MICRO, SMALL AND MEDIUM-SIZE ENTERPRISES (MSMEs) AS SUPPLIERS TO THE EXTRACTIVE INDUSTRY

Report

January 2015
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Acknowledgements

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Cover Image(s)
A banner on trade and industry done by the County Government of Kwale, Kwale, Kenya

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Report Prepared by Winnie W. Wairimu
Contents

Contents ........................................................................................................................................... 5
List of Tables .................................................................................................................................... 6
List of Figures ................................................................................................................................... 6
List of Maps ...................................................................................................................................... 6
List of Boxes .................................................................................................................................... 6
Acronyms and Abbreviations .......................................................................................................... 7
Executive Summary .......................................................................................................................... 8

1.0 Introduction and Background Information ............................................................................... 11
  1.1 MSMEs in Kenya ....................................................................................................................... 14
  1.2 MSMEs role in the Extractive Industry ...................................................................................... 15
  1.3 Why local supply in the Extractive Industries? .......................................................................... 15
  1.4 What can MSMEs supply and how? a literature review .............................................................. 16

2.0 Study Objectives ....................................................................................................................... 16
  2.1 Kwale County ........................................................................................................................... 17
  2.2 Kitui County ............................................................................................................................. 19

3.0 Research design and Methodology ............................................................................................. 21
  3.1 Data collection .......................................................................................................................... 22
  3.2 Sample size .............................................................................................................................. 23

4.0 Findings ...................................................................................................................................... 24
  4.1 SMEs in Kenya: a short profile .................................................................................................. 24
  4.2 SMEs Contribution to the National Economy ......................................................................... 27
  4.3 Contribution to employment and employment trends ............................................................... 28
  4.4 SMEs as Suppliers to the Extractive Industry .......................................................................... 37
  4.5 Supply chain analysis of Existing and potential SMEs ............................................................. 48
  4.6 Factors hindering growth of SMSEs to the National Economy and Kitui and Kwale Counties Economies ........................................................................................................ 53

5.0 Recommendations and strategies ............................................................................................... 56
  5.1 Measures to mitigate the challenges ......................................................................................... 56
  5.2 Guidelines for implementing the recommendations ................................................................. 62
  5.3 Recommendations for policy and legislative action ................................................................. 66

References .......................................................................................................................................... 67
List of Tables
Table 1.1: Quantity of minerals mined and total earnings through the years
Table 1.2: Gross Domestic Product contribution by mining and quarrying in GDP 2005 - 2013 and changes over time
Table 1.3: Benefits of involving MSMEs in local supply chains
Table 2.1: Geological formations, minerals and their location in the county
Table 4.1: Total Number of MSEs
Table 4.2: MSEs and Their Employment
Table 4.3: Non-agricultural MSE
Table 4.4: Average Monthly Income of MSE Entrepreneurs (Ksh)
Table 4.5: Average MSE Monthly Salaries paid to workers (Ksh)
Table 4.6: Contributions of MSEs to Employment per Sector
Table 4.7: Contributions of MSEs to Employment Creation
Table 4.8: Total employment, 2009-2013
Table 4.9: Number of persons engaged in the informal Sector by activity, 2009 - 2013
Table 4.10: Sex Distribution of Respondents (or Owners) of MSEs
Table 4.11: Percentage Distribution of Total MSE Employment by Location and Sex
Table 4.12: Percentage Distribution of Male and Female Workers amongst gender of SME owner
Table 4.13: Percentage Distribution of men and women in MSE employment
Table 4.14: Some potential goods & services for local supply in the extractive industry
Table 5.1: Varying expectations between SMEs and Mining Companies

List of Figures
Figure 4.1: The three segments of women entrepreneurs: Gaps and needs
Figure 4.2: Oil and Gas Industry Structure
Figure 4.3: Mining Industry structure
Figure 4.4: The Supply chain process
Figure 5.1: Business Linkage Model: Supplier Development

List of Maps
Map 2.1: Location of Kwale County in Kenya
Map 2.2: Kwale County constituencies
Map 2.3: Location of Kitui County in Kenya
Map 2.4: Kitui county map showing the location of Mui coal basin

List of Boxes
Box 1: The status of Kwale roads
Box 2: Zimele: Support to supplier development
Box 3. The IFC Copperbelt SME Suppliers Development Program
Box 4: Mozal Linkages Programme project
Box 5: The Mozambique Business Network
Box 6: UNDP Kenya’s County Biashara Centres
Box 7: ExxonMobil Supplier Database
Acronyms and Abbreviations

EAC  East African Community
EI   Extractive Industries
EAP  Engineers Against poverty
CBS  Central Bureau of Statistics
CDF  Constituency Development Fund
GDP  Gross Domestic Product
GOK  Government of Kenya
CSR  Corporate Social Responsibility
FGD  Focus Group Discussions
IFC  International Finance Corporation
ILO  International Labour Organisation
ICEG International Center for Economic Growth
KCSPOG Kenya Civil Society Platform on Oil and Gas
KEPSA Kenya Private Sector Alliance
KIIs Key Informant Interviews
KIPPRA Kenya Institute for Public Policy Research Analysis
KNBS Kenya National Bureau of Statistics
KNCCI Kenya National Chamber of Commerce and Industry
Ksh  Kenya Shilling
MTP 11 Second Medium Term Plan
MDP  Ministry of Devolution and Planning
MSEs Micro and Small-Size Enterprises
OGI  Oil and Gas Industry
OGM  Oil, Gas and Mining
RN  Resource Nationalism
MSMEs/MSMEs Micro, Small- and Medium-Size Enterprises
NGOs  Non-Governmental Organization
UNDP United Nations Development Programme
US   United States
Executive Summary

Kenya is a natural resource dependent country, with 75 percent of the population relying on natural resources. Traditionally, the main productive sectors have been agriculture, livestock, horticulture, wildlife based tourism, forestry, and fisheries. However, with the discovery of oil, gas, mineral resources and rare earth elements, the Extractive Industry is set to grow enabling the country to join the league of major income earners. The Extractive Industry is an economic determinant that can boost the Gross Domestic Product of the country.

The expectations of the role and impact the Extractive Industry will have on the economy and towards achieving sustainable development are not unrealistic. These expectations are also pegged on the ability of Kenya to manage and govern these resources and to redistribute it’s benefits for development. Such prudent resource management will debunk the ‘resource curse’ associated with Extractive Industry.

Similarly, there is a lot of interest in Micro, Small- and Medium-Size Enterprises (MSMEs) in relation to their importance to the social economic development of Kenya. This study is an attempt to link this group of enterprises to the Extractive Industry, following the recognition of the need to create wealth and jobs for Kenyan companies and citizens in EI. Borrowing from other countries experiences, this drive for linkages is triggered by the perceived economic multiplier effect of involving SMEs for instance as suppliers to the EI industry. While pre-existing businesses involved directly with the industry benefit from more training and increased income, the livelihoods of those involved are impacted on directly. There is also the indirect effects which include spurring of new and secondary businesses in and out of an area.

The study provides an assessment of the supply of inputs line for the extractives industry in Kwale and Kitui Counties. The aim is to inform the development of Micro, Small- and Medium-Size Enterprises (MSMEs) as suppliers to the extractive industry while drawing on lessons from countries with more mature extractive sectors. It assesses the opportunities, challenges and risks of MSMEs and their capacity as suppliers to the extractives industry in Kenya. While the report could escalate to having a national outlook, it specifically focuses on Kitui and Kwale Counties. The findings draw on literature review and interviews carried out with Kitui and Kwale County Government officials (trade, budget, mining and statistical departments), MSMEs owners and Mining companies’ management, procurement and Corporate Social Responsibility department staff.

It finds that MSMEs comprise of both formal and informal businesses, but a majority of the MSMEs operate informally. These are concentrated within the urban centres in both Counties due to better services and infrastructure as compared to the rural areas. Majority of these MSMEs are traders while it is not uncommon to find businesses that operate within the same sphere and sector operating next door.

MSMEs have a significant contribution to the national economy. Specifically, MSME share contribution to GDP has recorded increases through time, rising from 13 percent in 1993 to as much as 20-25 percent between 2011 -2014. Looking further is their potential for job creation that is important in the country. This is important because there has been stagnation of job creation in the public sector yet the public wage bill has risen beyond sustainable levels. This means MSMEs provide a sustainable opportunity to create numerous jobs and raise incomes for many households. In 1999, about 2.3 million people were employed by SMEs, in 2003, approximately 4.6 million and by 2013, 6.4 million persons, accounting for 84 percent of the total work force in the country will be employed by this sector. Of particular importance is the ability to create new jobs in the country, often slated as taking the biggest share. In 2013, they constituted 84.3 percent of all new jobs.
With regard to supplies in the Extractive Industry, the principal opportunity for Kenyan companies in the mineral development value chain is the supply of inputs to the international resource companies, e.g. camp operations, catering, and quality assurance. The major strengths Kenyan companies have include their proximity to companies in the extractive industry thus largely providing convenience. The study noted an average capacity by SMEs to perform required technical activities but with low managerial ability. Virtually all Micro, small scale SMEs and a number of those that can qualify as medium scale do not have internal management systems. The assessment indicated very low levels of flexibility in terms of the ability of the MSMEs to respond to random and especially high quantity of orders of any particular kind. In addition, there was a general concern on work ethics, general laxity and perceived willingness to work, especially in Kwale County.

With regard to specific categories of goods and services that MSMEs can supply in the extractive industry in the two counties, it was found out that:

- The general services category (comprising of transportation, catering, cleaning and security services, among others) has the least overall availability of existing and potential local suppliers in both Kwale and Kitui Counties because of the preference for specialised large scale firms by mining companies and the lack of capacity within the Counties. Catering services for instance for one of the major companies in Kwale is currently contracted out to a medium sized Nairobi based company.

- Similar to the case of general services, the construction and trade category also entails a low presence of MSMEs both potential and as existing suppliers to the extractive industry. Particularly for telecommunications, data systems and low-voltage electrical maintenance, this is not considered an area for MSMEs largely because these require high technical capacity not found in both Counties. However, exceptions were found in Civil works maintenance and construction. There was at least one credible construction company capable of handling large constructions and Corporate Social Responsibility (CSR) efforts such as in schools and markets as well as small project works in both Counties. The other exception area is in simple mechanical maintenance and small vehicle maintenance where both Counties have garages that deliver quality piecemeal body work but incapable of handling large volumes of work.

- The provision of goods such as food, furniture, cleaning supplies, in wholesale, retail or distribution provides the highest potential for MSMEs involvement in the extractive industry. This is a factor of the nature of MSME businesses found in both Kwale and Kitui, and even nationally. The largest number of MSMEs in Kenya is traders. In some cases, such as food supplies, the segmented nature of MSMEs presents logistics concerns.

In the supply chain analysis of existing and potential MSMEs, the production planning and inventory control process is least applicable in the two Counties. This is because majority of the suppliers in both Kwale and Kitui Counties are traders, service providers and suppliers of finished goods. One cannot make inferences about improvements in the physical condition of products procured and delivered into the supply chain. Lack of harmony in County taxes affecting businesses especially in the construction industry is the biggest challenge in this process. Similarly, since most MSMEs in Kwale and Kitui Counties are traders and providers of finished goods, they largely fall under the distribution and logistics process of the supply chain. Value addition in this section of the supply chain mainly relates to convenience and location. Challenges related to logistics and transport are therefore most relevant. Poor and inefficient infrastructure, a lack of organized marketing infrastructure coupled by poor industrial development, are the main challenges in this section of the supply chain.
Central to both processes of the supply chain (i.e. the production planning and inventory control process and the distribution and logistics process) are information gaps and lack of familiarity with the nature of activities in the extractive industry or even opportunities for tendering and service provision are cited. People are also aware of the location of the companies involved in mining activities. However, most people considered the companies unreachable due to the nature of security mechanisms set up. In addition, MSME proprietors and managers indicated they had not taken any initiative to approach these companies.

Generally, the main challenges that hinder MSMEs contribution to the economy of Kenya are a lack of current data and statistics on MSMEs, financial constraints and weak or absent associations that they have., There are also challenges associated with low technology absorption capacity, limited market access, too many administrative rules, regulations and taxation and the lack of information on public programmes and policies.

The recommendations from this study aim to inform and build on MSMEs contribution as suppliers to the extractive industry. These recommendations particularly highlight linkage programmes and the establishment of MSME centres of excellence as key areas of action. It requires the involvement of several stakeholders in the mining industry, (including MSMEs, mining companies management and procurement departments, external parties as funders, business associations, the government etc.) with a third party as a facilitator of the programme i.e. the Government.

The report ends with policy recommendations. These are (i) the need for counties to set clear regulations consistent with national level policies and which do not overburden SMEs and (ii) the need for a local content policy in the country to supplement the highly inadequate clauses 44, 45 and 49 in the mining bill. This is largely because there is there is limited opportunity for linkage development in Africa without the right policies and strategies to leverage mineral extraction and processing operations into broader economic development outcomes.
1.0 Introduction and Background Information

Kenya is a natural resource dependent country with about 75 percent of its population depending on natural resources. The main productive sectors are agriculture, livestock, horticulture, wildlife based tourism, forestry, and fisheries (UNDP and GOK 2013; AfIDEP and PAI 2012). The recent discovery of mineral wealth especially oil, gas and rare earth elements is set to propel the country into the league of major income earners. This discovery is a major economic determinant as it will boost the Gross Domestic Product (GDP)¹ exponentially. Specifically, the mining sector and mineral exports are expected to rise to the top four on the ‘export league table behind the traditional big three - tea, horticulture and floriculture, and tourism’ (Armitage 2013: 23). This is welcome given that exports, foreign receipts and tax income from tea, coffee and tourism have experienced significant decline in the recent past (KCSPOG 2014).

Within a span of about five years Kenya has discovered an expanse of minerals. At national level, this includes discovery of oil reserves by Tullow Oil in remote Turkana County in the north west of Kenya, coal in the Mui basin in Kitui County, gold deposits in the Loilgorien area of Narok County and in Homa-bay County, natural gas reserves in Malindi County, niobium and rare earths in Kwale County, and Base Titanium’s Kwale County Mineral Sands. This adds to an already existing expanse of soda ash, gas, rare earth metals, coal, iron ore, gold, limestone, gypsum, manganese ore, fluorspar, diatomite, titanium, zircon, chromite, niobium and silica sand limestone, cement and gemstone, among others (GOK 2012a).

Table 1.1: Quantity of minerals mined and total earnings through the years²

<table>
<thead>
<tr>
<th>Mineral quantities (000 tonnes)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total earnings (Ksh in millions)</td>
<td>6,809</td>
<td>6,650</td>
<td>10,374.9</td>
<td>12,483.1</td>
<td>9,618.9</td>
<td>15,131.4</td>
<td>18,318.0</td>
<td>27,568.5</td>
<td>19,680.1</td>
</tr>
</tbody>
</table>

* Provisional

¹ The study uses the World Bank’s (Liebenthal et al. 2005) definition of extractive industries to include oil, gas, and mining of minerals and metals. Mining for construction materials such as sand, including cement production and quarries, is not included. The term is used to define processes and the different activities that lead to the extraction of raw materials from the earth (such as oil, metals, mineral and aggregates), processing and utilization by consumers (Sigam and Garcia 2012).

² Includes soda ash, fluorspar, salt, crushed refined soda, carbon dioxide, diatomite, Gold and gemstones only.

Commercial exploitation of minerals has several negative effects. These include threats to the environment, disruption of livelihoods through displacement and loss of land rights, insecurity and conflicts, and other community related concerns (See KCSPOG 2014 for an elaboration of such). Despite these challenges, there is hope in the role that commercial exploitation of the extractive industry and its recent discoveries will play in the increased contribution to growth in the Kenyan economy (KIPPRA 2013). Currently, the industry contributes a negligible percentage (about 0.8 to 1%) to the GDP and in terms of total export revenues; it is less than

11 MSMEs as suppliers to Extractives Industry
two percent (GOK 2012a; Armitage 2013; ASI 2013). This is despite an increase in the number of mineral quantities through the years (Table 1.1) and an increase in the share contribution of the same to the GDP (Table 1.2).

Table 1.2: Gross Domestic Product contribution by mining and quarrying in GDP 2005 - 2013 and changes over time

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share contribution to GDP (%)</td>
<td>0.5</td>
<td>0.5</td>
<td>0.7</td>
<td>0.7</td>
<td>0.5*</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.6*</td>
</tr>
<tr>
<td>Growth rate of GDP change (%)</td>
<td>2.7</td>
<td>4.1</td>
<td>12.9</td>
<td>2.9</td>
<td>-4.5</td>
<td>9.7</td>
<td>7.1</td>
<td>4.1</td>
<td>7.4*</td>
</tr>
<tr>
<td>Sector contribution to the GDP growth (%)</td>
<td>0.2</td>
<td>0.3</td>
<td>0.8</td>
<td>0.9</td>
<td>-0.8</td>
<td>0.7</td>
<td>0.7</td>
<td>0.4</td>
<td>0.7*</td>
</tr>
</tbody>
</table>

* Provisional

Source: KNBS 2010a; 2011; 2012; 2013; 2014

The expectations on the role of this socioeconomic industry on the economy and towards achieving sustainable development are not unrealistic. In 2010, Kenya earned Ksh 6.2 billion from the sale of two tonnes of gold (Michira 2011). In 2012, growth in total earnings in the mining sector was driven by gold and fluorspar. The value of gold exports in that year more than doubled to become the major earner for the sub sector (KNBS 2013). Recently, Cortec Mining indicated that the rare earth deposit on Mrima Hill in Kwale is approximately 40 million tonnes with a concentration of approximately five percent total Rare Earth Oxides. This means that Kenya enters the league of some of the largest rare earth producers in the world (Kagwe 2013), behind Brazil and Canada. This deposit is valued at approximately United States (US) $62.4 billion (Kenya Shillings 5.3 trillion). Niobium content is valued at US $35bn (Ksh2.9 trillion) (Kagwe 2013). The coal in Mui basin is estimated at a value of Sh6.9 trillion. Already one of the coal blocks i.e. C is valued at Ksh 3.4 trillion with the exploration of the other three blocks ongoing. The projected production of ilmenite (one of the compositions of titanium ore) is expected to account for ten percent of the annual global supply.\(^4\)

The ability of Kenya to manage and govern these resources and to redistribute the benefits for development could be the key to boost the economy. By doing so, it can avoid the ‘resource curse’ associated with such ventures as witnessed in other countries.\(^5\) Several measures are in place to achieve this:

- The governance structure is currently under review. As recent as August 2014, President Kenyatta was reported to indicate the commitment by Government to transparency and the intention on full disclosure of petroleum agreements.\(^6\) A ministry dedicated to the

\(^5\) Dobbs et al. (2013) argue that a large body of evidence suggests that the discovery of or boom in minerals often leads to a short term benefit. Such gains do not however always lead to better economic performance or improvement in the standards of living in the long run. To put it bluntly, too often ‘an abundance of resources does not enhance economic development but impedes it’. Gulbrandsen et. al (2008) go further to link these high revenues from extractive industries with high levels of corruption, a weak system of tax collection, lack of development of other sectors of the economy apart from oil, and increasing social inequality.
The mining sector was set up in recognition of the potential of the sector and the contribution to national and local growth.

