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POLICY IMPLICATIONS FOR PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KENYA

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ABSTRACT

Background: Small and Medium Enterprises (SMEs) are engines of growth, vital to most economies. While Kenya's SMEs continue to create numerous jobs and boost the country's GDP, they face a myriad of challenges that always hamper their performance. SMEs are hindered by inadequate capital, limited market access, poor infrastructure, inadequate knowledge, skills, and rapid changes in technology. Unfavorable regulatory environments present other bottlenecks to this vital cog of the economy.

Study Objective: The aim of this paper was to determine the policy implications for performance of SMEs in Kenya. The specific objectives were to identify the key factors influencing performance of SMEs in Kenya; to determine the challenges faced by SMEs in Kenya and to provide policy recommendations on performance of SMEs in Kenya.

Methodology: This study applied a systematically review of recent literatures including a critical analysis of empirical of past findings on the subject matter. The study findings indicated that finance and access to new markets remains the most critical challenge affecting the SMEs in the country.

Conclusions and Recommendations: The study concludes that SMEs inadequate finances and technical knowledge significantly affects the performance of the SMEs. The study recommends on increased innovation and productivity by strengthening the SMEs through, incentives, financial grants and technical assistance.

Keywords: *Financing, Innovation, Markets, Challenges, Performance, SMEs & Kenya*

1.0 Introduction

The paper presents the context of policy implications for performance of small and medium enterprises. This is presented from a Global, Africa and Kenyan perspectives. The roles played by SMEs in the economy, factors influencing their startups, Internal Policies/ External (Government) Policies and the overall performance of SMEs is presented.

The SMEs industry is actually significantly viewed as an important motor for job production, work creation and also economic development (World Bank, 2020). This has been actually demanded by the raising understanding within the government that large tasks in the commercial market are much less most likely to generate the requisite employment opportunities, given the high capital-intensity of outcome in the field. The SME sector is progressively being acknowledged as the key driver for economic growth in the developing and developed countries (Ngetich, 2020). In most countries across the world, the level of economical reliance on SMEs has increased in recent years.

Small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms which employ fewer than a given number of employees (Srinivasan & Srinivasan 2022). This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as in the European Union (Garrido-Prada, 2021). However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees (Pilz, *et al*., 2020). Undertaking comparative VET research in international teams: The example of exploring recruitment and training cultures in SMEs in Germany, Australia and the United States (Kilimis, Lehmann & Berger, 2019). Just as the requirements for the categories differ per nation, so do the names and abbreviations. The EU, the United Nations (UN), and the World Trade Organization (WTO) commonly use SME, whereas in the United States these firms are frequently referred to as small-to-mid-size businesses (SMBs (Dalton, 2020). The challenge of engaging with and reporting against the SDGs for SMEs such as Sydney Theatre Company. Elsewhere, in India, they go by the name MSMED, or micro, small, and medium enterprise development (Singh *et al*., 2019).

Regionally, SMEs contribute significantly to the economic development of Sub-Saharan African countries through job creation, GDP, poverty reduction, women's empowerment, and support for large corporations (Abisuga-Oyekunle & Muchie, 2020). According to Nieuwenhuizen (2019), a South African study, SMEs contribute significantly to economic development and improve the discovery and utilization of new markets. The majority of SMEs in Kenya are small businesses with fewer than ten employees, and 70% of them are run by a single person. The majority of SMEs are small businesses with fewer than ten employees, and 70% of them are run by a single person. (Azzan, 2021). This suggests that majority of SME business owners are operating at the bottom of the economy, with a considerable percent falling amongst the 53 percent of Kenyans living below the poverty line of USD 1 each day (Kathambi *et al*., 2021). The last are largely for subsistence and take part in economically uncompetitive activities both in metropolitan as well as rural area (Esaku, 2020).

In Kenya, a recent World Bank report ranked the nation at number 61 out of the 190 economic situations tasted for the survey in terms of regulatory high quality and also effectiveness for organization startup, obtaining credit report, trade across the border, ease of operating, paying tax obligations, to name a few (World Bank Report, 2020). The authorities as a result require recognizing and dealing with any type of governing restrictions that are crucial in the effective performance of companies, specifically the SMEs (Muathe & Otieno 2022).

1.1 Small and medium-sized enterprises

Small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms which employ fewer than a given number of employees (Srinivasan & Srinivasan 2022). The most commonly used denominator for a definition is the number of employees, followed by turnover and assets (MSEA, 2021). This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as in the European Union (Garrido-Prada, 2021).

