. Furthermore, there are no training institutions for their product lines, so firms train labour at an average cost of KSh 28,000 per worker.
- The soles, leather and accessories that are available locally are of poor quality, which impacts the quality of the products that they manufacture.
- MSMEs lack collateral, which creditors require in order to provide finance.

Their investment budget and strategy for the anchor ABU is KSh 523.4 million, broken down as follows:

- Machinery: KSh 210 million divided across:
  - Designing, cutting and sewing equipment: KSh 60 million
  - Shoe lasting production line: KSh 80 million
  - Sole manufacturing machines: KSh 60 million
  - Finishing equipment: KSh 10 million
- Premises/godowns (warehouses): KSh 100 million
- Labour: KSh 1.4 million
- Materials per month: KSh 162 million
- Contingency costs: KSh 50 million

### *Market and consumers*

Despite the fact that footwear comprises the biggest share of final leather products manufactured in Kenya, the country still imports more than it exports. Kenya is a net importer (\$8.3 million) of leather footwear and many experts estimate the true value of leather footwear imports to be even greater.

The *mitumba* market accounts for around 63% of footwear (26.5 million pairs) sold in Kenya per year (World Bank, 2015a). The majority of purchased shoes are in the low-cost category, with non-leather shoes dominating both the *mitumba* and lower price range in footwear. Of an estimated 42 million pairs of shoes purchased in Kenya annually, 15 million pairs are leather

shoes. Domestic producers only supply low-price and mid-price leather shoes into the market, however. In the low-price leather shoe market there are still vibrant local producers, mainly the informal (*Jua Kali*) sector, which competes against cheap imports from China and Ethiopia. In addition, there has been a worrying trend of the mass copying of Maasai products in China and importation into Kenya which undermines the local leather craft industry (pers. comm., A. McCreath, October 2018). In the mid-price category only about 0.8 million leather shoes are made in Kenya, with another 1 million pairs imported. There are currently no local producers of high-end leather footwear.

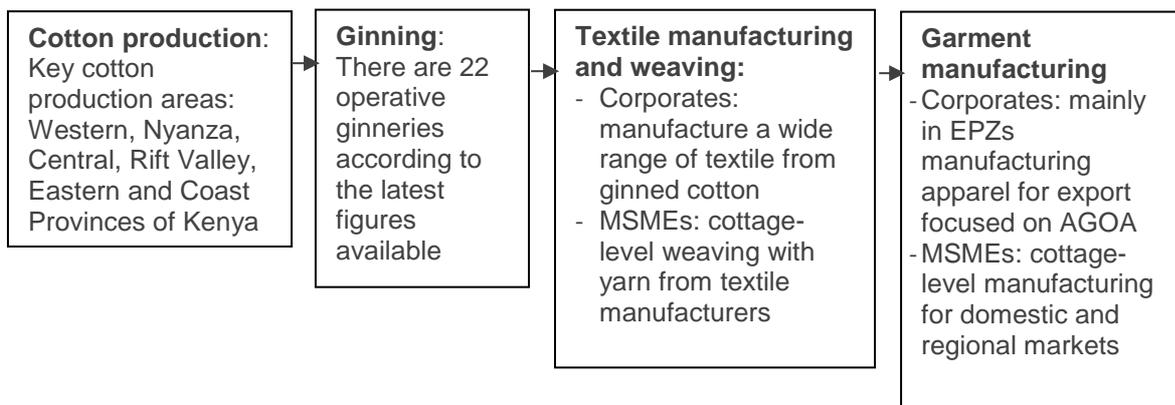
After footwear, leather bags make up the second biggest leather sub-sector in Kenya. This market dynamic discourages value addition into the sector because there is a limited domestic market for the sale of goods. Poor tanning and lack of standardisation, lead to low value addition and inability to meet export standards of high-income markets.

Generally a lack of skills across the value chain lowers the quality of leather products manufactured in Kenya. Poor animal husbandry practices, flaying and hide handling in abattoirs and slaughterhouses, coupled with low skill levels in leather goods production decrease the value of hides and skins and leather products. This is partly because of a lack of institutions with niche training across the value chain as well as the lack of demand for training in the leather sector.

#### 4.2.2 Specific constraints in textile value chains

In this section we identify various challenges faced by MSMEs in the textile value chain.

Figure 8: Snapshot of textile and garment chain



Source: Authors

The first constraint is that cotton production areas are spread across Western, Central and Eastern Kenya and the Coast Province with some growers often a long way from a ginnery. They are therefore often forced to sell to intermediaries, which can lower profit margins (Gitonga et al., 2016). Secondly, most farmers have production issues such as poor agronomic practices, inadequate extension services, low use of inputs due to their high cost, and poor-quality seed (FAO, 2012). Thirdly, producer institutions are weak and disorganised, hindering their capacity for collective bargaining to secure better prices, as well as their ability to access credit (ibid.).

The lack of irrigation facilities means cotton is mostly grown under rainfall conditions, which adversely affects yields due to unreliable rainfall. Where irrigation is present, there can be improper water use that leads to water logging and poor crop yield (Gitonga et al., 2016).

The costs associated with spraying, weeding and harvesting cotton crops lead to a high cost of production. Pesticide costs are particularly high and contribute around half of the input costs. Inadequate use of mechanisation also contributes significantly to high production costs (ibid.).

### *Ginning*

Most ginneries are not operating at their full capacity due to the low supply of domestic seed cotton (FAO, 2012). Because of this inadequate supply, ginneries often have to travel long distances to purchase small quantities of seed cotton (RATES Center, 2003). As discussed previously, local ginners also face competition from imported lint mainly from Sudan, Uganda and Tanzania (ibid.), and face high energy costs due to the use of outdated or aged technology as well as unreliable electricity supply.

### *Textile manufacturing constraints*

**Costs of mechanisation.** Some MSMEs in Uhuru Market use basic manual or electricity-powered handlooms to make knitwear from purchased yarn. However, these are micro in nature with no capacity for mass production. The main constraint that prevents MSMEs from participating in this section of the value chain is financing, particularly for the purchase of equipment that would allow the manufacture of a large quantity of high-quality textiles. Further, manufacturers use equipment and technology that is outdated and inefficient with regards to energy consumption (World Bank, 2015b).

**Low capabilities.** Interviewees reported that there is a dearth of knowledge regarding technical and engineering skills. Firms often struggle to find employees with the right skillsets and thus have to spend time and resources training them. This added cost for MSMEs diverts money and time away from core production.

**High costs of inputs and costs of energy.** Chinese and Indian firms are more competitive than Kenyan manufacturers due to the subsidies that their governments offer textile firms. This results in cheaper fabric being imported into the Kenyan market. Other challenges include the high cost of energy, a young labour pool that is less dedicated than older employees, and old machinery that reduces efficiency. Competitiveness is also affected by the fact that there is no domestic manufacture of inputs required for garment-making, such as high-quality textiles, filament yarn (polyester, nylon) or zips, buckles and buttons. As a result, both large firms and MSMEs have to import the bulk of inputs, which adds cost and time to their production schedules.

Finally, EPZ firms have been allowed to sell garments in the domestic market, making them more competitive than textiles companies that operate outside the zone and that do not benefit from EPZ incentives. This has created an uneven playing field in terms of price points and puts MSMEs at a disadvantage.

### 4.2.3 Specific constraints in garment value chains

Garment manufacturing is located mainly in EPZs, dominated by large firms focused on the United States' market through AGOA. While there are numerous ways through which MSMEs interface with the EPZ and related firms, a number of constraints prevent deeper linkages, as well as the manufacture of garments by MSMEs themselves.

In our interviews a central constraint faced by both MSMEs and larger firms was the saturation of the local garments market with cheap imported and second-hand apparel. This is exacerbated by counterfeit and undervalued garment imports which originate mainly from China and Asian countries. Illicit, substandard and counterfeit wares affect local garment manufacturers on the domestic market, while counterfeit locally manufactured brands negatively affects the reputation of local manufacturers.

### Box 14: Columbia – transformation of the garment sector with a focus on fashion design

In 2005, the Colombian government made a decision to move from manufacturing for international fashion brands to dominating their own domestic markets (which were predominantly international brands) and exporting Colombian brands. The government supported their manufacturers to create brands, secure prime retail property and to connect them with designers to create lines that were specifically cut for local markets and the specifics of their body types. This process created jobs for textile manufacturers, local designers, pattern cutters, garment manufacturers, models, photographers, graphic designers and advertisers. At the same time, the government supported local fashion colleges to provide better training on wider skill sets, and looked for opportunities to promote Colombian brands and designers internationally.

By 2013 over 60% of their domestic retail was Colombian brands, and by 2016 their designers dominated interest at Messe Frankfurt fair in Paris, which is a premier international fair for fashion.

Source: pers. comm. A. McCreath, October 2018.

Another key constraint in the apparel value chain is that local fashion designers have to pay exorbitant duty on imported fabrics, because local fabrics are not of the desired quality and variety for the local and international consumer market (pers. comm., A. McCreath, October 2018). Further, there is little to no innovation in the actual cloth construction, unless designers go to individual weavers who are too costly for mass market fashion (ibid.).

## 4.3 Constraints to integrating MSMEs into the design of economic zones

While there are constraints and opportunities for MSMEs to take part in value chains, there are additional considerations around taking part in economic zones such as SEZs.

*A key challenge with regards to SEZ design and development is terminology* as the terms SEZ, EPZ and industrial parks are used interchangeably by many. There is no clear government position on the precise scale, features and incentives that pertain to SEZs versus industrial parks, for example, or how these fundamentally differ from EPZs. Because of the ambiguity in terminology, it has been a challenge to win focused support and funding from within government for SEZs.

*The development of SEZs is uncoordinated.* There is no single official position on the development of SEZs from the government, the private sector, or from domestic and foreign entities. As a result, even getting a list of approved (let alone operational) SEZs is difficult. There are however recent plans to work on SEZs in Naivasha and the Mombasa port area.

*The SEZ Authority has been insufficiently supported in terms of funding and staffing.* Funding to the authority has been paltry, partly because of the lack of clarity over the role, features and design of SEZs. This has led to a 'go slow' on the development of SEZs, despite the central role the government has placed on these zones in the context of developing manufacturing and the 'Big Four' agenda.

*There is also a lack of clarity about the target market for goods produced by companies in SEZs.* Will SEZs be export-oriented or focus on domestic and EAC markets? The SEZ Act is not clear on the delineation of incentives depending on SEZ company activity. This is important to define because it would be imprudent to create a context in which SEZ companies have an advantage over companies making the same products outside the SEZ, which would make the latter's products uncompetitive.

*There is little indication that national government is engaging with county government in SEZ design and development, despite the fact that SEZs will sit in locations supervised by county governments. Because county governments have not been in the loop in terms of SEZ design and development, their support and commitment has yet to be secured – going forwards it is important for national government to collaborate with county governments when mapping out and establishing SEZs. Amendments have already been proposed for the inclusion of counties in the SEZ Act, but the process by which counties can set up SEZs should be clarified.*

*Finally, government has not articulated the importance of the domestic private sector and MSMEs in SEZ design and development. Large domestic private sectors fear that they will be locked out of SEZ development as government focuses on attracting foreign investors, while MSMEs have no idea how they can plug into SEZ development for their own benefit. Neglecting the domestic private sector in SEZ design risks creating a scenario where the multiplier links of SEZ into domestic economic growth is undermined. There is a need for clarity on how large firms and MSMEs can make use of government intent to establish SEZs and to ensure SEZs are anchored in the local economy.*

## 4.4 Potential pathways for MSMEs in value chains and economic zones

Section 3 explored current pathways through which MSMEs participate in value chains. If the constraints described so far in section 4 are addressed, MSMEs can leverage opportunities in their value chains and participate in various potential pathways detailed below.

The ‘potential pathways’ are separated into two categories:

1. ‘Incremental’: do not need heavy new investment or new forms of capabilities. These pathways are relatively developed in Kenya already and marginal support over the short term can lead to quick and easy gains.
2. ‘Substantive’: require more investment and the acquisition of new knowledge and capabilities to functionally upgrade into new pathways or significantly improve the performance of an MSME in the pathway. This is a long-term strategy as it involves heavy investment and time.

Tables 13 to 15 summarise the potential pathways.