- The policy and legal framework has been set in place. The Energy Bill 2014 and the Petroleum Exploration, Development and Production Bill 2014 are examples of recent efforts. The National Assembly on 28th October 2014 passed the Mining bill 2014 to replace the outdated 1940 bill. The new bill will regulate all matters on mining and create relevant institutions to enhance efficiency in the sector. The new Natural Resources (benefit sharing) bill, 2014 sets the distribution of revenue as 20 percent which will go into the National Government established sovereign wealth fund, 80 percent shared between National and County Government at the ratio of 60:40. Part of the 40 percent to the County shall be assigned to local community projects and the 60 remaining will be utilised throughout the County (GOK 2014).

- The supportive infrastructure is being put in place. Planned developments in line with these discoveries include the Lamu Port Southern Sudan-Ethiopia Transport (LAPSSET) Corridor project which includes a proposed construction of a new sea port, pipelines and standard gauge railway lines from Lamu to South Sudan.

- Local and International Non-Governmental Organizations (NGOs) are lobbying for environmental conservation, human rights as well as working with local communities on how best they can benefit from the extractive industries. This is important since many of these minerals are found in arid and semi-arid areas as well as areas with high population numbers living in poverty. Civil society coalitions are also involved (Adam Smith International 2013), with the Kenya Civil Society Platform on Oil and Gas (KCSPOG) been a well know initiative ‘established to mobilise civil society and citizens to play their rightful role of ensuring that the process for the development of the policy and legal frameworks is inclusive and participatory’ (KCSPOG 2014).

- International agencies like the Department for International Development (DFID) have set out processes and studies based on inclusive multi-stakeholder consultations to come up with recommendations on how the extractive industry can be used as a transformative and inclusive support and development for all Kenyan stakeholders. This resulted in for instance the document titled ‘Recommendations for the Development of Kenya’s Extractive Industries’ by Adam Smith International (ASI).

The place of these minerals is increasingly recognised in national planning documents - with the faith that it will give the country the boost and transformation it requires to achieve development. Specifically, the extractive industry is expected to act as a springboard for development and contribute to economic development. This is in tandem with the ambitious and aspirational development agenda stipulated in its planning strategy, officially known as Kenya Vision 2030 (GOK 2007) and the second Medium Term Plan (MTP 11). Vision 2030 aims at making Kenya a newly industrializing, middle income country providing high quality life for all its citizens by the year 2030. One of the key mainstays in Vision 2030 is the economic pillar where the Kenyan Government commits to achieve a sustained average Gross Domestic Product (GDP) growth rate of ten percent per annum. In this economic development, the mining sector/extractive industry is set to play a vital role with its recognition as the seventh priority sector under the Economic Pillar of Kenya Vision 2030 (GOK 2013b; Adam Smith International 2013). The second medium term Plan recognises the ability of the mining sector to contribute to increased export earnings, higher GDP growth, broader social development, and to act as a major spur for infrastructure development and job creation (GOK 2013b: 68). At the

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same time, some of these recent discoveries and their exploitation have been tagged as flagship projects towards the achievement of Vision 2030.

1.1 MSMEs in Kenya
This study looks at the place of Micro, Small- and Medium-Size Enterprises (MSMEs) - often associated with but extending beyond the informal sector i.e. the Jua Kali sector - within the extractive industry. This is a group that has generated a lot of interest in relation to their importance to the economic development of Kenya as witnessed in the various Sessional Papers through time e.g. Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth, Sessional Paper Number 2 of 1992 on Small Enterprise and Jua Kali Development and the Sessional Paper No 2 of 2005 on the Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction.

Recent focus resulted in the Micro and Small Enterprise Act of 2012 and its operationalization through the setting up of relevant institutional mechanisms. A good example is the Micro and Small Enterprise Authority within the Ministry of Industrialisation and Enterprise Development (MSEA 2013). The MSE Act provides for new rules and institutions to support micro and small businesses in Kenya to enable them succeed. It provides legal and institutional frameworks for the promotion, development and regulation of MSEs. These include Office of the Registrar of MSE associations (to formalise and register MSEs), MSE tribunal (for conflict resolution) and the MSE fund (to address issues of financing). It also provides for the establishment of the MSE Authority to (GOK 2012b):

- Provide an enabling environment
- Facilitate formalization and upgrading of informal MSEs
- Promote a culture of entrepreneurship
- Promote representative associations

Given that this study deals with Micro, Small- and Medium-Size Enterprises (MSMEs), it is prudent to define them. In Kenya, the classification of enterprises is primarily by the number of employees engaged by firms and their turnover. The Micro and Small Enterprises (MSE) Bill 2012 defines:

- **Micro enterprises** as any firm, trade, service, industry or a business activity, formal or informal that has an annual turnover that does not exceed Kenya Shillings 500,000 and employing (or rather engaging) 1-9 people. The total assets and financial investment or the registered capital of the enterprise does not exceed Ksh 10 million in the manufacturing sector and does not exceed Ksh 5 million in the service and farming sector.

- **Small enterprises** as those firms, trade, service, industry or business activities that post an annual turnover of between Ksh500,000 and Ksh5 million and have an employee list of 10 to 50. In the manufacturing sector, investment in plant and machinery should be between Ksh 10 million and Ksh 50 million and registered capital of the enterprise between Ksh 5 million and Ksh 25 million in the service and farming sector.

Given the mandate of the Act is limited to micro and small industries, and for the purpose of this study, we will extend the focus to include medium enterprises. The definition of medium enterprises is guided by the MSE bill, the Sessional Paper No 2 of 2005: Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty and the Ernst Young 2009 study commissioned by the East African Community (EAC). Medium enterprises are therefore firms with between 51-100 employees and a capital investment of not more than Kshs 30 million.

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9 The bill’s mandate relates only to micro and small enterprises and not medium scale enterprises.
1.2 MSMEs role in the Extractive Industry
With the rise of the extractive industry in Kenya and borrowing from lessons and experiences in other countries, there is increasing Resource Nationalism (RN). This is defined by Solomon (2012) as growing citizen expectation and national desire for greater control and benefits from resources, characterised by rising citizen and civil society activism. This study looks at RN as the desire by people in resource-rich countries to derive more economic benefit from national resources alongside the resolution of their Governments to exercise greater control over the national resource sectors. This largely refers to the need to use the EIs to achieve development goals i.e. shift to a development mindset and economic development as opposed to looking to the EIs as simply extraction.

In the Kenyan context, particularly, the need to create wealth and jobs for Kenyan companies and citizens respectively in the extractive industry is already recognised (see ASI 2013). This can be through stimulating growth in several sectors through linkages into and out of resource sectors such as mining and the oil and gas industry. The Kenya Civil Society Platform on Oil and Gas (2014: 12) foresees what they refer to as ‘non-fiscal benefits such as leveraging on the oil and gas resources to add value to the economy’. This, partly framed as possible through developing the ‘local content’ (borrowing from the 2014 Petroleum Exploration, Development and Production Bill) or the term ‘national content’ that is more preferred by the Government. This is taken to represent the need for foreign producers of goods and services to (1) create local employment for citizens as well as (2) local businesses through the procurement and supply of inputs from the local economy in the form of good and services (Ibid), and also encompasses training opportunities for local companies as providers of the required services and goods (Adam Smith International 2013: 22). These are all ideals echoed in the Africa Mining Vision 2050 that emphasizes the development of local resource supplier/inputs sector where feasible (particularly capital goods, services and consumables), through the use of flexible local content milestones (AUC et. al 2011). Africa Mining Vision 2050 is the African Union’s (AU) resource-based industrialization and development strategy for the mining industry. It advocates for the ‘transparent, equitable and optimal exploitation of mineral resources to underpin broad-based sustainable growth and socio-economic development’ (Ibid: 8).

The issue of local employment is beyond the scope of this study. The study focuses on opportunities to buy goods and services from local and domiciled companies.

1.3 Why local supply in the Extractive Industries?
In available literature, Extractive Industries (EI) analysts agree on one major factor in the involvement of local companies in the supply of products and services - the economic multiplier effect. While pre-existing business companies involved directly will benefit from more training and increased income, and livelihoods are impacted on directly, the indirect effects include spurring of more and secondary businesses in and out of an area. For instance, a case cited in a study in Tanzania found that one job in the mining areas has the tendency to create five more jobs (Kweka 2009). Table 1.3 provides a few of the possible benefits for the companies involved and the MSMEs. This shows involvement can result in created shared value for both the mining companies and for local businesses.

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10 Local content at times can be misused to mean that only local communities should benefit. It is a sensitive term to use in the Kenyan Context, due to relation of the term local to tribal or ethnic, while such areas entail different groups of people.
Table 1.3: Benefits of involving MSMEs in local supply chains

<table>
<thead>
<tr>
<th>MSMEs</th>
<th>ET companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>More diversified client and market structures/additional</td>
<td>Reliability of supply and quality improvement</td>
</tr>
<tr>
<td>supplier/customer relationships</td>
<td></td>
</tr>
<tr>
<td>Enhanced skills, standards and capacity</td>
<td>Cost efficiencies</td>
</tr>
<tr>
<td>Increasing supplier competitiveness</td>
<td>Gaining social license to operate which reduces social risk</td>
</tr>
<tr>
<td></td>
<td>and increases acceptance of the companies through social</td>
</tr>
<tr>
<td></td>
<td>mining programs</td>
</tr>
<tr>
<td>Improved performance and expanded capacity</td>
<td>Improved relationships with governments</td>
</tr>
<tr>
<td>Growth and expansion of sustainable businesses</td>
<td>Meet future needs for labour and services</td>
</tr>
</tbody>
</table>

Source: Ashley 2009; Engineers against Poverty 2007; Esteves et al. 2009; Hackenbruch 2011; Jenkins 2007; Tapiero 2009

1.4 What can MSMEs supply and how? A literature review

Reviewed literature for this study indicates SMEs can provide goods and services if several linkages with mining companies are available or established. These linkages may include the following as observed by (ILO 2014; McMahon 2010; Bebbington 2011):

- Backward/upstream activities/linkages: These include a contribution in the exploration or supply equipment or services that support extraction or production stages of mining (ILO 2014). These activities are noted as requiring capital intensive and high-tech equipment (McMahon 2010).
- Forward/downstream activities/linkages: These involve product processing and refining into finished or semi-finished products. There exists opportunities for developing manufacturing activities around this section. Concern is that most raw materials extracted in resource rich African countries are often processed abroad. In some cases, processing is undertaken in-country when the finished goods have a large domestic market potential (McMahon 2010). However, even in such cases, such processing this is still geographically far from point of extraction (Bebbington 2011).
- Horizontal/sidestream linkages: These are not directly related to core mining activities but are support goods and services that have high potential for unlocking indirect business and employment opportunities in other sectors. These include financial services, logistics provision, distribution services, skills and technology development (ILO 2014).

Reviewed literature for this study suggest a focus and emphasis in developing countries should be on sidestream linkages (domestic sourcing) as more jobs and contracts for SMEs can be found in these linkages.

2.0 Study Objectives

The United Nations Development Programme (UNDP), in cooperation with the Government of Kenya has proposed to support SMSEs in Kenya in order to maximise on the opportunities for job creation and to increase income security. Consequently, this assignment is meant to provide a comprehensive assessment of the opportunities, challenges and risks of SMSEs and their capacity as suppliers to the extractive industry in Kenya. This analysis is to inform the development of Small- and Medium-Size Enterprises (SMEs) as suppliers to the extractive industry, drawing on lessons from countries with more mature extractive sectors.

11 The Terms of Reference (TOR) uses both Small- and Medium-Size Enterprises (SMEs) and Micro, Small- and Medium-Size Enterprises (MSMEs). These are used interchangeably in this study unless when referring to reviewed literature where the study keeps the term used by the authors of a particular document.
This study entailed a supply chain analysis in Kwale and Kitui Counties, to inform the development of Small- and Medium-Size Enterprises (SMSEs) as suppliers to the extractive industry, drawing on lessons from countries with more mature extractive sectors. In order to achieve the above objective, it was a requirement to:

- Define the assessment criteria
- Assess current contribution of SMSEs to the National Economy, as well as to the economies of Kitui and Kwale Counties.
- Provide gender specific socio-economic data and analyses, based on gender disaggregated statistics/data, to determine the current contribution of SMSEs to household incomes, economic opportunities and job creation for men, women and youth.
- Identify and undertake an assessment of SMSEs who are already engaged in or have potential of engaging in supply value chains for extractive industries in Kwale and Kitui Counties.
- Carry out a supply chain analysis of SMSEs as suppliers to the extractive industry, drawing on lessons from countries with more mature extractive sectors.
- Identify challenges faced at various links in the value chain.
- Highlight policy, economic, social, and political factors hindering growth of SMSEs to the National Economy, as well as to the economies of Kitui and Kwale Counties.
- Recommend gender sensitive approaches on how to mitigate these challenges and enhance the equitable and sustainable MSME development.
- Develop and share guidelines implementing the recommendations
- Based on stakeholder consultation workshop(s), provide recommendation for policy and legislative action that will ensure sustainable MSME development

This study provides a comprehensive assessment of the supply of inputs line for the extractive industry in Kwale and Kitui Counties. It assesses the opportunities, challenges and risks of SMSEs and their capacity as suppliers to the extractives industry in Kenya. The study has a national outlook, but specifically focuses on Kitui and Kwale Counties.

2.1 Kwale County

Kwale County is located in the coastal region of Kenya. It borders the United Republic of Tanzania to the South West, and Taita Taveta County to the North West, Kilifi County to the North East, Taita Taveta and Kilifi to the North, Mombasa County and the Indian Ocean to the East and the Indian Ocean to the East. The County covers an area of 8,270.2 square Kilometres (km) and accounts for 1.42 percent of Kenya’s total surface area. This excludes the Exclusive Economic Zone coastal strip of 200 miles.

Kwale County has three administrative units, namely: Kinango, Matuga and Msambweni. The County’s capital is Kwale town and the main towns are Ukunda (62,529), Kwale (population of 28,252), Msambweni (11,985), Kinango (7,958) and Lungalunga (3,670).

The area has a population of about 713,512, accounting for 1.7 percent of the total Kenyan population according to the 2009 census (KNBS 2010b: 23). This consists of 346,910 males and 366,602 females (KNBS 2010c), found within 122,047 households. The population is largely youthful. 32 percent of the population is between the ages of 14 and 34.80 percent of the total population is below 35 years. Given that 51 percent of the population is below 15 years, this

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12 Section partly based on Kwale County government website [http://www.kwalecountygov.com/](http://www.kwalecountygov.com/), Commission on Revenue Allocation (CRA) [http://www.cra kenya.org/county/kwale/](http://www.cra kenya.org/county/kwale/) and the KNBS 2009 survey (Both viewed 30 September 2014), the Kwale County first integrated development plan and the 2013 Kwale County development profile.
translates to a high dependency ratio of 102.3 (GOK 2013c). The main ethnic groups are Digo and Duruma communities, and small numbers of Kambas, Arabs and Indians.

Map 2.1: Location of Kwale County in Kenya       Map 2.2: Kwale County constituencies

15, 18 and 67 percent of the land in Kwale consists of medium potential, marginal and range/semiarid/arid lands respectively. There exist five livelihood zones in Kwale: livestock farming, mixed farming, fisheries, informal employment and formal employment. The main economic activities in the area are within agriculture, tourism, trading and formal employment. Approximately, 49 percent of the population is engaged in either one or several of these activities (i.e. the labour force comprising of the age group 15 -64) (GOK 2013c), but largely in the agricultural sector as subsistence farmers and other unskilled or semi-skilled areas. Women and the youth constitute the majority of this group in the labour force (Ibid). At the same time, the youth constitute the highest group of the unemployed and/or underemployed. The area has a poverty rate of 74.9 percent and is ranked as the 13th highest County contributing to poverty in the Country (KNBS 2014).

During an interview, the county executive officer in charge of Lands and Natural resources equated Kwale as ‘the western Australia of Kenya’ in terms of its mining potential. This is largely due to the geological formations of the County and its underlying rocks - that result in a high mining potential in the County (see Table 2.1). These include gneisses schists, quartzites and granitoids, and crystalline limestone found in the North West; the Karoo Sediments (Duruma Sandstones) in Taru, Maji-ya-Chumvi, Mariakani and Mazeras thus covering the middle strip of the county to the foot of Shimba Hills; the rock underlying the Coastal strip (the Jurassic - Cretaceous Rocks) which includes Kambe limestone found between the North East of Shimba Hills and on the Western shores of Mombasa Island. There are other recent sediments and deposits which consist of the Marafa and the Magarini formations.