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1.2 Roles of SMEs in the Economy

Small and medium-sized enterprises (SMEs) play an important role in the economy despite their small size. SMEs are important in most economies, especially in developing countries (Nizaeva & Coşkun, 2018). SMEs account for the vast majority of businesses worldwide, and they play an important role in job creation and global economic development (Kot *et al*., 2020). They account for roughly 90% of businesses and more than 50% of global employment. In emerging economies, formal SMEs contribute up to 40% of national income (GDP) (Kaggiah, Salimi & Morton, 2022). The SMEs industry is widely regarded as an important engine for job creation, economic development, and job creation (2020). This has been necessitated by the growing understanding within the government that large tasks in the commercial market are much less likely to generate the required employment opportunities, given the field's high capital-intensity of outcome (Wilson & Makau, 2018). The SME sector is increasingly being recognized as the primary driver of economic growth in both developing and developed countries (Ngetich, 2020). The level of economic reliance on SMEs has increased in most countries around the world in recent years.

Micro and Small Enterprises, more than any other sector, play a significant role in creating employment opportunities for a large percentage of Kenyans. According to the Republic of Kenya Economic Survey (2020), 720,000 (86%) new jobs were created in the informal MSE sector, compared to 120,000 (14%) in the formal sector (Kiveu, Namusonge, & Muathe, 2019). This compares to 700,000 new jobs created in the informal Micro and Small Business market in 2014 and 100,000 in the formal industry (MSEA, 2021). SMEs serve as incubators for medium and large-scale markets, which are necessary for industrialization. The demand for key management methods in SMEs to improve functionality has been a topic of discussion and emphasis, as many policymakers believe that these are critical in improving the SMEs market and the overall economic situation. Because market conditions are more active, and competition is more intense. SMEs in Kenya and other countries are developing initiatives to understand how SMEs can maintain and improve their financial, advertising, and marketing performance. Some strategy and tactical experts have encouraged businesses to implement calculated administration methods in order to compete (Baariu, Gathungu, & Ndemo, 2021).

1.3 Sectors of the economy where SMEs are found

Majority of the SMEs in the economy are under wholesale & retail trade; repair of vehicles at 57.1% followed by manufacturing at11.2%. Others are accommodation and food service activities (8.8%), financial & insurance services (4.2%), education (2.4%), transportation & storage (1.0%), administrative & support services (1.6%), professional scientific and professional services (1.1%), arts, entertainment recreation (0.9%) and ICT (0.8%) (MSEA, 2021).

1.4 Factors influencing SMEs startups

Several factors affect the performance of SMEs proposed including entrepreneurial aspect, competence of human resource, innovativeness, and sustainability. Setha (2018) distinguished five main environmental factors affecting organization formation: social; economic; political; infrastructure development; and market emergence factors. In Kenya, a recent World Bank report ranked the nation at number 61 out of the 190 economic used for the survey in terms of regulatory high quality and also effectiveness for organization startup, obtaining credit report, trade across the border, ease of operating, paying tax obligations, to name a few (World Bank Report, 2020). The authorities as a result require recognizing and dealing with any type of governing restrictions that are crucial in the effective performance of companies, specifically the SMEs (Muathe & Otieno 2022).

2.0 Policy Implications

The key internal and external factors and policies that have a direct impact on the SME performance include capital financing, accessibility to loans, taxation, licensing, government policies and regulations.

2.1 Definition of policies

Internal policies involve the development of legislations by the SMEs, methods, and treatments to control their operations several of the plans consist of; capital financing and ease of access to loans. While external government policies include the advancement of laws by the government to govern SME procedures, some of the external policies include tax and also licensing.

2.2 Internal Policies

Capital financing is one of the significant obstacles to local business growth. The lack of monetary markets in creating nations like Kenya worsens the trouble. Small business proprietors discover it tough to obtain funding to increase their procedures, and they are often challenged with concerns such as security, feasibility studies, as well as strange financial institution costs. This implies they are unable to obtain the cash they need to increase (Nzive, 2020). Absence of expertise regarding where to get financing, limiting loaning offered by industrial financial institutions, lack of accessibility to fund, inadequate financing, lack of record needed by banks, restricted access to collateral, as well as the fact that financial institutions do not have appropriate framework for handling SMEs are all examples of finance-related concerns. Accessibility to capital is important for SMEs to improve their competitiveness because they should buy brand-new technology, skills, and development. Issues of access to finance cannot be solved by established financing strategies or initiatives in a vacuum cleaner. Institutional troubles exist at all degrees, from the macro to the micro, and they are accompanied by capacity shortages (Muturi & Njeru, 2019).

