
Ochieng Apondi Nisbet

Adm No: R50/70135/2013

A project Submitted in Partial Fulfilment of the Requirements for the Degree of Master of Arts in International Studies

October 2015
DECLARATION

I hereby declare that this is my original work and has not been presented for the award of degree in any other university.

Sign......................................... Date.............................................

Ochieng Apondi Nisbet

This project has been submitted for examination with my approval as university supervisor.

Sign................................. Date.................................

Gerrishon K. Ikiara
DEDICATION

I dedicate this work to my parents Mr. and Mrs. Ochieng for believing in me and to
daughter Tulani Marwa for energizing me in a special way to always strive for the
best and tackle anything in this world.
ACKNOWLEDGEMENTS

The successful completion of this thesis is credited to many people. I am first and foremost grateful to the Lord my God for the gift of life and health to the very end of the study.

I appreciate the intellectual guidance, inspiration and support of my Supervisor, Mr. Gerrishon K. Ikiara.

I wish to acknowledge the lecturers and staff of the Institute of Diplomacy and International studies for the support they provided.

I also thank my classmates for the wonderful moments we shared.

Special appreciation goes to those who contributed to the production of this work, especially Mr Kahuria for the guidance.

To my family, I dedicate all the good things that may accrue from this study.

To my parents Philip and Pamela from whom the river of life originated, am forever grateful to you for making me who I am.

To my daughter Marwa, may you live to enjoy the fruits of my study, may the loneliness you endured not be in vain, but be a humbling experience, and know that mummy loves you to bits.

I am also indebted to everyone who has in one way or another contributed to the completion of this work.

In acknowledging everyone who contributed to this study, I in no way intend to make them accountable for any shortcoming herein. This remains my sole responsibility, for which I accept the blame. God bless you all.
## ABBREVIATIONS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>AGOA</td>
<td>African Growth and Opportunity Act</td>
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<tr>
<td>CBS</td>
<td>Central Bureau of Statistics</td>
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<td>FTA</td>
<td>Free Trade Agreement</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>SMEs</td>
<td>Small and Medium Enterprises</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<td>WTO</td>
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ABSTRACT

Successive regimes in Kenya have appreciated the significance associated with the SME sector as numerous policy initiatives have been introduced during the past decade to accelerate the growth and survival of SMEs. Although there has been a growing interest paid to the sector by the government of Kenya through a raft of policy actions, limited scholarly attention has been paid to the challenges Kenyan SMEs face in the international market environment from a foreign policy viewpoint. This study sought to answer the research question; is Kenya’s SME policy responsive to the international market factors affecting the performance of Kenyan SMEs? The general objective of the study was to investigate the international market factors affecting the performance of SMES in Kenya. The Specific objectives were two-fold: to establish the factors in the international market affecting the performance of Kenya’s SMEs and to examine the role of Kenya government policy on the competitiveness of Kenyan SMEs in the international market. The study is based on both secondary and primary data. The results show that the international market factors affecting SME competitiveness include global economic conditions, globalization, market integration and government policies. The study shows that Kenya’s government policy was not adequately responsive to these factors affecting the SME competitiveness in the international economy.
CHAPTER ONE

INTRODUCTION

This chapter presents a general overview of the small and medium enterprises (SME) sector and its importance in the global economy and nations across the world. It discusses the growing interest in the sector and identifies the dynamics and challenges that the external environment portends to the sector with respect to the international marketplace.

The research problem is discussed from a foreign policy perspective in the wake of an increasingly globalized and integrating world given the unique constraints SMEs are faced with due to their sheer size. The overarching research question is then posed, from which the study objectives are drawn.

The chapter further reviews existing literature with regards to SME internationalization and the factors underpinning their competitiveness in the international market. Similarly, the theoretical framework which informed the study scope is discussed.

The chapter also describes the methodology that was adopted to undertake the research and details the research design, population and sample, as well as data collection and analysis procedures. The chapter winds up with an outline of the rest of the report.
1.1 Background

In the last decade, there has been substantial and growing interest in small and medium enterprises (SMEs).\(^1\) The SMEs fall under the informal sector which is increasingly viewed as an important engine for employment creation and economic growth. This has been necessitated by the increasing awareness within countries that large projects in the industrial sector are less likely to generate the requisite employment opportunities, given the high capital-intensity of output in the sector.\(^2\)

SMEs have become more important in the economic matrixes as seen in recent years across the globe through increased deliberate government policies and legislation aimed at nurturing SMEs as engines of economic growth and employment creation.\(^3\)

It is estimated that SMEs constitute the majority of enterprises in most economies with a high rate of employment growth. They are also a vehicle for increased industrial production and exports. For example, in Africa, the SME sector has been instrumental for the creation of 80 percent of all new jobs and currently the number has increased.\(^4\) In East Africa, it is estimated that SMEs account for about 56 percent of direct employment and 48 percent of indirect employment in the private sector.\(^5\)

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The majority of the large international companies have their beginning in small and medium enterprises, suggesting that the future large corporations that act in the international markets are the SMEs of today that must be nurtured to ensure their growth.\(^6\) Hence, the sector is generally perceived to be the seedbed for indigenous entrepreneurship and generate all the many small investments, which would otherwise not have taken place.

The SME sector accounts for million jobs worldwide.\(^7\) Data from some African countries clearly demonstrates this fact. In Nigeria, SMEs account for 95 percent of formal manufacturing activity and 70 percent of industrial jobs. In South Africa micro and small firms provided more than 55 percent of total employment and 22 percent of GDP. In 2013 the sector in Kenya employed 3.2 million people and accounted for 18 percent of the national GDP.\(^8\)

There have also been bilateral and multilateral support by African Growth and Opportunity Act (AGOA), (The Act offers tangible incentives for African countries to continue their efforts to open their economies and build free markets) all geared towards making the SMEs sub-sector vibrant.\(^9\) Just as it has been a great concern to all and sundry to promote the welfare of the sector, the fact that the vital sub-sector has fallen short of expectation has also been a great cause of concern to all. The situation is more disturbing and worrying when compared with what other developing


\(^7\) Emil Stavren (2006). “Measures of underlying inflation in the Euro Area: Assessment and Role for informing monetary policy”. IMF working paper WP/06/197


and developed countries have been able to achieve with their SMEs and this is coupled with numerous policies that lack effective regulatory framework.

The impacts of globalization have pressured the sector to greater demands. Particularly in the manufacturing sector SMEs are facing a pressure to increase research and development, innovation and quality. Innovation relies on bringing together different types of research and utilizing this knowledge to design new products, thus, innovation increasingly depends on links between scientific research and industrial research and development and without the same focus, SMEs risk falling behind competitors in innovative new products. Most of the developed countries allocate about 3% of GDP to SMEs research and growth activities. Countries like; China, India and Brazil have rapidly increased their research expenditure, to levels with those of the world’s most developed countries.

The overall spending on research and SMEs growth in most of the developing countries mostly in Africa is still low at 0.26% of total expenses. There is thus a need to increase government subsidies in terms of SMEs research support in order to gain competitive advantage over their competitors regionally and even globally.


Africa’s SMEs have little access to finance, which thus hampers their emergence and eventual growth. Their main sources of capital are their retained earnings and informal savings. Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities. Small business in Africa can rarely meet the conditions set by financial institutions, which see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. The financial system in most of Africa is under-developed and thus provides few financial instruments. Capital markets are in their infancy, and no long-term financing is available for SMEs. Non-bank financial intermediaries, such as micro credit institutions, could be a big help in lending money to the SMEs but they do not have the resources to follow up their customers when they expand. SMEs in Africa and Kenya in particular require long term source of finance if they have to grow. Despite the critical role played by the small enterprise sector, it is faced with numerous challenges and constraints that include unfavourable policy, access to financial services and markets.

The African Union, points out that the worldview of SMEs as an index of technological backwardness or as a sign of industrial backwardness is changing tremendously with time. Indeed, in many developed and developing nations of the world, SMEs are now appreciated as a necessary complement to the industrial structure of any modern economy. The Growing SMEs conference is the international setting for both entrepreneurs starting or growing a business in

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16 Ibid
emerging markets and investors seeking for high potential business plans and committed entrepreneurs. Together with experts on different fields, networkers and business centers, they gather to connect, exchange and ultimately invest.\textsuperscript{17}

1.2 Statement of the Research Problem

The world today is increasingly becoming a single global marketplace as globalization blurs geographical boundaries that hitherto characterized the international market environment for a very long time. However, the specific advantages accruing from a global market seem to favour large corporations, often at the expense of SMEs as most of the competitive advantage in the international market is size-related. Those SMEs which are internationally active tend to be larger than the average SME. The average SME employs less than 10 people, whereas the bulk of SME exports and international investment comes from SMEs which employ more than 50 or 100 employees.\textsuperscript{18} In this increasingly integrated global market, SMEs suffer two fold problems: on the one hand, asset constraints restrict their capability to compete in the international market arena; while on the other hand, the local markets that they serve are being attacked by powerful multinationals.\textsuperscript{19}