**Table 13: Potential pathways of MSMEs in leather value chains**

Potential pathway of the SME	Incremental versus substantive	Details on pathway
<b>1: Backward – support core (vertical) manufacturing – parts of main product</b>	Incremental: providing raw hides	Competitive advantage already exists as MSMEs have considerable experience in managing slaughterhouses; basic investment required to provide health and safety officers, veterinary services and upgrading of abattoirs and slaughterhouses
<b>2: Backward – intermediary services</b>	Incremental: skinning	Skinning of cows, goats and sheep; TVET training required to improve precision of the skinning as well as the provision of equipment and machinery to increase productivity

<b>4: Forward and logistical – support core (vertical) manufacturing, parts of main product</b>	Substantive: accessories manufacturing and design  finishing the hide	
<b>6: Forward and logistical, intermediary services (finishing)</b>	Substantive: speciality designs	Setting up design houses and design training institutes to train MSMEs in international designs; currently design is primarily focused on local and regional market Upgrade software to teach and perform three dimensional designs
<b>7: Integrated, full product from backward to forward</b>	Substantive  Kariokor cluster development	Improve collective efficiency

Table 14: Potential pathways of MSMEs in textiles value chains

<b>Potential pathway of the SME</b>	<b>Incremental versus substantive</b>	<b>Comments</b>
<b>1: Backward – support core (vertical) manufacturing – parts of main product</b>	Incremental: cotton farming	Supporting the farmers through extension services and engaging with international actors such as the Better Cotton Initiative, to improve overall productivity and standards
<b>2: Backward, intermediary services</b>	Incremental: agro-vets	Training agro-vets in extension skills, so they can support the farmer
<b>6: Forward and logistical, intermediary services (finishing)</b>	Incremental: embroidery	TVET in complex embroidery and crocheted work so that MSMEs can develop new designs
<b>4: Forward and logistical, support core (vertical) manufacturing – parts of main product</b>	Substantive: handlooms to looms	Upgrade looms and introduce digital technology so as to keep up with fast fashion demands. Furthermore, support value addition through TVET training in how to dye, bleach, print textiles
<b>1: Backward – support core (vertical) manufacturing – parts of main product</b>	Substantive: integrated cotton farming and ginnery for MSME	Supporting development of integrated ginneries and contract farmers, to get year-round supply of cotton lint
<b>7: Integrated, full product from backward to forward</b>	Integrated mills (for larger players, not possible for small)	Supporting other firms to develop, like Rivatex, to ensure integrated mills for quicker supply that is 'traceable'

Table 15: Potential pathways of MSMEs in garments value chains

Potential pathway of the SME	Incremental versus substantive / function change	Comments
<b>4: Forward and logistical – support core (vertical) manufacturing – parts of main product</b>	Incremental: making accessories (buttons, laces)	Supporting MSMEs in TVET training to learn new design skills and use machines to improve their moulding and fitting skills
<b>6: Forward and logistical, intermediary services (finishing)</b>	Incremental: ironing and permanent press	Providing new technical support (skills and machines) to develop MSMEs to perform such value-added services
<b>6: Forward and logistical, intermediary services (finishing)</b>	Incremental: marketing and branding services	Providing mentorship and marketing training as well as expanding networks of MSMEs to re-brand and market their products
<b>6: Forward and logistical, intermediary services (finishing)</b>	Incremental: design	New skills in fashion design tying up with international universities and investment in new design technology
<b>5: Forward – producing core product, filling capacity deficit of large firm</b>	Substantive: subcontract to make up capacity deficit of large firms	Technical and managerial capabilities support through skill development programmes and cheaper credit to upgrade machinery
<b>7: Competition, integrated, directly competing with manufacturing of core product</b>	Substantive: providing support to medium-sized firms to grow to large firms	Technical and managerial capabilities support through skill development programmes and cheaper credit to upgrading machinery

Strengthening the performance of MSMEs in each pathway, and having MSMEs graduate into more profitable and complex pathways, will make them more viable partners for large firms that are likely to be anchor investors in economic zones. Firms in economic zones will only make concrete direct and indirect linkages to MSMEs if it makes business sense, however. Thus, there is a need to strengthen MSME performance in pathways in order for larger firms to pull MSMEs into the supply chain and business activities of firms in economic zones.

## 5 POLICY SUGGESTIONS FOR INTEGRATING MSMEs INTO VALUE CHAINS AND ECONOMIC ZONES

Based on our interviews and literature reviews we have a good understanding of the constraints that MSMEs face when integrating into value chains and economic zones. This section discusses the measures that the Government of Kenya already has in place to support MSMEs (5.1) before considering what more it could do to overcome the constraints to integration (5.2).

### 5.1 Current policies to support MSMEs

There are several policies, plans and structures in place in Kenya to support MSMEs, some of which will help integration into value chains and economic zones:

- **Vision 2030.** This is the government's development blue print which aims at transforming Kenya into a newly industrialising, middle-income country able to provide a high quality of life to all its citizens by 2030 in a clean and secure environment. The role of the manufacturing sector in Vision 2030 is to create employment and wealth. A number of interventions are proposed that will enable Kenya to be globally competitive and prosperous (MoITC, n.d.b). The objectives to be pursued are:
  - strengthening the capacity and local content of domestically manufactured goods
  - increasing the generation and utilisation of research and development results
  - raising the share of products in the regional market from 7% to 15%
  - developing niche products for existing and new markets.
- **Kenya Industrial Transformation Programme (KITP).** The KITP programme is anchored to the Vision 2030 (MoIED, 2015), and focuses on the following objectives:
  - to launch sector-specific flagship projects in agro-processing, textiles, leather, construction services and materials, oil, gas and mining services, and information technology related sectors that build on comparative advantages
  - to develop Kenyan SMEs by supporting rising stars and building capabilities with model factories
  - to create an enabling environment to accelerate industrial development through industrial parks/zones along infrastructure corridors, technical skills, supporting infrastructure and ease of doing business
  - to create an industrial development fund.
- **Big Four Agenda.** This strategy will guide the government's development agenda from 2018 to 2022 and is focused on four pillars: food and nutrition security, universal health coverage, affordable housing and manufacturing. Textiles and leather are key sectors under the manufacturing pillar (KIPPRA, 2018; Mutahi, 2018).
- **MSE Act and MSEA.** The MSE Act<sup>17</sup> provides clear definitions on what constitutes an MSE. Housed under the Ministry of Industry, MSEA is the government body responsible for the development of the MSE sector.
- **SEZ Act and SEZA.** The SEZ Act<sup>18</sup> provides a legal framework for SEZs while SEZA is the institution charged with SEZ development.
- **Upcoming Biashara Bank.** This will have the potential to direct government funding to MSMEs. It should also be said that several development finance institutions such as the Dutch development bank (FMO), the International Finance Corporation (IFC) and the African Development Bank (AfDB) have made available credit lines for local banks for lending to SMEs.

<sup>17</sup> <http://industrialization.go.ke/index.php/policies/99-micro-and-small-enterprises-act-2012>

<sup>18</sup> <http://extwprlegs1.fao.org/docs/pdf/ken160896.pdf>

- **Kenya Industrial Estates** is a critical government agency under the MoITC. It offers several services, including incubators and accelerators. Box 15 below, explains the crucial role they play currently.

### Box 15: The role of Kenya Industrial Estates in building clusters and supporting MSMEs

KIE is a government agency under MOITC and, among other services, offers incubation and accelerator support deployed via work sites and industrial parks, which is complemented by financial support and business advisory services. KIE has 37 industrial parks/incubators, which serve as work sites and accelerators to MSMEs in 37 of the 47 counties in Kenya. It hosts modern incubators in Nairobi Industrial Area, which could be replicated to meet the specific needs of individual clusters such as the Uhuru Market textile cluster. KIE focuses on the following sectors/value chains: textiles and apparel; leather and leather products; agro-processing; metal fabrication and furniture-making; and construction materials.

KIE has already financed and offered business advisory services to textiles and apparel customers in the Jogoo Road/Uhuru Market cluster as well as to leather MSMEs in the Kariokor cluster. In Nairobi, it has supported entrepreneurs in the textiles, leather and leather products, agro-processing, metal fabrication and furniture-making and construction materials sectors, as detailed below:

Sector	No. of MSMEs	Financial support (Kenyan shillings, Ksh)
Textiles and apparel	66	34,570,192
Leather and leather products	18	47,028,412
Agro-processing	124	62,688,972
Metal fabrication and furniture	28	35,409,750
Construction materials	26	16,901,286
Total	262	196,598,612

Projected targets for support in each cluster for the next two years are as follows:

Sector	No of MSMEs	Budget Ksh (millions)
Textiles and apparel	4,500	450
Leather and leather products	1,200	120
Agro-processing	8,000	800
Metal fabrication and furniture	1,800	180
Construction materials	1,700	170
Total	17,200	1,720

Other government initiatives targeting MSMEs include:<sup>19</sup>

- 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.

<sup>19</sup> These initiatives emerge from priorities communicated by the Ministry of Industry during research for this project.

In addition, we have already discussed the institutional support structure for SMEs in section 2.1 (e.g. MSEA) and section 4.

## 5.2 Policy suggestions for fostering potential MSME pathways

Based on the current pathways and constraints discussed above, we suggest a range of policies that can help MSMEs to integrate into value chains. These are summarised in Figure 6. We will then discuss how these MSMEs can also be integrated (both directly and indirectly) into economic zones (Section 5.3). Broadly the MOITC should continue to remain responsible for implementation of the policy suggestions and the Executive Office of the President support the coordination of inter-ministerial activity to drive the cross-cutting interventions in MSME development, including supporting MOITC's priority areas of intervention to avoid duplication of roles and enhance collaboration

Figure 9: Policies supporting potential pathways for MSMEs to link with value chains



Source: authors.

### 5.2.1 Provision of information along the value chain

A key constraint to better integration of MSMEs into value chains and economic zones is the lack of a country-wide, comprehensive assessment that details the capacity of MSMEs in each pathway elucidated in this paper. For example, there are no data that indicate which pathway has the most MSME participation and why. Thus, there is a fundamental knowledge gap that needs to be addressed and a capacity assessment of MSMEs and their role in each pathway is important. Without doing this, it will be difficult to develop policy that informs the graduation of MSMEs within and between pathways.

The data could be aimed at developing, maintaining and updating information on the MSME sector through ongoing MSME surveys. KNBS produced their inaugural MSME survey in 2016; such efforts should be encouraged and done in partnership with MSEA, with a legal requirement

on the time intervals during which the MSME survey must be completed. Key data points that ought to be consistently collected include: economic size of the sector, sector contribution to GDP, number of enterprises, location and focus of activity, and MSME contribution to the economy (agriculture, manufacturing and services).

Additionally, there needs to be more and better accessible information that is relevant for MSMEs. The information available would include initiatives by both state and non-state actors for which MSMEs are eligible, such as:

- Funding opportunities:
  - o Through the Biashara Bank: This should include sharing information on how to apply for funds as well as assisting MSMEs in the application process.
  - o Funding opportunities from non-state actors for which MSMEs qualify.
- Technical and business training and mentorship programmes offered by state and non-state actors.
- Relevant legal and regulatory changes.
- Marketing opportunities such as national, regional and international trade fairs and expos and how to participate.
- Fostering networking by linking MSME clusters with each other especially along value chains.
- Scale of funding for which MSMEs can qualify (grant, debt, equity etc.): financing source, conditions for financing eligibility with two streams, one focused on MSE and the other on SMEs.
- MSME investment readiness.

There are clear information gaps along the leather value chain that impede the development of the sector and the role of MSMEs within it. The following are suggestions on how to plug the information gaps along the value chain:

- **Animal herders:** Conduct a livestock census over consistent time intervals.
- **Abattoirs:** Collect information on the scale and quality of hides and skins collected at abattoirs and key source markets. This can support efforts to improve the quality and quantity of hides and skins.
- **Tanneries:** Source information on the extent to which tanneries comply with environmental standards (such as the Leather Working Group) for leather production in terms of effluent treatment and chemical levels in leather produced. This can be part of the process to ensure that Kenya does not go through grave tannery-related environmental degradation, and could also allow entry to higher-income markets with more stringent leather-related chemical standards. In terms of micro tanners, there is a need for basic information on their core features such as size, scale and activities.
- **Leather goods producers:** Research at a country level and on countries that have potentially high appetites for leather goods; research on how to penetrate the AGOA market with leather goods.

Likewise, there are clear information gaps along the textiles and garment value chain that affect the development of the sector and the role of MSMEs within it. The following are suggestions on how to plug the information gaps:

- **Cotton production:** Collection of updated data on geographical spread, scale and quality of cotton production and production potential.
- **Ginning:** Regularly updated information on dormant and active ginneries, geographical spread, capacity utilisation.
- **Textile design, manufacturing and weaving, and garment manufacturing:** Information on MSMEs active in the segment of the value chain across the country in terms of scale of production, clustering and specialisation. This can form the basis on which MSMEs can collaborate and coordinate production to increase their ability to service larger orders and at scale. MSMEs could play an important role in textile and garment design, pattern cutting/grading as well as packaging.