Availability to lending is an additional internal policy for SMEs, Financing, especially medium-to lasting financing, is mentioned by SMEs as the most significant obstacle to development and financial investment. There are two sorts of impediments. Deficiencies in both the macroeconomic as well as microeconomic contexts create problems in the least developed countries, in addition to numerous changes and developing economies: High budget deficits, varying exchange rates, and a complicated lawful, governing, as well as administrative atmosphere all make it tough for SMEs to get finance (Omondi & Jagongo, 2018). Awinja and Fatoki (2021) carried out a study on the impact of Biashara Boresha Loan (BBL) on the performance of Micro and small Enterprises had by Kenya Commercial Bank (KCB) Ruiru branch consumers to assess the borrowing treatments of biashara boresha funding, evaluate the result of BBL on MSEs efficiency, and also uncovering the difficulties faced in providing to SMEs. It also found no conclusive evidence of a web link in between business owners' educational achievement as well as company efficiency. 49.5 percent of the 51 percent of respondents that got training in their areas of business stated their business were doing well, implying that relevant training can yield beneficial lead to the procedure of an organization.

2.3 External (Government) Policies

Tax is one of the outside policies utilized by the government to create its revenue supported by regulation to make certain the citizens are provided with basic features. Taxation is a method used by a government to generate its income supported by law to make sure the citizens are provided with basic amenities. It is a required dedication by a nation applied on its people for the federal government to be able to do its mandate. Tax is very critical for SME efficiency. It has a straight effect on their performance. MSEs play a critical duty beforehand the country's socio-economic development goals. As a result, alignment is essential relating to the tax obligation system regarding the atmosphere (Kamuri & Odhiambo, 2020).

Licensing regulative restrictions additionally position substantial obstacles to the advancement of SMEs (Kamuri & Odhiambo, 2020), and while broad structural reforms have caused some enhancements, prospects for venture development should still be dealt with at the company level. SMEs operations are hampered by licensing as well as registration needs, in addition to the high price of settling legal claims as well as extreme hold-ups in court procedures (Wilson & Makau, 2018). A lawful and regulatory framework that produces overly complicated registration and licensing needs and demands time-consuming and pricing coverage approaches is likely to suppress service operations while also placing a hefty burden on business owners as well as their ventures. Aondo (2018) study on the challenges facing Kenyan women entrepreneurship found that the licensing of enterprises was flawed since it permitted wholesalers to obtain a retailer's license. This not only allows for rivalry between the two, but it also gives wholesalers an unfair advantage because they can participate in hoarding to sell at a premium to retailers or refuse to sell their fast-moving items. An encouraging environment for SMEs is expected to contribute to the effectiveness and sustainability of support programs, in addition to sustaining the establishment of new services and supporting their stability and growth. Consequently, a desirable and enabling policy and governing atmosphere are crucial to the growth of SMEs (Ali, 2020).

3.0 Performance of SMEs

The performance of SMEs refers to the outcomes of their business activities. It can be quantified using a variety of indicators. Financial and non-financial indicators are important performance indicators for SMEs.

3.1 Measurement of SMEs Performance

SMEs measure their performance using both financial and non-financial performance procedures. Financial efficiency actions are made use of a lot more often than the non-financial ones. Of the financial efficiency steps, one of the most popular ones are sales development, capital, operating revenue and web revenue margin. One of the most preferred non-financial steps are client focused. These include response time, clients' fulfillment, percent of repeat clients and clients' issues. performance measurement is made use of by the SMEs primarily for monitoring the business, determining the performance of the business, improving service processes, identifying troubles as well as maximizing making use of sources (Mjongwana & Kamala, 2018).

SMEs performance based on company profitability. A company's profitability affects its value and the amount of income it generates for its owners. The net profit and return on assets are used to assess a company's performance in terms of profitability. This provides data on a competitor's operational and financial performance. Performance of SMEs can also be measured by the growth of employment in the firms, which also indicates that firms' sales are increasing (Baharun *et al*., 2019).