Given the important role SMEs play in the growth of nations the world over, governments need to come up with foreign relations policies and legal frameworks that protect and nurture the SME sector in the wake of globalization and economic


integration. Such policies need to be informed by a systematic inquiry and critical analysis of the full range of international market factors affecting the performance of SMEs, especially SMEs of a developing country such as Kenya which suffer limited market constraints blamed on a shrinking domestic market due to globalization.\textsuperscript{20} For example, it has been observed that the overall aggregate demand for the SME sector in Kenya is low as markets are saturated due to overproduction and dumping of cheap imports.\textsuperscript{21} Consequently, Kenyan SMEs, just like most of their counterparts elsewhere, remain underrepresented in the international economy.\textsuperscript{22}

Successful regimes in Kenya have appreciated the significance associated with the SME sector as numerous policy initiatives have been introduced during the past decade to accelerate the growth and survival of SMEs. Their growth has however been disappointing. The mortality rate of the SME remains very high in Kenya.\textsuperscript{23} This is due to the numerous challenges and constraints that continue to face the sector, which includes unfavourable policy, access to financial services and markets, inadequate business know-how and linkages with large enterprises.\textsuperscript{24}

Although there has been a growing interest paid to the sector by the government of Kenya through a raft of policy actions, limited scholarly attention has been paid to the challenges Kenyan SMEs face in the international market environment from a foreign

\begin{itemize}
\item \textsuperscript{21} Ibid
\end{itemize}
policy viewpoint. A recent study of market challenges faced by Kenyan SMEs undertaken by Kiveu and Ofafa\textsuperscript{25} made a brief discourse of the internal factors constraining SME competitiveness in the global market but failed to shed light into the international market factors underpinning the underrepresentation of the SMES in the international economy. This study seeks to answer the research question; is Kenya government policy responsive to the international market factors affecting the performance of Kenyan SMEs?

1.3 Objectives of the Research

The general objective of the study was to investigate the international market factors affecting the performance of SMES in Kenya.

The Specific objectives were two-fold:

i. To establish the factors in the international market affecting the performance of Kenya’s Small and Medium Enterprises.

ii. To critically analyze Kenya’s policy framework for the promotion of SME competitiveness in the international market.

1.4 Justification of the Research Problem

Designers of government economic policy concerning the growth of SMEs would find this study useful. It is the objective of the Kenyan government to stimulate economic growth through businesses. The government could use the recommended policies in this study to design and implement policies that are meant to enhance SMEs growth towards the economic development of the country. The study would

therefore inform policy actions by the Ministry of Foreign Affairs and the various government agencies they collaborate with towards the promotion of the SME sector. The study would also be of great importance to other researchers and academicians who seek to understand the international market challenges faced by SMEs and how these challenges could be managed.

1.5 Literature Review

This section explores various literature that address the emergence, operations and successes as well as challenges of SMEs. A positive environment can be defined as the existence of a competitive market with access to all the requirements that pertain to a conducive business environment. In addition, the business environment needs to be connected to an increasingly global economy by an efficient and viable infrastructure and guided by a well-structured legal and regulatory framework.

Hamilton and Mark highlight the problem for SMEs in outside regions that are accessible to SME growth information and find that the SME owners have less knowledge regarding tax, governmental regulations, marketing opportunities and production technology. Their study therefore focused on the internal aspects of

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SME performance although their study is important in highlighting the aspects of regulation as a determinant of SME growth.

Brata\textsuperscript{29} reviewed studies in Indonesia that revealed that SMEs in Java have suffered more than other islands during the Asian financial crisis. Brata also assumes the possibility of regional differences in the crisis impact. Chu and Siu\textsuperscript{30} discussed that the rural sector was less affected by the financial crisis than urban areas, whereby rural sector was more affected by severe drought in 1997-98 season. These studies illuminate the fact that SMEs are susceptible to global economic conditions.

Thai’s\textsuperscript{31} study on internationalization of Vietnamese SMEs found that the degree of internationalization of the Vietnamese economy has been steadily increasing since 1986, when Vietnam started to implement its open-door policies, dismantling the barriers that traditionally segmented local business opportunities and local firms from their international counterparts. Swept up in this trend toward increased liberalization of the exchange of goods and capital to and from Vietnam, Vietnamese SMEs can now access much larger international markets. The author claimed in fact that, the number of exporting and importing SMEs recorded by the end of October 2004 accounted for 80.6% and 84.2% respectively of the total number of enterprises participating in import-export activities in Vietnam. This is because the Vietnamese government and international organizations have made great effort to promote Vietnamese SME competitiveness in the international market. This study therefore


highlights the importance of government action through policies and international relations strategies towards the promotion of SMEs to be more competitive in the international economy.

Tambunan\textsuperscript{32} studied cases of successful export firms under the crisis in the agro, ceramic, metal casting, rattan handicraft, footwear, and garment industries. Tambunan further discussed that the engineering goods industries that were dependent on most of their inputs on imports such as the automotive industry were heavily damaged. The automotive industry was also struck because of its characteristics that vehicles are purchased on credit.

Karlan and Valdivia\textsuperscript{33} noted two kinds of operations by SMEs that worked positively for survival under the Asian financial crisis: penetration to foreign markets and entry into lower price domestic markets. First, non-exporters were the ones hit most severely, thus SMEs that had sold products only in domestic markets before the crisis started pursuing foreign markets. The Asian financial crisis influenced Asian countries heavily, but not much for countries in other regions. For example, IMF raised its forecast of GDP growth rate of US, when it was revised after outbreak of the crisis. Hence markets in other regions could be sources for revival of SMEs in Asian countries.

Biekpe\textsuperscript{34} presented evidence that SMEs in most countries are confronted with a clear downturn in demand for goods and services if not a demand slump in the fourth


quarter of 2008. Many expected a further worsening to come. For SMEs there are two related stress factors: increased payment delays on receivables which added together with an increase in inventories- result in an endemic shortage of working capital and a decrease in liquidity and an increase in reported defaults, insolvencies and bankruptcies.

Neely and Chandra\textsuperscript{35} argue that the stagnation in lending due to global economic downturn is true even of banks in countries where governments have deliberately strengthened banks’ balance sheets to allow them to grant additional credit to SMEs and/or where credit guarantee schemes exist. Most countries have not only recapitalised their banks, but also extended the funds and guarantees available for SME financing. But the effects of the incentives to lend to SMEs put in place by governments in some countries (such as the provision of additional capital) have not yet yielded the desired results. Some governments are closely monitoring this situation or have put in place “credit mediators” to ease the flow of credit to SMEs or have enacted binding codes of conduct for SME lending. SMEs often lack face-to-face contact with bank managers who understand their specificities. Inappropriate and indiscriminate use of credit scoring mechanisms can lead even deserving SMEs to be denied credit. To some extent, a proper use of individual assessment through “relationship banking” can counteract this, and it has survived in some countries because the banking sector is composed of many “local” or “regional” banks which have been less affected by the crisis, are liquid, and continue to lend to SMEs (Switzerland and the United States, for example). There are also some large banks that are preserving “relationship banking” at the local level.

\textsuperscript{35} Neely, S. & Chandra, C. (2002). Enhancing the effectiveness of benchmarking in manufacturing organizations, Industrial Management & Data System, spring board Publishers
Karlan and Valdivia\textsuperscript{36} similarly noted that SMEs are confronted with worsening access to credit. SMEs are exploring alternative sources of finance such as the mobilisation of reserves, self-financing and factoring. The financial crisis has had a three-fold impact on venture capital and private equity markets. First, exit opportunities are reduced. Second, fundraising activities seem to be shrinking. And thirdly, invested capital has stagnated or even slowly started to decline, especially investments in new projects.

Yonggui\textsuperscript{37} examined a set of internal and external factors/variables that may be critical to distinguish high-growth SMEs from those of poor performance. The study based on the relationship between factors and determinants concerning entrepreneur/top management team, firm characteristics, organizational strategies and external environment, and poor performance and high-growth performance in SMEs in China. Yonggui emphasized that the process of entrepreneurship is not limited to the for profit sector; numerous entrepreneurial factors in the public and not-for-profit sectors play crucial roles. It motivates one to examine the different roles played by these factors, and how their joint contributions interact to develop and commercialize a new technology. This in turn makes it possible to understand how the risk, time, and cost to an individual entrepreneur are significantly influenced by developments in the overall infrastructure for entrepreneurship.

In a nutshell, past studies heavily focused on the global economic downturn experienced in the last decade but did not explore the full range of factors affecting


SME competitiveness in the international economy. Other factors such as globalization, market liberalization and integration, technology and political actions potentially interplay in the SME competitiveness in the international marketplace. Using the Kenyan context, this study sought to explore these factors in addition to global economic conditions already examined in past research.