## 5.2.2 Public support actions to develop MSMEs

### *Rules: Safeguarding against illicit trade*

There is a need to protect the domestic market in garments and textiles value chains from illicit trade and the entry of substandard, counterfeit and under-declared imports (new and second-hand). This can be done by *strengthening the Multi-Agency Team*, comprising of KEBS, the Kenyan Revenue Authority (KRA) and the Anti-Counterfeit Agency mandated to identify, seize and destroy substandard, under-declared and counterfeit goods, particularly at ports of entry.

Tariffs and duties play a significant role in both value chains for MSMEs as they affect the cost of production. It is important to *conduct a tariff and duties review for imports* that feed into the textiles/garments and leather value chains and then identify imports for which a decrease in duties would be meaningful for both industries. The tariff review can also explore where duty ought to be increased for finished garments and leather goods.

In the leather value chain, *a tariff structure should be created that facilitates the import of inputs into leather goods value addition* with a focus on removing duty on soles, leather boards and stiffener. A recommendation made during interviews is the need to improve customs processes. It is recommended that duty be charged per pair of imported shoes with proper labelling in terms of shoe composition so that the right price is paid at the point of entry into the Kenyan market.

In the garments value chain, EPZ firms have been allowed to sell 20% of their goods into the domestic market. Because of their preferential treatment as EPZ firms, the allowance has put domestic firms outside EPZs at a disadvantage as they do not benefit from the EPZ incentive structures. Media reports in August 2018 indicated that the Kenyan government has, 'silently stopped companies in the Export Processing Zones (EPZs) from selling their products in the local market' (*Daily Nation*, 2018). This, however, contradicts remarks by President Uhuru Kenyatta made in 2017 to increase EPZ local quotas from 20% to 40% (*ibid.*). It is important that the government resolves this issue and perhaps *creates a tariff structure that levels the playing field in the domestic market between EPZ and non-EPZ firms*.

### *Economic fundamentals: infrastructure (energy), skills and finance*

There is a clear need to *reduce the cost of electricity and increase its quality*. While the government seems committed to doing both, it would be useful to determine the minimum price per kilowatt hour that would resolve the cost of energy as a major constraint for both large firms and MSMEs.

In both value chains, labour shortages and skills are a challenge. *More attention should be paid to mentoring schemes to support trainees* in the implementation of the newly learned content.

In the leather value chain there is a need for training as follows:

- Animal herders: livestock disease prevention and treatment; livestock nutrition; cattle branding.
- Abattoirs and slaughterhouses: flaying; hide handling; adoption and use of hide pulling machines.
- Hides and skins traders: hide handling; curing and maintenance of hides; hide grading.
- Tanneries: improved environmental compliance; better quality leather production.
- Leather goods producers: export market access; quality of goods production; types and brand of goods produced.

In the textile and garment value chain there is a need for training as follows:

- Cotton production training should focus on improving agronomic practice to raise seed cotton yields. Training can focus on tillage, water management and irrigation, timing of planting, and improving plant population and spatial arrangements.
- Ginneries would benefit from the purchase of technology and training on its use.

- Textile manufacturers possess various skills needed to manufacture fabric ranging from equipment use to its maintenance. Given the volume of employees in textile mills, it is important that they are able to partner with TVETs, for example, to train staff in the appropriate skills.
- In terms of MSMEs, which are mainly weavers, the training focus ought to be on increasing productivity and the use of modern equipment.
- MSME garment producers should also be supported by TVETs in the skilling of their staff. Core management ought to be trained on business management, fundraising/ financing and how to access export markets, particularly AGOA.

The challenges faced by MSMEs when seeking credit have been discussed at length. There are three elements that ought to be considered in addressing MSME financing needs.

Firstly, on the supply side, there is a need for a government funding policy that is MSME-focused. A certain portion of the financing from the Biashara Bank ought to target existing MSMEs, particularly those in clusters. This strategy is important as not only will it finance the largest employer type in the country, it will also directly finance marginalised groups such as women and youth, most of whom run MSEs to earn a living. At the same time, the experience of male-led larger SMEs should not be sidelined in funding policy so as to ensure the collective experience of MSMEs is leveraged during financing as a risk mitigation strategy.

Secondly, also on the supply side, financing should be coupled with an ecosystem of support that raises the performance of MSMEs. The ecosystem should consist of technical training, managerial upskilling, marketing and human resources, compliance with the legal and regulatory framework (for more established SMEs), the use of technology and innovation, and business mentorship. Financing and/or training cannot be effective if implemented in silos; they need to be complementary and buttressed by mentorship.

Finally, on the demand side, MSMEs need to be more deliberate in making themselves ready to qualify for, receive, absorb and repay financing. At the moment, MSEs in particular are at a stage where they are poorly prepared for financing, even if they are a high-potential enterprise. A proposed MSME readiness tool, discussed in the next section enables identifying high potential MSMEs, which are ready for investment and support to move into high value adding pathways.

#### *Market access*

The first step to improve market access for MSMEs in both leather and textile/garment value chains is to focus on the domestic market and to prevent substandard, under-declared and counterfeit garments and leather goods from entering the country. Secondly, MSMEs would benefit from better information on opportunities to market their goods such as national, regional and international trade fairs and expos and how to participate in them. Government and private sector associations such as KAM ought to make deliberate efforts to inform MSME clusters of such marketing opportunities. Additionally, as part of financing MSMEs, the Biashara Bank should include support for marketing of products beyond existing networks. Without support in marketing, improvements in productivity and quality of goods may not translate into profits.

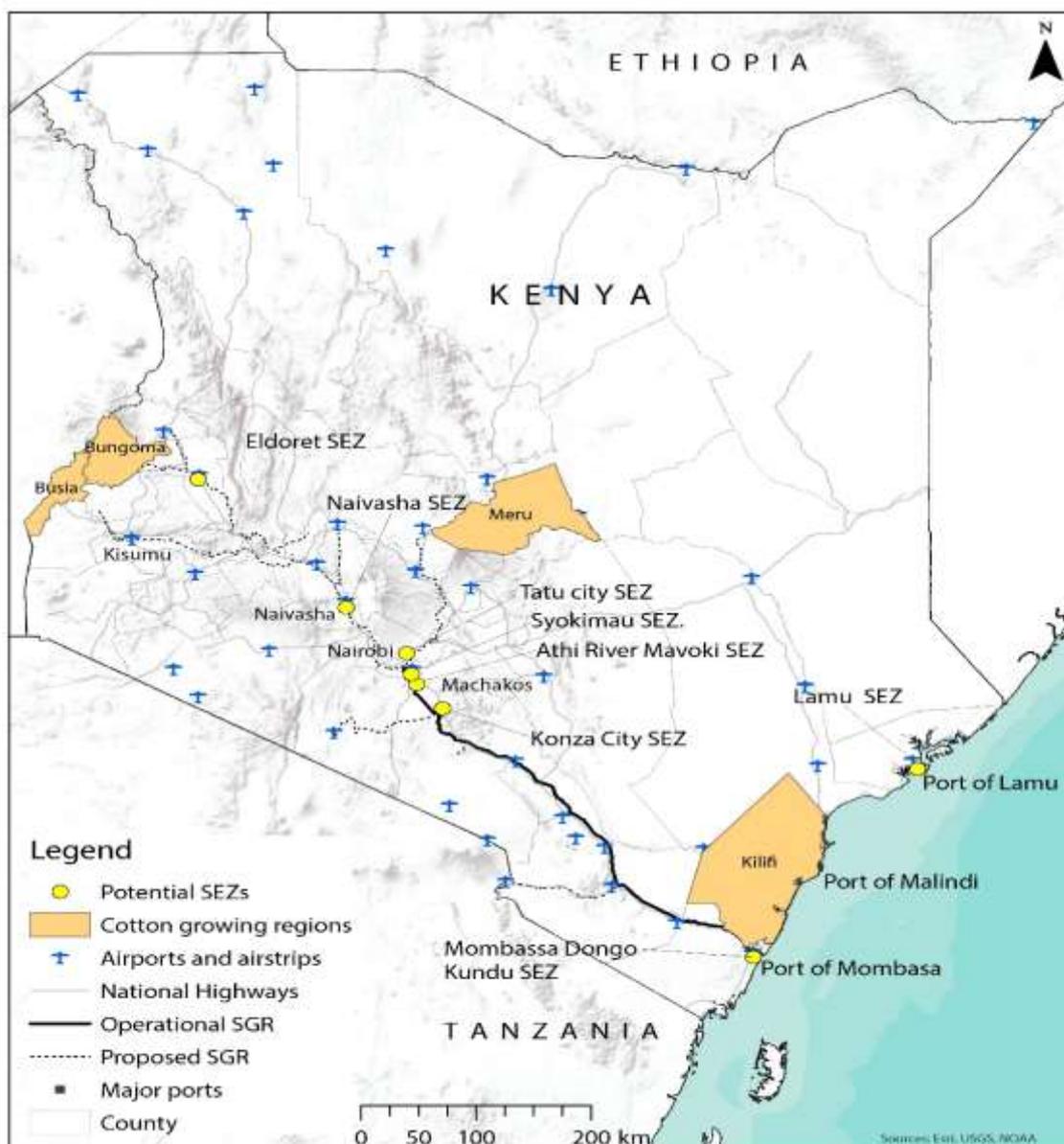
Further, MSMEs themselves ought to foster networking by linking MSME clusters with each other, especially along value chains. MSMEs also need to begin to trust each other and become better at collaborating in order to secure large orders, which are presently out of their individual reach. The current culture of mutual suspicion, even in clusters, prevents MSMEs from scaling up and seizing orders in the market that require collaboration.

In terms of improving leather quality and market access, the government ought to focus on several strategies such as the creation of an annual leather quality award and recognition programme. This will increase the profile of outstanding enterprises and serve as a useful marketing platform. Government or the private sector could also finance an international Kenya leather trade fair and sponsor Kenyan stands in international leather fairs.

In the textile and garment value chains, the biggest constraint in terms of access to markets is low cotton production. This prevents full capacity utilisation by ginneries, which limits their sale of lint into the domestic and regional markets. Thus, cotton production ought to be expanded and should have a focus on improved yields. The textile and garment value chain can mirror suggestions made for leather in terms of an annual award that recognises exceptional players in textiles and garments, as well as the creation of international Kenya textile and garment trade fairs.

Figure 10 maps local cotton-producing regions, and the potential SEZs to understand the distances required by farmers and other intermediaries to transport cotton. Long distances on poor quality roads causes delays in just-in-time manufacturing for firms. The map indicates that Kilifi county is connected close to the SGR to bring cotton to many potential SEZs and Meru seems well placed too.

Figure 10: Kenya cotton growing regions, potential SEZs and infrastructural facilities



Source: authors.

### *Institutions (coordination)*

The MOITC should play a crucial role in the strengthening of MSMEs in value chains and EZs, as suggested in box 16 below.

#### **Box 16: The crucial role of MOITC in strengthening the role of MSMEs in leather, textiles and garments value chains**

MOITC's experience is that the greatest challenges in addressing the integration of MSMEs into value chains successfully are:

- inadequate capacity (financial and human) of the implementing agencies to execute the strategies identified in current and previous development plans, including under the Big Four Agenda Manufacturing Plan
- need to facilitate and strengthen the institutional framework established by Government to support MSMEs
- delayed operationalisation of the relevant legal frameworks such as the MSE Act, owing to funding constraints, to conclude regulations and operationalisation
- lack of alignment between MSME development priorities and budget allocation.

Illustrative actions by MOITC to strengthen MSMEs include the following:

- continue policy reviews and reforms to promote inclusivity of MSMEs
- establish the MSME digital portal, which will host a database of MSME profiles that will provide a basis for credit- and trust-rating to facilitate de-risking and improve access to funding. MOITC requires support in collating all relevant data and information on the value chains sought by MSMEs
- finalise the MSME financing policy, which seeks to establish a Credit Guarantee Scheme and to operationalise the MSE fund, which is provided for under the MSE Act
- strengthen institutions dealing with MSEs – that is, MSEA and KIE.

The **county governments** can also play a significant role in supporting MSMEs and EZ designs. With devolution, county governments have greater agency to cater to the needs to MSMEs in their regions. Box 17 explains the important role the Nairobi Council has and can play in developing MSMEs.