The County website and the 2013 Kwale County Integrated Development Plan (CIDP) indicate there are several on-going mining activities.13 These include exploitation of:
- Limestone at Waa by Coast Calcium Limited
- Titanium (rutile, ilmenite, zircon) at Nguluku and Mrima by Base Titanium Limited
- Small scale gemstones

Silica sand for manufacture of glass by Milli Glass Limited, Kenya Breweries Glass Limited and Eastern Chemicals at Waa, Tiwi, Ramisi and Msambweni Pacific Wildcat Resources Corps (PAW), the Canadian firm and its partner Cortec Mining Kenya (CMK) are prospecting for niobium at Mrima Hills, finding huge deposits of these rare earth minerals. However, large-scale mining is mainly related to titanium. All in all an estimated 9,746 people are involved in mining and quarrying (GOK 2013c).

Table 2.1: Geological formations, minerals and their location in the county

<table>
<thead>
<tr>
<th>Geological Formations</th>
<th>Mineral Type</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basement rocks</td>
<td>Gemstones green garnets, red garnets, and rubi</td>
<td>Kuranze</td>
</tr>
<tr>
<td>Intrusive rocks</td>
<td>Rare Earth Elements, Niobium</td>
<td>Mrima Hill/Samburu</td>
</tr>
<tr>
<td>Karoo Sediments</td>
<td>Duruma Sandstones</td>
<td>Mariakani, Maji ya chumvi,</td>
</tr>
<tr>
<td>Recent Sediments</td>
<td>Titanium, Silica Sand</td>
<td>Nguluku/Maumba/Msambweni/</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ngombeni/Ramisi/Tiwi</td>
</tr>
</tbody>
</table>

Source: Mafimbo, undated, CGK 2013

2.2 Kitui County

Kitui County is located in Eastern Kenya, about 160 km east of Nairobi. It covers 30,496.5 square kilometres and borders seven counties; Tharaka and Meru Counties to the north, Embu County to the northwest, Machakos and Makueni Counties to the west, Tana River County to the east and southeast, and Taita Taveta County to the south.

Administratively, the County has eight sub counties, namely Kitui Central, Kitui West, Kitui East, Kitui South, Kitui Rural, Mwingi North, Mwingi Central and Mwingi West. The capital is Kitui town, with the main urban centres been Kitui (109,568 people) and Mwingi (15,970 people) (CGK 2014). Current urban population stands at 16 percent of the total population. It is anticipated that with the development of the Special Economic Zones, the exploitation of coal in Mui basin and limestone in Mutha, more towns will eventually emerge due to high migration into the County and increased economic activity.

According to the 2009 national census, the County has a population of 1,012,709, with 481,282 males and 531,427 females (i.e. male - 48% and female - 52%). Majority are Kambas, but with a sizeable Swahili and Somali population. Similar to Kwale and in tune with the population pyramid of the country, Kitui consists of a very young population. 46.6 percent of the population is below 15 years. At the same time, 30 percent of the total population is between 15-34 years.

The main economic activities include agriculture, small scale trading and commercial business. Subsistence agriculture is the backbone of the County despite the unreliable and sporadic rainfall. This is the main activity for 87.3 percent of the population. Tourism is a low-key economic activity with Mwingi National Reserve been the main attraction. Still 63.8 percent live below the poverty line. The County is ranked as the seventh largest contributor to National poverty figures.

In Kitui, the main mineral resource is coal, which has been explored in the Mui basin. This is a National flagship project for the realisation of Vision 2030. The estimated value of coal in one (i.e. C) of the four blocks (A, B, C, D) is estimated at Ksh3.4 trillion. This block is projected to have a deposit of 400 million metric tonnes. There is ongoing exploration of blocks A, B and D (CGK 2014).

Other minerals include:
- Limestone in Mutomo, Mui, Mutito and Kyuso, where Athi River Mining (ARM) limited and East Africa Portland Cement Company are the main companies involved. There have been reports in the local media of interest and plans by Aliko Dangote - the Nigerian businessman to open a limestone plant in Kitui.
- Gypsum is mined in Mwingi South
- Gemstone in Tharaka and Tseikuru.
- Iron ore
Map 2.4: Kitui county map showing the location of Mui coal basin

A view of Mui Basin from Migwani

### 3.0 Research design and Methodology

The research design for this study is exploratory whilst employing a participatory approach which ensured consultation of key stakeholders. By combining qualitative and quantitative data collection methods, the study benefits from the strengths of each of the data collection methods.
3.1 Data collection
Data collection entailed two concurrent processes at the National and County level.

3.1.1 National Level Focus
Was largely by:

Literature review of relevant data
The scope of the study is localized within the geographical areas of Kwale and Kitui Counties. However, the findings from the study escalate to National level given the consequent implications of E.I on the economy. Most of the supplementary data was generated through review of existing documents. This captured the role, place and current contribution of SMSEs in poverty alleviation and to the economy of the country, to household incomes, economic opportunities and job creation for men, women and youth. It included opportunities, challenges and experiences of SMSEs to the rest of the country.

The review extended to include lessons from countries with well-established E1 sector. Desk research was used to ascertain previous lessons learnt and best practice in engaging SMEs in the extractives. Particularly, this study highlights that there is no need to reinvent the wheel but rather it’s crucial to learn and to take other countries’ experiences as the starting point. The study therefore borrows heavily on cases from other countries and highlights some of these experiences in text boxes throughout this document. The recommendations are therefore largely based on a review of case studies in other countries as required by the TOR.

The study noted a dire absence of data on SMEs and SME surveys in Kenya. The last comprehensive survey was conducted in 1999. One challenge of relying on several sources is that their use of the term SME or even MSMEs and its definition vary. To highlight a case, the economic surveys by the Kenya National Bureau of Statistics take the informal sector to represent SMEs. This is a definition shared by the SME authority. However, the 1999 SME survey notes that SMEs cuts across formal and informal sectors. At times conflicting data is published in the same document such as the Kitui County development profile.

Relevant Consultations and Interviews
Consultations included relevant individuals and institutions at the national level, drawn from government ministries and associations working with or representing SMEs such as SME Authority and Kenya National Chamber of Commerce and Industry (KNCCI).

3.1.2 County Level Focus
A major element of the study is primary research - both qualitative and quantitative among SMEs owners and other stakeholders. It entailed more specific and detailed data collection in the two main Counties i.e. Kwale and Kitui, capturing the existing SMSEs as well as those with potential to act as suppliers to the extractive industries.

This phase of the study employed:

Key Informant Interviews (KIIs)
Interviews were carried out with Kitui and Kwale County Government officials (trade, budget, mining and statistical departments) and SMSEs owners. Mining companies’ management, procurement and Corporate Social Responsibility (CSR) departmental staff (specifically in Kwale) was interviewed to assess what services they seek, the place of SMSEs and their experiences working with SMEs.

Focus Group Discussions (FGDs)
An FGD involved an association/cooperative of miners in Kwale.
Observation and pictures
Largely pictures were used to capture and visualise data. Where possible and applicable, participant observation was used.

Case Study Approach
Some cases studies are included as textboxes to highlight other countries experiences and to give ideas on how specific recommendations.

3.1.3 Stakeholder Validation Workshops
A final stage in the data collection was the stakeholder validation workshops. Consultations with stakeholders which included County Government, SMEs, associations, some NGOs, experts/consultants and UNDP staff helped validate data and refine the report.

3.2 Sample size
Sampling of SMEs was undertaken within the five main and largest towns in Kwale County i.e. Kwale, Ukunda, LungaLunga, Msambweni and Kinango. In Kitui, the sampled SMEs were from Mwingi, Migwani, Bazaar, Tulia/Mutonguni, Kabaï and Kitui Town.
In total 68 individuals randomly drawn from the various categories were interviewed.
4.0 Findings

4.1 SMEs in Kenya: a short profile
The 1999 National MSE Baseline Survey by Central Bureau of Statistics (CBS), International Center for Economic Growth (ICEG), and K-Rep Holdings Ltd established that there were 1.3 million Micro and Small Enterprises country-wide (Table 4.1). These were mainly found in rural areas and indicated a slight rise in the number of enterprises, compared to the 1.2 million enterprises noted in the 1995 survey (CBS, K Rep and ICEG 1999).

<table>
<thead>
<tr>
<th>Stratum</th>
<th>% of national population</th>
<th>MSEs Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nairobi and Mombasa</td>
<td>9.7</td>
<td>204,280</td>
<td>15.8</td>
</tr>
<tr>
<td>Other major towns</td>
<td>6.2</td>
<td>157,533</td>
<td>12.2</td>
</tr>
<tr>
<td>Rural towns</td>
<td>2.1</td>
<td>81,320</td>
<td>6.3</td>
</tr>
<tr>
<td>Rural areas</td>
<td>82.0</td>
<td>845,879</td>
<td>65.6</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>1,289,012</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999

Majority of the MSMEs are a mixture of dynamic enterprises involved in an array of activities but largely within the service sector (transport and communication), wholesale and retail trade, manufacturing, construction, finance, real estate, community and personal services and insurance (KIPPPRA 2013; KNBS 2014). The wholesale and retail trade sector in Kenya is predominantly comprised of informal MSEs.

MSMEs comprise both formal and informal businesses. But majority of the MSEs operate informally. The Kenya Economic Report 2013 estimates that only over 35,000 SMEs are formal MSEs. The current number of informal ones is largely unknown given that SMEs consist of one of the least registered groups. According to the 1999 MSE Survey, 88.6 percent of MSEs operated informally. To illustrate this, in a 2008 study by the Kenya Institute for Public Policy Research Analysis (KIPPPRA), 72 percent of the over 2,500 firms sampled were not registered. Even amongst those registered, only a mere 8 percent were formally registered as limited companies with the Registrar of Companies. Where registered, these are sole proprietorships and in a few cases partnerships. Many of the MSMEs are family based businesses, often relying on family labour especially at management level.

The following are the main characteristics of MSMEs in Kenya:
- Cash based businesses;
- Ease of entry and exit;
- Small scale nature of activities;
- Self-employment with a high proportion of family workers and apprentices;
- Require little capital and equipment to start and run;
- Use of labour intensive technology;
- Require and employ low level of skills;
- Entail low level of organization with little access to organized and international markets;
- Often engage in unregulated and competitive markets;
- They have limited access to formal credit;
- Owners and workers have low levels of education and training;

15 The study defines MSEs as businesses employing up to 50 workers and include both formal and informal sectors.
- Limited access to services and amenities
- A limited focus on value addition
- Have a very high turnover rate - many new businesses are created, many fail, and a few grow.

Source: Numerous including Waweru, 2007

4.1.1 Kwale

In Kwale, MSMEs operate within a number of sectors including trade, construction, welding and small scale metal fabrication, textile and tailoring, furniture manufacture, light motor vehicle maintenance and transport business. Majority are traders (of foodstuffs, household goods, clothes), with at least 2179 registered retail traders and 19 wholesale traders (CGK 2013). Many of these in trade sell similar goods and offer services often located next door. This means an entrepreneur faces a lot of competition from similar businesses in the area.

There are a total of 68 small scale market centres spread throughout the County. Most of the goods traded in these markets are foodstuffs and livestock. There is a wholesale and fresh produce market at Kombani under Economic Stimulus Programme (ESP) (CGK 2013).

The County also registers 162 women and 195 youth active groups. These are however, largely merry go round associations, involved in social sectors such as health, education, savings mobilization and not business related enterprises. It is not clear how many of these can be classified as potential MSMEs.

Most of the MSMEs are concentrated within the urban centres i.e. Kwale town, Msambweni, Ukunda and to a lesser extent in Lungalunga and Kinango towns. Ukunda is particularly unique given its vibrancy and the presence of major SMEs. This is because the town lies along the Mombasa-Lunga Langa highway - which is an international trunk road and along the Diani coastline - a favourite tourist destination. The coastal resorts and hotels provide good business for the town. The county has 22 tourist class hotels located majorly in Diani Beach. At the same time, Ukunda has better supply of piped water; telecommunications, electricity, as well as other commercial services that create employment opportunities particularly in the tourism and hotel sector (GOK 2013c) and provide necessary facilities to spur the growth of small and medium businesses. The large population in the area provide a market for goods and services

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16 The county however has a higher number of registered youth groups at 709 but their role in development is minimal (CGK 2013).
A majority of the enterprises in the area are sole proprietorships mainly family owned with the family as the main source of labour. The study identified very few partnerships and registered businesses with majority located in Ukunda and Kwale town. Of all the enterprises sampled, most have less than 2 employees and had been in existence for less than 5 years. Enterprises in the construction and light vehicle maintenance (i.e. garages) sectors were found to be slightly older.

4.1.2 Kitui
The profile of SMEs in Kitui largely matches Kwale, with majority of the businesses falling under micro enterprises owned by individuals. These businesses are mostly not registered. They engage mostly in the food industry, hawking enterprises, hardware, artisans and the like. Those that are registered however have premises, are licensed, and have trading permits issued by the County councils. Registration data is largely available for the wholesale and retail trade and industry. There are 5532 retailers and 142 wholesale traders.

The profiles of businesses are largely family owned businesses. A few medium scale enterprises are found in for instance the construction industry, accommodation/hospitality/hotels and hardware stores located in Kitui town. Micro and small businesses are dominant but are most prevalent in Mwingi and a host of the smaller urban centres.

When inquiry was made about level of association and networking, many of these businesses reported operating individually. The County development profile, however notes that the jua kali sector has 9 associations (GOK 2013c). The Women and Youth enterprises has also spurred a lot of women, youth and self-help groups. Currently the County has 161 women and 312 youth groups with a total membership of 10000 (GOK 2013c). These are not engaged in business but are social enterprises and welfare associations.

By last census, the county labour force (although not clear how many are employed in SMEs) stood at 487,648 people, which was 40 percent of the total population, and was projected to be 514,133 by 2013. Women constitute 56.7 percent of the total population in the group and males constitute the remaining 43.3 percent.
4.2 SMEs Contribution to the National Economy

The economy of Kenya has continued to grow in the recent past despite the slowdown noted in 2011. Analysts agree that the economy registered considerable progress and improvement in 2012 despite a myriad of challenges. These challenges included drastic currency weakening and depreciation, rapid inflation, turbulent global economy and delayed long rains (ADB et. al 2012; ADB et. al 2014; ADB et. al 2013; KIPPRA 2013; KNBS 2013). Annual growth was registered at 4.6 percent in GDP compared to 4.4 percent in 2011 (KIPPRA 2013), with considerable but varied improvement in all sectors i.e. agriculture and forestry, wholesale and retail trade, transport and communication, manufacturing and construction (KNBS 2013).

The progress was sustained and improved on in 2013. GDP expanded by 4.7 percent in 2013 (KNBS 2014). This was expected to accelerate to above 5 percent in 2014 to 5.2 percent in 2014 (ADB et. al 2013).

Government planning documents and studies such as those by Adam Smith International (2013) recognise the role that SMEs play in the growth of the Kenyan economy. The blueprint strategy for development and growth - Vision 2030 recognises that the SME sector is a crucial component of the economy. This is central in national strategies for stimulating economic activity, reducing unemployment and poverty. That a competitive SME sector is a critical and strategic engine for growth in attaining vision 2030 is not negotiable. These are the base of entrepreneurial development and the ‘seed bed’ for inculcating an entrepreneurial culture and supporting rural industrialization and industrial development (Kirori and Achieng 2013: 41). This is the reason the document emphasises several development strategies on the sector including the need for SME industrial parks in the five major towns of the County - to spur industrial growth, improving their (SME) productivity and innovation (Ibid).

The SME sector is considered important in:

- generating employment and raising household income
- provision and source of goods and services
- complementing the process of adjustment to large enterprises by bringing linkages for products and services; they form dynamic supply-chain linkages between small-scale producers and lucrative urban, national, or export markets e.g. in 2011 the SME sector sale of goods and services in neighbouring Uganda and Tanzania was the main driver of revenue growth in 76 percent of all the SMEs
- driving competition and innovation; introducing new business methods, products, and services
- enhancing enterprise culture; is a seedbed for entrepreneurial pursuits
- driving industrialisation
playing a critical role in easing foreign exchange constraint
penetrating new markets
stimulating growth and development particularly in the rural areas; with about 70 percent of such enterprises located in rural areas, the sector has a high potential for contributing to rural development.

Given SMEs are more prevalent in rural areas (Table 4.2) and that they are a main source of economic growth and employment, Ramachandran (2008, quoted in Wangombe 2013), sees SMEs as ‘central in creating a balance between the needs of rural and other disadvantaged areas, where the majority of the poor live thus increasing competition and contributing to a more equitable distribution of income.’ In doing this, they help spread the benefits of economic growth by engaging low-income groups in rural areas in national development.

4.2.1 Contribution to Gross Domestic Product
In terms of their contribution to Gross Domestic Production, available figures vary but still indicate that the sector plays a crucial role in growing the economy. Specifically, it is important to note that MSME share contribution to GDP has recorded increases through time. It has risen to 18 percent in 1999, from the 13 percent recorded in 1993 (KNBS 2002). By 2008, this had reached about 40 percent (CMA 2010).

In 2009, KIPPRA estimated that MSEs contributed as much as 25 percent to GDP (ADB et al 2013). Other studies have slated this at 18 percent (Kithae et. al 2012) and 20 percent in 2011 (ADB et. al 2012; Kiraka et. al 2013).

4.3 Contribution to employment and employment trends
The potential for economic growth in Kenya partly lies in the private sector and more so MSMEs which play a large and crucial part in this. One way to establish this is to look at MSME potential for job creation in the country. This is important if we first consider that there is a stagnation of job creation in the public sector. Secondly, that the public wage bill has risen beyond sustainable levels hence recent efforts to reduce it. This means MSMEs provide a sustainable opportunity to create numerous jobs and raise incomes for many households.

Notably is MSMEs ability to create new jobs in the country, often slated as taking the biggest share. At least 87 of new jobs are by SMEs. According to the 2006 Economic Survey, the sector contributed over 50 percent of new jobs created in the year 2005 (Bowen et. al 2009).

To establish SME contribution to employment, the study relies on the most comprehensive SME survey of 1999 and later the annual economic surveys to establish the trends in the late 1990s, early 2000s and then the last five years.