1.6 Theoretical Framework

This research was undertaken through the lenses of economic diplomacy theory. Economic diplomacy is concerned with international economic issues and what governments do about them.\(^\text{38}\) It is understood as the use of political means as leverage in international negotiations with the aim of enhancing national economic prosperity, and the use of economic leverage to increase the political stability of the nation.\(^\text{39}\) Thus, it is diplomacy concerned with economic policy questions and diplomacy that employs economic resources either as rewards or sanctions in pursuit of a particular foreign policy objective.\(^\text{40}\)

Economic diplomacy uses a full range of instruments and embraces the whole spectrum of measures from informal negotiation and voluntary cooperation through soft types of regulations such as codes of conduct, to the creation and enforcement of binding rules.\(^\text{41}\) A distinctive feature of economic diplomacy is that it is sensitive to market developments as increasing economic integration has created global markets


\(^{40}\) Ibid.

for production and investment and national regulatory policies can change the competitiveness of different locations.\textsuperscript{42}

It is argued that in their economic diplomacy, governments are trying to reconcile three types of tensions to make their policies mutually reinforcing than conflicting: the tension between economics and politics, the tension between international and domestic pressures and the tension between governments and other forces.\textsuperscript{43} For example, it is noted that by government giving more opportunities to private firms and by transferring power to them in the form of removal of trade barriers, deregulation and privatization, this transfer of power opens the question of what responsibilities governments should keep, what private business should undertake and how government and business can work together. This is especially linked to the issue of how governments deal with market pressures.\textsuperscript{44}

Economic diplomacy theory was applicable to this study because its aim is to influence decisions about cross-border economic activities including export, import, investment, lending, aid and migration pursued by governments and non-state actors.\textsuperscript{45} This made the theory suitable for the study of international market factors affecting SME competitiveness in the international economy. Specifically, the theory was relevant because of Kenya’s recent shift from political diplomacy to economic diplomacy. The recently published Kenya’s foreign policy states that through economic diplomacy, the country will continue to strengthen and consolidate its trade


\textsuperscript{43}Ibid, p5

\textsuperscript{44}Ibid, p6

and investment links with traditional partners while exploring new trade and investment partners in order to expand access of Kenyan products to foreign markets while at the same time increasing investments in the country.46

1.7 Study Hypothesis

Kenya government policy has not been adequately responsive to international market factors affecting SME competitiveness in the international economy.

1.8 Research Methodology

1.8.1 Research Design

The study was conducted by the use of the survey design. Survey studies are normally intended to describe and report the way things are. They are characterized by systematic collection of data from members of a given population through questionnaires and interviews. Thus this design is deemed appropriate in this study since it involves the procedures of collection and analysis of data from SMEs whose businesses were located Nairobi County.

1.8.2 Population

The study population comprised all the SMEs but specifically focused on SMEs engaged in international trade which are located in Nairobi County. There are a total of 10,350 SMEs in Nairobi County.

1.8.3 Sample Size

Based on a table of determining sample size according to Connaway and Powell, at a confidence level of 95% and margin of error 5.0%, the sample size for the SMEs was 186. The SME respondents were the business owners or senior managers of the enterprises. Simple random sampling was used to select the SMEs that participated in the study. Random sampling procedure ensured that all subjects have equal chances of being selected.

1.8.4 Type of Data

In this study, emphasis was given to both secondary and primary data. Secondary data was collected through desk research whereas primary data was collected using questionnaire. Prior to data collection, an introduction letter authorizing data collection was obtained from the University of Nairobi. Other relevant documents from the City Council were also obtained to facilitate the process.

1.8.5 Data Analysis Procedures

Data for the study was analysed using descriptive statistics, such as frequencies, percentages and measures of central tendency, with the application of the statistical package for social sciences (SPSS) software. Descriptive statistics was used to describe the basic features of the data in the study. Inferences were drawn from the results that were obtained.

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1.9 Outline of the Study

The report is outlined as follows:

Chapter One discusses the importance of the SME sector in world economies and made the case for national and international policy development towards its promotion. It also states the problem and specifies the study objectives. A review of pertinent literature is also made, along with a discussion of the theoretical lens upon which the study was based.

Chapter Two focuses on the SME sector in Kenya and critically discusses the policy framework for the promotion of the sector by looking at the laws, and acts of parliaments as well as political actions taken over the period 2000-2014.

Chapter Three explores the international market factors affecting the performance of SMEs generally and the challenges constraining the competitiveness of Kenyan SMEs in particular. This entails a review of factors such as globalization, global economic conditions including economic integrations since the new millennium as well as technological changes fuelling globalization.

Chapter Four analyzes the international market factors affecting the performance of SMEs in Kenya based on primary data obtained from the respondents.

Chapter Five draws conclusions and makes recommendations with regards to the international market constraints to SME competitiveness in the global marketplace from a foreign policy perspective.
2.1 Introduction

This chapter identifies and critically discusses Kenya’s policy developments since the turn of the century and considers their role in the nurturing and growth of the SME sector in Kenya to-date. In this endeavour, the chapter commences by profiling Kenya’s SMEs thereby operationalizing the SME definition. The chapter then examines recent legislative and policy frameworks introduced such as the Micro and Small Enterprise Act 2012, the place of the SME sector in Kenya’s Vision 2030 and the recently published foreign policy document, along with other government actions towards the promotion of the sector.

2.2 Profiling Kenya’s Small and Medium Enterprises

There are three profiles of SMEs operating in Kenya. The categorisation include: micro-enterprises, very small micro-enterprises and small-scale enterprises. These are differentiated by their demographic profiles; extent of previous business experience, needs, access of resources and growth orientation. The Jua Kali micro-enterprises are identified as owners of unregistered (informal) businesses who have little formal education and lack entrepreneurial and business knowledge. They also have little

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access to credit, with limited awareness of markets and market opportunities. They are constrained by their household responsibilities and marital status.\textsuperscript{49}

The very small enterprises are identified as those registered, operating from legitimate business premises and employing over 10 workers and having at least, secondary level of education with some previous experience as employees. The sector is constrained by lack of access to finance for various reasons, including having no land/property title deeds to be used as collateral for large loans. In Kenya, “small enterprise” means a firm, trade, service or business activity whose annual income ranges between five hundred thousand and five million shillings; and, which employs between ten and fifty people.\textsuperscript{50} The Act also defines a “micro enterprise” as a business whose annual turnover does not exceed five hundred thousand shillings and which employs less than ten people.

In Kenya, lenders’ definitions vary, but typically they define SMEs as businesses with six to 50 employees or with annual revenues less than 50 million Kenyan shillings.\textsuperscript{51} Compared to the legal definition hitherto provided, there exist stark differences in the way SME is perceived. The lack of a universal definition, statistical information and specific regulation on SMEs makes it difficult to accurately determine the exact size of this key sector in Kenya.\textsuperscript{52}

\textsuperscript{51} The Act also defines a “micro enterprise” as a business
\textsuperscript{52} Ibid.
Official statistics indicate that SMEs comprise about 75% of all businesses in Kenya, employ 4.6 million people (30%), accounts for 87% of new jobs created and contributes 18.4% of the GDP.\textsuperscript{53} A survey by the Central Bureau of Statistics in Kenya revealed that micro, small and medium enterprises that employ up to 50 people make up 100% of the employment in trade, 35% of the employment in industry and 13% of the employment in services.\textsuperscript{54} The report further states that small and medium enterprises, that is, those that employ between 5 and 50 people and are registered as companies are the ones that falls squarely into the formal sector in that they are liable to taxation. According to OECD Development Centre, these small and medium-sized enterprises employed 3.2 million people and produced 18 per cent of the nation's GDP.\textsuperscript{55}

The SME sector in Kenya is characterized by: the ease of entry and exit; the small scale nature of activities; self-employment with a high proportion of family workers and apprentices; and the little amount of capital and equipment required to start.\textsuperscript{56} Also, the sector is characterised by labor intensive technology, low level skills and low level of organization with little access to organized markets. Further, the sector has competitive markets, their limited access to formal credit, the existent of low levels of education and training and the limited access to services and amenities.


\textsuperscript{55} Ibid.

\textsuperscript{56} Kasende L (2010).\textit{ Financing SMEs; Uganda's experience}. Paper submitted to the UNCTAD Expert meeting on Improving the competitiveness of SMEs in developing countries, the role of finance to enhance enterprise Development, on 22-24 October.
SMEs operate in all sectors of the economy, which include: manufacturing, and trade and service sectors.\(^5^7\) The unregistered SMEs are known as Jua Kali enterprises while those formally registered small-scale businesses such as supermarkets, wholesale shops and transport companies represent the formal sector SMEs. The capital invested in the enterprise varies from as little as five thousand Kenya shillings to about five million Kenya shillings.\(^5^8\) Almost two-thirds of all these businesses are located in the rural areas with only one-third found in the urban areas.

About 16 per cent of SME businesses are located in Nairobi and Mombasa.\(^5^9\) Close to 70 per cent of them are in the trade sector, which include buying and selling goods and commodities to generate income. The manufacturing sub-sector account for 13 percent of the SMEs while SMEs in the services sub-sector accounted for 15 per cent whereas the collective group of other service providers such as bars, hotels and restaurants which are categorised as the hospitality industry account for 6 per cent.\(^6^0\) Enterprises in the construction industry accounted for less than 2 per cent of the total SMEs in the country.\(^6^1\)

Kenyan SMEs within the manufacturing industry have not seen much development since independence due to financial constraints.\(^6^2\) Jua Kali Sector, a Kiswahili term

\(^{5^7}\) Kasende L (2010). *Financing SMEs: Uganda's experience.* Paper submitted to the UNCTAD Expert meeting on Improving the competitiveness of SMEs in developing countries, the role of finance to enhance enterprise Development, on 22-24 October.