Suggestions for institutional developments for the future are as follows:

- *Development of an MSME private sector body (KEPSA of MSMEs).* This would be a single key institution to represent the interests of MSMEs, particularly those in the informal economy. There are currently numerous associations that represent MSE clusters, but no single overarching and united body. It is important that consultations are conducted with leaders of the MSME sector and firm plans made either to strengthen an existing body or to create a body that represents and pursues the development of MSMEs from an enterprise perspective.
- *Restructure of the MSEA.* Our research has revealed several weaknesses in the MSEA that limit its effectiveness as the governing body responsible for MSEs. These include:
  - lack of trust in MSEA by MSEs and related associations
  - lack of institutional unity in MSEA, particularly in leadership and senior management
  - lack of capacity and financing to MSEA by the line ministry.

Thus, the Ministry ought to engage with MSEA to address internal issues and then jointly consult MSE leadership bodies on how to improve the functioning of MSEA.

- *Biashara Bank.* A key component of the Biashara Bank ought to be focused financial support to MSMEs as well as the facilitation of related support to MSMEs that receive financing.

Funding criteria ought to clearly delineate specific funding opportunities for MSMEs with special consideration for MSMEs owned and managed by women and youth.

*Coordination unit for MSME development.* A key element for the development of MSMEs in each of the value chains is a point of coordination. It is suggested this be in the Party of Democratic Unity, which would ensure all government ministries, departments and agencies as well as relevant private sector representatives are part of the team of coordinators in an MSME Development Coordination Unit. Key entities that ought to be present in this unit are the Treasury, the Ministry of Industrialisation, the MSEA, the Ministry of Education, particularly the Technical and Vocational Education and Training Authority, the Council of Governors, KAM/KEPSA, KNCCI, and MSME Association umbrella bodies (e.g. Kenya National Association of Jua Kali Associations).

### Box 17: The role of county government in supporting MSMEs – the example of Nairobi county

Under the devolved government structure, county governments have their own initiatives targeting MSMEs, which complement efforts by national government. It should be noted that county governments are fairly independent, and thus vary in terms of the extent of support deployed to MSMEs as well as the approach used.

In order to more effectively harness county capabilities towards MSME development, the following measures will be important:

- development of a framework by MOITC in consultation with county governments to ensure more effective coordination and complementarity in efforts to target MSMEs. This may include the development of a list of priority MSME value chains for each county, such as agro-processing
- better engagement by county governments on land under their ownership that could be assigned to county MSME initiatives
- a stronger role for counties in providing marketing opportunities, such as organising trade fairs for MSMEs.

#### *Highlights from Nairobi county*

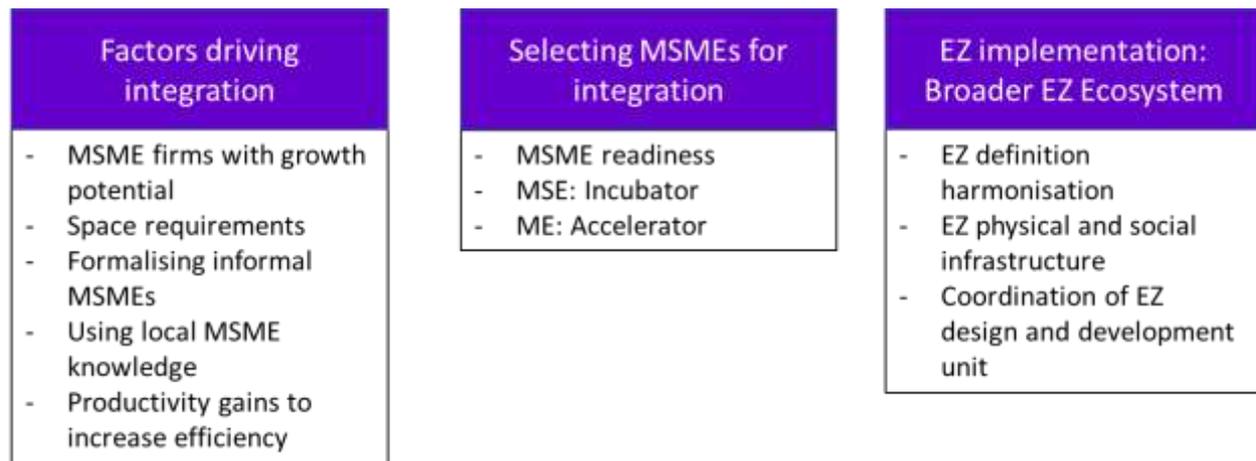
The bulk of the research for this evaluation was conducted in and around Nairobi county, which already provides the following support for MSMEs:

- provision of space for MSMEs during trade fairs such as the Nairobi International Trade Fair and other regional exhibitions
- provision of land for the development of MSMEs
- capacity-building and training with a focus on entrepreneurship.

## 5.3 MSME integration into the design and implementation of economic zones

There are a range of factors that drive the need for MSMEs to integrate (directly or indirectly) into EZs. We have used different tools that can help the government to decide on MSMEs suitable for EZ integration, along with incubator (MSEs- micro and small enterprises) and accelerator (medium enterprises) programmes that could help foster MSME growth and promote upgrading. We situate this discussion within a broader EZ ecosystem, highlighting the pre-conditions necessary for effective EZ implementation. Figure 11 shows our approach.

Figure 11: MSMEs in the design and implementation of economic zones (EZs)



### 5.3.1 Factors driving integration

There are several key actions required to ensure MSMEs are not only developed but also integrated into the roll-out of the EZ design and implementation. The first is to prioritise companies that are active domestically. The rationale behind this is that such firms, particularly Kenyan firms, already have linkages to MSMEs in different elements of their company’s operations. Thus, in prioritising domestically active firms, there is a higher likelihood that MSMEs will be used in terms of procurement, outsourcing, services provision and subcontracting.

Second, MSMEs themselves are interested in moving into EZs and require packages that make sense to them and incentivise the move. A key constraint faced by some MSMEs in the value chains of focus is space, particularly within the Kariokor cluster. There is a need to research space needs of MSMEs and how EZ design can incorporate those needs affordably going forwards. Further, MSMEs are a source of tacit knowledge and have experience in local conditions, another reason why they should be part of EZ design, development and implementation.

Thirdly, a key element of this process will be determining a formalisation strategy in order to ensure MSEs qualify for EZ inclusion. There is a need to address factors that incentivise informality, and to create a clear incentive structure that details the benefits of formalisation, particularly in the context of EZ design and development.

Fourth, ongoing work should be done outside EZs to improve the productivity and efficiency of MSMEs within value chains, such that EZ anchor investors (domestic or foreign) view MSMEs as a natural linkage required for business operations. Failure to improve the performance of MSMEs in linkages within the value chain and large domestic players will relegate MSMEs to the periphery as they are not seen as commercially important units. Thus, addressing issues such as skills, technology, financing and space is crucial, such that MSMEs are seen as natural partners in value chains.

Further, it is important to encourage and leverage the benefits of clustering by MSMEs outside EZs as a build-up to EZ integration. Given the long-term nature of EZ design, it is important that natural MSME clusters in both value chains (such as the Uhuru textile cluster and the Limuru and Kariokor leather clusters) are strengthened in terms of skills, facilities and financing, as well as in being prepped to move to EZs. But what are the requirements and support structures required to allow MSMEs interested in moving into EZs to do so?

It should be noted that there is already interest by SMEs in leveraging opportunities for clustering, which is currently only available by participating in EPZs. Tulips is an SME that independently

went through the process of relocating to the EPZ in Athi River. A key element of EZ design is the creation of a clear process that SMEs can easily plug into should they seek to be located in SEZs.

Finally, an integral element of EZ design is the need to ensure that zone development does not disadvantage firms that choose not to relocate to zones. Incentives for both larger anchor firms and MSMEs to relocate must be clear, fair and industry-driven.

### 5.3.2 Selecting MSMEs for integration

MSMEs can be upgraded to participate better in value chains and EZs by mapping their readiness level and facilitating inclusion into incubator programmes (focused more on MSEs for growth and upgrading to better pathways) or accelerator programmes (upgrading to better pathways and integrated when designing EZs).

#### *MSME readiness*

We have already discussed examples of several medium-sized enterprises such as Preca, Stealth Hides and Tulip that have been able to graduate to better pathways and export products. However, it is a far more difficult path for micro and small enterprises (MSEs) to graduate to the same extent therefore it is necessary to apply different sets of policies to these actors. We posit that it is primarily medium-scale firms that can more readily move into EZs and be factored into EZ designs, while the main aim for MSEs would be to grow and complement large firms, by supplying to them.

We have developed an MSME readiness indicator that uses four criteria to determine if an MSME is ready to be integrated into a EZ (see Table 16). Using such criteria can shed light on an MSME's readiness to absorb new investment to participate in an incubator or accelerator programme, and their potential to ultimately integrate into an EZ.

Table 16: Criteria for MSME readiness

<b>MSME readiness criteria</b>	<b>Explanation of criteria</b>
Company structure and economic criteria	The structure of the company (financial, legal, goals, sustainability), governance structure, education of owners, types of products
Capabilities, capital and technical intensity	The technical (knowledge) and managerial capabilities, the digital readiness (e-commerce use, websites, ICT), technological readiness (mechanisation), standards used
Dynamism	Adaptability and flexibility to change with sudden market shocks
Critical relevance of the pathway (capacity/ task deficit analysis)	The national, regional and world demand for the pathway, the elasticity, comparative advantage of the MSME in the pathway

Source: Authors' construction; see Appendix F on the MSME selection criteria.

We find that Tulip Ltd satisfies all of the above criteria as it has developed a formal hierarchy and is able to subcontract, thus performing a higher value-added activity, and has good social networks and technical expertise.

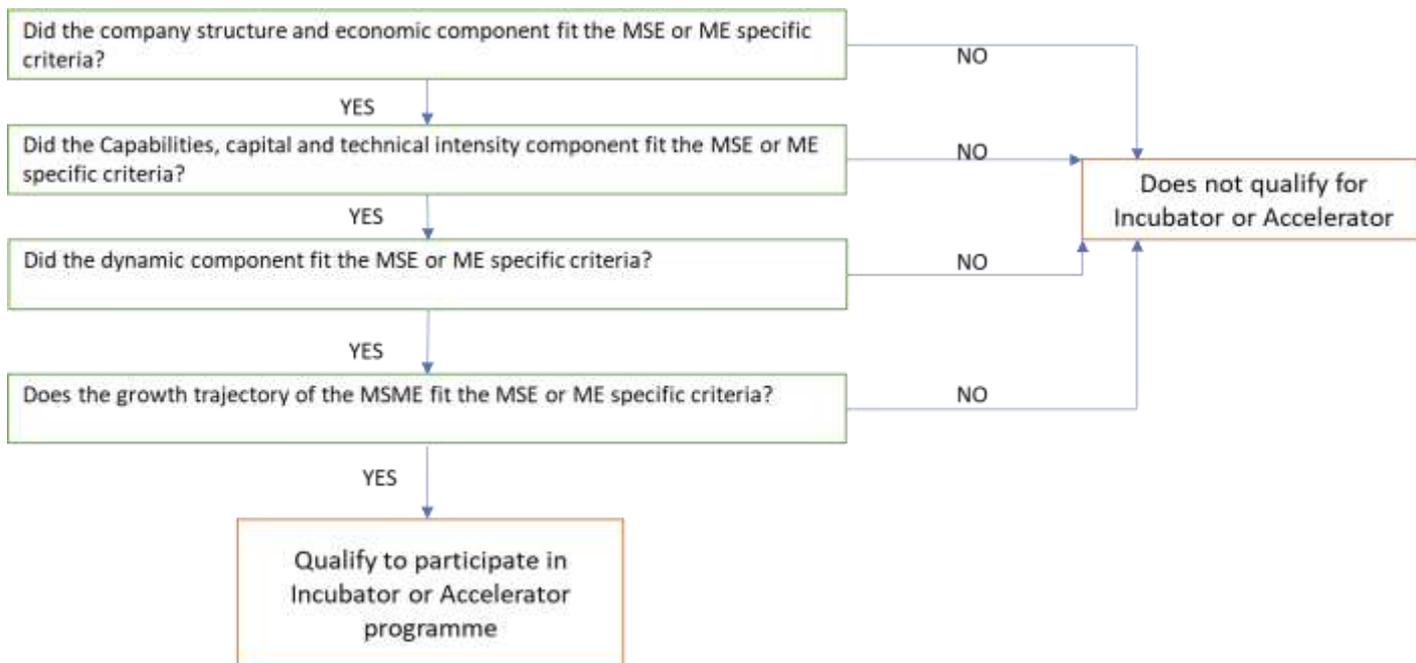
#### *Incubator and accelerator programmes*

The 'accelerator' programme facilitates the growth of medium enterprises to be standalone companies with the potential to integrate into the EZ, while the 'incubator' programme supports micro and small enterprises to grow and complement large firms in specific pathways.