4.3.1 1999
The 1999 National MSE Survey found that there were 1.3 million MSEs country-wide employing about 2.3 million people (Table 4.2). About 26 percent of the total 6,084,693 households in the country then were involved in some form of business activity (CBS, K Rep and ICEG 1999). This showed that the sector is an important source of livelihood for a majority of the country’s population. Rural areas took the biggest share of the SMEs employment (Table 4.2) - replicating the same trend witnessed in the 1995 and 1993 surveys. However, on average, SMES in Nairobi employed a higher number of persons.
Table 4.2: MSEs and Their Employment

<table>
<thead>
<tr>
<th>Stratum</th>
<th>% of national pop</th>
<th>Workers</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>Nairobi and Mombasa</td>
<td>9.7</td>
<td>394,838</td>
<td>16.9</td>
</tr>
<tr>
<td>Other major towns</td>
<td>6.2</td>
<td>279,133</td>
<td>11.8</td>
</tr>
<tr>
<td>Rural towns</td>
<td>2.1</td>
<td>135,349</td>
<td>5.6</td>
</tr>
<tr>
<td>Rural areas</td>
<td>82.0</td>
<td>1,551,930</td>
<td>65.7</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>2,361,250</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999

In terms of sectors or activities, majority of those found in SMEs were in trade, followed by industry (Table 4.3).

Table 4.3: Non-agricultural MSE Labour force

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Women</th>
<th></th>
<th></th>
<th>Men</th>
<th></th>
<th></th>
<th>Both</th>
<th>% of MSEs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total employed</td>
<td>Employed in MSEs</td>
<td>Total employed</td>
<td>Employed in MSEs</td>
<td>Total employed</td>
<td>Employed in MSEs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>4,173,071</td>
<td>-</td>
<td>3,503,515</td>
<td>-</td>
<td>7,676,587</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Industries</td>
<td>143,069</td>
<td>63,372</td>
<td>703,362</td>
<td>236,668</td>
<td>846,431</td>
<td>800,040</td>
<td>35.4</td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td>539,586</td>
<td>594,932</td>
<td>613,645</td>
<td>577,382</td>
<td>1,153,231</td>
<td>1,172,314</td>
<td>101.7</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>2,000,145</td>
<td>132,271</td>
<td>1,165,645</td>
<td>577,385</td>
<td>3,165,358</td>
<td>408,656</td>
<td>12.9</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>6,855,871</td>
<td>790,575</td>
<td>5,965,735</td>
<td>1,090,435</td>
<td>12,841,607</td>
<td>1,881,010</td>
<td>14.6</td>
<td></td>
</tr>
<tr>
<td>Total non-agricultural</td>
<td>682,800</td>
<td>790,575</td>
<td>2,482,220</td>
<td>1,090,435</td>
<td>5,165,020</td>
<td>1,881,010</td>
<td>36.4</td>
<td></td>
</tr>
</tbody>
</table>

Such a discrepancy is due to rounding off errors as one cannot expect to obtain equal figures from the households and from the enterprise in a sample survey
Source: CBS, K Rep and ICEG 1999

SME entrepreneurs made an average of Ksh 6,008 per month, almost 2.5 times higher than the then minimum wage (Table 4.4). Unexpectedly, the average wages/salaries paid to workers in SMEs were also higher (i.e. Ksh 6,496) (Table 4.5) representing 2.7 times the minimum salary (4.5 times in urban areas and 0.8 time in rural areas).
Table 4.4: Average Monthly Income of MSE Entrepreneurs (Ksh)

<table>
<thead>
<tr>
<th></th>
<th>Manufacturing</th>
<th>Trade</th>
<th>Services</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Women</td>
<td>3,634</td>
<td>3,455</td>
<td>12,872</td>
<td>4,344</td>
</tr>
<tr>
<td>Men</td>
<td>5,507</td>
<td>5,519</td>
<td>17,523</td>
<td>7,627</td>
</tr>
<tr>
<td>Both</td>
<td>4,869</td>
<td>4,370</td>
<td>15,730</td>
<td>6,008</td>
</tr>
</tbody>
</table>

In multiples of the minimum salary

<table>
<thead>
<tr>
<th></th>
<th>Women</th>
<th>Men</th>
<th>Both</th>
</tr>
</thead>
<tbody>
<tr>
<td>Women</td>
<td>15</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td>Men</td>
<td>15</td>
<td>23</td>
<td>18</td>
</tr>
<tr>
<td>Both</td>
<td>23</td>
<td>47</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999

Table 4.5: Average MSE monthly salaries paid to workers (Ksh)

<table>
<thead>
<tr>
<th></th>
<th>Manufacturing</th>
<th>Construction</th>
<th>Trade</th>
<th>Services</th>
<th>Urban</th>
<th>Rural</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,771</td>
<td>5,192</td>
<td>7,852</td>
<td>13,130</td>
<td>10,973</td>
<td>1,845</td>
<td>6,496</td>
<td></td>
</tr>
</tbody>
</table>

In multiples of the minimum salary

|       | 1.6 | 2.2 | 3.3 | 5.6 | 4.6 | 0.8 | 2.7 |

Source: CBS, K Rep and ICEG 1999

4.3.2 2001- 2003

The next section illustrates with available and reliable data the employment trend in SME sector in Kenya between 2001-2003. Here data is sourced from Kithae et al (2012) which rely on the 1999 survey estimates. These are estimates which show that in the year 2002, the SME sector consisted of 74.2 percent of total national employment. By 2003, SMEs employed approximately 4.6 million people in the manufacturing, construction, services, transport and communication. This was also a gradual increase in contribution to employment through the early 2000s (Table 4.6 and 4.7)

SMEs particularly continued to surpass the public sector in terms of creating new jobs as Table 4.7 shows and in terms of taking up the biggest share of employed population.

Table 4.6: Contributions of MSEs to Employment per Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing sector</td>
<td>779,900</td>
<td>861,800</td>
<td>934,200</td>
<td>1,029,800</td>
</tr>
<tr>
<td>Construction sector</td>
<td>109,500</td>
<td>125,900</td>
<td>133,200</td>
<td>139,500</td>
</tr>
<tr>
<td>Services sector</td>
<td>1,924,400</td>
<td>2,145,600</td>
<td>2,405,200</td>
<td>2,691,400</td>
</tr>
<tr>
<td>Transport &amp; communication</td>
<td>95,900</td>
<td>106,800</td>
<td>120,600</td>
<td>135,600</td>
</tr>
<tr>
<td>Others</td>
<td>152,100</td>
<td>169,600</td>
<td>188,200</td>
<td>210,000</td>
</tr>
<tr>
<td>Total</td>
<td>3,353,500</td>
<td>3,738,800</td>
<td>4,150,500</td>
<td>4,624,500</td>
</tr>
</tbody>
</table>

Source: Kithae et. al 2012

Table 4.7: Contributions of MSEs to Employment Creation

<table>
<thead>
<tr>
<th>Sector</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector</td>
<td>1,743,200</td>
<td>1,753,800</td>
<td>1,760,700</td>
<td>1,742,500</td>
</tr>
<tr>
<td>Small and medium enterprises</td>
<td>3,353,500</td>
<td>3,738,000</td>
<td>4,150,900</td>
<td>4,624,400</td>
</tr>
<tr>
<td>Total</td>
<td>5,096,700</td>
<td>5,492,600</td>
<td>5,911,600</td>
<td>6,366,900</td>
</tr>
</tbody>
</table>

Source: Kithae et. al 2012
4.3.3 Past 5 years (2009 - 2013)

Data for this section is derived from the annual economic surveys by Kenya National Bureau of Statistics (KNBS) and KIPPRA (2013). Interviews at KNBS and the MSE authority revealed that the informal sector is considered to represent SMEs. Here they are characterised as semi organised, unregulated, and use low and simple technologies with low numbers of people employed per business (KNBS 2014.) This excludes small scale farming and pastoralist activities.

Table 4.8: Total employment, 2009-2013

<table>
<thead>
<tr>
<th>Activity</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modern establishments-urban and rural areas:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage employees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Self-employed and unpaid family workers</td>
<td>195.90</td>
<td>2016.2</td>
<td>2084.1</td>
<td>2,155.8</td>
<td>2,265.7</td>
</tr>
<tr>
<td>Informal sector</td>
<td>8,676.6</td>
<td>9,371.1</td>
<td>9,958.3</td>
<td>10,549.4</td>
<td>11,175.3</td>
</tr>
<tr>
<td>Total</td>
<td>10,703.1</td>
<td>11,457.1</td>
<td>12,116.2</td>
<td>12,782.0</td>
<td>13,524.8</td>
</tr>
</tbody>
</table>

*provisional

1 figures refer to employment stock as at 30th June and excludes small scale farmers and pastoralist activities

Source: KNBS 2014

Table 4.8 above shows that in 2011, SMSEs employed 80 percent of the total workforce in Kenya. The total employment in 2013 in the SME sector was estimated at 6.4 million persons. They are also the biggest creators of new jobs:

- In 2013, the informal sector created an estimated 625.9 thousand jobs constituting 84.3% of all new jobs
- 591.4 thousand in 2012 i.e. 89.7%
- In 2011, it was 587.4 thus 95.7%
- In 2010, 440.9 thousand out of 503.5 thousand;
- and in 2009, 390.4 thousand jobs accounting for 87.6% of all new jobs.

Table 4.9: Number of persons engaged in the informal Sector by activity, 2009-2013

<table>
<thead>
<tr>
<th>Activity</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing.........................................</td>
<td>1,769.9</td>
<td>1,890.8</td>
<td>1,964.7</td>
<td>2,044.4</td>
<td>2,238.9</td>
</tr>
<tr>
<td>Construction..........................................</td>
<td>224.9</td>
<td>238.3</td>
<td>261.3</td>
<td>282.5</td>
<td>292.9</td>
</tr>
<tr>
<td>Wholesale and retail trade, hotels and restaurants.</td>
<td>5,175.3</td>
<td>5,605.3</td>
<td>6,007.0</td>
<td>6,406.5</td>
<td>6,708.3</td>
</tr>
<tr>
<td>Transport and communications2..</td>
<td>268.3</td>
<td>291.6</td>
<td>308.9</td>
<td>328.7</td>
<td>346.1</td>
</tr>
<tr>
<td>Community, social and personal services............</td>
<td>843.2</td>
<td>918.5</td>
<td>967.4</td>
<td>1,029.4</td>
<td>1,086.7</td>
</tr>
<tr>
<td>Others..................................................</td>
<td>395.0</td>
<td>426.8</td>
<td>449.0</td>
<td>457.9</td>
<td>502.4</td>
</tr>
<tr>
<td>TOTAL......</td>
<td>8,676.6</td>
<td>9,371.1</td>
<td>9,958.3</td>
<td>10,549.4</td>
<td>11,175.3</td>
</tr>
<tr>
<td>Urban.................................................</td>
<td>2,867.8</td>
<td>3,082.8</td>
<td>3,248.5</td>
<td>3,411.9</td>
<td>3,982.9</td>
</tr>
<tr>
<td>Rural.................................................</td>
<td>5,808.8</td>
<td>6,288.5</td>
<td>6,709.8</td>
<td>7,132.5</td>
<td>7,192.4</td>
</tr>
</tbody>
</table>

*provisional

1 estimated

2 includes mainly support services to transport activity

Source: KNBS 2014
As shown by Table 4.9 above, SMEs continue to cut across several sectors with trade as the dominant engagement. There was a 5.9 percent employment growth in the informal sector with urban areas showing higher growth of 16.7 percent as compared to 0.8 in rural areas. Ideally, wholesale and retail trade and hotels and restaurants registered the largest increase of 301,880 thousand persons - findings that will be confirmed by the empirical work in later sections of this report.

Particularly, it is interesting to note that the trend in the early 2000s where the rural areas register the highest number of persons engaged in the informal/SME sector largely continues in the late 2000s and beyond. This mirrors the trend in population where majority of the population is still found in the rural areas despite noticeable rural-urban migration.

These findings and trends on employment continue to confirm the prolific role of micro, small and medium enterprises (MSMEs) in employment creation, income generation and consequently poverty reduction. For instance, the share of informal jobs has steadily increased from 70 percent in 2000 to 83 percent in 2012. This is despite a declining capacity in the formal sector to create employment (KIPPRA 2013). Thus the belief that MSMEs can help to achieve the broad goals outlined in Vision 2030 of making Kenya industrialised and achieving a high quality of life for its citizens is not unfounded. Most reviewed literature for the study are in agreement on this role. However some quarters of analysts are not so optimistic. The study by KIPPRA (2013: 30) shows that “most of the informal economy jobs are characterized by higher ratios of casualization, are more precarious, and exhibit lower productivity and wages. These outcomes imply that the relatively strong economic growth since 2003 may not have translated into meaningful improvement in the quality of jobs created. This may have undermined the welfare of workers and their families.” The study continues (P31) to add that:

‘the large share of employment in the informal sector in Kenya indicates low productivity, low pay and high levels of unpaid family employment. Informal sector employees are also often excluded from social security schemes, and labour protection legislation. The growing informal economy is characterized by either under-employment or working for very long hours, and a large share of the informally employed are classified as the working poor.’

In summary, the argument is that these jobs are not meaningful in improving the livelihoods of those involved.

### 4.3.4 SMEs, youth and Women

SMEs are noted to provide opportunities for vulnerable population such as women, unemployed youth and in some cases children (KNBS 2014). KIPPRA (2013) noted that relative to workers aged 15-64 years, women and the youth are more likely to be engaged in informal activities. In his speech titled ‘SMEs as strategic drivers of African social and economic development: challenges and policy prescriptions’, at the 3rd African Governance, Leadership and Management Convention 2012 held in Whitesands Hotel, Mombasa, Kenya on 5th - 9th August 2012, Ambassador Juma V. Mwapachu, President of Society For International Development and Former Secretary General of the East African Community, noted that:

‘with a youth bulge, the job crisis will be accentuated. In this context, the growth of SMEs, many of which will be urban based, will be critical in creating jobs to fit this population growth. It is estimated that EAC’s labour force will grow by 27 million people between 2010 and 2020. The huge question is where the jobs will come from to absorb such a labour force. One answer is increased Investments in SMEs.’

The SME sector is particularly relevant in light of the so called ‘Africa rising’ phenomenon. An excerpt from Ford (2014) notes that ‘this now-familiar narrative observes Africa’s high average
economic growth rates; growing confidence and capability among technocratic reformers; greater variation in the geopolitical origin of economic partners; and the potential of Africa’s youthful, urbanising, aspiring and innovative populations. The sector is thus seen to provide the social and economic potential to absorb the youth and their enterprising innovations.

This narrative is relevant in addressing the problems of Kenya. The youth comprise 62.9 percent (and growing) of the population (GOK 2013a) while half of the total population is female (KNBS 2010b; 2010c). Other sources like ADB et al (2012) note that youth unemployment constitutes 70 percent of total unemployment in Kenya. This means that the problem of unemployment is predominantly a youth issue. Recently, Government efforts such as Kazi Kwa Vijana, The Women Fund and Uwezo Fund have played a key role to draw even more women and youth into SMSEs given the special youth agenda and focus of the 2010 Constitution. This is largely aimed at ensuring the Government curbs youth and women unemployment and contributes to poverty alleviation.

Seeking data on women and youth enterprises is however not without challenges. While the 1999 SME survey might provide reliable data as at then, follow-up data and figures highly vary between sources. In 1999, there were 612,848 women in MSEs in Kenya, accounting for 47.4 percent of all those in MSEs. It was estimated that the ownership of Kenyan MSEs by both men and women was almost equal with women standing at 48 percent and men accounting for 52 percent. However, other variations were found:

- Men were found to own more rural enterprises (54%) while women owned more of those in the urban areas (52%) (Table 4.10)
- Women were largely engaged in trade (74.7%) as opposed to manufacturing, services and construction
- Men generated more employment compared to women (60:40 ratio) (Table 4.11)
- Men tended to work in MSEs owned by men while the vice versa was also true. Table 4.12). 80 percent of the men worked in MSEs owned by men and 68 percent of the women worked in MSEs owned by women
- Women operated smaller enterprises than men. The average number of employees in a women owned versus men owned was 1.54 versus 2.1

However, if we refer to table 4.4, the biggest difference is in income. In all activities (manufacturing, trade, services) women consistently made less than men. While men earned an average salary of Ksh. 7,627/-, women earned Ksh. 4,344/-.

### Table 4.10: Sex Distribution of Respondents (or Owners) of MSEs

<table>
<thead>
<tr>
<th>Locations</th>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Col%</td>
</tr>
<tr>
<td>Urban</td>
<td>213,262</td>
<td>31.8</td>
</tr>
<tr>
<td>Rural</td>
<td>457,465</td>
<td>68.2</td>
</tr>
<tr>
<td>Total</td>
<td>670,727</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999
Table 4.11: Percentage Distribution of Total MSE Employment by Location and Sex

<table>
<thead>
<tr>
<th></th>
<th>Men</th>
<th></th>
<th></th>
<th>Women</th>
<th></th>
<th></th>
<th></th>
<th>Total</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Col%</td>
<td>Row%</td>
<td>No</td>
<td>Col%</td>
<td>Row%</td>
<td>No</td>
<td>Col%</td>
<td>Row%</td>
<td></td>
</tr>
<tr>
<td>Urban</td>
<td>470,380</td>
<td>33.3</td>
<td>58.1</td>
<td>338,940</td>
<td>35.8</td>
<td>41.9</td>
<td>809,320</td>
<td>34.3</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Rural</td>
<td>944,270</td>
<td>66.7</td>
<td>60.8</td>
<td>607,660</td>
<td>64.2</td>
<td>39.2</td>
<td>1551,930</td>
<td>65.7</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1,414,650</td>
<td>100.0</td>
<td>59.9</td>
<td>946,600</td>
<td>100.0</td>
<td>40.1</td>
<td>2361,250</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999

Table 4.12: Percentage Distribution of Male and Female Workers amongst gender of SME owner

<table>
<thead>
<tr>
<th>Owner</th>
<th>Male workers</th>
<th>Female workers</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>79.6</td>
<td>32.1</td>
<td>57.1</td>
</tr>
<tr>
<td>Female</td>
<td>20.4</td>
<td>67.9</td>
<td>42.9</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CBS, K Rep and ICEG 1999

After 1999, most of the data available on SMEs disaggregated by gender (outside of the annual economic surveys) is anecdotal and does not provide much information. These indicate that:

- 48 percent of the total employment in SMEs in 2004 was women (Omwenga et. al 2013)
- In 2003, there was an estimated 1.3 million women MSEs in the country (Kiraka et. al 2013).
- Women-owned businesses account for half (48 percent). 85 percent of women's businesses are found in the informal sector (Cutura undated).