\(^{5^9}\) KNBS (2014). *Small and medium size businesses in Nairobi County.* 2014 Report


\(^{6^1}\) Ibid.

for a hot sun, is comprised of low scale artisans who mostly apply appropriate intermediate technology. This sector, given all conditions for growth can bring about industrial revolution in Kenya. There are many other areas where SMEs seem to be picking well for instance, with development of information technology in the world, Kenya is slowly and steadily moving towards embracing the technology. It is evident everywhere in the major Kenyan towns with the rate at which cyber café and other information and communication technology businesses are coming up.

2.3 The Micro and Small Enterprises Act 2012

Due to the important role that SMEs play in social and economic development worldwide, many countries have created legal and policy frameworks to nurture their growth as a key strategy for industrialization, employment creation, income generation and poverty reduction.63 In Kenya, the Micro and Small Enterprise Act was passed by Parliament in the year 2012 to set up new rules and institutions to support micro and small businesses in Kenya to succeed.64 The Act defines a micro enterprise as a business organization having a maximum of 10 employees; a small enterprise has a minimum of 11 employees and a maximum of 50 employees; while a medium enterprise has between 50 and 150 employees.65

The objectives of the Act is to provide a legal and institutional framework for the promotion, development and regulation of micro and small enterprises by: providing

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65 Ibid.
an enabling business environment; facilitating access to business development services by micro and small enterprises; facilitating formalization and upgrading of informal micro and small enterprises; promoting an entrepreneurial culture and promoting representative associations.\textsuperscript{66}

The Act makes provisions for the establishment of the Micro and Small Enterprises Authority, financing, development and promotion of micro and small enterprises, settlement of disputes and miscellaneous provisions guiding MSE associations and umbrella organizations.\textsuperscript{67} Subsequent to the Act was the establishment of the MSE Authority, a state corporation domiciled in the Ministry of Industrialization and Enterprise Development and mandated to formulate and review policies and programmes, promote and develop MSE sector, monitor and evaluate implementation policies, programmes and activities related to MSE development.\textsuperscript{68} Further, the Authority is established to coordinate, harmonize and facilitate integration of various Public and private policies, programmes and activities related to Micro and Small Enterprises in Kenya.\textsuperscript{69} This makes the MSE Act the most progressive policy action to-date towards the promotion and nurturing of the SME sector in Kenya.

\textbf{2.4 The Place of Kenya’s SMEs in the Vision 2030}

Kenya’s blue print and strategy for development known as Vision 2030 aim at making Kenya a newly-industrialized middle-income country capable of providing high


\textsuperscript{67} Ibid


\textsuperscript{69} Ibid
quality of life for all its citizens by the year 2030. According to the vision, Kenya’s competitive advantage lies in agro-industrial exports. For superior performance of the manufacturing sector, one proposed strategy includes strengthening SMEs to become the key industries of tomorrow. This, according to Kenya’s Vision 2030, can be accomplished by improving their (SME) productivity and innovation. Vision 2030 therefore recommends a need to boost science, technology and innovation in the sector by increasing investment in research and development. However, the period following the publication of the economic blueprint, the contribution of the manufacturing sector to the GDP decreased from 10.6% in 2008 to 9.5% in 2009.

In 2007 the Kenya government initiated the Youth Enterprise Fund, a two billion Kenya Shillings initiative (US$25 million), whose aim is to provide start-up capital to small enterprises whose owners are below 30 years of age. A similar fund was set up to support women entrepreneurs called the Women Enterprise Fund. These Funds were managed through microfinance institutions and continue to receive government support. Anecdotal evidence suggests that some success has been registered, but no empirical study assessing their effectiveness has been documented. In addition, among the flagship projects in the year 2012 was to increase the women enterprise fund from Ksh.1 billion to Ksh 2 billion as well as sustain and increase the youth enterprise fund from Ksh.1 billion to Kshs 2 billion.

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Vision 2030 sees one key strategy to development of SMEs as being the development of SME Parks in Kenya.\textsuperscript{74} The Vision 2030 also seeks to promote the internationalization of Kenyan SMEs through business process offshoring, a process that involves providing business services via the internet to companies and organizations in the developed world with the aim to make Kenya one of the top three BPO destinations in Africa.\textsuperscript{75} However, the significant economic impact of these provisions is yet to be felt in Kenya’s SME sector.

2.5 The Place of SMEs in Kenya’s Foreign Policy

Kenya’s foreign policy, the first written foreign policy since the country attained independence was published in the year 2014.\textsuperscript{76} The policy provides a broad framework on Kenya’s foreign relations and diplomatic engagements within a contemporary globalized environment.\textsuperscript{77} Working with other government agencies, the Ministry of Foreign Affairs and International Trade is mandated to pursue Kenya’s foreign policy and international trade affairs in accordance to the Constitution of Kenya with the overall objective of promoting and protecting Kenya’s interests abroad.\textsuperscript{78}

The economic diplomacy objective of Kenya’s foreign policy includes but not limited to: support of export promotion and investment by Kenyan enterprises within the


\textsuperscript{75} Ibid


\textsuperscript{77} Ibid

\textsuperscript{78} Ibid, p7
region and beyond; expansion of access to traditional markets and exploration of new destinations for Kenya’s exports, and promote fair trade and equitable bilateral, regional and multilateral trade agreements. However, while Kenya’s foreign policy recognizes the phenomenon of globalization which has led to emergence of an international network of social and economic systems with both positive and negative effects, especially the competition of capital flows, shrinking market access and economic marginalization of developing economies, the policy document is conspicuously silent on the contribution of the SME sector towards the advancement of the economic prosperity of Kenya and her people.

2.6 Recent Key Business Sector Reforms in Kenya

The strategic framework laid out in major Government policy pronouncements since 2003 focuses on a private/business sector driven development process. This was articulated in The Economic Recovery Strategy for Wealth and Employment Creation that led to the Private Sector Development Strategy (PSDS. To this end certain identified constraints that were clearly inimical to private sector growth had to be urgently alleviated through far reaching reforms. Some of these constraints include: the poor and costly infrastructure, the problem of insecurity, limited specialized skills in the market, bureaucratic regulations and procedures that inordinately delay business operations and limited access to capital.

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80 Ibid, p16

Through a robust public/private dialogue, it has been possible to implement key reforms that have seen an accelerated GDP growth from negative 0.6% in 2002 to over 7% in 2007, and capable of resilience from the setback caused by post-election violence. These reforms which have translated into significant socio-economic development such as poverty levels reduced by 12% from 56% to 44% - include public sector reform to enhance service delivery. In order to rationalize functions, the government split certain ministries to offer sector-specific services, created Semiautonomous Government Agencies (SAGAs), commercialized and privatized some state functions and instituted a Results Based Management (RBM) system in the form of Performance Contracts. Moreover, the government has put in place an ambitious electronic-government (e-government) programme to boost the utilization of Information Communication Technology (ICT) in the management of public affairs. Likewise, reforms are currently taking place in local authorities.

2.7 Government Reform Programme on SMEs

There has been limited structured dialogue between the public and private sectors in terms of policy formulation, implementation and monitoring and evaluation. All this has now changed through the recognition of the private sector as an active partner and leading stakeholder in national affairs. It is encouraging that the participation of the private sector has become an integral part of important government processes like annual budget preparation and implementation of Vision 2030 Medium


Term Plan (MTP), where they sit in sector working groups. Furthermore, the Grand Coalition Government initiated forums such as the Prime Minister’s Round Table that came up with an 11-point National Business Agenda (NBA) whose aim was to fast track critical legislation, tax, licensing and administrative reforms as well as overseeing rapid improvement of infrastructure. Notable results included the huge reduction of business licenses, review of taxes, making Mombasa a 24-hour port to achieve faster movement of goods, a fast-improving road network, and the installation of broad-band cable communication network to link up Kenya with the rest of the world.

2.8 Broadening Access to Capital

Several policy initiatives have attempted to reform the financial framework, including the imposition of limitation on the government’s domestic borrowing, the Micro–Finance Act, 2006, the Savings and Credit Cooperative Societies (SACCOs) Act, Land Reforms Programme and the establishment of the Association of Micro Finance Institution (AMFI). The last few years have witnessed a dramatic expansion of outreach by commercial banks to the rural area coupled with the introduction of innovative products that target specific business sectors such as micro enterprises, agro business, women and youth entrepreneurs. The government has also established the Youth Enterprises Development Fund (YEDF) and Women Enterprise Fund (WEF) as a stimulus package to these vulnerable groups.84

2.9 Trade Expansion

The government has signed and subscribed to the implementation of the East African Customs Union which has created an expanded domestic market to include the other East African partner states.\textsuperscript{85} This covers a population of 120 million. In addition, the participation of Kenya in COMESA Free Trade Area (FTA) has further served to create an expanded market. To keep up this momentum, Kenya is looking to new market opportunities in the Far- and Middle East. Joint trade agreements have been signed with China and India among other emerging markets. Meanwhile, to expand its range of tradable goods and services, the government is continuing to support the private sector to diversify into non-traditional export products including cut flowers and horticulture, as well as services such as business process outsourcing (BPO).

