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Thinking Policy Together

Integrating Small and Medium Enterprises into Global Value Chain through Financial Interventions

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Introduction

Kenya is yet to fully tap its potential in positioning itself in the global production network. Primary agriculture and minerals still dominate its share of global trade participation. Firm involvement in grobal value chains (GVCs) has potential to create employment opportunities and ultimately propel structural transformation. However, despite a relatively strong geographic and logistic positioning, most Kenyan firms, especially the Small and Medium-sized Enterprises (SMEs) mainly produce for the domestic market. The country's involvement in Global Value Chains (GVCs) is still limited, and mostly on low value-added phase. Only 15% of SMEs in Kenya engage in global value chains. Significant gaps between GVC players and non-GVC players emanate primarily from financial constraints.[1] SMEs have a higher level of financial vulnerability, lack lead firm's technical assistance, technology and skills transfer.

Policy Status of Global Value Chain in Kenya

A standalone policy on global value chain is lacking, although GVCs are identified in the National Industrialization Policy and National Trade Policy. The current industrialization policy in Kenya relies heavily on developing export processing zones (EPZs). However, many small-scale enterprises have not integrated into the EPZ, making the EPZ emerge like a larger firms' enclave. On a macro level, there are several constraints blocking SMEs from entering into foreign markets. They include unfavourable macro environments and inadequate regulatory and policy supports, rigid labour markets, low product quality, and poor trade facilitation for non-GVC players. Several strategies have been applied to mitigate these effects, especially in the agriculture sector. Notable among them were the Strategy for Revitalizing Agriculture (SRA) (2004-14) and the Agricultural Sector Development Strategy (2009-2020) that have since lapsed. Despite the various policies and programmes, the problems are still persistent. It would be important to develop adequate strategies and policies that are tailor made for SMEs participation in global value chains.

It may be challenging for many SMEs who are accustomed to serving local markets to fully comprehend the benefits and possibilities of overseas sub-contracting. This also holds true for the possibility for SMEs to outsource a portion of their manufacturing to increase their competitiveness through resource optimization. While the uptake of information technology has made it simpler for SMEs to gather market data, their limited financial resources and lack of management skills continue to obstruct appropriate information and analysis on the potential in overseas markets.

Global value chains are therefore an important approach for SMEs to enter global markets. There are several advantages for SMEs that join these value chains, but the main one is that GVCs boost SME competitiveness. Policy makers should provide technical and financial assistance to SMEs and their owners, managers, and employees, while also improving the broader business climate. This is imperative in connecting SMEs with the Global market leaders, which is a key ingredient to GVC participation. While these initiatives are not simple, the evidence and suggestions in this policy brief can inform policy makers decisions on what measures to take.

Intervention Areas

(i) Effective involvement of SMEs in global value chain involves a variety of capacity building and financing efforts, in addition to the construction of a business-enabling environment. Increasing productivity of firms is important and this can be done through investment in human capital development, including on-job training programmes, and investment in efficient production technologies.

(ii) There is need to build awareness among firms on the importance of international certifications on business and sensitization in participating in global value chains. This can be done through close collaboration between the government agencies concerned with quality and Business Membership Organizations (BMOs) that the firms are participating.

(iii) To increase access to finance, there is need to create credit information infrastructure for firms that focus at the credit score or rating. The Central Bank of Kenya would provide incentives to commercial banks to engage in institutional financial innovation programmes that promote group lending. This would assist to reduce the bottlenecks that currently impede SME credit access.

(iv) The National Government can design loan subsidies earmarked to specific projects or key performance indicators such as firm's export performance. The subsidies can be channelled through microfinance banks. In South Korea and Taiwan, a similar initiative proved effective in encouraging global value chain involvement.

(v) Gainful involvement in value chains sometimes necessitates large financial outlays to purchase or build superior manufacturing technology and logistical systems, invest in human capital, or certify newly necessary standards. Additionally, suppliers frequently receive payments from their client's weeks or even months after the fulfilment of their orders, making it difficult for SMEs to enforce contracts and collect payments. Small sub-contractors can overcome liquidity issues with the assistance of policies targeted at increasing SMEs' accounts receivables and enabling supplier financing, for example by supporting the development of financial models.

(vi) Investment in research and development through creation of business hubs and innovation centres, and creating acceleration programmes will improve firms' capability when participating in GVCs. Technical support initiatives run by the Ministry of Cooperatives and Micro and Small Enterprise that connect SMEs with bigger firms might be beneficial. Such initiatives may assist in increasing the capability of SMEs and making them more appealing as suppliers to large corporations. Furthermore, the Ministry of Cooperatives and Micro and Small Enterprise should promote industry standards, and international cooperation in product and production laws to allow economies of scale and stimulate exports.

Endnotes

[1] Wanjala and Abdulahi (2022), Firm-level analysis of global value chain participation in Kenya. KIPPRA Discussion Paper.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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