Selection for the incubator programme: can be based on the MSME readiness indicators. Specific criteria can be developed in order to assess at which stage/how developed the MSE is, which can in turn determine whether it qualifies to participate in the incubator.

Selection for the accelerator programme: can be based on the MSME readiness indicators, however it is expected that medium enterprises are more advanced, and therefore should be assessed on more progressive criteria than MSEs.

Figure 12: Assessing selection into an incubator or accelerator programme



Source: authors.

Section 6.2 details the design of the incubator and accelerator programmes in more detail and highlights the key actors and next steps required to make this actionable.

*Relocation costs*

Other important factors to consider when deciding if an MSME should be factored into EZ design are the relocation costs and efficiency and labour market gains that it can bring.

Table 17: Relocation costs for improved EZ design

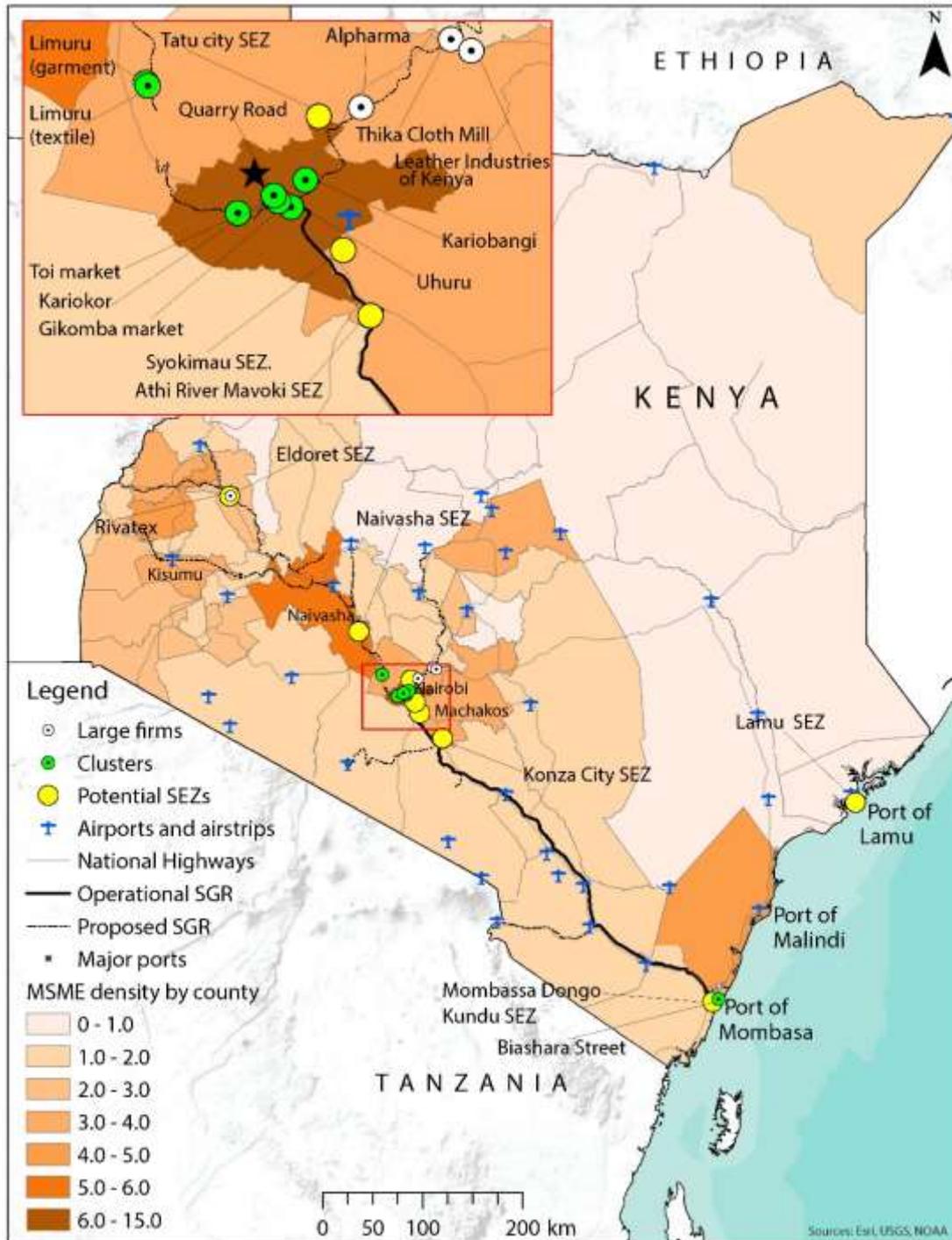
Costs to relocate	Explanation
Relocation costs	Economic, social and environmental costs of moving and the infrastructural needs required to facilitate relocation
Efficiency and labour market gains, when relocating	Increase in job opportunities, quality of jobs and efficiency per transaction

Source: Authors' construction.

Figure 13 presents a map of the MSMEs, leather, textile and apparel clusters, potential SEZs and large leather, textile and garment firms to gain insights into the spatial locations for each of these.

The map helps comprehend the possibility of re-location directly into the EZ for either MSMEs or clusters or indirectly through increasing supply of products to large firms. Clearly Nairobi and areas in its periphery are hubs of EZs, MSMEs, clusters and large firms, as they are located very close together, while the rest of the country is much more spread out. This suggests that MSMEs located in Kisumu, for example, would face more challenges to directly or indirectly integrate into an EZ, as they are located far away with limited infrastructural facilities.

Figure 13: MSMEs, potential SEZs, leather and garment clusters and firms



Source: authors.

### 5.3.3 Developing the broader ecosystem for inclusive integration

There are also a number of specific design and implementation issues relating to zones that can help MSMEs. Some relate to SEZs in particular.

#### *SEZ definition and legislation*

There is a clear need to get consensus in government, with the participation of the private sector, as to what an appropriate definition of SEZ is in the Kenyan context. This should be reflected in the provisions in the SEZ law regime which positions SEZs in Kenya as platforms through which the country can attract foreign direct investment and promote retail and wholesale trade, back office services, tourism and ICT, together with manufacturing as the engines of growth. This may require a review of existing SEZ legislation in order to ensure that SEZs play a complementary rather than competing role in the industrialisation of Kenya. Further, there are areas that need to be modified in SEZ law to address conflicts with other laws. An example is a conflict between the SEZ Act and the Income Tax Act<sup>20</sup> on the taxation of SEZ developers and enterprises. The SEZ exempts the developers and enterprises from income tax but under the Income Tax Act, the developers and enterprises are subject to tax at a rate of 10% for the first 10 years and 15% for subsequent years (KPMG, 2015). Such conflicts ought to be resolved and legal provisions in SEZs should be made clear.

#### *SEZ physical and social infrastructure*

On physical infrastructure, the government ought to make clear what facilities will be available to firms that are located in SEZs. The World Bank (2015b) makes the point that developing hard and soft infrastructure inside the zones and integrating it more effectively with the domestic market must be a priority. Further, in order to avoid the problem with good quality infrastructure stopping at the zone gates, government must address the wider trade-related infrastructure. This issue can be addressed by ensuring SEZs are, wherever possible, within or adjacent to major ports, airports, or other key trade infrastructure (ibid.).

A second element of physical infrastructure is the provision of physical space for MSMEs in SEZs. This can be done through the inclusion of SME parks in SEZs, which is already part of government strategy under Vision 2030's Manufacturing Sector and KITP. Such MSME parks can serve both as a space for industrial and business activity, as well as incubator and accelerator spaces for MSME development.

The social infrastructure of SEZs is crucial because, as the World Bank (ibid.) points out, by attracting large numbers of (usually unskilled) workers from rural areas, many zones place huge burdens on the social infrastructure of the communities in which they are based. It is important that the government thinks through the provision of quality social infrastructure, especially housing, education and healthcare, in order to attract and retain the workers needed to make SEZs successful (ibid.).

#### *Enhance private sector participation*

Given the large investments required to support zones and their uncertain return, private sector participation plays an important role in reducing the government's risk in zone programmes. Regardless of the role the private sector plays in zone development and management, greater private sector participation in strategic planning and policy decisions affecting zone programmes should be encouraged (ibid.). There are distinct areas such as energy provision or housing that are suitable for private sector investment.

#### *Coordination of SEZ design and development in the PDU*

A key element of SEZ design and development is the need to ensure that there is a focus on MSMEs and that there is a point of coordination that ensures MSMEs are well integrated into SEZs. Thus we propose an Economic Zone Development Coordination Unit. Key entities that

<sup>20</sup> <http://www.kenyalaw.org/lex/actview.xq?actid=CAP.%20470>

ought to be present in this unit are the Treasury, the Ministry of Industrialisation, SEZA, KenInvest, the Ministry of Energy, the Ministry of Lands, the Council of Governors, MSEA, KAM/KEPSA, and MSME Association umbrella bodies. It is proposed that this unit not only coordinates the relocation of qualified MSMEs into economic zones, but also manages and strengthens MSME linkages to EZ firms. The Presidency can play a useful coordinating role here.

## 6 CONCLUSIONS: ROADMAP TO POLICY STRATEGY

Based on the analysis and case studies of MSMEs described in this paper, Section 6.1 discusses cross-cutting challenges across the leather, textile and garment value chains, and highlights the necessary short- and long-term policy measures to mitigate them. These are already prioritised through our own assessments and are consistent with the findings from a recent roundtable with the President organised by Strathmore University (see Appendix G). We then proceed in section 6.2 to discuss in more detail three priority action points that are critical to ensuring the success of MSME integration in value chains. Taken together, these sub-sections provide the government with a practical roadmap for implementation.

### 6.1 Policy measures for leather, textile and garment value chains

The analysis in this paper suggests that MSMEs face five broad challenges:

1. Lack of information along the value chain which can help financiers or linkage programmes.
2. Illicit trade and counterfeiting which undermines small manufacturers.
3. Poor economic fundamentals such as infrastructure, skills and finance.
4. Lack of market access through clusters.
5. An inadequate institutional support framework for SMEs.

In the sub-sections that follow, we identify several short- and long-term policies that could be used to overcome these challenges.

#### 6.1.1 Short-term policies

Table 18 combines short-term policy measures that can be taken across MSMEs, along each value chain and with regards to SEZ development. These include the need to co-ordinate MSME development through a unit in the Presidency, targeted finance vehicles by the Biashara Bank and selected other banks<sup>21</sup> (and the design of SEZs).

Table 18: Short-term policy suggestions to integrate MSMEs with value chains

Value chain	Key policy required	Key benefits	Main actors to involve
<b>Leather</b>	Provision of info on sector along the value chain: livestock census; quality and quantity of hides collected; environmental compliance of tanneries; trade information on the African Growth and Opportunity Act and countries with demand for leather goods	Comprehensive data and analysis of the entire value chain that are regularly updated and that inspire policy and strategy for government and non-state actors	Ministry of Livestock; MOITC; Kenya Leather Development Council; Ministry of Environment; relevant SMSE associations; Kenya Private Sector Alliance (KEPSA) Kenya Association of Manufacturers (KAM); Kenya National Chamber of Commerce and Industry (KNCCI); county governments
	Development of common manufacturing facilities	High-quality leather goods and	MOITC; MSME leather associations; fashion associations

<sup>21</sup> There has been progress recently in the extent to which local banks have drawn finance from international finance institutions such as FMO, AfDB and IFC for on lending to the SME sector.