Some of the collapsed industries including Kenya meat Commission, Kenya Cooperative Creameries and Rift Valley Textile Mills have also been rehabilitated and institutions created to revive cotton, coconut and cashew nut production, to mention a few initiatives. Collins\textsuperscript{86} says that in order to enhance competiveness of local goods, the government has enforced international quality and environmental standards that are being policed by regulatory authorities such as National Environmental Managements Authority (NEMA) and the Kenya Bureau of Standards (KEBS). Meanwhile the Kenya Anti-counterfeit Authority has been established to cushion local manufacturers against competition from sub-standard goods.


\textsuperscript{86} Ibid.
2.10 Micro and Small Enterprise (MSE) 2030 Initiative Project

The Government is in the process of developing centres of excellence for micro and small enterprises (MSEs) to promote transfer of technology, build capacity and market MSE products\(^\text{87}\). The centres will be developed in each County, with specialization in given subsector of the MSEs. Due consideration will be made to the resource endowment in each region. Land has been set aside for MSEs operators across the country. Most of these sites are partially serviced and have great investment potential for private investors. To revolutionize and modernize the MSE sector, concerted efforts are required towards upgrading the following sub-sectors; agro-processing such as fruit processing, essential oil extraction, vegetable processing and cereal processing, animal products and fish processing, milk and meat processing, hides and skins and fish products. Other areas are chemical, electrical and electronics, building and construction, metal and metal works and motor vehicles accessories. These present major investment opportunities.

2.11 Other Regulatory Actions

Globally competitive SMEs will have to enter into international strategic alliances more aggressively in the future and in this light the Kenya Revenue Authority has adopted various types of strategic alliances with professional bodies, business community, clearing agents and other East African countries to cope with the challenges of global crisis. Marketing of manufactured products and services through

public education, billboards advertising, and media broadcasting can furnish a deep understanding of customer needs and demands.\(^{88}\)

### 2.12 Conclusion

This chapter has presented an overview and critical discussion of the policy initiatives taken by the Government of Kenya to foster the development and growth of the SME sector. It has identified the Small and Microenterprise Act 2012 as the most progressive regulatory framework to-date that seeks to promote and develop the SME Sector in Kenya. Other provisions are made in Kenya’s Vision 2030 which is the economic blueprint that directs the country’s policy priorities. A number of reforms have also been initiated by the government. It has identified that one such policy priority manifest in Kenya’s shift towards economic diplomacy which emphasizes regional economic integration and strategic bilateral as well as multilateral agreements with other governments. A notable inclusion in the foreign policy document is Diaspora diplomacy while the SME sector as a key pillar of Kenya’s economic growth is not addressed. It is upon this background that the international market factors affecting the performance of SMEs in Kenya are discussed in the next chapter.

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CHAPTER THREE

INTERNATIONAL MARKET FACTORS AFFECTING SME COMPETITIVENESS

3.1 Introduction

This chapter analyses the international market factors affecting the performance of SMEs and looks at technology, globalization and global economic conditions from the perspective of SME competitiveness. It also discusses the internationalization issues of SMEs and the influence of technological change in the competitiveness of SMEs.

3.2 Globalization

The globalisation of business, including the recent wave of global industrial restructuring has increasingly drawn SMEs, especially those in sectors subject to strong globalisation forces, into global value chains through different types of cross-border activities.89 The SMEs are facing competition from multinationals due to globalisation, though the process of globalisation has led to the expansion of space where trade can take place, the process has also brought restrictions which generally favour the multinational companies.90

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The competition is increasing from transnational firms that have advantage of high levels of know-how within management as well as increased competition from foreign firms. Numerous entrepreneurs from SMEs find difficulties in complying with regulations set up by organizations such as the World Trade Organization (WTO), in other words technical barriers to trade due to poor quality. Many countries like China, India, Vietnam and Indonesia produce similar products as SMEs, such as low-cost, low value-added, labour-intensive products, thus, the enterprises have to compete with these countries since many businesses focus on price competition strategy through low labour cost.

3.3 Global Economic Conditions

During the last decade, the world economy experienced deep recession and severe financial crisis. The policymakers together with managers are struggling to find ways to manage current accelerating changes and how to answer this difficult situation. The behaviour of subjects has changed during the recession and has affected the economic climate everywhere in the world. Companies face the threats of declining sales and profits and are searching for new approaches towards their business activities. The complexity of today’s global economic environment has made it more important than ever to recognize and encourage the qualitative as well as the quantitative aspects of growth, integrating such concepts as social and environmental sustainability to provide a fuller picture of what is needed and what works. For instance economic crisis has constrained the development process in many developing countries in Asia

which has a great impact on SMEs as they play an important role in these countries.\textsuperscript{92}

It is argued that SMEs are more vulnerable to economic crisis and due to their small size they have limited resources such as finance, knowledge technology and skills.

The adaptation to new conditions is the prerequisite to survive. Not only companies need to address these circumstances but SMEs too. The crisis has highlighted the lack of confidence in the business and economic activity. Recessions are often periods of destruction in which old technologies, products and ideas meet their end, while new ones emerge. Recession impacts the business, poses major threats to, but also offers significant opportunities for, businesses. In order to survive all entities need to adapt. According to Sato\textsuperscript{93} destructive forces may not be a source of failure, but the inevitable pressure for necessary corrections of companies’ philosophy.

Every business in the world, regardless of size and type of business, cannot avoid the evolutionary process, which is bringing incremental changes as a reaction on external environmental development. Crisis periods are more difficult especially for SMEs. SMEs are particularly vulnerable to external shocks, for the reason of limited resources, customers and product lines. Their small size restrains their adaptation strategies as downsizing or diversification of business activities is difficult. SMEs lack the resources, in particular financial and information resources, necessary to cope easier with the negative economic conditions in the economic environment\textsuperscript{94}.

Nevertheless, they form the backbone of the national economy and can play a crucial

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role in the recovery from the global crisis. SMEs have been considered one of the driving forces of modern economies due to their contribution in terms of technological upgrading, product and process innovations, employment generation, and export promotion.

Economic crises denote occurrences arising suddenly and unexpectedly which affect the country's economy at the macro level and functioning of the companies at the micro level. Economic crisis can be classified in various categories. The economic crises may occur in the form of global and local crises in terms of their nature. While local crises only affect a country and a region, global crises affect many countries; however, local crises may cause global effects depending on the country where the crises have taken place and to extent of development of the region same has occurred. Much as the concepts of economic crisis, real sector crisis and financial crisis have been employed in the same sense in this study, economic crises can be divided into two as the real industry crises and the financial crises in the SMEs sector.

The real sector crises are crises that take place in goods, service and labour markets and generate effects such as leading to decline in production as well as decrease in employment. However, financial crises denote financial market disorders that may lead to devastating effects on the real sector and which may hinder the functioning of the markets in an effective manner. According to another point of view, financial crisis

means rapid depreciation of the domestic currency due to overt or covert speculative attacks and decrease in the amount of the country's international. On the other hand, both types of crisis also have the possibility to trigger each other.

The 2008 global financial crisis in the SMEs sector begun in the housing market due to the "mortgage" loans in the USA and then turned into a global economic crisis which has affected the whole world. Much as the real sector has resisted for a long time in terms of production, investment and employment, it also has been affected by the financial crisis over time. Thousands of companies have closed due to the crisis, growth rates have become negative and unemployment has reached high amounts.

Two important points stand out in the crisis of 2008 in the SMEs sector. The first cause of the crisis is the lack of supervision in the financial sector. Financial institutions have performed transactions with a high level of risk due to this uncontrolled and disorderly situation. Hence, it has become inevitable to take action for making a healthy arrangement for financial markets around the world again.

The second issue that the crisis has revealed that the level of countries in terms of being affected through the crises increases in parallel with the integration thereof with external markets. Countries like Turkey which strive to open to external markets and be more effective in the world markets in recent years have been dramatically affected through the global crisis.

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100 Ibid
101 Ibid
3.4 Economic Liberalization

The macro-environment consists of stakeholder groups that a firm has regular dealings with. The way these relationships develop can affect the costs, quality and overall success of a business. Although the move towards economic liberalization proposed in the late 1980s and 1990s was aimed at reducing distortions in the economy, deregulation of markets has had adverse impact on SMEs. The effects include increased macro-economic instability characterized by high inflation rate, current account deficits and policy uncertainty. While the effects have been harmful to all private enterprises, the SMEs have been particularly hurt given their small size, and because they have fewer options to ride over instabilities.¹⁰²

For business owners, important regulations include state actions relating to the following but not exhaustive list: contract enforcement, property rights, including intellectual property, corporate governance, taxation and financial reporting, employment and health and safety, trading standards and consumer rights, environmental protection, premises and planning rules, data protection, transport. Environmental regulations concerning the storage and use of hazardous substance are likely to have a greater impact on certain sectors than others, for example, agriculture, manufacturing and transport and communications businesses¹⁰³.