Good management of employees' knowledge adds value to firms and makes them competitive in the market economy, which is another measure of performance for SMEs. According to Abdullah and Othman (2019), employee compensation and rewards are a good indicator of a SME's performance. Intangible dimensions of performance for SMEs include public image and perception, customer satisfaction, employee satisfaction and attrition, skill levels, product and service innovations, training investments, and new value streams (Abbott et al., 2019).

3.2 Importance of SMEs Performance

SMEs' performance plays an important role in providing entrepreneurship skills, supply of ideas, and innovations to the economy. Globally SMEs hold the key to economic growth based on the fast growth of enterprises and the role of SMEs in generation of employment. According to Al-Haddad *et al*. (2019) the concentration of SMEs has a close relationship with economic growth. SMEs dominate the world economies in terms of employment and number of companies. Also, SMEs contribute to the societal provision of goods and services. Without SMEs, large corporations may be unable to meet the growing demand for goods and services from their customers.

In the economy, performance of SMEs play an important role in achieving the SDGs, promoting inclusive and sustainable economic growth, creating employment and decent jobs, promoting sustainable industrialization, fostering innovation, and reducing inequality. The performance of SMEs sector promotes entrepreneurial activity throughout the country, in both urban and rural areas, and has thus made significant contributions to the country's socioeconomic development and transformation (Osano, 2019).

According to the Kenyan government, the performance of the SME sector has contributed to the achievement of the development blueprint. SMEs have been identified as a more significant contributor to the Kenyan economy, providing both employment and a platform for innovative ideas. SMEs employ approximately 75% of the general labor force and contribute approximately 18% of Kenya's GDP. SME performance in Kenya generates income, creates jobs, and contributes to economic growth. The performance of SMEs has been recognized as the primary engine of economic growth and poverty eradication in Kenya (Mwangi, 2018).

3.3 Factors Influencing the Performance of SMEs

Several factors affect the performance of SMEs including internal policies and external government policies.

Internal policies consist of; capital financing and ease of access to loans. Financial constraints continue to be a major concern for Kenyan SMEs. The most difficult obstacle that many businesses face is obtaining startup capital. Even after you've started your firm, acquiring enough money to keep it growing is a challenge. Christopher, Jane and Yussuf (2021) conducted research for the Kenya Rural Enterprise Programme (K-Rep) and found that funding is a major restriction in the small business enterprise sector. Finance, according to (Nzive, 2020), is one of the major impediments to small business growth. The lack of financial markets in developing countries like Kenya exacerbates the problem. Small business owners find it difficult to obtain financing to expand their operations, and they are frequently confronted with issues such as collateral, feasibility studies, and inexplicable bank fees. This means they won't be able to get the money they need to expand.

Lack access to credit, particularly from financial institutions like commercial banks (Njoroge & Mugambi, 2018). This is due to the lending terms imposed on them, such as the requirement of collateral for the loan. Due to their limited asset base, some businesses may not be able to provide security such as immovable properties. As a result, the majority of small businesses rely on borrowing from friends and family. However, this sort of financing is insufficient to meet all of the needs of medium and small businesses. As a result of the shortage of finance, management is forced to adopt low-cost, indigenous technology, which is frequently ineffective (Mutiso & Njuguna, 2021).

On external government policies consist of taxation and licensing. Kenya's government enacted several new digital taxes in order to increase government revenue. The Tax Law (Amendment), Act 2020, includes a 20% withholding tax rate on sales, promotion, advertising, and transportation services for non-residents, a 1.5 percent digital tax in the Finance Act 2020, which went into effect in January 2021, and the proposed Digital VAT Tax regulations on any business with an online presence, as highlighted in the regulations' definition of taxable scope (Mwenda, 2020). These new taxes posed a new challenge to both existing and new businesses, the vast majority of which were SME's (SMEs). Small and medium-sized enterprises (SMEs) are the backbone of the Kenyan economy, accounting for roughly 98 percent of the business sector and employing approximately 14.5 million Kenyans (Mwenda, 2020).

Taxation and regulatory constraints are also significant barriers to SME development (Kamuri & Odhiambo, 2020), and while broad structural reforms have resulted in some improvements, prospects for enterprise development must still be addressed at the firm level. MSE operations are hampered by licensing and registration requirements, as well as the high cost of settling legal claims and lengthy court proceedings (Wilson & Makau, 2018). A legal and regulatory framework that imposes overly complicated registration and licensing requirements, as well as time-consuming and costly reporting methods, is likely to stifle business operations while also imposing a significant burden on entrepreneurs and their businesses.