Value chain	Key policy required	Key benefits	Main actors to involve
	for leather goods subsector MSMEs	productivity for MSMEs	
<b>Textiles</b>	Provision of info on the sector along the value chain: updated data on cotton production, ginning activity and MSMEs active in textile manufacturing and weaving	Comprehensive data and analysis of the entire value chain that are regularly updated and that inspire policy and strategy for government and non-state actors	MOITC; Ministry of Agriculture;; Cotton Development Authority; relevant SMSE associations; KAM; county governments
	Commercialisation of seed varieties that have better yield to improve cotton production	Higher cotton yields for textile production	MOITC; Ministry of Agriculture; Cotton Development Authority
	Development of a strategy for the fashion subsector under the Creative Sector Policy	Stronger functional linkages between textiles production and fashion subsector	MOITC; KAM; KEPASA; KNCCI; fashion associations; handloom associations
	Development of a branding and marketing strategy for textiles and garments subsectors	Stronger investor and market interest in investment in and purchases from the subsectors	MOITC; KAM; KEPASA; KNCCI; fashion associations; handloom associations
<b>Garments</b>	Provision of information on MSME garment manufacturers and the fashion subsector	Comprehensive data and analysis of the entire value chain that are regularly updated and that inspire policy and strategy for government and non-state actors	MOITC; relevant MSME associations; KEPASA; KAM; KNCCI; county governments
	Linking EPZ companies with local manufacturers to support growth of MSMEs (e.g. using VAT exemptions)	Stronger functional linkages between EPZs and MSMEs	MOITC; EPZA; relevant MSME associations; KEPASA; KAM; KNCCI; county governments
	Development of common manufacturing facilities for fashion subsector MSMEs	High-quality garments and productivity for MSMEs	MOITC; MSME garment cluster associations; fashion associations; handloom associations
	Development of market access opportunities for MSMEs to local, region and international markets	Increased market access for MSMEs	MOITC: Export Promotion Council; county governments; annual fashion event organisers
<b>General:</b>	Inform the task force concerned with economic zone development on the definition and legislation, ensuring a level playing field and opportunities for MSMEs	Clear definition, legislation and practices of economic zones that provide opportunities to MSMEs and SEZ development	MOITC (leather, textile and SME desks); economic zone development bodies (EPZA, SEZA); relevant MSME associations; all county governments, to develop a policy framework/strategy on industrialisation
<b>Economic zone design, development and implementation</b>	Coordinate economic zone design,	Better government coordination of economic zone	MOITC; Economic Zone Task Force/Development Coordination Unit coordinated in the Presidency

Value chain	Key policy required	Key benefits	Main actors to involve
	development and implementation	design, development and implementation internally and with non-state actors	that supports MOITC economic zone financing and implementation of activities (work with and enhance SEZA)
	Enhance private sector participation, from both large companies and MSMEs	Private sector buy-in on zone design and development	MOITC; EPZA; SEZA; KAM; Kenya Private Sector Alliance; relevant MSME associations
<b>General</b>	Provision of info on value chains, e.g. KIE, MSEA and county-level government; and funding opportunities for MSMEs through Biashara Bank and private equity support	Accurate and updated info on MSME sector to better inform policy and strategy; MSMEs able to better leverage funding opportunities	Kenya National Bureau of Statistics (KBS); MOITC, especially MSEA
	Creation of an MSME readiness tool that assesses MSME readiness for financing and economic zone integration	MSMEs ready for financing and economic zone integration	MOITC; Ministry of Livestock; Ministry of Agriculture; EPZA and SEZA
	Finance vehicles by Biashara Bank and selected banks that target MSMEs	Increased access to finance for MSMEs	MOITC; Biashara Bank and banks with an MSME focus
	Establish an MSME Credit Guarantee Scheme and operationalise the MSE fund	Increased access of financing for MSMEs	Various
	Coordinate MSME development	Better government coordination of MSME development internally and with non-state actors	MSME Development Coordination/Oversight Unit in Presidency, with clear links to implementers such as MOITC
	Implement counterfeit legislation building on recent successful activities (create awareness and uptake of intellectual property)	MSMEs protected from imports of illegal and substandard goods	MOITC; Multi-agency Taskforce on Illicit Trade; Kenya Anti-Counterfeit Agency; KBS

### 6.1.2 Long-term policies

Table 19 summarises long-term policy measures that can be taken across MSMEs, along each value chain and with regards to SEZ development. These include the development of an incubator for micro and small enterprises, an accelerator programme for medium enterprises, development of a united MSME body, restructuring of MSEA and development of SEZs.

Table 19: Long-term suggestions to integrate MSMEs with value chains

Value chain	Key policy required	Key benefits	Main actors to involve
<b>Leather</b>	Value chain interventions for animal herders; abattoirs and slaughterhouses; hides and skins traders; tanneries and leather goods producers	Better-quality leather and leather goods	Ministry of Livestock; MOITC; Kenya Leather Development Council; relevant MSME associations; KAM
<b>Textiles</b>	Value chain interventions for cotton producers; ginneries; textile manufacturers	Better cotton production and textile manufacture	Ministry of Agriculture; MOITC; Cotton Development Authority; relevant MSME associations; KAM
<b>Garments</b>	Value chain interventions focused on MSME garment producers	Higher profitability for MSME garment producers	
	Develop an investment policy for economic zones with a focus on manufacturers of accessories, (trims, threads, zippers, buttons and lace)	Better garment input ecosystem for value-addition by MSMEs	MOITC; KenInvest; KAM; KEPSA; KNCCI
<b>Economic zone coordination and implementation</b>	Physical infrastructure development	Economic zone facilities that attract private sector and investors	Economic Zone Development Coordination Unit/Task Force
	Social infrastructure development	Facilities that attract and retain appropriate labour for economic zones	Economic Zone Development Coordination Unit/Task Force
<b>General</b>	Incubator for micro and small enterprises; accelerator programme for medium enterprises, drawing on those developed by KIE for example	Development of MSMEs ready for financing and economic zone integration	MOITC; MSEA, MSME associations
	Development of a united MSME body	United MSME representation led by MSMEs for coordination of sector	Relevant MSME associations
	Restructure and support MSEA	An MSEA that is supported by MSEs and is active and engaged in activities focused on MSMEs	MOITC; relevant MSME associations
	Cheap, reliable and accessible electricity	Affordable and high-quality electricity for MSMEs	Ministry of Energy; MOITC
	Skills development	Better-skilled, productive and profitable MSMEs	MOITC; Ministry of Education; Technical and Vocational Education and Training Authority

Appendix H includes an implementation matrix across each value chain and, across that, details how the policy priorities can be implemented through short- and long-term measures. This matrix lays out the policies and tasks each actor needs to undertake, and highlights the specific departments and agencies that need to be involved to ensure efficient implementation.

## 6.2 How to proceed: three policy actions

Having discussed several policy priorities for the short and long term, we need to consider how to proceed and to prioritise actions further. Based on discussion and appreciation of the current policy and institutional framework, we put forward three steps that the Office of the President can spearhead now:

*1. Restructure MSME support structures such as MSEA by feeding into current reviews by the Government of Kenya:* Institutions supporting MSME development are fragmented on both the public and the private sides, leading to the neglect of MSMEs' interests. The Executive Office of the President can coordinate government actions towards MSMEs, promote a change in the governance of MSEA, increase the transparency of MSME integration and create a hotline for MSMEs. There is some value in central coordination, but clearly any restructuring needs to take into account existing reviews and, when appropriate, enhance the activities already implemented by line ministries such as MOITC. The Office of the President should:

Co-ordinate government actions towards MSMEs: the Presidency could kickstart a streamlined co-ordination unit which ensures there is co-ordination across ministries towards MSMEs. This could involve forming a committee from representatives across the relevant ministries, business associations and the private sector, to meet quarterly to discuss the progress of MSME integration into value chains. It can be modelled under the regular SME forum suggested by the President.

Promote a change in the governance of MSEA: the current governance structure within the MSEA has been ineffective due to lack of leadership and unequal representation across the *jua kalis*. This prevents the MSEA from acting as a cohesive organisation.

Increase transparency of MSME integration: hold a regular SME forum with various stakeholders to invite feedback on the current situation and the quality of programme implementation. See Appendix G for a note on the most recent SME forum at Strathmore Business School, held in October 2018.

Establish a hotline for MSMEs: one of the support structures the MSEA should provide is a telephonic one-stop-shop to answer questions raised by MSMEs regarding access to inputs, trade-related issues, grievances they face selling to large players, and support on application processes.

*2. Introduce more and better dedicated incubator and accelerator programmes –* Many MSMEs are not ready for linkages, but some are or can be prepared with support. An incubator programme could start with promising MSMEs such as those in the Kariokor leather cluster and Uhuru garment cluster. It will be important to be informed by and/or support existing government structures in this area, such as incubator and accelerator programmes provided by KIE. Before rolling out incubator and accelerator programmes across the country, it is necessary to pilot it. Stage 1 would involve selecting MSEs that qualify for participation in an incubator programme. Appendix F has a checklist to help the government decide which MSMEs it needs to incubate or accelerate. The selection helps to identify which MSMEs are most likely to be able to absorb new capabilities and use investment productively to grow. This makes a critical business case for how much to invest and the returns thereafter. Once applicants are selected, the next stage is to offer places in the incubator or accelerator programme, depending on whether they are MSEs or medium-sized enterprises.

The incubator and accelerator programmes could focus on the leather and garment value chains and start with *around* 100 MSEs in Kariokor working with footwear and fashion accessories and 100 MSEs in the Uhuru garment cluster making garments. The programme could offer support and training for varying lengths of time depending on the complexity of the activities, and should be provided flexibly so as to minimise disruption to the day-to-day work of MSMEs. The courses will need to be benchmarked and certified to East African Community/Africa/ international standards or be created in discussion with large firms, multinational corporations and civil society organisations to develop a dynamic course (topics could include digital and technical capabilities, marketing and networks, management capabilities and finance skills). The incubator and accelerator programmes could be set up as a public–private partnership (PPP), with the government providing classroom space and subsidising the costs of MSME attendance, while the costs of staffing could be covered by private sector or international organisations. This shared cost model could also include support for the mentorship of MSMEs in the incubator and accelerator programmes that help them leverage and make use of any training received.

3. *Involve county governments:* Develop a framework for engagement with and by county governments in coordination with MOITC and private sector actors.

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## APPENDIX A: LIST OF INTERVIEWS

Type of stakeholder	Respondent name	Position	Organisation
Bank association	Roselyn Njino	Senior Communications Officer	Kenya Banker's Association
MSME – private	Andrew Simiyu	CEO	Stealth Hides Tannery
Business association	Elkana Epiche	National Leather Textile Secretariat Committee	KNCCI
Large player – private sector	Rudolf Isinga	Group Administration Manager	New Wide Garments
State corporation – National Government	Evelyn Noah	Linkages & Resource Mobilization, Research, Strategy & Compliance Directorate	EPZA
Large player – private sector	Niaz Hirani	CEO	LIK and KAM Leather Sector Chair
MSME – private sector	Mukunjura	3 SMEs-co-ordinator	Dagoretti Slaughterhouse
MSME – private sector	Davis Njehia	CEO	Tulip Collections
State corporation – National government	Carole Kariuki	SEZA Chairperson	SEZA
State corporation – National government	Charles Mahinda	Support and SEZ Project Coordinator	SEZA
Cluster	Kariokor Cluster Representatives	Leather	Kariokor cluster
State corporation – National government	Rajeev Arora	Ministry of Industry, Textile desk	Ministry of Industry
State corporation – National government	Yassin Awale	Leather Desk	Ministry of Industry
State corporation – National government	Florence Kimata	SME desk lead	Ministry of Industry
Business association	Abel Kamau	Textile Advisor	KAM
MSME – private sector	Daniel Kinuthia	CEO	Preca Limited
State corporation – National government	Nancy Muya	CEO	MSEA
State corporation – National government	Isaack Noor	CEO	Kenya Leather Development Council
Large player – private sector	Tejal Dodhia	CEO	Thika Cloth Mill

Bank	Connie Macharia and Enodius Makiwa	Tier 2 bank for SMEs	I&M BANK- TIER 2
Bank	Mary Wamae	Group Executive Director	Equity Bank
International organisation	Paul Mutungi	Resilience Advisor	Food and Agriculture Organization
Cluster	Ng'ang'a	Textiles MSE Cluster Chairman	Uhuru Textiles Market