3.5 Technological Change

Change in technology stemming from product and process innovations contributes to technological uncertainty. Strategic responses involve capability building to respond quickly to changing market conditions of SMEs. Such capability building usually involves investing in diverse resources and possessing a wide array of strategic options. Because technologically uncertain markets are likely to offer a greater number and range of threats and opportunities for firms to adapt and improvise, competitive flexibility is expected to be of crucial importance in an environment that is characterized by high levels of technological uncertainty. Indeed, the rapid advancement in information and communication technology will greatly facilitate the development of global products of SMEs. Empirical evidence suggests a growing number of companies are attempting to develop global products by adopting global virtual teams.

SMEs could successfully take advantage of the stream of innovations in information technology (internet and electronic commerce) to reach new customers and to increase interaction with old ones. This chance does not turn into a direct competitive advantage; while new communication technology is easy and accessible (low investment and large results), this holds true for all competitors and there is no reason to think that SMEs may take better advantage of it than larger firms.


Innovation strategies are the response to global challenges or future opportunities of SMEs. It invariably needs a purpose and, therefore, the introduction and identification of a new consumer need or the development of additional technology within the marketplace usually initiates the process. This is more commonly identified as the push-pull process. Consequently, the key precipitating environmental factors for innovation are uncertainty, risk and change. The generation of new ways of doing things, or new product or services, has tended to be the domain of research and development as a response to the challenges of global crisis, new and old knowledge combine to generate innovation. Research and development functions do not just create, or drive, innovation they are also charged with the dissemination of the outcomes. An innovation is of little practical use if it cannot be absorbed by the market, SMEs, process or service at which it is targeted. There is empirical evidence that research and development not only generates new knowledge, but it also enhances an organization’s ability to assimilate existing knowledge. A related stream of research suggests that an increasing number of firms have begun to develop global products as a response in order to overcome the challenges of globalization. Such globally oriented new product development efforts are apparently evident in SMEs as well as large multinationals, attempting to design and develop products aimed at the worldwide market.

The World Wide Web is a powerful platform for expanding and reaching new markets for SMEs while the Internet is critical in enhancing a firm's market reach and operational efficiency. ICT offers SMEs flexibility in trading by enabling 24 hours of trading.

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borderless market space and leverage SMEs to compete against larger enterprises on the same platform.\textsuperscript{108}

The United Nations Economic Commission for Europe claims that investments in technology are required in order to build up existing capacity and to improve the quality and productivity of production which will generate higher value-added products that will improve the competitiveness for firms.\textsuperscript{109} Additionally, it is crucial for small firms to make the most strategic business decisions hence government support of technology initiatives and networks with research institutions should assist SMEs in terms of technological development.

\subsection*{3.6 Internationalisation and Cooperation of SMEs}

There are many possibilities of how to improve competitive position of SMEs. Nowadays, the global economy is characterised by the accelerating globalisation processes that are enhancing the need for fast decisions and innovations\textsuperscript{110}. Generally, a firm gains its strength when it learns from competitors or in cooperation with business partners. There are two sets of adaptation strategies that might be used during a recession period: to cut the cost or to innovate products/business processes. Desired strategy is the implementation of both options according to firm’s possibilities and capabilities. Firms involved in the internationalisation might benefit from the learning effects of international expansion. The cooperation with a foreign

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partner or the necessary adjustment of products or strategies to foreign market environment support the ability of firm to innovate or to react to changing circumstances in a flexible manner. Many studies have confirmed that internationally active firms introduce product or process innovation more often than their non-internationally active counterparts. Innovation is very often an outcome of product development necessary to enter foreign market as well as the consequence of the firm’s foreign market activities. Internationally active firms are forced to innovate in order to build competitive advantage in foreign markets and development of new product/service is often a consequence of competition from foreign enterprises on the domestic market.

Ongoing globalisation processes together with the impacts of global crises are highlighting the need to address changes in the international environment promptly and to recognise new opportunities that may improve a firm’s competitive position\textsuperscript{111}. Foreign market activities provide firms with access to knowledge, technologies and especially to experiences that are new or different in comparison with domestic information base. This allows the firm to utilise learning effect originated in the export/internationalisation processes and decisions. There is a link between the innovation and internationalisation at least in the sense that firms need to innovate in order to gain and maintain competitive advantage in foreign markets. SMEs also have to deal with foreign competitors effectively not only in foreign markets, but also face foreign spill over effects that may take place from foreign competitors in the domestic market.

\textsuperscript{111} Yonggui, W.Z. (2002). The key factors distinguishing high-growth small and medium-sized enterprises from those of poor performance: Evidence from China
Internationalisation of SME business activities has many benefits not only for their economic performance but also help to improve their market position both in national and foreign market. Foreign market activities may reduce market risk and help to exploit different economic level and economic development of countries in the world. Internationalisation supports innovation of product or processes and reduces dependence on any particular market. That notwithstanding, many SMEs do not even plan to become internationally active, as they are not able to overcome many barriers associated with internationalisation. There are two main types of these barriers. Internal barriers are related to a firm’s capability while external barriers are related to the firm’s business environment. SMEs have a tendency to underestimate or overestimate barriers of internationalisation. These differences in the firm’s perception of foreign market barriers are connected to experience with foreign market activities. Many SMEs give barriers higher importance than it is in reality. Information and experience with international business activities may play a crucial role in starting foreign markets activities.

3.7 SMEs’ adaptation to International Market Environment

SMEs are conducted and managed by their owners or a manager. Their relatively small size and favourable working environment facilitate the cooperation between owners and employees that may often lead to mutual agreement on further development of the company. However, owners always have the responsibility

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regarding the strategies they adopt, although their choices is often affected or constrained by resources and relations with other stakeholders. The nature of SMEs makes them very vulnerable to any changes in environment or in relations with stakeholders. They depend on trustworthiness and loyalty of their business partners, customers, suppliers or employees.

Any business and strategic decisions may drain or deploy resources that are crucial for their future survival. There is no guarantee, that a particular strategic decision will bring required results. Success or failure of any business activity strongly depends on the important stakeholders such as suppliers or customers as well as the small business owner. Product innovation, for example, may increase sales and have positive effects on customers and their loyalty to small business, but there is also a possibility that innovation may have opposite effects and will not produce the intended outcomes. Failure of changed strategy is extremely dangerous especially for SMEs. Limited resources, in particular financial and information resources, give them not as many chances to adjust the strategy as to their larger counterparts. Small size and limited resources as well as the smaller customer base and product lines restrict a firm’s capacity to cope with competitive pressures during the crisis period.

Two major decisions related to adaptation of small business on external shocks in economic environment are costs cutting or product/process innovation. Cost cuts may produce required outcome in order to maintain survival in the short-run. On the other

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hand, investing in order to invent new products or processes may create opportunities for long-term value creation.

Recession has compelled firms to rethink their business strategies. It is difficult to decide whether to cut costs or the converse, to invest financial resources into innovation processes. Reducing staff, for instance, might reduce the firm´s capacity to mobilise human resources when necessary, or it might cause the loss of the trust of employees toward the employer. Likewise, the firm might have not enough human capital to undergo crucial changes during recovery, as well as recession. Investment in the innovation processes might drain the firm´s resources and might fail to generate sufficient sales to cover costs. Studies of small enterprises demonstrate the importance of both cost-cutting activity and revenue generation practices. Performance of SMEs is closely linked to the actions taken during the recession period. The particular form of adaptation is contingent upon the circumstances and depends on the individual firm´s situation and possibilities. There is no golden rule that will guarantee the success of the adaptation.

SMEs without enough resources for penetrating foreign markets had shifted their target domestic markets to the demand of low price products utilising domestic raw materials. Import of materials from abroad was impossible since foreign banks refused to receive letters of credit from Indonesian banks on behalf of Indonesian enterprises. SMEs producing low quality but cheaper products had survived in a better way than large enterprises that were more dependent on imported materials. For the shift to the domestic low-end markets, it was necessary to pay much effort to reduce the costs. Cost increase ranges of imported materials were approximately 100 to 600
per cent for the textile industry and 50 to 250 per cent for the food industry\textsuperscript{115}. SMEs’ greater flexibility than large enterprises allowed them to adjust production processes under such conditions. Of course, small firms cannot absorb cost increase only by reducing material costs. Hence the cost reduction was also through reduction of salaries and other managerial costs. Collaboration with other firms for purchasing material at cheaper prices and financing at lower financial costs through cooperatives took an important role.

3.8 Conclusion

This chapter has examined the international market factors affecting the performance of SMEs. These factors include globalization, economic integration, global economic conditions, and technological changes as well as SME internationalization strategies. Specifically, the chapter has shown that the global crisis triggered many economies into severe recession. Business climate has changed rapidly since 2009.

Most developed countries are experiencing just modest recovery from crisis which is discouraging business activities of firms. SMEs are more vulnerable to external shocks and to volatile development. Unstable economic environment forces them to adapt their strategies in order to survive current inauspicious pressures. Small business adaptation and performance depend similarly as in case of large companies on their owners or managers and also on other stakeholders (customers, suppliers, competitors, government and others). Their ability to implement adaptation strategies is constrained by limited financial, managerial and human resources. From this point

of view, the SMEs find it easier to cut the costs than to invest in order to innovate. However, adaptation decisions are contingent upon various factors, including government actions to promote SME internationalization and competitiveness in the international economy.