Exceptions apply to the studies by Stevenson and St-Onge (2005) and McCormick (2001). The two studies highlight important characteristics of female owned enterprises. Most important is that women enterprises are much smaller and located in the home. This thus restricts women to sectors related to food and drink, dress and hair making unlike their male counterparts in metalwork, vehicle and construction (McCormick 2001). These are characteristics that she attributes to lower levels of education, lower savings and the burden of domestic work and responsibilities. Interesting enough is that women generally tend to form and join associations compared to their male counterparts.

Stevenson and St-Onge (2005) categorise women entrepreneurs into three categories -which can also be summarised in Figure 4.1:

- Numerous numbers of the micro *Jua kali* entrepreneurs - These are unregistered, with little or no education and limited access to both credit and markets. They are also highly constrained by domestic responsibilities and their husbands in seeking for instance training to improve their businesses.
- Small number of small entrepreneurs - They run registered business, are educated to secondary level, employing small groups of 6-10, have some experience in public or private sector enterprise management, supportive husbands, can access business development services (BDS), training and micro-finance, but constrained by access to financial services.
- Limited number of an elitist class - well educated to university level, have entrepreneurial family backgrounds and supportive husbands, are well travelled, experienced (due to former work experiences in management in the corporate world), access to networks,
information and financial services. These factors combine to mean that they largely own small, medium-sized or larger enterprises with potential to grow.

Figure 4.1: The three segments of women entrepreneurs: Gaps and needs

- Need growth management and leadership training
- Need more flexible and diverse loan products to meet working capital needs
- Need information about technologies, international linkages, trade fairs, export practices

Medium/large enterprisers (tiny number but going for growth)

- Collateral constraints limit bank financing option; MF too limiting
- Want financial and management training focused on growth
- Need exposure to business ideas, opportunities, market information/access
- Would benefit from opportunities to learn from other growth oriented women entrepreneurs

Small enterprisers (very small number; potential to grow)

- Low level of education
- Need market access and premises
- In need of business knowledge and skills; can’t afford BDS
- Limited capital resources; group-lending hinders ability to grow; most don’t know how micro-credit operates; need lots of training
- Problems moving to ‘formal’ status; difficulty with licensing/tax issues
- Affected strongly by patriarchal structures (e.g., role of husbands)

Micro-enterprisers (lots of them, but serious constraints to growth)

Source: Stevenson and St-Onge 2005
A much recent report by the International Labour Organisation (ILO) (2008) noted that women comprise half of the SMSEs (ILO 2008) (Table 4.13 below)

<table>
<thead>
<tr>
<th>Stratum</th>
<th>Male Workers</th>
<th>Female workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nairobi and Mombasa</td>
<td>53.8</td>
<td>46.2</td>
</tr>
<tr>
<td>Major Towns</td>
<td>52.3</td>
<td>47.7</td>
</tr>
<tr>
<td>Rural towns</td>
<td>44.2</td>
<td>55.8</td>
</tr>
<tr>
<td>Rural areas</td>
<td>53.0</td>
<td>47.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>50.8</strong></td>
<td><strong>49.2</strong></td>
</tr>
</tbody>
</table>

Source: ILO 2008

**4.3.5 SMEs contribution in Kwale**

In Kwale the ratio of formal to informal sector is 20:80 (KIPPRA 2013). Wage employment contributes about 8.6 percent of household income. The contribution of self-employment to household income is at 1.9 percent and 6.2 percent for rural and urban areas respectively. A big number of this group is engaged in the *jua kali* sector and other SMEs. The agriculture sector, mainly subsistence farming, contributes 80.6 percent to the household income employing about 62,681 people in the County.

At the same time, the County estimates on waged income earners is at 8.6 percent including general labourers. Those employed in service industry are teachers and public servants. It is however not clear how many of these wage earners are employed by SMEs.

**4.3.6 SMEs contribution in Kitui**

In Kitui, the ratio of formal versus informal sector is 20:80 (KIPPRA 2013). The County’s labour force stands at 433,800, with a higher percentage of women engaged (56.7), compared to men (MDP 2013b.) The *jua kali* sector and retail businesses are counted as one of the major sources of employment. Other sources of employment include, agribusiness and the formal sector. The number of *jua kali* businesses employ up to 720,000 people. Through this we can therefore infer that SMEs contribute however marginally to household income. Notably, urban self-employment as a sector is slated to contribute 4 percent to household income in the whole County.

In addition, the number of those in self-employment is approximated as 40,000. However, it is not possible to discern how many of these are in SMEs. It is noted still that a substantial number of the 40,000 are found in the goods sector as shop retailers and wholesalers - areas that our observation and interviews indicate that they hold a large number of SMEs.

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17 There are discrepancies in the county development profile as it also lists *Jua Kali* artisans as 75.
4.4 SMEs as Suppliers to the Extractive Industry

The extractive industry mainly comprises of two unique life cycles that entail several stages. These relate to the Oil and Gas Industry (OGI) – Figure 4.2 and the mining industry – Figure 4.3. These do provide opportunities for Kenyan SMEs as suppliers at the various stages.

**Figure 4.2: Oil and Gas Industry Structure**

![Oil and Gas Industry Structure Diagram](source)

**Figure 4.3: Mining Industry structure**

![Mining Industry Structure Diagram](source)

Source: Modified from Casavant and Musinamwana 2014; Sigam and Garcia 2012.
Figure 4.3 is relevant to Kwale and Kitui as activities here relate to mining. However, in both Counties, while companies located in the County are involved in extraction their processing plants are located outside the Counties e.g. Milli Glass is located in Mombasa County. Athi River Mining is located in Machakos County. Only Base Titanium consists of well-established on-site plant that can offer points of contact.

In Kenya generally - just like other low income countries - the greatest opportunity in the mining structure lies in provision of goods and services that possess three main characteristics. These are goods and services (Engineers Against Poverty 2007: 2):

- That have a large local market
- That employ a lot of manpower/labour and whose technological and capital investment is low
- Whose operational and related risks are low given the low capacity to withstand high risks related to the extractive industry

In the initial stages of set up i.e. most upstream and some midstream activities in Oil and Gas exploration and development (see Figure 4.2) as well as some processing activities in the mining sector (see Figure 4.3), provide much lower opportunities for Kenyan SMEs. These are largely capital heavy investments (refer to characteristics of SMEs and their lower capital base) and entail very specialised equipment. In the case of Kwale, interviews with mining companies indicated that the equipment used in exploration and construction was largely procured abroad with the opportunities for local firms limited to support services such as transport.

The report by Adam Smith International (2014: 22) recognises two principal opportunities for Kenyan companies and for employment levels through which key parties to the Kenyan economy can benefit. The two opportunities they argue are based and aligned with two stages of the mineral development value chain:

- Supplying inputs to the international resource companies, e.g. camp operations, catering, quality assurance
- Buying and processing outputs of the international resource companies, e.g. refining, smelting, petrochemical processing

Processing of inputs largely does not meet the recommended criteria mentioned by Engineers Against Poverty (2007) and Utterwulge (2014) as the Kenyan SME sector is not yet well developed. This is also a category of provision that largely falls outside of the scope of many SMEs due to high capital investments and the required level of technology. In more detail and following the recommendations by Engineers Against Poverty (2007), the supply of inputs is of most relevance to this study, given the scope of SMSEs and the requirements in provision of these goods. This can be broken down into a more detailed supply of goods and services as indicated in Table 4.14 below. Although these can be considered as short term, non-core and more supportive services, these are also not specialised services and goods and provide a higher number of and easier opportunities for SMEs to capitalise on and dominate in their provision.
Table 4.14: Some potential goods & services for local supply in the extractive industry

<table>
<thead>
<tr>
<th>General Services</th>
<th>Logistics and Warehousing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accommodation</td>
<td>Transportation services</td>
</tr>
<tr>
<td>Pest control</td>
<td>Mailing and courier services</td>
</tr>
<tr>
<td>Catering</td>
<td>Landscaping and gardening</td>
</tr>
<tr>
<td>Printing and photography</td>
<td>Personnel agencies</td>
</tr>
<tr>
<td>Cleaning and laundry services</td>
<td>Basic professional services (legal and accounting)</td>
</tr>
<tr>
<td>Forestry and environmental services</td>
<td>Translation services</td>
</tr>
<tr>
<td>Security</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Construction &amp; Trades</th>
<th>Air-conditioning maintenance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small vehicle maintenance</td>
<td>Carpeting and floor coverings</td>
</tr>
<tr>
<td>Telecommunications and data systems</td>
<td>Earthworks</td>
</tr>
<tr>
<td>Low-voltage electrical maintenance</td>
<td>Fencing and paving</td>
</tr>
<tr>
<td>Road marking &amp; signage</td>
<td>Painting and corrosion protection</td>
</tr>
<tr>
<td>Simple mechanical maintenance</td>
<td>Waste recycling and management</td>
</tr>
<tr>
<td>Roofing and waterproofing</td>
<td>Sewage, storm water and drainage</td>
</tr>
<tr>
<td>Civil works maintenance and construction</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Goods (Wholesale, Distribution, Manufacture)</th>
<th>Cleaning supplies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automotive parts</td>
<td>Office equipment and stationery</td>
</tr>
<tr>
<td>Furniture and fixtures</td>
<td>Food supplies</td>
</tr>
<tr>
<td>Small motor vehicles</td>
<td>Appliances and electrical goods</td>
</tr>
<tr>
<td>Laundry equipment</td>
<td>Uniforms</td>
</tr>
<tr>
<td>Fuels, lubes and greases</td>
<td>Construction supplies and hardware</td>
</tr>
<tr>
<td>Machined tools and spare parts</td>
<td></td>
</tr>
</tbody>
</table>

Source: Engineers Against Poverty 2007

Table 4.14 acts as a guide, while the the starting point of the study is the mining companies and the services they required. We contextualise this table to the Kenyan extractive industry and to Kwale and Kitui Counties. This combined with a scan of the major towns (see methodology section for towns visited) resulted in emphasis of several goods and services as will be highlighted in the sections below.

4.4.1 Supplier availability and assessment in the two counties

This section assesses SMEs availability, readiness/willingness and capability to supply goods and services in the three main categories of goods and service provision. A key part of the survey and interviews attempted to gauge how existing and potential SMEs viewed their ability to service the resources sector across a range of key capabilities. This was coupled with the consultant’s perception based on the interviews as well as interviewed mining companies views, perception and experience with existing SMEs who provided a range of services. Capability here was defined as a function of several factors, including:

- Price and price competitiveness
- Business scale
- Lead time, delivery timeliness and reliability i.e. ability to complete work on time
- Technical capability and competence
- Buyer criteria of product or service quality i.e. capacity in enterprises to meet the company’s standards in quality as well as compliance with industry standards for safety
- Volume capabilities: ability to handle large volumes
- Tender preparation capabilities
- Contract/project management capabilities
- Risk management capabilities; for instance in the case of motor vehicle maintenance, companies need to provide security for the cars during maintenance and repairs
- Financial capability/requirements to meet procurement needs and orders
- Flexibility: degree to respond to random fluctuations in the demand and order pattern

As at time of research, a number of SMEs worked with the extractive industry or had at least engaged once in the past few years. A good number of SMEs and those that border the medium scale SME classification in Kwale particularly had some companies as repeat clients. They had a relationship established, and in some cases solidified with the companies. As the next section will show, this was for a number of varied services. However, for those in Kitui, this interaction was limited and almost none existent, largely because two companies involved are located outside the county.

It is still important to note that in Kwale there exists very little understanding of what these mining companies do, The nature of their activities in the County and the possibility of providing services and goods to them is not information among many locals. This is a factor raised under constraints. It was interesting to note that despite a number of SMEs knowing of or having heard of Base Titanium for instance, there was little knowledge of what the company does. Information available was largely limited to the location of the company, the sight of their vehicles in towns and hearsay. This was similar to the presence of Coast/Kenya Calcium Limited. This was not any different in Kitui. Largely, there seems to be very little interest from the SME sector in the extractive industry.

The three categories so identified i.e. general services, construction & trade and lastly goods are discussed respectively as follows:

a) General Services
This category has the least overall availability of existing and potential local suppliers in both Kwale and Kitui Counties. Catering services, for instance, for one of the major companies in Kwale is currently contracted out to a medium sized Nairobi based company. This is due to the lack of credible catering services that MSMEs can provide. Further, the high requirements of food safety in the industry are a deterrent for international companies to risk engaging in a local company.. Similarly, security companies are largely companies like G4S and Security Group Africa (SGA) which are hardly MSMEs.. However, such international security companies do have local offices e.g. G4S has an office in Kwale town and are generally considered as well capable of providing the necessary services to satisfaction. This is the same case with courier services. Given the wide expanse of coverage that is required in courier services, it is unrealistic to expect MSMEs in this kind of service. It requires high capital expenses and investment in motor vehicles. Despite the presence of a thriving hospitality industry in Diani, it is unique that the study could not identify personnel agencies. This is attributed to hotels undertaking their own staff recruitment exercises.

Exceptions were found in the accommodation, transportation, printing and photography, basic professional services (legal and accounting) and translation services sections. There exists a number of affordable, clean and well established accommodation (both small hotels and what are referred to as guest houses), mostly in Kwale, Diani and to a large extent in Kitui. Diani (including the larger Ukunda and the beach road area) particularly is strategically placed. However, the challenge is the preference by company staff of more permanent house arrangements due to price implications. A good number of the expatriate and local workers in the companies prefer permanent house arrangements with house owners that cannot be categorised as MSMEs. Kitui will be well positioned to supply guest houses during the exploration stage as companies set up in the limestone areas. However, there are concerns about issues of distance.
Currently, staff transportation services for some mining companies in Kwale County, is provided by local companies. In the case of Base Titanium, vehicles used for staff pick up and drop offs is by an MSME. Despite the company being located in Mombasa, it also has offices in Ukunda. Transport of water to the community as part of the companies CSR activities is also carried out by local businessmen.

Legal and accounting firms/SMEs exist in the area. Mining companies however have their own in-house staff as accountants and prefer specialised large scale firms for legal services.

In terms of translation services, the hotel industry has spurred a good number of individuals and small schools to cater for this. Again the challenge is that such services are not required in Kwale. The mining companies have set up shop and have been present in the County for some time and already have local staff to assist in the same. In the case of the limestone company, the management are natives to the larger geographical area and do not need these services. Translation services are most important during the exploration and feasibility stages.

There are a number of photography shops in use by locals in both Kwale and Kitui. There are cyber shops that offer printing services but on a very small scale. However, customised printing services i.e. with company logos, in large scale and to the required standards are not available locally. A limestone company noted that they receive these services from Mombasa or Nairobi but would be interested if they were available locally and up to the required standard.

A hotel in Mwingi town

**b) Construction and trades**

Similar to the case of General Services, this category also entails a low presence of MSMEs. They both have potential as existing suppliers to the extractive industries in many of the categories listed in Table 4.14 above. Visits to the towns in both Kitui and Kwale Counties did not reveal MSMEs in air conditioning maintenance, carpeting, floor coverings, painting, and corrosion protection. Painting and corrosion protection is considered as part of construction work as illustrated below. Telecommunications, data systems and low-voltage electrical maintenance is not considered an area for MSMEs because these areas require high technical capacity not found in both Counties. The set up of telecommunications and data systems is done by National level companies with their regional offices based in Mombasa and at times Nairobi.

Plant maintenance in the case of Base Titanium is still foreign based. Interviewees argued that operations are needed around the clock and thus they are comfortable with quality being
delivered by foreign based organisations. It was highlighted that the risk of poor maintenance has dire consequences in terms of costs and stoppage or slowdown of essential services needed to run the mining sites.

In this category of construction and trades, the highest potential for MSMEs, and areas where they currently function best in both Counties, are in mainly two areas:

- **Civil works maintenance and construction**
  In both Counties, at least one credible construction company was found. Such a company was capable of handling large constructions both for the contracting company and their Corporate Social Responsibility (CSR) related construction works such as in schools and markets as well as small project works. These construction companies deliver quality work. There was an overall perception of satisfaction with their work by the companies and outsiders. A good example are the two companies in the case studies the section below.

In Kitui, despite the absence of onsite operations that require within the County construction work for the mining companies, several construction companies exist. These are also considered to deliver quality work. For instance, the County Government contracted such companies for projects which have been successfully completed in the recent past.

- **Simple mechanical maintenance and small vehicle maintenance**
  Kwale County has several garages and small vehicle maintenance units mainly located in Ukunda town and to a smaller extent in Kwale town. In Ukunda, these garages serve both the extractive industry and a host of other clients including the hospitality industry i.e. hotels, NGOs and the local population. Service provision by these garages is a factor that has spurred the rise of a vibrant industry and networking initiatives. In Ukunda, 13 of these garage owners and mechanics have formed an association of mechanics and garage owners. The association is their point of contact and negotiation for loans from financial institutions. These garages range from small scale to medium scale garages with well-constructed and strategically located facilities. An interview at Base Titanium for instance revealed that the small and medium scale garages they use do deliver quality work and within required timelines. These garages were also found to be competitively priced. However, the main concern was the inability to handle large volumes of work at ago. This necessitates work splitting amongst several garages. There still exist cases which necessitate the involvement of garages in Mombasa for work that was considered beyond the capacity of the garages in Ukunda.