## APPENDIX B: LIST OF FIRMS IN EPZS AND INDUSTRIAL PARKS (AS AT 2017)

Name of EPZ/ industrial park/ cluster	Zone status	Zone investment (Ksh m.)	No. of firms in zone registere d	No. of jobs	Total exports (Ksh m.)	Firms' investment (Ksh m.)	Key products
Africa Apparel EPZ Ltd/Sunflag	Multi	679.045064	2	1,749	1340.53503	1540.257679	Apparel
Alpha Logistics Services EPZ Ltd (Plot 164)	Multi	67.972754	1	110	1371.88841	2197.785708	Logistics
Alpha Logistics Services EPZ Ltd (Block 150)	single	63.810714	1	10	0	791.575867	Logistics
Ammar EPZ Ltd (formerly Emirates Changamwe)	Multi	131.037824	1	9	449.611948	621.957182	Real estate and logistics
Ammar EPZ Ltd (formerly Emirates Jomvu)	Multi	300	1	4,966	4272.067875	1300.263184	Real estate and logistics
Asante Capital EPZ Ltd	Multi	107.170551	1	42	2.233656	250.06462	Forestry, tropical crops, wood processing
Ashton Apparels EPZ Ltd(Coast Industrial Park)	Multi	46	0	0	0	0	Apparel
Athi River EPZ Ltd	Multi	6354.3	67	18,878	23702.32097	33271.28207	Apparel, cotton yarn, human and veterinary pharmaceuticals, sisal dartboards, gemstones,

							computers, food processing, tanning products
<b>Avo Health EPZ Ltd</b>	Multi	60.347594	1	1	0	43.652406	Human and veterinary pharmaceuticals
<b>Ayman Industrial Park EPZ Ltd</b>	Multi	40	1	791	561.189592	150.830446	Manufacturing- lead ingots & alloys
<b>Balaji EPZ Ltd (formerly Indigo)</b>	Multi	37	2	7,680	5301.253166	6674.608965	Manufacturing - garments
<b>Bedi Investments EPZ Ltd</b>	single	55	1	760	116.328289	150	Garments; men, boys, toddlers denim pants
<b>Biocorn Products EPZ Ltd</b>	single	733.240478	1	59	0	2363.833924	Developer and manufacturing – furfural, acetic & formic acid
<b>Chebango EPZ Tea Co. Ltd</b>	Multi	301.795901	1	81	621.802977	553.574533	Tea processing and packaging
<b>Comarco Properties EPZ Ltd</b>	Multi	38	2	255	136.040164	4533.855895	Services - fabrication of sea-going vessels
<b>De La Rue Currency and Security print EPZ Ltd</b>	Single	2154.7085	1	305	1338.769966	4001.6015	Zone developer/ operator and manufacturing – currency and security documents production
<b>Forest Gate EPZ Ltd</b>	Multi	50	1	433	1345.694146	395.138232	Premium and prepared vegetables, roses
<b>German Kilifi EPZ Ltd</b>	Multi	110	1	67	16.29228	10.797905	Commercial – O-rings
<b>Gold Crown Foods EPZ Ltd</b>	Single	150	1	475	3285.483001	3949.768056	Manufacturing – tea blending and packaging
<b>Goodison 218 EPZ Ltd</b>	Multi	268.866	1	342	20.065825	100	Horticulture packaging and processing

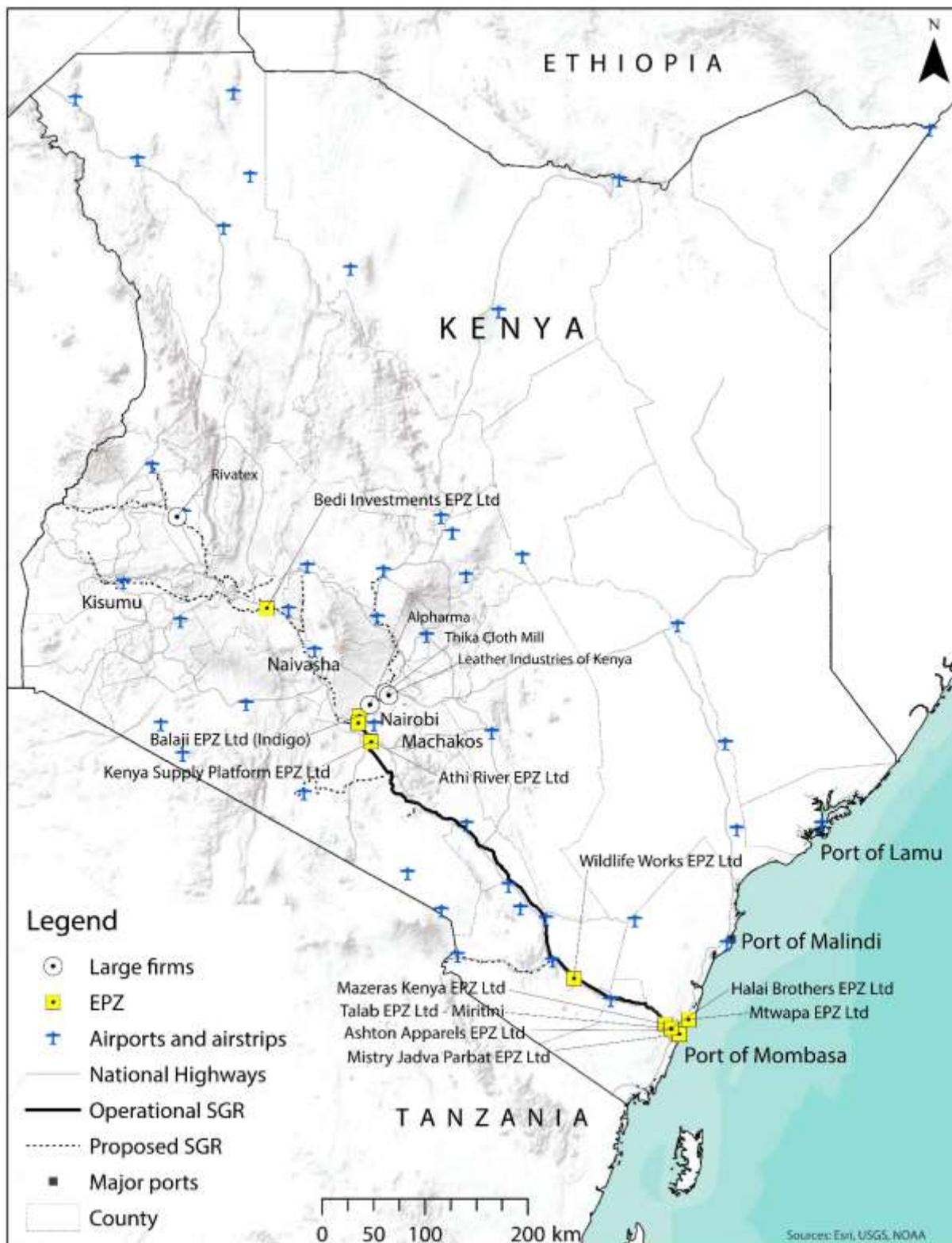
<b>Halai Brothers EPZ Ltd</b>	Multi	48	1	2,784	2301.473889	1378.773736	Apparels
<b>Hopetoun EPZ Ltd</b>	Multi	15	2	228	167.434687	599.306738	Manufacturing – avocado, macadamia nut oils
<b>Keben Business Park EPZ Ltd</b>	Multi	26.124131	1	228	655.253485	577.012	
<b>Kenya Fluorspar EPZ Ltd</b>	Single	100	1	1	158.832054	919.146	Processing of fluorspar
<b>Kenya Supply Platform EPZ Ltd</b>	Multi	45	1	1	0	12.605	Apparel, suppliers, waste recycle
<b>Kinanie EPZ Ltd</b>	Multi	1200	0	0	0	0	
<b>Kingorani EPZ Ltd*</b>	Multi	246.36	3	253	1267.950553	706.251755	Plastic bottle flakes
<b>Kipevu EPZ Ltd</b>	Multi	1080	3	37	0	335	Service – construction of industrial buildings for EPZ firms and container handling services.
<b>Laburnum Investments EPZ Ltd - Changamwe (formerly Kapric)</b>	Multi	400	2	1,946	1949.239126	645.695021	
<b>laburnum Investments EPZ Ltd - Miritini (formerly Birch)*</b>	Single	230.2002	0	0	0	0	
<b>Mara Tea Factory EPZ Ltd</b>	Multi	233.970814	1	20	0	125.013671	Tea processing and packaging
<b>Mazeras Kenya EPZ Ltd</b>	Multi	77.601	1	2,686	1764.603723	267.345445	Knit garments

<b>Milstar Investments EPZ Ltd*</b>	Multi	130	0	0	0	0	
<b>Mistry Jadva Parbat EPZ Ltd</b>	Multi	74	1	2,203	1589.134624	750	Garments
<b>Moringa For Life EPZ Ltd</b>	Multi	427.8374	1	128	19.8368	230.373984	Herbal medicines
<b>Mtwapa EPZ Ltd</b>	Multi	332.5	1	5	0	17.5	Garments
<b>Mvita Industrial Park EPZ Ltd</b>	Multi	131.548404	0	0	0	0	
<b>Privamnuts EPZ Kenya Ltd</b>	Single	318.751763	1	339	256.723051	459.193775	Macademia
<b>Organic Growers &amp; Packers EPZ Ltd</b>	Multi	494.2	1	79	84.317438	211.8	Horticulture growing, packaging and processing
<b>Ravco Kenya EPZ Ltd</b>	single	5	1	21	1017.583238	579.243489	
<b>Revital Healthcare EPZ Ltd</b>	Multi	280	1	255	288.532015	758.85	Manufacturing – plastic disposable syringes
<b>Samburu EPZ</b>	Multi	200	0	0	0	0	
<b>Sameer Industrial Park EPZ Ltd</b>	Multi	265.421	7	943	1429.528642	936.023871	Developer/operator
<b>Sasini EPZ Park Ltd</b>	Multi	300	1	1	0	150	Macademia
<b>Saw Africa EPZ Ltd</b>	Multi	54	2	1,947	809	500	Manufacturing – processing of macademia/edible nuts
<b>Siomo Tea Factory EPZ Ltd</b>	Multi	382.578311	1	158	277.179104	578.005757	Tea processing and packaging

<b>Stegro EPZ Tea Factory Ltd</b>	Multi	214.5	1	2	0	115.5	Tea processing and packaging
<b>Swati Investments Co. EPZ Ltd</b>	Multi	65	1	2	0	5	
<b>Talab EPZ Ltd - Miritini (formerly Zois)</b>	Multi	100	1	1,777	766.415069	362.416182	Garments
<b>Talab EPZ Ltd - Mtwapa (Formerly Zois)*</b>	Multi	300	1	1,540	2015.735556	188.362814	Garments
<b>Talab EPZ Ltd - Mtwapa (opposite Former Zois)</b>	Multi	285	1	1	0	15	Garments
<b>Taurus EPZ Ltd</b>	single	467.6	1	35	0	200.4	Manufacturing – pharmaceutical formulations including allopathic, herbal or ayurvedic medicines
<b>Vipingo Business Park EPZ Ltd</b>	Multi	195	1	1	0	5	
<b>Wildlife Works EPZ Ltd</b>	Multi	218.838175	2	130	28.547977	56.357305	Manufacturing – garments

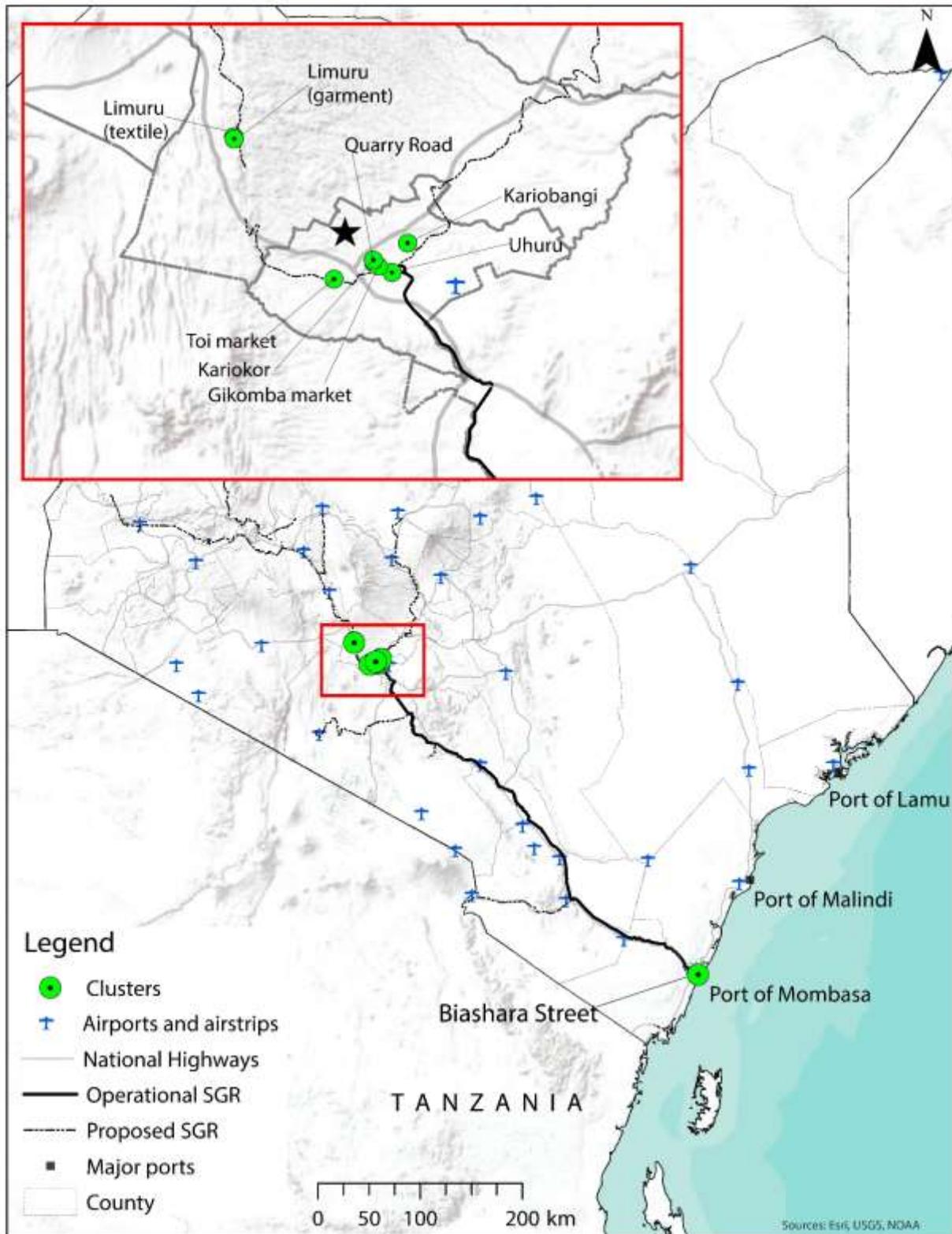
Source: Collated from EPZA annual reports and data files, and company websites.