Globalization of the world economy and financial liberalization in the recent years has also brought major issues therewith. Uncontrolled and irregular functioning of financial markets lead to significant problems over time, and these problems have the potential to affect the whole world. Accordingly, necessity has arisen for taking serious measures to provide a healthy functioning of the national and international economy. In particular, the tools and institutions utilized in financial markets should be subjected to sufficient regulation.
CHAPTER FOUR

FACTORS AFFECTING THE PERFORMANCE OF KENYAN
SMES IN THE INTERNATIONAL MARKET

4.1 Introduction

This chapter covers analysis and presentation of the data collected through questionnaires and interview guide. The chapter is divided into four sections. The first section analyzes the demographic information from the respondents. The second section presents the findings on international market factors affecting SMEs in Kenya. The third section presents the results concerning Kenya government policy responsiveness to the SME competitiveness in the international market. The last section presents the analysis of qualitative data from key informant interviews.

4.2 Response Rate

The targeted sample size was 186 SME owners. Those filled and returned questionnaires were 150 in total, making a response rate of 80.65%. According to Mugenda and Mugenda (1999), a response rate of 50% is adequate for analysis and reporting; a response rate of 60% is good and a response rate of 70% and over is excellent. This means that the response rate for this study was excellent and therefore adequate for data analysis and interpretation.
### Table 4.1: Response rate

<table>
<thead>
<tr>
<th>Questionnaires</th>
<th>Frequency</th>
<th>Percent (%)</th>
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<tbody>
<tr>
<td>Response</td>
<td>150</td>
<td>80.65%</td>
</tr>
<tr>
<td>Non-response</td>
<td>36</td>
<td>19.35%</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>186</strong></td>
<td><strong>100.00%</strong></td>
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</tbody>
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Source: Own Research (2015)

#### 4.3 Demographic Information

The study sought to establish the demographic information. The demographic information of the respondents included age, gender and education levels of the respondents.

##### 4.3.1 Gender of Respondents

Table 4.2 displays distribution of respondents by gender.

### Table 4.2 Gender of the Respondents

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Male</td>
<td>99</td>
<td>66.0%</td>
</tr>
<tr>
<td>Female</td>
<td>51</td>
<td>34.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

The study sought to establish the gender categories of the respondents. The findings revealed that majority (66.0%) of the respondents were male while 34.0% of the
respondents were female. This implies that male gender were the majority, suggesting that the international market environment did not attract as many women entrepreneurs.

4.3.2 Age Bracket of the Respondents

The researcher sought to establish the age categories of the respondents.

Table 4.3: Age Bracket of the Respondents

<table>
<thead>
<tr>
<th>Age bracket</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 - 30 years</td>
<td>43</td>
<td>28.67%</td>
</tr>
<tr>
<td>31-40 years</td>
<td>50</td>
<td>33.33%</td>
</tr>
<tr>
<td>41-50 years</td>
<td>32</td>
<td>21.33%</td>
</tr>
<tr>
<td>51-60 years</td>
<td>15</td>
<td>10.00%</td>
</tr>
<tr>
<td>60 years and above</td>
<td>10</td>
<td>6.67%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

From the findings majority of the respondents (33.33%) were aged between 31-40 years, followed by the respondents aged 20 - 30 years (28.67%). The table shows that 21.33% of the respondents were of age 41-50 years; 10.00% of the respondents were 51-60 years of age while only 6.67% of the respondents were aged 60 years and above. The findings imply that business owners or senior managers of the enterprises were young.
4.3.3 Level of Education of the Respondents

Table 4.4 shows the respondents’ level of education.

<table>
<thead>
<tr>
<th>Level of education</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary education</td>
<td>94</td>
<td>62.67%</td>
</tr>
<tr>
<td>Diploma</td>
<td>26</td>
<td>17.33%</td>
</tr>
<tr>
<td>Bachelor’s degree</td>
<td>17</td>
<td>11.33%</td>
</tr>
<tr>
<td>Master’s degree</td>
<td>13</td>
<td>8.67%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

From the findings, it was noted that majority (60.67%) of the respondents had Secondary education; 17.33% of the respondents had Diploma; 11.33% of the respondents had Bachelor’s degree while 8.67% respondents had Master’s degree. The findings imply that majority of business owners or senior managers of the enterprises had basic education.

4.4 International Market Factors Affecting the Performance of Kenyan SMEs

This section analyzes the various international market factors affecting Kenyan SME performance in the international economy.
4.4.1 The Effect of Global Economic Crisis on SME Performance

The views of the respondents were sought as to whether global economic crisis periods were more difficult especially for SMEs. Table 4.5 shows the results. The table shows that 68.54% of the respondents agreed and a further 25.84% of the respondents strongly agreed whereas 5.62% of the respondents were neutral. Therefore, majority (94.38%) of respondents agreed that crisis periods are more difficult especially for small and medium enterprises (mean=4.20). This implies that compared to large multinationals, SMEs were more at a disadvantage because of their sheer size. This finding agrees with the observation by the OECD\textsuperscript{116} that SMEs which are internationally active tend to be larger than the average SME.

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>39</td>
<td>25.84%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>103</td>
<td>68.54%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>8</td>
<td>5.62%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

4.4.2 The Effect of External Shocks on SME Resilience

Respondents were asked whether their SMEs were particularly vulnerable to external shocks due to limited resources, customers and product lines. Table 4.6 shows that 60.80% of the respondents agreed and 20.35% of the respondents strongly agreed. However, 12.36% of the respondents were neutral whereas 3.12% of the respondents disagreed and another 3.12% of the respondents strongly disagreed. On aggregate, majority (81.15%) of the respondents agreed that their enterprises were particularly vulnerable to external shocks, for the reason of limited resources, customers and product lines (mean=3.97). This finding implies that the SMEs were vulnerable to external shocks as a combination of resource constraints and shrinking markets. This is consistent with the government of Kenya’s own acknowledgement through its foreign policy that the phenomenon of globalization has led to, among others, shrinking market access and resource constraints with negative ramifications on developing economies.\textsuperscript{117}

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>31</td>
<td>20.35%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>91</td>
<td>60.80%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>19</td>
<td>12.36%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>5</td>
<td>3.12%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>5</td>
<td>3.12%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

\textsuperscript{117} Ibid, p16
4.4.3 The Effect of Resource Constraints on SME Competitiveness

The views of the respondents were sought as to whether their enterprises were constrained by financial and information resources necessary to cope with the negative economic conditions of the international market environment. Table 4.7 shows that 68.54% of the respondents agreed and a further 25.84% of the respondents strongly agreed. However, 5.62% of the respondents were neutral whereas no respondent disagreed or strongly disagreed. On average, majority (94.38%) of the respondents agreed that their SMEs lack the resources, in particular financial and information resources, necessary to cope easier with the negative economic conditions of the global business environment (mean=4.20). This finding further reinforces the view that participation in the international economic was directly correlated with firm size, and specifically, SME competitiveness in the international economy was limited by their resource capability.

Table 4.7 The Effect of Resource Constraints on SME Competitiveness

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>39</td>
<td>25.84%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>103</td>
<td>68.54%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>8</td>
<td>5.62%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)
4.4.4 The Effect of Lack of Suitable Foreign Exchange Products on SME Performance

The views of the respondents were sought as to whether banks had difficulty providing tailored foreign exchange products to SMEs. Table 4.9 shows that 57.3% and 31.46% of the respondents agreed and strongly agreed, respectively. However, 11.24% of the respondents were neutral but no respondent disagreed. Therefore, majority (88.76%) of the respondents agreed that the banks had difficulty providing suitable foreign exchange products to the SMEs that can encourage their participation in the international economy. This means that the SMEs that seek to venture into the international market must transact with the banks using terms that are more favourable to large enterprises. This potentially inhibits their competitiveness in the international market, thereby partly explaining SMEs underrepresentation in the international economy.

Table 4.8: Lack of Suitable Forex Products

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>47</td>
<td>31.46%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>86</td>
<td>57.30%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>17</td>
<td>11.24%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)
4.4.5 The Effect of SME Insolvency on Ability to Access Short Term Debt

The opinions of the respondents was sought with regards to the statement that increased insolvency contributed to their inability to obtain short term financing. Table 4.10 shows that 60.67% of the respondents agreed and 22.47% of the respondents strongly agreed. However, 14.6% of the respondents were neutral 60.67% and 2.25% of the respondents agreed. Therefore, majority (83.7%) of the respondents agreed that their SME insolvency increased their inability to obtain short term financing (mean=4.03). This finding implies that SME competitiveness in the international market was inhibited by lack of access to short term debt financing attributable to their insolvency. The implication of this is that unlike large enterprises that have various sources of short term debt open to them, the SME sector is not able to compete effectively in the international market since the financial market shy away from financing their working capital they would need as a stop gap before they are able to convert their accounts receivables into cash. This then becomes a vicious cycle as their resource constraints limits their funding options which in turn limits their ability to grow to a size that can effectively participate in the international market economy.