Kalundu is a well-known area in Kitui that acts as the home of garages and mechanics. The area consists of a street with at least 10-15 garages and a host of mechanics that serve the town. At the time of visiting the area, the garages were a buzz of activity handling a variety of small vehicles.

c) **Goods (Wholesale, Distribution, Manufacture)**
The highest number of MSMEs (existing and potential) largely falls within this category. This means that (at the time of research) provision of goods provides the highest potential for MSMEs involvement in the extractive industry. This is a factor in the nature of MSME businesses found in both Kwale and Kitui, and even Nationally. This finding is in line with other studies such as the 2013 Kenya private sector study. This study also established that the largest numbers of SMEs in Kenya are traders.
The largest potential is in:

- **Furniture and fixtures and Office equipment and stationery**
  A high number of furniture enterprises are found in Kwale and to a limited extent in Ukunda. However, there was preference to use furniture installations from larger companies. Despite the quality of local suppliers been rated as average, the logistical implications and ability to deliver large volumes was something that was beyond the capacity of SMEs in Ukunda and Kitui. This is also complicated by the fact that such large scale installations happened during the set up stage - a stage noted by the companies to involve very low levels of procurement in Kwale.

  Stationery shops are found in both Kwale and Kitui. These also have the ability to provide large volumes. However as noted earlier, companies prefer customised stationery that is not available or currently on print in both Kwale and Kitui.

- **Cleaning supplies**
  Given that most SMEs are involved in trading goods, there is potential for this. However, there is preference for contracting a single contractor to handle cleaning services with a preference to buy cleaning supplies in bulk from one or a few suppliers, often not located within the locality. An example is the case of Base Titanium company hiring firms outside the locale.

- **Food supplies**
  Kwale County consists of a mixture of several large and small food markets located in the major towns. These food markets do not consist of SMEs but rather a fragmented number of men, women and the youth. The sellers are mainly individuals selling a variety of fruits and vegetables. Despite the ability to provide a variety of reasonably priced and fresh products, their fragmented nature poses logistical difficulties for any one large company that requires large volumes. Companies, for instance Base Titanium, prefer their catering services to be handled by a single contractor i.e. African Eco Safaris. However, a unique arrangement was negotiated to ensure the community benefits. In 2013, a community buying centre was set up in a partnership between African Eco Safari - a catering firm - and Base Titanium, the mining company. Each Tuesday, a market day is held at the centre, where the community members can sell their produce to the caterer who supplies food workers at the mining site. Given the high presence of hotels in Diani Beach, these are also invited to buy the supplies. The model has had moderate success. However there are a few teething problems as locals expect the company to provide transport to the centre. There are expectations that the company should buy all the produce brought to the market while in reality they can only buy what they need.

  Similarly in Kitui, food sellers consist of numerous, small scale and fragmented groups of vegetable sellers. These are found in the main market in Kitui town or by the roadsides. While these have the potential to provide affordable supplies, they face logistical problems due to their fragmented nature.

In both cases of Kitui and Kwale, other non-perishable food supplies can be sourced from national supermarkets chains such as Nakumatt and Naivas, local supermarkets such as Samrat and Chandarana in Ukunda, as well as the numerous small scale shops often referred to as *kiosks*. Unique is the existence of a number of wholesale shops that stock a wide variety of non-perishable consumables that have the potential to act as suppliers to the extractive companies.
Community buying center constructed by Base Titanium in Kwale County

- **Construction supplies and hardware**
  Both Kwale and Kitui have numerous hardware shops. In Ukunda alone at least 10 hardware stores were located along the main roads. These shops range from large stores, that are well stocked, capable of handling huge volumes of supplies and which are at the centre of the spurring construction industry in both Counties - to small hardware stores. A number of these hardware stores have well established connections to the construction companies already highlighted.

- **Uniforms**
  Provision of uniforms and protective clothing is unique. The extractive industry requires high quality protective gear that can withstand wear and tear and which provide the wearer maximum protection. Currently, headwear (helmets), shoes and reflectors including jackets are sourced locally in Ukunda or Mombasa. In Ukunda there exist at least one store that stocks such.

  The uniforms vary. In the case of shirts, an interviewee would note that ‘for shirts we have tried and are always disappointed. The shirt could not withstand three washes. However, for trousers, they are ok and we have kept up with local procurement.’ This statement was in reference to shirts procured in Kenya. In this category of uniform supply, the shirts are thus sourced from Australia to ensure quality.

- **Automotive parts, Fuels, lubes and greases, Machined tools and spare parts**
  Companies that provide small motor vehicles parts or large parts for motor vehicles were not found in Kwale. Most of these companies are located in Mombasa town. Spare parts shops that serve the vibrant mechanical industry exist in large numbers in the two Counties. Complementary relationships and associations were identified between the spare parts stores and existing garages. It was notable that these spare part shops are largely small in scale but capable of handling large supplies with the right assistance.
General Assessment

Generally, MSMEs are optimistic in their capabilities of providing certain services. The major strengths include their proximity to these companies in the extractive industry thus largely providing convenience.

The study observed and heard of average capacity to perform required technical activities, but with low managerial ability. Virtually all small scale SMEs and a number of those that can qualify as medium scale do not have internal management systems. The assessment also indicates very low levels of flexibility in terms of the ability of the MSMEs to respond to random orders. Moreover, the challenge extends to high volume of orders of any particular kind. This is largely because (apart from a few medium scale sized enterprises) majority of the MSMEs procure and hold within the stores small quantities of produce at any one given time. Goods are largely procured on order. This is due to their limited holding capacity, limited financial capacity, concerns for security and inability to project future demands.

In very few cases, there arose cases of collaboration. A few SMEs indicated a link to business networks and associations. An example is the garage owners association in Kwale. Limited cases of cooperation means limited avenues for bolstering business scale and improving chances to receive major projects given the scale and size of SMEs.

Interviews with the companies in Kwale to seek their experiences indicated they had witnessed a positive change in capacity over several years of engagement with local SMEs. An interviewee would note that ‘a lot of training and negotiation has happened. That they needed to register as partnerships and companies...needed to be tax compliant...that we cannot pay in cash...they needed bank accounts...we have a standard to meet...some are getting there but not all are there yet.’

MSMEs main concern and criteria is largely quality, safety, costs and reliability. Existing MSMEs are considered to perform well on most of these criteria. Technical capacity and ability to provide quality work in areas such as construction work and reliability in terms of hardware stores are a selling point. It was interesting to receive a number of referrals from these companies to MSMEs they had worked with and considered a valuable addition to their work. Concerns mainly arose in terms of the reliability in the case of delivery of goods. A good example given by one company was the failure by a local contractor to deliver water on the required date. This forced the company to source water elsewhere to meet the unexpected delay. The delivery however happened two days later. Such cases were noted to be very common.

There was a general concern on work ethics, general laxity and perceived willingness to work. One company indicated wanting work ethic especially of diligence in conducting business among MSMEs. Overall, there was a concern that MSMEs in Kwale tend to shy away from issues that they are capable of handling such as bottling of water. There is a perception that these require a lot of capital, while the companies thought differently. It was also noted that there is very little initiative to approach the mining companies. Existing contracts are largely because of a need by the companies and not due to the outgoing nature of the MSMEs. However, interviews showed that MSMEs do not have an understanding of the nature of operations within the mining companies’ compounds. Access to the compounds is highly restricted given the high security measures in place.

The assessment shows there is a performance and supply gap generally due to several factors that will be highlighted in the sections below. It is also important to note that despite this assessment focussing on the two Counties as case studies, interviews indicate that the capacity which lacks in
the two Counties is found in Mombasa and Nairobi to a considerable extent. A substantial number of services and goods are sourced from these two major towns as already indicated in the various sections.

In addition, it is important to highlight that the technical capabilities of MSMEs highly varies. Some companies already have such high ability to provide goods and services while the majority in any one field comprise of numerous micro and a substantial number of small enterprises with limited capacity. Only a few medium scale and relatively well-developed enterprises exist in both Counties.

**MSME Case Studies**

This section highlights SMEs interviewed for this study. This is to illustrate the nature of their businesses, involvement in the extractive industry so far as well as those with potential and their experiences - to give a visual image to the findings so far. The case studies also show the varied level of scale of the MSMEs and hint on some challenges that will be expounded in the sections that follow.

### Case 1: *Kins Motors*

This garage is a sole proprietorship located in Ukunda Town, Kwale County. It is one of the largest and most vibrant garages in Ukunda. The owner has been a mechanic for 10-15 years but the garage is listed for a lesser number of years i.e. 5-6 years. It employs four staff as casual labourers. The garage specializes in body work and repairs. For larger repairs, it sources for supplies largely from Toyota Kenya, DT Dobie, and Simba Colt dealers in Mombasa and Nairobi. It also relies heavily on the many small spare part shops in Ukunda for supplies for impromptu and small scale repair work.

When asked to classify himself, the proprietor would answer, ‘I am jua kali but not jua kali at the same time’. This is because in comparison to other garages in Ukunda, Kins is organized to a large extent but at the same time lacks key internal management systems. The proprietor basically handles all administrative, management and logistical work, and part of the repair and car maintenance work. *Kins* garage is unique: the proprietor has experience with E.I tenders and has applied for several of them. His garage is preferred by a number of NGOs and hotels - at the time of research we found WWF vehicles undergoing repair. He is also a member of the local *Jua kali* mechanics and garage owners association. The association act as the link to financial services from banks such as Equity bank. He is the former chairman of the association.

*Kins* garage is involved with the extractive industry and provides light vehicle maintenance and repairs for one of the mining company. However, they do not have any partnership agreement and depends on needs arising from the companies.

The proprietor attributes his success to his learning ability and regularly undertakes refresher course on new models of vehicles.

The proprietor noted the greatest challenge he faces is lack of adequate finances. Given most work is not paid immediately; it affects his operations by locking out capital. He argued the lack of rules and guidelines to govern garages and mechanics is a great hindrance to the development of the sector. He would prefer investment in business skills and linkage to financial institutions.
**Case 2: Nzambani Hardware and Soneneka Construction Limited**

Nzambani hardware is a registered partnership business since 2000. It deals in hardware, building materials and transport services. It is located in Kitui town and currently boasts of supply of building materials (cement, iron sheets, timber, sand etc.) to a host of NGOs (e.g. AMREF Kenya, World Vision, ADRA, RedCross), companies, Government departments and the Kitui County Government. These materials are sourced locally, especially timber, ballast and sand, but at times from Malawi and Tanzania in the case of timber. Other supplies are largely from Nairobi (e.g. steel, iron sheets, wire products and water tanks, water fittings and electrical fittings).

The hardware participates in tender bids in the E.I and employs around 16 workers with half retained on permanent basis.

Soneneka Construction is an outlet for the hardware supplies and owned by the same partners. They have undertaken several construction works for the County Government and constructed the building that currently houses the MP in the County. The company is comfortable accessing capital from banks using available contracts and invoice discounting. A number of the banks have backed up its tender bids in the past. Their major challenge is competition from the many similar medium scale businesses in Kitui. In addition, they experience delays in supplies due to their location.

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**Case 3: Haggai Enterprises**

Haggai is a local tailor with 4 years experience, having previously run a food business that went under due to competition. He is located in LungaLunga. He largely knits and sells women clothes. This is because of Swahili women's love for fashion, he always has a market. He often gets his supplies from Mombasa and since it’s too far away, it is a costly endeavour forcing him to buy in small quantities. His clothes are thus expensive. He cited lack of capital as his major constraint.

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**Case 4: Kawandi Building Construction**

This was formerly a sole proprietor but now registered as a limited company. Kawandi undertakes general construction work - builds schools, health centres etc. This is tax compliant company that has no problem accessing financial services since it uses the contracts to negotiate with banks. The company has internal systems set up, including required staff for auditing and survey work. He has had interactions and engagement with some mining companies, Local Government as well as received contracts through the Constituency Development Fund (CDF).

The company sources for its building materials locally (sand) and from neighbouring Counties like Kilifi (building blocks) and Mombasa (cement).

Their biggest challenge is the tax overburden from the central as well as the County Government. Given they source for building materials from other Counties, it finds the ferry a big constrain and time consuming exercise for companies located on the South Coast.
4.5 Supply chain analysis of Existing and potential SMEs

This section will focus on supply chain analysis. It also identifies the barriers and gaps in MSMEs participation in the extractives sector. In particular, the focus is on identifying and evaluating the barriers that inhibit involvement of MSMEs. While the supply chain will relate mainly to existing MSMEs, it can be used to infer to the procedure even for companies that are potentially capable given contextual and geographical factors remain similar. Further, there is the general fact that many of these MSMEs do not differ in characteristics. At the same time, given the varied nature of businesses engaged, it makes sense to organise these challenges as generic along the various steps of a supply chain analysis i.e. see Figure 4.3 below.

Supply chain here is defined as ‘a set of relationships among suppliers, manufactureres, distributors, and retailers that facilitates the transformation of raw materials into final products’ (Beamon 1998:18). It entails several stages of working together by several actors to acquire raw materials, to convert these raw materials into specified final products, and to deliver these final products to retailers in time and good condition (ibid). These steps and parties are involved directly or indirectly from the procurement to the delivery of the final product to the consumer i.e. in the extractive industry to the mining companies involved.

Supply chains consist of two parts: the supply of components to the manufacturer, and distribution of final products to the end user. Since this study focuses on the second part of the supply chain i.e. the distribution and logistics process, only a fraction of the actors relevant for supply chain management are examined by the study. It focusses in a very limited sense on the manufacturing component i.e. production planning and inventory control process of Figure 4.4.

**Figure 4.4: The Supply chain process**

![Diagram of the supply chain process](source: modified from Beamon 1998)
4.5.1 The Production Planning and Inventory Control Process

This process entails factors internal to the production process hence deemed more controllable. However, majority of the suppliers in both Kwale and Kitui Counties are service providers and suppliers of finished goods. The process of production therefore comprises the least number of MSMEs in the extractive industry in the two Counties. This is to a large extent because there exist limited (almost non-existent) production or manufacturing companies for goods relevant to the extractive industry in the Counties.

Construction work is one service that uniquely falls in this supply chain category. This is largely attributed to the fact that most materials for use are accessed in their raw form. The final product is a different finished product.

The challenges in the Production Planning and Inventory Control Process include but are not limited to lack of harmony in County taxes. Since the start of the devolution process, there is increasing pressure on Counties to generate revenue locally. First, some Counties take advantage of this pressure to exorbitantly tax supplies such as those in the construction industry. Secondly these taxes are not harmonised between Counties and hamper the running of businesses. It is also evident that there is limited consultation and engagement of MSMEs in their formulation. An interviewee explained that he is often required to pay taxes to a minimum three Counties on any one trip, after sourcing for building materials from north coast. If he resists, harassment by local authorities followed by way of confiscating his supplies. The construction business is most affected given many of these taxes are on raw materials and unfinished goods that tend to move from one County to another.

4.5.2 The Distribution and Logistics Process

Since most MSMEs in Kwale and Kitui Counties are traders and providers of finished goods, they largely fall under the distribution and logistics process of the supply chain. The supply chain process here thus entails procurement of goods from storage facilities, transportation and delivery of the goods and services to the retailer in this case the companies involved in mining. A shorter version of this process is the procurement of goods from distribution centres, transportation and direct delivery. Some variants of this supply chain involve transporting, storage and then delivery to the mining companies or to a larger contractor (who has a contract with the company). African Eco Safaris and the locals providing food supplies in Kwale is a case in point of the latter.

Value addition in such a section of the supply chain mainly relates to convenience and location as most MSMEs are not manufacturers. Therefore, one cannot make inferences about improvements in the physical condition of products procured and delivered into the supply chain. This section concerns improvements, processes and challenges concerning the overall SMEs capacities to handle logistics as well as their conditioning and performance as shaped by external factors.

Logistics and transportation tends to be the most cumbersome process encountered. It also takes the longest time since as already indicated, there is the absence of manufacturing and production companies in the two Counties. Very few goods and services are found within the area. Majority of the goods and services are sourced from outside the Counties; with Mombasa, Nairobi and neighbouring Counties taking the lead in Kwale. In Kitui, goods are sourced from Embu and predominantly Nairobi. To demonstrate this with a few examples; perishable food supplies are sourced from Kongowea Market in Mombasa in the case of Kwale and from Embu and/or Nairobi in the case of Kitui. Vehicle spare parts, lubes and greases are sourced from
Mombasa in Kwale as is the case of Kitui from Nairobi as the source market. This increases the costs for most MSMEs resulting in high cost of operations. Other examples are illustrated in text boxes below as MSMEs case studies.

The challenges in the various links in the Distribution and Logistics Process of the supply chain include:

a) Poor and inefficient infrastructure

Poor infrastructure increases the cost and messes the logistics of transportation. It is a major challenge for transporting goods to the smaller towns in both Counties. One major hindrance and logistical complication for small and medium scale enterprises in Kwale is the ferry and its related delays. An interviewee who owns a medium scale construction company indicated that it takes him on average three to four hours for a trip from Mombasa due to ferry delays - a trip that is normally supposed to take less than an hour. This increases the cost of doing business in Kwale.

Kitui on the other hand has 210.2 km of bitumen, 1564.9 km of gravel surface and 1846.7 km of earthen road. Most of these roads are in poor condition, impassable during the rainy weather and severely affected by soil erosion. A case in point was the need to change the route for data collection during this study. This means transport between the major towns Kitui and Mwingi and other 200 smaller urban centres is poor, hindering development of market centres and access to markets for agricultural produce (GOK 2013c).

b) Lack of organized and poor marketing infrastructure coupled by poor industrial development

Weak and inadequate farmers’ cooperative societies and associations coupled with poor roads condition in the county is a hindrance to marketing process. Both Kwale and Kitui

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**Box 1: The status of Kwale roads**

Existing road network in the County is inadequate and in a deplorable poor condition. Of the County's total classified road network of 1,483.1 kilometres only 187.7 kilometres (or 12.6 percent) is of bitumen standard. The tarmac road network only serves the coastal strip (Mombasa - LungaLunga) and the northern part of the county (Mombasa - Nairobi Road). Kwale town is also served by a tarmac road network. The rest of the county is served by earth roads which become impassable during rainy seasons. The dearth of roads providing access to isolated hinterland areas is compounded by the poor state of repair of existing roads. The deficient condition of the County's roads has impacted on the local community in a variety of ways namely high prices of farm inputs, high cost of transportation leading to high prices of farm products that cannot compete nationally, inaccessibility of medical facilities. Roads to high impact socio-economic areas such as the Kwale-Kinango-Samburu road, Lunga-Lunga Kinango road and Kinango Mariakani Road, Msambweni - Lukore road are not tarmacked. The southern beach stretch extending from Majoreni to Vanga is yet to be opened up for serious tourism activities. Earthen roads are not regularly and professionally maintained. The Likoni ferry crossing is time-wasting, unreliable and therefore unacceptably costly to the economy of the entire South Coast and Tanzania. The continued delay in the construction of the Dongo Kundu bypass project has continued to adversely affect economic development of the County.
lacks industries to process and preserve most of their agricultural produce. Suppliers are forced to rely on Kongowea market in Mombasa.