3.4 Enhancing Performance of SMEs

Most SMEs recognize the importance of improving SMEs' performance and have begun to adopt social media and electronic commerce platforms with the goal of improving their marketing strategies and, as a result, their operational performance (Chepngetich, 2016). Effect of financial literacy and performance SMEs. Evidence from Kenya. Evidence from Kenya. Transforming the way businesses operate and advertise their products and services today However, social media has begun to attract and encourage many unemployed people to start their own businesses online.

SME capacity building in terms of financial statement and business plan preparation, as well as financial literacy and management training, have a positive impact on SMEs' performance (Aladejebi, 2018). Further, strengthening horizontal and vertical links with other SMEs and larger firms would improve SMEs' market access (Hoetoro, 2020). Effective financial literacy skill implementation leads to improved SMEs performance due to improved ability to track business events from the record system (Molina-Garca et al., 2022).

3.5 Conclusion

The following major points must be addressed for a healthy economy and a bright future in the SME sector. SME funding concerns, technical and business skills training, a favorable investment climate, and the implementation of solid SMEs legislation are all part of the financial rescue package. This is not the only way the SME sector will alter. It is a process that necessitates the implementation of crucial measures by all development sectors. This is required for the sub-sector to achieve integral growth.

For the sector to improve then it needs to be strengthened with the necessary solutions that can ensure increased performance. Some of the policy recommendations to improve the SME growth and productivity are:

3.5.1 Networking to improve the SME environment.

SME's can benefit from a networking approach. SMEs might earn profit on several levels when they are connected in networks or operate through professional groups (Kamuri & Odhiambo, 2020). Certain organizations have been in the forefront of facilitating SME sector networks and partnerships. For example, UNIDO has offered direct help to professional groups in Africa as well as assisting business networks from diverse SMEs industries. UNIDO cooperated with local banks and credit associations to develop a new scheme providing mutual guarantee funds for the SME sector in order to improve access to finance for these networks of SMEs (Esaku, 2020). This program will provide financing to manufacturing projects at reasonable interest rates. To obtain the greatest benefits for SMEs, SME networking, technical help, and financial services require a favorable local environment. As a result, the project has mobilized multi-stakeholder working groups (containing members from local government, the corporate sector, and civil society organizations), strengthened their managerial and technical skills, and entrusted them with the coordination of future collaborative projects.

3.5.2 Improvement of CDF

The CDF Act, which was published in The Kenya Gazette Supplement No. 107 in 2003, was created to promote constituency-level, grass-root development programs. The goal of the CDF is to create an equitable distribution of development resources across regions, a difficult task that frequently threatens to strain Kenya's socio-ethnic fabric. Despite the controversy surrounding the theft of the kitty, key milestones in rural development have been reached. Improvements in infrastructure and the implementation of several other CDF-supported projects have aided the expansion of SME's in rural areas to some extent. Hence an improvement on the allocation and there being due diligence on the funds will go a long way to improve the SME sector around the country.

3.5.3 The role of the ministry of finance

The idea to establish a revolving fund to provide low-interest loans to SME's should serve as a wake-up call to banks to lend on more favorable terms (Kamuri & Odhiambo, 2020). Kenya's budget for the year 2012 surpassed Ksh 1 trillion. As a step toward rejuvenating the sector, this budget included a SMEs component. By all accounts, however, this is still a little sum. With a population of 40 million people, if a trillion dollars were distributed equally, each Kenyan would receive approximately Sh.25, 000.

This is far more than the average worker earns in a month's pay or the profits generated by the Small and Micro Enterprises (SMEs) to whom the Ministry issued a Sh3.8 billion credit line. The 2010 Budget established an ambitious goal of fostering growth in every corner of the country under the theme "towards inclusive and sustainable rapid economic development." The government's decision to encourage SMEs' growth is a new re-awakening based on what may be considered as a gradual recognition of the sector's intrinsic potential for boosting economic growth. Hence, this will in the long term improve the sector

3.5.4 Access to finance

The report suggests that the Kenyan government implement methods for financing SMEs. The development of many funds, such as the Youth Development Fund and the Women Development Fund, has helped to encourage this to some extent. This would make it easier for SMEs in Kenya to get access to the money they need to expand and thrive.

3.5.5 Government regulations

The government policy and regulations that affect the business should be adjusted to ensure they do not affect the performance of the business in a negative way. The study also recommends that the government should ease the process of license application.

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