## APPENDIX C: MAP OF LEATHER, TEXTILE AND GARMENT EPZs



Source: authors.

## APPENDIX D: MAP OF CLUSTERS



Source: authors.

## APPENDIX E: LEATHER VALUE CHAIN TRAINING FOCUS

There is need for training along the value chain: animal herders need to be trained by animal health and husbandry extension officers on issues such as disease prevention and treatment and parasites in livestock, appropriate cattle branding and livestock nutrition for high quality hides and skins production. Animal-herding communities also ought to be trained on the value of hides and skins and how to earn income through quality hide production.

At the abattoirs and slaughter-house stage there is a need for training interventions at both slaying, and storage and sale stages as follows:

- Slaughterhouses
  - Training on proper flaying techniques and provision of tools for flaying
  - Adoption of technology in flaying such as hide pulling machines
  - How to handle hides and skins in the abattoir/ slaughterhouse.
- Hides and skins traders
  - How to cure hides and skins: drying processes and techniques, how to avoid moisture and 'greening'
  - How to treat hides and skins to deter pests
  - What chemicals to use in hides and skins preservation
  - How to grade hide and skins
  - How to transport and handle hides and skins.

Tanneries can be trained on how to improve environmental compliance in line with the Leather Working Group (LWG). This can be an area for focused training for tanners who are not using the most up-to-date chemicals in their tanning processes. Micro tanners ought to be trained on basics such as modern tanning methods, and how to manage hazardous tanning-related chemicals. Both segments can be upskilled in how to produce better quality leather from hides and skins.

Leather goods producers ought to be trained on how to access export markets, particularly AGOA. MSMEs in the segment ought to be trained on how to improve the quality of goods produced as well as on how to expand the range of goods sold.

## APPENDIX F: MSME READINESS QUESTIONNAIRE

Components	Sub-components	Do they meet the criteria (Y/N)?  (to be filled by auditor)
<b>Company structure and economic criteria</b>	Does the MSME have clear future goals?	
	Is the current product type niche, small batch, high value, low value?	
	Is the current governance structure clearly defined?	
	What are the current input dependencies into product?	
	Is there a clear legal structure?	
	Is there a clear financial structure and knowledge around financing options?	
	What are the opportunities for market growth?	
	What is the level of education of the owners?	
	Does the company have a sustainability agenda?	
<b>Capabilities, capital and technical intensity</b>	What is the skill-level breakdown of the MSME? High versus low skill?	
	Do companies have sufficient management competence?	
	Are there brand management and marketing personnel in the MSME?	
	What is the digital readiness level of the firm?	
	Is the firm able to absorb and utilise new technologies easily?	
	What is the manufacturing readiness level of the firm?	
	Does the firm have any patents or in the process of acquiring any? (i.e. what is the innovation potential of the firm? Does the firm invest in research and development?)	
	Does the company have the requisite regional or international standards?	
<b>Dynamism</b>	Has the MSME been able to respond quickly to a change in the tasks expected of it?	
	Has the company been able to adapt itself and technology to diversify and upgrade?	
	Does the MSME have strong social networks it can mobilise?	
	Does the MSME have a capital buffer to tide over times of shock?	
	<b>Criticalness of the pathway (capacity/task deficit analysis)</b>	Does the MSME have a comparative advantage in the pathway?
Has the MSME responded to shocks in the past? (e.g. filled a capacity deficit of a large firm, quick turnaround of product)		
What is the job creation potential?		
Is there scope for market diversification?		

## APPENDIX G: NOTES FROM STRATHMORE BUSINESS SCHOOL'S MSMEs FORUM

Strathmore Business School hosted a two-day event in October 2018 with the President on the role of MSMEs in value chains. The agenda included breakout sessions and presentations on agro-processing, aquaculture, construction, livestock, textiles and garments. This appendix provides a summary of the most relevant issues discussed during the forum.

### MSMEs in leather value chains:

Key opportunities identified for MSMEs in the leather value chain include:

- establishment of a leather business hub to aid in market access and encourage innovation
- utilisation of common manufacturers' facilities to improve quality of workmanship in the *jua kali* sector.
- maximum penetration in Kenyan market due to growing demand of high quality leather products among the middle class.
- skills development in the *jua kali* sector by technical training institutions.
- Buy Kenya Build Kenya. Presidential directive for all state agencies to source locally produced goods.

Enablers identified in the sessions ranged from:

- skills training; technical training institutes and vocational schools
- branding framework; Brand Kenya
- enforcing standards within sector; KEBS
- access to finance; BMOs/associations
- innovation; design studios in CMFs.

The main areas where government intervention was deemed necessary were around:

- establishment of a leather business hub to market products and source for raw materials
- increasing common manufacturing facilities
- operationalising existing facilities in KITI, KIPI, KIRDI
- design studios to be hosted in TPCSI, KITI Mombasa and KITI Nakuru
- creating a mechanism to de-risk access to finance for MSMEs
- developing market linkages through international and local trade fairs and exhibitions
- sensitising MSMEs on the use of Made in Kenya brand for locally produced goods
- introducing subsidies for imported accessories used in the manufacture of leather goods
- building capacity of associations to provide business development services to members.
- protection of intellectual property.

### MSMEs in textile and garment value chains

Key opportunities identified for MSMEs in the textile and garment value chain include:

- increasing production of raw materials for textiles e.g. more cotton farms
- better power access e.g. support for individual power production and other ways of driving cost down
- government should stop being producers and empower other stakeholders to provide services
- growing the brand – Buy Kenya Build Kenya, Made in Kenya
- opening up policy directives to local service providers: subs for plastic bags can all be locally made

- Introducing direct flight between Kenya and the United States to implement AGOA via small quantities
- harnessing technology e.g. use of social media for brand growth
- accessing to finance through innovative products and services from banks and other institutions
- accessing training opportunities especially through multilateral organisations like the World Bank
- opportunities for export promotion council to increase market access.

*Enablers identified in the sessions ranged from:*

- replacing cheap low-quality material from China. There is a need to replace this by growing quality local textile production and consumption and introducing customer awareness campaigns
- encouraging health competition among markets between manufacturers and traders on how to price relative to quality, with cooperation needed between markets to set prices
- scaling down of tax on additives to reduce production cost
- providing access to affordable finance, risk-sharing/guarantee to avoid reliance on collateral
- creating new marketing channels through exhibitions
- developing modern, secure, affordable space with good occupational health considerations.

*The main areas where government intervention was deemed necessary were around:*

- implementing and enforcing a legal framework for Buy Kenya Build Kenya with government leaders personally leading by example; targeting good quality school bags made in markets; targeting one day in the week to be an 'Africa attire day'
- ensuring unified business licensing (fire, machine, trading etc.) e.g. replicate the current experience in Nakuru county
- providing support around intellectual property to get names back (Kikoi and Kiondonames, brand theft)
- providing vocational training targeting two specific audiences
  - o for MSEs, especially in financial management (bookkeeping, taxes etc). Ensure training is free, accessible and practical for youth (no hidden costs e.g. examination fees) especially
  - o for SMEs focus on increasing efficiency and productivity through custom-made courses
- securing larger physical spaces for modern markets that are secure, clean and affordable
- establishing County Special Economic Zones that enhance existing markets
- providing seed and early stage financing from Biashara Bank (grants, below market rate loans, patient and flexible)
- realigning existing financing e.g. the Indian Development Bank fund to enable entrepreneurs to become job creators
- providing better linkages between nodes in the value chain that exist in and outside markets
- recognising fashion designers as an integral part of the textile value chain
- improving local production of cotton and other fabrics (silk, synthetics, etc.) by bringing the key agricultural and technical players into the conversation.

## APPENDIX H: IMPLEMENTATION MATRIX

This appendix contains an implementation matrix, detailing what each actor needs to do to implement the policy suggestions in Section 6. This study can only provide general steps and each actor will need to formulate specific plans. The list of actions is not exhaustive and focuses on selected key actions (more actions are listed in Section 6 and further analysis is required to put these in an implementation matrix).

### Key leather sector interventions

Short-term interventions (January–June 2019)

Name of the actor	Key short-term measures required	Specific departments/agencies
Ministry of Livestock	Provision of information: livestock census, and quality and quantity of hides collected	Kenya Leather Development Council
Ministry of Industry	Information on quantity and quality of leather goods produced; trade information on AGOA and countries with demand for leather goods	Ministry Leather Desk
Ministry of Environment	Focus on environmental compliance of tanneries	NEMA National Environment Monitoring Authority
County governments (Council of Governors)	Provision of information on the sector along the value chain: livestock census, quality and quantity of hides collected, environmental compliance of tanneries	County governments with significant livestock populations and abattoir/slaughterhouse capacity
Private sector and MSEs associations	Provision of information on the sector along the value chain: livestock census, quality and quantity of hides collected, trade information on AGOA and countries with demand for leather goods	KAM, relevant MSE associations

## Long-term interventions (January 2019–2022)

Name of the actor	Key long-term measures required	Specific departments/agencies
Ministry of Livestock	Value chain interventions for animal herders, abattoirs and slaughterhouses, and hides and skins traders	Kenya Leather Development Council
Ministry of Industry	Value chain interventions for tanneries and leather goods producers	Ministry Leather Desk
County governments (Council of Governors)	Value chain interventions for animal herders, abattoirs and slaughterhouses, hides and skins traders, tanneries and leather goods producers	County governments with significant livestock populations and abattoir/slaughterhouse capacity
Private sector and MSE associations	Value chain interventions for animal herders, abattoirs and slaughterhouses, hides and skins traders, tanneries and leather goods producers	KAM, abattoirs, slaughterhouses, Kenya Tanners Association, Kariokor leather cluster

## Key textile and garment sector interventions

## Short-term interventions (January–June 2019)

Name of the actor	Key short-term measures required	Specific departments/agencies
Ministry of Agriculture	Provision of information on the sector along the value chain: updated data on cotton production and ginning activity	Cotton Development Authority
Ministry of Industry	MSMEs active in textile manufacturing and weaving; Provision of information on MSME garment manufacturers	Ministry Textile Desk Ministry SME Desk
County governments	Provision of information on the sector along the value chain: updated data on cotton production, ginning activity and MSMEs active in textile manufacturing and weaving; Provision of information on MSME garment manufacturers	County governments in cotton growing and ginning areas; and with textile and garment manufacturers
Private sector and MSE associations	Provision of information on the sector along the value chain: updated data on cotton production, ginning activity and MSMEs active in textile manufacturing and weaving; Provision of information on MSME garment manufacturers	KAM Uhuru textile cluster

Long-term interventions (January 2019–2022)

Name of the actor	Key long-term measures required	Specific departments/ agencies
<b>Ministry of Agriculture</b>	Value chain interventions for cotton producers and ginneries	Cotton Development Authority
<b>Ministry of Industry</b>	Value chain interventions for textile manufacturers; value chain interventions focused on MSME garment producers	Ministry Textile desk Ministry SME desk
<b>County governments</b>	Value chain interventions for cotton producers, ginneries and textile manufacturers; value chain interventions focused on MSME garment producers	County governments in cotton growing and ginning areas; and with textile and garment manufacturers
<b>Private sector and MSE associations</b>	Value chain interventions for cotton producers, ginneries and textile manufacturers; value chain interventions focused on MSME garment producers	KAM Uhuru textile cluster