Kitui has a large number of dormant cooperative societies. Undeveloped agro-industries mean the potential to organise, process and add value to crops is lost. At the same time, the industrial base is low meaning most of the produce and goods are sourced from outside.

c) Increase in un-necessary costs and competition
Many of the SMEs sell similar products. There is little innovation. Many respondents thus reported use of price as a competitive edge by selling more cheaply than their competitors.

Other challenges that cut across both processes of the value chain
These are challenges that cut across both processes of the value chain:

a) Information gaps and lack of familiarity
As previously noted MSMEs are not familiar with the nature of activities in the extractive industry or even opportunities for tendering and service provision. It seems most people had heard or had seen the companies’ vehicles in the towns or even had seen signboards put up where the companies had undertaken CSR activities. People were also aware of the location of the companies. However, most considered the companies unreachable due to the nature of their security measures. Where information was available, it was highly skewed in the perception that the companies were only involved in ‘taking away our resources.’

Scanty information regarding tender opportunities and availability of business opportunities was noted. This is due to a lack of interest by SMEs, perceived absence of information in the public domain and possibly inaccessible tendering processes. One company indicated the presence of a closed tendering system conducted on phone and based on established relationships with some select SMEs. A number of SMEs considered themselves as beyond the target reach of the companies i.e. ‘they do not deal with our kind’ or ‘we are too small for them.’

b) Varying expectations
There are also differences between MSME expectations and the reality of procurement process of these companies. The large companies prefer to deal with one major supplier and put safety or quality as key on the agenda. The reality in Kitui and Kwale is one of many fragmented SMEs.

c) Inadequate access to finance
Many SMEs faces financial difficulties. This is despite the presence of several international and local financial institutions in both Counties. Kitui is served by six commercial banks: Barclays, Equity, Cooperative, Family Bank, Kenya Commercial Bank and K-Rep Bank. Micro financial institutions include Kenya Women’s Finance Trust (KWFT) and Jamii Bora (GOK 2013c). Kwale County is serviced by nine commercial banks and four micro finance institutions including Barclays, Cooperative Bank, Kenya Commercial Bank, Fidelity, National Bank, KWFT, Imperial, Diamond Trust Bank, and Family bank. However, this large presence of financial institutions does not translate to accessible financial services as lending terms are not favourable (GOK 2013c). Few MSMEs have the required level of collateral or security. Many of the micro and small SMEs are largely considered ‘unbankable’.

MSMEs lack financing to service certain categories of contracts. Most of the contracts are on delivery, and with few cases of advance payments, which poses problems for many SMEs. The empirical results indicate that there was an information gap in MSME financing, that is, the necessary knowledge on financial sources was lacking. The respondents felt that they had difficulties knowing where to access business finance that they can actually qualify for.
In terms of pre-financing, medium scale enterprises that are able in a few cases to access some contracts indicated that banks mainly finance and honour contracts by the Government and not those from the private sector.

A section of the street in Kwale Town

d) Un healthy suppliers relationships
Suppliers are considered to be an important resource which plays a major role in the success of any organization. Supplier selection is ideally based on a wide range of criteria, including total cost, quality and technical performance. Interviews for this study showed that supplier selection is largely about cost. Reliability and timely deliveries feature to a negligible extent. This exposes many MSMEs integrity as suppliers themselves while security of supply is a major concern by the mining companies.

e) Capacity gap
Another problem raised by many of the interview participants is the lack of capacity of small businesses. The perception exists that local contractors based in remote locations and even those in urban centres such as Ukunda and beyond, often lack capacity to deliver and ensure safety procedures in order to meet industry standards.

By capacity gap, I mean inadequate storage and warehousing and general low volume capabilities. Due to limited financing, SMEs rely on piecemeal orders and deliveries. Low stockholding levels means most local SMEs struggle to meet demand.

Structure and organisational capacity is a key impediment. Internally, many MSMEs lack capacity to prepare tender bids. As noted earlier, many do not have internal management systems, business plans and lack skills in financial management. Others seemed overly unconcerned and even ignorant about the importance of such systems even in their basic form. Largely, business are run irrespective of the lack of expertise of the proprietor. Others have employed family members with no expertise to run or grow the business. There is little investment in human capacity.
Logistics capability to leverage other suppliers and actors into the provision of services is limited. Many MSMEs have limited access to networks and business connections to leverage in joint supply and meeting customer needs. This lack of cooperation can also be attributed to intense competition as most SMEs sell similar products.

f) Unavailability of raw materials
Most supplies in the Counties are sourced from outside. This increases the costs for most MSMEs resulting in high cost of operations, as reiterated several times in this study.

4.6 Factors hindering growth of SMSEs to the National Economy and Kitui and Kwale Counties Economies
This section highlights policies at the level of social, economic, and political factors that hinder MSMEs from contributing effectively to the National economy as well as to Kitui and Kwale Counties. Some of the factors mentioned here overlap with challenges that MSMEs at various links in the supply chain analysed earlier.

Lack of updated data and statistics
There is virtually a dearth of information and data on SMEs. The largest source of credible information on SMEs is the 1999 SME survey by the Kenya National Bureau of Statistics (KNBS). While the annual economic surveys entail sections on the informal sector, these are estimates and only cover a few areas - they are not comprehensive to allow for adequate planning for the sector and to facilitate small enterprise development. Numerous studies are available with a very limited geographical focus. Further, these studies rely on the above two mentioned sources for their statistics. Although interviews showed that such an undertaking is costly, it is difficult to plan adequately for the MSMEs sector in the absence of reliable and updated data. This is a concern raised elsewhere too (KIPPRA 2013).

Financial constraints
This has been reiterated as a serious constraint for MSMEs functioning, growth and expansion. Lack of or limited access to credit is attributed to several factors. First, is the lack of collateral. Most banks and financial institutions require some form of security to issue loans. SMEs on the other hand have limited assets and experience unwillingness of people to act as guarantors. Particularly, this is compounded for women owned SMEs as many Kenyan women face cultural barriers in owning fixed assets such as land (Stevenson and St-Onge 2005; Kiraka et. al 2013). There is also a general perception that given the informality of SMEs and their accompanying lack of legal status (many are not registered); they present a huge risk to banks. At the same time, the costs of monitoring and enforcing the loan contracts are high (CMA 2010). Limited access to capital reduces the competitiveness of MSMEs.

Weak or absent associations
A large portion of SMEs function outside of any major association. While there are associations such as the Kenya Private Sector Alliance (KEPSA), the average micro and small scale association is not aware and are not members of such or any other association. This limits their collective voice and negotiating power, meaning limited involvement in policy decisions and limited ability to address issues related to the sector or their businesses.

Low technology absorption capacity
Despite the crucial role that ICT plays in a number of sectors and the unprecedented growth of Information and Communication Technology (ICT) operations in businesses in Kenya, SMEs still employ low and inadequate technologies in their work. This is due to their own internal processes and management, where crucial management tools are inaccessible to many. In any case, such management tools are for external uses such as access to market information.
Related to the above are the low levels of education and skills available amongst SMEs.

**Limited market access**

Many SMEs have limited access to credible markets. Often they have access to localised markets within particular towns or geographical areas. Poor infrastructure and high transaction costs act to further contain the movement of their goods and services. This translates to market saturation, increased competition and inappropriate business practices such as corruption to outdo the competition. The African Centre for Open Governance (AFRICOG) (2013) notes that corruption is therefore so widespread in the SME sector that it is to a large extent accepted as common practice.

SME inability to access larger markets is also due to limited information and their low quality products. Little innovation means poor ability to access niche markets or to provide specialised services. Ernst Young (2009), notes that most international standards and minimum qualities lock out SMEs.

**Excessive administrative rules, regulations and taxation**

Many business rules and regulations including the tax regime are overly complex and administratively heavy on SMEs. These act as deterrent and punitive to the sector rather than enabling progress. In tandem with the findings of this study, the African Development Bank and The Government of Kenya (2013) note that the absence of harmonised and standardised laws and regulations at the local authority (County) level is not conducive to the growth of SMEs. Further, labour laws deter many SMEs from formalising. Giving an example of this rigidity, many MSMEs argue that minimum wage is increased annually without consideration to the market.

**Lack of information on public programmes and policies:**

Largely based on the interviews in Kwale and Kitui, SMEs have little knowledge and access to public information on policies and programmes that affect them and that can resolve issues they currently face. Inquiries on Youth and Women Enterprise Fund or County Government related programmes revealed that this knowledge is privy to a limited group. It thus effectively hinders their involvement in development programmes and in ensuring transparency and accountability in their implementation.

**Summarizing MSME related challenges**

MSMEs challenges can therefore be summarised as largely related to and associated with two factors:

- Ease of doing business in Kenya: In the most recent issue of ‘doing business,’ Kenya is poorly ranked, standing at number 129 out of 189 countries (World Bank 2013). This indicates deterioration in the rankings. The report shows that out of the 10 areas assessed, i.e. starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency, Kenya is increasingly performing worse in all but getting credit and trading across borders. This means the country is unfriendly for businesses on major fronts, with larger effect on SMEs given their low capacities already.

- Of greater interest is that the report argues that countries ranked well often perform well on two factors: low level of informality and greater gender inclusion - by not ‘depriving the economy of the skills and contributions of women’ (Ibid: 5). Given the current position of Kenya and the trends over the years, it thus speaks volumes about the position of women (and by inference, women owned or managed SMEs) in the Kenyan context.
The problem of informality: SMEs problems are largely due to the nature of their existence i.e. they are informal. Majority SMEs in Kenya are not registered, are not tax compliant and in most cases operate illegally. While this may be considered as an advantage, it works against their progress. The ‘benefits of informality (perhaps lower or no taxation, inspection and licensing burdens) outweigh the costs (perhaps lower access to formal finance)’ (ADB et. al 2013: 8).\textsuperscript{18}

\textsuperscript{18} See also Ogalo (2010) for more advantages versus disadvantages of informality.
5.0 Recommendations and strategies

This section contains measures that mitigate challenges faced by SMEs both in the extractive industry and in their contribution to the National Economy. Later sections entail general strategies and guidelines in relation to implementation of the mitigation measures. These however are biased towards the extractive industry which is the core subject of this study, although in some cases may apply to general SME programmes and development.

5.1 Measures to mitigate the challenges

A number of measures can help mitigate challenges and enhance the equitable and sustainable MSME development in the extractives industry. Here the report highlights several core measures, with emphasis on fostering linkages and creation of SME centres of excellence.

5.1.1 Fostering backward-forward linkages through Linkages programmes.

Business linkages are programmes that offer particular opportunities for linkage of small and medium enterprises to existing companies supply chains. The aim is to spur the growth and development of competitive and resilient MSMEs with a hope that this will spill over into the broader sector and foster economic development. Linkages provide substantial growth opportunities to upgrade and improve the supply and business capacity of local firms and to stimulate the local economy. They act as the predominant form of interface between SMEs and larger companies (IFC and Mozal Aluminium 2008), as part of what is increasingly referred to as ‘social mining’ (Saffer et. al 2009).

The integration of MSMEs into the supply chain of large companies which in this case can include transnational or multi-national corporations or even national companies is through use of a technical and business skills mentoring approach. These are tried and tested methods in many contexts and which can help MSMEs benefit (Wilson 2009).

There exists manuals on how such linkages can be pursued through IFC and Mozal Aluminium (2008) ‘Developing SMEs Business Linkages: A manual for practitioners based on the Mozlink mentorship experience in Mozambique’ or ‘Creating the Foundations for a Linkage Program in a Rural Setting Lessons Learned from the Early Stages of the Ahafo Linkages Program in Ghana’ (Newmont and IFC 2009). Ashley (2009: 3) argues that the guide, ‘Developing SMEs through Business Linkages - The MozLink experience’ is ‘the most comprehensive good practice guide to this approach.’

In addition several examples of how such linkages have been developed exists, expounding on the content, nature and experiences of such linkage opportunities both in the extractive industry and broadly (see Figure 5.1 and text boxes 2-4). A scan of these experiences highlights several components as essential to any linkage programme (Wilson 2009; IFC undated):

- Supplier development - This is where the aim and integral component is to support MSMEs to become suppliers and to provide goods and services. It entails both use and development of MSMEs as well as influencing local procurement. Developing supplier capabilities should aim at helping MSMEs meet the requirement of the company in terms of quality, safety, delivery etc. This can be achieved through skills development, capacity building, training and mentoring programmes that touch on management skills and production.

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19 Programmes that combine sustainable socioeconomic development and corporate management and strategy goals (Ibid: 3).
Demand Identification - This entails identification and anticipating the demand and needs of the companies involved, while projecting how these can best be met locally by MSMEs. This takes the shape of need (mining companies) versus opportunity (for MSMEs) and seeking the ‘best fit.’ Here the companies act as clients of MSMEs, but not exclusively. A major advantage of arrangements between MSMEs and the mining companies in any linkage programme is the ‘reputation effect’. Having contracts for supply of goods and services with large mining companies opens up opportunities for MSMEs to gain easier access to other companies in the same sector or even outside (Goldin, 2004; Robbins et al 2009).

It is possible to customise a linkage programme to suit and address a variety of needs in a given context depending on the actors involved. For instance, variants of such linkage programmes can also address the problem of limited access to credit for MSMEs. Financial Sector Deepening (FSD undated) in Kenya highlights issues of invoice discounting to address credit problems. This is a system that allows a ‘business to draw money against its sales invoices before the customer has actually paid. To do this, the business borrows a percentage of the value of its sales ledger from a financial company, effectively using the unpaid sales invoices as collateral for the borrowing’ (Ibid: 1). According to FSD, the invoices are exactly where the opportunity lies: as they are for goods delivered to and certified by large corporate buyers. Their payment is guaranteed by entities (the corporate buyers) more creditworthy than the supplier. These invoices can serve as collateral for credit. Therefore, the risk depends on the buyer and in this way it addresses issues of lack of credit worthiness and lack of collateral.

Box 2: Zimele: Support to supplier development
Zimele is touted as a private sector initiative that supports enterprise development and empowerment. It supports supplier development, looking for opportunities for SMEs in South Africa to supply to the Anglo group in the mining industry. It is a form of affirmative action investment fund, targeting SMEs managed or owned by previously disadvantaged people to act as suppliers. It focusses on linking the purchasing departments of Anglo and local SME, offering training, skills transfer and technical assistance, provision of finance and loans etc. It also runs Business Hubs to support SMEs in formulating business plans, tax advice etc.
By 2006, Zimele had invested in 100 companies and later stopped support of 70 of them. Of these, it is argued, 90 percent survived.

Source: IFC and Anglo American 2008; ADB, OECD, UNDP and ECA 2013
Figure 5.1: Business Linkage Model: Supplier Development

Opening Opportunities

- Board and executive level commitment for supplier diversity development
- Policy and strategy to embed the commitment
- Targets, measures and incentives
- Procurement opportunity identification and preparation
- Outreach and Sourcing

Company diagnostic

- Strategic Management Improvements (strategy, organisation, business planning, marketing etc.)
- Operational Improvements (production, product, quality, assurance etc.)
- Back Office support improvements (accounting, HR etc.)
- Training, mentorship, Coaching

Increased business linkages

- No progress, drop from program

Networking and matchmaking

Source: Modified from James 2012
5.1.2 Support the creation of SME centres of excellence

SME centres of excellence also go by different names, such as Enterprise Development Centres and Incubation and Support Centres. An SME centre of excellence is basically a one-stop-shop for SME local content or business development. Particularly, what such a centre achieves is a simplification of support and engagement for and with MSMEs. According to the UK Department of Trade and Industry (DTI 2002), MSMEs often face a barrage of assistance from varied actors - assistance which at times conflicts and overlaps. A centre of excellence can

Box 3. The IFC Copperbelt SME Suppliers Development Program
This was implemented as a partnership between IFC and the leading multinational mining corporation in Zambia. It helped build the capacity of SMEs to engage as suppliers with multinational mining companies. The program provided services to the SMEs including: business diagnostics, logistics arrangements to pick supplies from pre-defined points, training, information sharing, quality control systems and feedback, financing etc.
The success of this programme include over 300 SME participants trained, access to about US$20 million in contracts by SMEs and over 70 jobs created.

Source: IFC, undated

Box 4: Mozal Linkages Programme project
The Mozal Linkage programme was a supplier development implemented in Mozambique. It helped create linkages between SMEs and large investment projects including those in mining. It arose to address issues of poor access to credit, markets and lack of competition by SMEs. Although its aim is to increase local SME participation in large investment projects in Mozambique, it started by creating a link to engage with the Mozal aluminium smelter during its construction phase. The SME Empowerment Linkages Programme (SMEELP) consisted of a number of important components:

- Targeting a group of 25 local SMEs to start with
- Unbundling of large contracts into smaller ones by Mozal
- A few SMEs (3-4) were allowed to bid for the smaller contracts
- SMEs participated in a training programme prior to bidding for a contract.
  The training included: how to work with large TNCs, how to bid successfully, how to deliver and manage contracts and marketing skills
  The main components of their strategy included: a database of local firms and their services (supply side); technical auditing of the SMEs in the database; identification of firm potential and existing gaps; identification of potential markets (demand side); and the introduction of local firms to Mozal.
  During the operational phase of the smelter, the linkage programme was called Mozlink I and II.

Source: Robbins et al. 2009

59 MSMEs as suppliers to Extractives Industry
provide a ‘single, local point of contact’ or entry through which assistance can be directed (Ibid: 7).

According to Domjan (2004), MSMEs centres of excellence can run both structured technical assistance programs and offer ad hoc advice to local firms, particularly about business processes. In addition other services may include:

- Business development services: Many local MSMEs need technical support in branding, internal systems and marketing. Diversification of products is also key. One of our findings in this study is that many MSMEs are involved in one nature of business, effectively competing with each other and bringing little innovation to the table. This can also address issues of internal capacity and setting up internal systems of management. A study by Wanyonko (2013) shows that incubation and business development programs have significant influence on growth of MSMEs in Kenya.

- Support to the formation and spurring of dynamic MSME networks. Engagement in inter firm and peer networks is a solid platform for more effective learning, information sharing, upgrading, promoting a culture of enterprise improvement, to learn about current and best practice etc. (DTI 2002; Robbins et al 2009). It reduces dependence on outsiders when local firms can tap into each other’s expertise and support one another (Ashley 2009). The networks can also act as a point of contact and negotiations with county governments on policy dialogue and to lobby for services and support.

- Supplier development forums - to bring actors together and to provide opportunities for local and regional businesses. These forums can foster best-practice discussions among the business development organizations.

- Provide business start-up advice: i.e. how to get started and spurring of future businesses

- Connecting suppliers with procurement packages to access contract opportunities. This can include dissemination of tender announcements to local suppliers via mobile applications and SMS, training on how to bid and prepare tender documents to increase number of MSMEs’ accessing and winning contracts

- Matchmaking to help local businesses in linking up to particular buyers and suppliers on request i.e. sharing information, establishing relationships and facilitating partnering between buyers and other actors (World Bank 2012). The Overseas Development Institute (2005: 7) recommends what they call Matching, Mergers and Acquisitions i.e. local ‘meet the buyers’ expos and ‘matching pools’ that bring investors and local companies together to exchange knowledge and collaborate on approaches to supporting local procurement. These means an identification of the windows of opportunity, knowing what is needed when and linking up MSMEs to provide the same.

- Research and Development e.g. market research and promotion of use of technologies. ICT and related innovations ensure the MSME has a better grasp of their own and the mining company’s prospective demand and requirements to address the information gaps identified earlier (Esteves et. al 2009).

**Box 5: The Mozambique Business Network**

The Mozambique Business Network is a network of 15 local SMEs that offer a forum for sharing ideas and experiences pertaining to contracts with large companies in Mozambique. Setting up of this business network was facilitated by the International Finance Corporation (IFC).

Source: Robbins et al 2009
5.1.3 Support the development of a comprehensive database and registry of competent and qualified local vendors/SMEs

Lack of supplier databases is a hindrance to participation in local sourcing (Levett and Chandler 2012). This work can start from integrating supplier databases that exist with mining companies in an area to upgrading to the development of regional lists of suppliers. The information in such databases of local suppliers can include:

- information on company
- contacts
- products and services
- capacity.

It is important to note that such databases can also be part of the linkages programmes or part of what the centres of excellence do as an ongoing process over time and based on their engagement with MSME members. It is recommended that certain pre-screening criteria be in place so as to focus efforts on areas where local procurement can result in meaningful, sustainable economic development (World Bank 2012). The bank (ibid) argues that such a database can help build suppliers track records and assist in building a reputation.

5.1.4 Setting up infrastructure

There is considerable evidence within the body of literature, highlighting the relationship between infrastructure and economic growth (IFC and Mozal Aluminium 2008). This has led to increased investment in the provision of infrastructure as a way of stimulating economic growth (Wise and Shylla 2007). Infrastructure programs, especially those within transport, energy, and telecommunications and others, which have a direct impact on costs and delivery time competitiveness should be prioritised. The country integrated development plan (2013) notes that the Samburu-Kinango-Kwale road will be tarmacked to open access to markets for goods and services produced in the County and to save man hours spent at the Likoni ferry. At the same time, the planned agro based wholesale market will reduce time and costs related to accessing produce from Kongowea and reduce the logistical issues related to disjointed produce sellers.

Box 6: UNDP County Biashara Centres in Kenya

It is notable that a day before the validation workshop in Kwale, a County business development centre was launched in Mvindeni, Ukunda ward under UNDP’s Economic Empowerment Program (EEP). It consists of an incubation unit, training room, ICT centre amongst others. It is key that the centre should play a key and deliberate role in linkages between the SMEs and the extractive industry in Kwale as highlighted under this section. Only then does it provide ability to transform the SME sector as suppliers to the extractive industry.

Ashley (2009) gives other examples of such centres as including BP’s Enterprise Center in Baku, Azerbaijan and ExxonMobil’s Enterprise Center in Chad, run jointly with IFC and the local chamber of commerce; and the rural business development centers.

Box 7: ExxonMobil Supplier Database

In Chad, ExxonMobil in partnership with external partners has developed a supplier database that contains contact details, goods and services offered, and needs information for over 60 potential suppliers that have been assessed by the company as well as over 1,000 additional SMEs surveyed by IFC and the local chamber of commerce (Ashley 2009).
5.1.5 **Provision of financial services**
Financing linkages for both men and women and which are geared towards the SME target groups need to be enhanced. Where such already exist, there is need for third party facilitation to ensure they work. This can take the form of invoice discounting as already discussed in earlier sections of the report. A 2008 ILO report quoted in Kiraka et al. (2013) highlighted the need for women-tailored products in financing.

5.1.6 **Need for SME associations, cooperative and unions at County level**
MSMEs should be supported to form associations. The case of the garage and mechanics association in Ukunda shows there is potential for associations to address challenges that face MSMEs. Tarus & Nganga (2013) foresee this as crucial to address the lack of rules while enforcing accountability in the sector. As noted earlier, MSMEs can also lobby for action from County Governments and enhance dialogue between themselves and local Governments.

5.2 **Guidelines for implementing the recommendations**
The requirement in the TOR was to develop and share guidelines implementing the recommendations. This section highlights key considerations in the implementation of the above mitigation approaches.

5.2.1 **Facilitation processes are essential**
Often the assumption is that the process of linkage between corporations and companies in the extractive industry or otherwise with MSMEs is an automatic process. This is true to some extent. Some linkages can develop on their own based on prevailing needs on the part of the corporations and the availability of competent and qualified MSMEs to meet that particular need. However, as Robbins et al (2009: 43) note, most linkage activity between corporations and local firms requires ‘active facilitation processes’ i.e. the development of ‘carefully conceived, planned and executed interventions.’ Commitment and collaboration of a third party ensures more number of MSMEs benefiting a sustainable and systematic manner (Robbins et al 2009) which enhances the legitimacy of such linkages. This facilitation can take the shape of linkages programmes or the work of SME centres of excellence as already described earlier in this study or the presence of a third party as a facilitator.

5.2.2 **Identify, convene and mobilize stakeholders**
For any intervention to succeed, it needs to bring together the diverse stakeholders in the extractive industries including those that offer support services to the MSMEs. It is thus essential to forge a network of these actors to include companies, civil society, local Government practitioners and donors (Tapiero 2009; Robbins et al 2009)

While mobilising is important, it is also crucial to facilitate regular stakeholder dialogue. This might require forums to bring together relevant stakeholders.

5.2.3 **Constitute partnerships, collaboration and commitment from relevant actors**
Reviewed case studies in the extractive industries show collaboration and the support of a range of institutional parties is essential. Due to the complex nature of some of these interventions, there is need to identify potential partner companies that support the strategy and will help deliver it. Particularly:

‘to reach desirable levels of scale, collaboration enables sharing of knowledge and information, to poll scarce or diverse assets resources, access new sources of innovation, create economies of scale and enhance the legitimacy of the parties’ individual activities. In addition to assembling the necessary resources and capabilities, collaboration can generate new capabilities and change operation environments in ways that create new strategic opportunities’ (Wise and Shtylla 2007:5).
Collaboration ensures an integrated approach is followed and possibilities for increased and sustainable impact are fully exploited (Hackenbruch 2011).

It is difficult to implement interventions in the extractive industry without a buy in from:

a) The Government
To improve the investment climate for enterprise development, largely shaped by the tax regime; and to create a good business climate, it essential to involve County Governments. Findings show the tax regimes and County Governments are currently stifling businesses through unharmonised tax regimes and revenue collection by the County Governments respectively.

Involving County Governments given the current system of governance (i.e. devolution) ensures:

- a receptive and supportive enabling environment both in terms of facilitatory Government policy and other measures.
- Revenues from the mining sector will support local SMEs or supplier development (World Bank 2012. Currently the mining bill proposes that 15 percent of mining proceeds in the country will go to County Governments. These can also support in studies, technical support, and standards and certification for local suppliers (World Bank 2012).
- Investment in physical infrastructure and critical utilities.

National Government can undertake the same roles as well as offer tax relief and other incentives to mining companies that demonstrate working with MSMEs.

b) Business associations:
Business organisations, sector bodies and trade associations such as Chamber of Commerce and Industry (KNCCI), Chamber of Mines, the MSES authority and others that represent MSE concerns are seen by Uterwulhe (2014) as critical in driving local procurement programs, training and education and representing SME concerns. These organizations are also important in accreditation of suppliers and building the confidence of the mining companies in the capabilities of SMEs.

c) Companies in the extractives industry
The companies in the extractive industry are a very important stakeholder. Securing involvement, commitment and willingness to share responsibility from senior management in the companies’ is important and crucial for the success of such interventions. Their commitment is needed to:

- de-bottleneck the system and ensure a transparent system for local contracting to integrate local MSMEs into the supply chain (Mehta 2008). There might be need to modify procurement processes and systems and adapt them to the characteristics of local MSMEs or rather to the local reality and to implement conducive bidding processes. Particularly, it’s essential to link procurement processes to the CSR arm of the companies which our interviews indicate are run as separate endeavours and departments.
- provide the initial demand for goods and in some cases the capital
- ensure sustainability- Securing internal commitment within the mining companies is key as linkage programs are long term processes. Ashley (2009) argues that these programs often run for 5, 10, or even 15 years to achieve credible impact. Investments are needed in form of money, time and expertise to sustain this through various changes in management. Key staff are both the senior management and the procurement officers who implement these decisions.

Given that few companies have such programmes in place, there might be need to pass them off as more sustainable CSR options, rather than the ad hoc manner in which CSR is currently undertaken.
d) Local suppliers
Local suppliers should be willing to invest in improving their systems because these systems are needed to communicate their needs (Utterwulghe 2014). Largely for these, as the added value of such programmes is demonstrated, it generates more interest and commitment from the rest (ibid).

e) External partners.
External partners such as UNDP are important for the delivery and coordination of technical assistance and facilitation of dialogue at the policy level between stakeholders (Utterwulghe 2014). Such arrangements are not new to UNDP globally. For instance, UNDP worked with Chevron to support general MSME development in Kazakhstan and Angola, to increase their capacity to become suppliers of goods and services to oil and gas companies (UNDP 2012). Other external partners can include the International Finance Corporation (IFC), which has experiences in facilitating and supporting these arrangements in a diverse number of contexts, including Africa.

f) In some cases the civil society
These can (World Bank 2012 be by):
- Lobbying mining companies to procure goods and services locally
- Where provisions of local involvement are required by law, monitoring and evaluation for implementation of commitments by both mining companies while holding Government responsible for follow up.
- Information sharing, capacity building and awareness building for all other parties involved
- Facilitation of stakeholder dialogue by bringing together relevant stakeholders to exchange knowledge and collaborate on approaches to supporting MSMEs.

5.2.4 Issue of balancing expectations and managing realities

There is often a need for a compromise to manage expectations of the actors involved (Ashley 2009; USAID 2012). Largely, there is often quite some unsustainable level of optimism in such programmes. Outside of these programmes, there exist differences in perceptions between actors. For instance, a high sense of entitlement was noted in Kwale amongst the Government and the local community. On the one hand, interviewed companies held the view that that CSR is not a right rather than something they do out of goodwill. On the other hand, some MSMEs may have unrealistic expectations on what the programme can achieve for them. CTA and USAID/SPEED (2012) provide interesting examples of what some of these differences in expectations can be in Table 5.1 below:
Table 5.1: Varying expectations between SMEs and Mining Companies

<table>
<thead>
<tr>
<th>SMEs</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>We can supply anything &amp; can do any work</td>
<td>Drive to keep costs as low as possible</td>
</tr>
<tr>
<td>They have an obligation to procure from us / employ us, because we are local</td>
<td>They will buy everything local ... if goods and services are exactly what they want (quality and volume)</td>
</tr>
<tr>
<td>We are poor and hungry</td>
<td>They want to buy as much as possible from as few as possible suppliers - 'strategic sourcing plan' Less relationships to manage</td>
</tr>
<tr>
<td>We have the skills</td>
<td>procurement is a reality</td>
</tr>
<tr>
<td>Government will make them do it</td>
<td>Communication - electronic &amp; reliable</td>
</tr>
<tr>
<td>They promised</td>
<td>Sophisticated plants / mines - sophisticated demands</td>
</tr>
<tr>
<td></td>
<td>Long-term agreements - 3 to 5 years</td>
</tr>
<tr>
<td></td>
<td>It is about security and safety so reliability and quality are essential. They will compromise safety</td>
</tr>
</tbody>
</table>

Source: Schuman 2012

5.2.5 Start small, simple and build on small successes

One way to manage expectations is to pilot programmes and build on lessons learnt. Start small, simple in scale and the number of partners involved (DTI 2002). Expansion however should be a long term goal (IFC 2009). Additional partners can come on board on a need basis and their added value to the programme.

5.2.6 Leverage on existing opportunities

It is important not to start from scratch unless it is very necessary. Use of existing opportunities and leveraging on this ensures actors do not see a linkage programme as an additional cost on them. For instance, the Government already runs a programme on public procurement than encourages women and the youth as well as small business development in greater participation in Government procurement. Banks and financial institutions in Kenya run programmes on financial services for MSMEs. Kwale County Government allocates funds for the trade development programme meant as business incubation centres and business interactive forums. Base Titanium is in the process of introducing an apprenticeship programme that entails training in business skills. Interviews at the MSE authority indicate the authority and UNDP are about to launch a programme on setting up County Business Solution Centres. The Youth and Enterprise Development Fund exists to provide links for financing of small enterprises.

Linkage or MSME supplier programmes can actually run as spin-offs of existing smaller initiatives without necessarily creating new ones but with the added advantage of bringing together and building relationships between these smaller initiatives.

5.2.7 It is about potential and corporate competitiveness

The rule should be about competition and business. Focus should be on MSMEs and areas that have potential if the programmes have to be sustainable. As trailblazers create jobs for others, the programme can also take other SMEs through simple business skills.

Some mining firms cannot downgrade their needs and requirements, as this has the potential to cause serious security and safety concerns in the extractive industry. Largely, it the capacity of local suppliers that needs to be upgraded for them to become viable partners and if they want to function sustainably. It might make sense to pick MSMEs that show potential to become ‘winners’ and to invest in learning. Realistically, not all MSME have potential. One way to address this is through rigorous conditions for MSMEs identification and involvement or to start with those already involved with the mining companies and address identified gaps in their capacity.
5.2.8 Context is important
Kwale and Kitui Counties are not the same. Findings show that the hospitality industry has created a vibrant MSME sector in Kwale compared to Kitui. The number and nature of partners are also not exactly the same. It is thus key to customise any generic programme to the unique circumstances of each County and influenced heavily by the dynamics of the sectors concerned.

5.2.9 Do not re-invent the wheel!
Learn from other experiences while customising these experiences by taking context into consideration. South Africa, Chad, Australia, Canada etc. have numerous examples to start with to see what has worked, how it has worked as well as what has not worked and why.

5.2.10 Flexibility
Flexibility is key to ensure the programme or any initiative responds to changing contexts and experiences coming out of own experimentation. Ideally, these strategies should lead to a combination of competent suppliers, willing mining companies and external actors who provide a conducive environment and/or relevant support for the SMEs.

5.3 Recommendations for policy and legislative action
This section is about recommendations for policy and legislative action that will ensure sustainable MSME development.

5.3.1 Advocate for a local content policy
According to the African Union Commission, African Development Bank and United Nations Economic Commission for Africa (2011:31) and Wilson (2009), there is limited opportunity for linkage development in Africa without the right policies and strategies to leverage mineral extraction and processing operations into broader economic development outcomes. There is need for adequate provisions for local content and empowerment of citizens through legislation and investment in human resources and knowledge development, particularly to grow the higher level technical skills base required by the minerals industry. The Mining bill 2014 has provisions on some of these issues. Clauses 44 and 45 provides for the employment and training of Kenyans and for preference of Kenyan citizens during employment of works by mineral right holders. Clause 49 tackles preference for local products and businesses. However, these clauses are highly inadequate in comparison to countries that have been able to leverage on the extractives for economic development. These for instance do not specify what goods and services should be procured locally. Monitoring mechanisms are left to the cabinet secretary. In terms of jobs and goods, there are no minimum thresholds. Some countries have developed specific laws and/or regulations to implement local content (KCSPOG 2014). Tanzania published a first draft of their local content policy in 2014. Nigeria passed the Nigerian Content Act 2010. Ghana has a Petroleum (Local Content and Local Participation) Regulations (LI2204).

Such a policy needs to set minimum levels of local content i.e. detail minimum requirements for local employment, procurement, specify services which must be procured in Kenya, develop measures to monitor and audit agreed commitments (which should ideally be devolved to County level or put in the hands of associations such as the Kenya Private Sector Alliance), set penalties for non-compliance etc.

5.3.2 Counties should set clear regulations consistent with National level policies
Counties need to set policies that do not overburden SMEs. Particularly, these need to be in line with national policies. In the case of the SME policy, this should be domesticated at the County level for consistency.
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