Table 4.9: The Effect of SME Insolvency on Ability to access Short Term Debt

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>34</td>
<td>22.47%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>91</td>
<td>60.67%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>22</td>
<td>14.61%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>3</td>
<td>2.25%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

**Total** | **150** | **100.00%**

Source: Own Research (2015)
4.5 Government Policies Responsiveness to SME Competitiveness in the International Market

This section analyses the effect of government policy on SME competitiveness in the international market and looks at the regulatory environment, procedures, government coordination, policy and support.

4.5.1 The Effect of Limited Government Regulatory Support to Banks

The views of the respondents were sought as to whether the banks had limited information and regulatory support to engage in SME lending towards their active participation in international trade. The findings are shown in Table 4.11.

Table 4.10: Limitations in Regulatory Support to Banks on SME Lending

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>54</td>
<td>35.96%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>83</td>
<td>55.06%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>13</td>
<td>8.98%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

Table 4.11 shows that 55.06% and 35.96% of the respondents agreed and strongly agreed while 8.98% of the respondents were neutral. Therefore, majority (91.02%) of the respondents agreed that banks have limited information and regulatory support to
engage in SME lending (m=4.27). This finding implies that the banking sector lacked regulatory incentives to encourage their investment in financial products that catered for the needs of SMEs in the international market. Thus, the hypothesis that Kenya government policy has not been responsive to international market factors affecting SME competitiveness in the international economy is accepted.

4.5.2 Lack of Adequate Government Support

In order to further test the study assumption, respondents were asked whether there was lack of adequate government support that hindered the further development of the SME sector. Table 4.12 shows that 55.06% of the respondents agreed and a further 18.10% of the respondents strongly agreed. However, 12.48% of the respondents were neutral whereas 7.87% and 6.49% of the respondents disagreed and strongly disagreed, respectively. Therefore, majority (73.16%) of the respondents agreed that lack of adequate government support hindered the further development of the SME sector (mean=3.79). This finding implies that the efforts by the government of Kenya to promote the SME sector were necessary but not sufficient for the sector’s active participation in the international market. The finding is consistent with the study hypothesis that government policy has not been adequately responsive to international market factors affecting SME competitiveness in the international economy. This for instance is reflected in Kenya’s written foreign policy which, although seeks to support export promotion and investment by Kenyan enterprises
within the region,\textsuperscript{118} does not make mention of the SME sector towards the advancement of the economic prosperity of Kenya and her people.

Table 4.11: The Effect of Lack of Adequate Government Support

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>27</td>
<td>18.10%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>83</td>
<td>55.06%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>19</td>
<td>12.48%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>12</td>
<td>7.87%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>10</td>
<td>6.49%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

4.5.3 The Effect of Lack of Coordinated Government Strategies

The study sought to establish whether respondents observed a lack of coordinated government strategies and approaches to stimulate SME development and participation in the international market. Table 4.13 shows that 69.66% of the respondents agreed and 23.60% of the respondents strongly agreed whereas 6.74% of the respondents were neutral. Therefore, majority (92.26%) of the respondents agreed that there is lack of coordinated government strategies and approaches to stimulate SMEs development and participation in the international market (mean=4.17). This means that the participation of Kenyan SMEs in the international economy was constrained by lack of a coordinated strategy and approach by the government. The

finding also implies that it is not enough for the government of Kenya to enact policies and come up with regulations in the domestic environment. Rather, a coordinated approach to the promotion of the SME sector in the international economy would increase SME representation in the international market. The results lead to the further acceptance of the study hypothesis that government policy has not been responsive to the needs of the SMEs in the international market.

**Table 4.12: The Effect of Lack of Coordinated Government Strategies**

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>35</td>
<td>23.60%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>104</td>
<td>69.66%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>10</td>
<td>6.74%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>0</td>
<td>0.00%</td>
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<tr>
<td>(1) Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

**4.5.4 The Effect of Government Bureaucracy on SME Performance**

The respondents were asked whether their enterprises were affected by tedious registration and certification processes in Kenya. Table 4.14 shows that 49.43% of the respondents agreed and 35.96% of the respondents strongly agreed. However, 7.87% of the respondents were neutral whereas 3.37% of the respondents disagreed and another 3.37% of the respondents strongly disagreed. Therefore, majority (85.39%) of the respondents agreed (mean= 4.11.). This implies that government bureaucracy potentially negatively influenced the SME sector participation in the international
market; thereby further confirming the study assumption that the government of Kenya, through its policies and practices, has not adequately responded to international market factors affecting SME competitiveness in the international economy. As the findings suggest, this lack of responsiveness manifest in the tedious registration procedures and certification processes required by the government before they can effectively participate in the international market economy.

Table 4.13: The Effect of Government Bureaucracy on SME Performance in the International Market

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5) Strongly agree</td>
<td>54</td>
<td>35.96%</td>
</tr>
<tr>
<td>(4) Agree</td>
<td>74</td>
<td>49.43%</td>
</tr>
<tr>
<td>(3) Neutral</td>
<td>12</td>
<td>7.87%</td>
</tr>
<tr>
<td>(2) Disagree</td>
<td>5</td>
<td>3.37%</td>
</tr>
<tr>
<td>(1) Strongly disagree</td>
<td>5</td>
<td>3.37%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Source: Own Research (2015)

4.6 Qualitative Analysis of Key Informant Interviews

According to the key informants\textsuperscript{119}, globalization affects the running of SMEs. Perhaps the most significant source of change impacting many organizations today is the increasing globalization of organizations and management. This occurs because firms need to control costs, especially to reduce labour costs. Of course another reason why firms are becoming more global is the response to competition. SMEs that are internationally active are generally growing faster than their domestic

\textsuperscript{119} an interview with Mwema business owner
equivalents. This puts pressure on SMEs to develop environmental strategies to remain competitive. Many SMEs lack the resources to meet the global challenge to internationalize.

According to the findings rapid and unanticipated movements in exchange rates are costly because they have negative consequences for investment, output and growth. It is interesting to note that the crisis posed challenges for both floating and managed currencies in the region. In countries with floating currencies, it has increased exchange-rate volatility, with serious consequences for long-term investment. In countries with managed currencies and above-trend inflation rates, interventions aimed at halting the depreciation of the local currency resulted in appreciation of the real exchange rate and reduced export competitiveness.

According to the key informants there are various other financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees. The scenario witnessed in Kenya particularly during the climaxing period of the year 2008 testifies to the need for credit among the common and low earning entrepreneurs. Numerous money lenders in the name of pyramid schemes came up, promising hope among the ‘little investors’ that they can make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to seek alternatives and soft credit with low interest rates while making profits. Financial constraint remains a major challenge facing SME’s in Kenya.

\[120\] An interview with business managers
\[121\] ibid
CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the findings, conclusions based on the findings and recommendations with regards to external and internal factors affecting performance of SMEs in Kenya and in international market. The chapter also presents recommendations for further studies.

5.2 Summary of Findings

The study aimed to investigate the international market factors affecting performance of small and medium enterprises in Kenya. The study was conducted by the use of the survey design. They were characterized by systematic collection of data from members of a given population through questionnaires and interviews.

The findings showed that majority (94.38%) of respondents agreed that crisis periods are more difficult especially for small and medium enterprises (mean=4.20). Majority (81.15%) of the respondents agreed that their enterprises were particularly vulnerable to external shocks, for the reason of limited resources, customers and product lines (mean=3.97).

Further results indicated that majority (94.38%) of the respondents agreed that their SMEs lack the resources, in particular financial and information resources, necessary to cope easier with the negative economic conditions of the global business
environment (mean=4.20). The results showed that majority (88.76%) of the respondents agreed that the banks had difficulty providing suitable foreign exchange products to the SMEs that can encourage their participation in the international economy. The findings showed that majority (83.7%) of the respondents agreed that their SME insolvency increased their inability to obtain short term financing (mean=4.03).

In terms of government policy, majority (91.02%) of the respondents agreed that banks have limited information and regulatory support to engage in SME lending (m=4.27). Further, majority (73.16%) of the respondents agreed that that lack of adequate government support hindered the further development of the SME sector (mean=3.79).

Subsequent findings showed that majority (92.26%) of the respondents agreed that there is lack of coordinated government strategies and approaches to stimulate SMEs development and participation in the international market (mean=4.17). The findings indicated that majority (85.39%) of the respondents agreed (mean= 4.11.).

5.3 Conclusions

The performance of Kenyan SMEs in the international market was affected by a number of global environmental factors. Top in the list of factors was the global economic conditions especially economic recession and financial crisis periods that put the SME sector at a significant disadvantage compared to their large multinational counterparts. A combination of resource constraints and shrinking markets exposed SME vulnerability in the international market economy. Particularly, their lack of
financial and information resources necessary to cope with the negative economic conditions of the global business environment constrained their ability to participate competitively in the international economy. This was further constrained by their lack of access to debt finance and absence of suitable foreign exchange products that can encourage their participation in the international economy.

With regards to government policy, the Kenya government has not been adequately responsive to the international market factors affecting SME competitiveness in the international economy. The banking sector lacked regulatory incentives to encourage their investment in financial products that catered for the needs of SMEs in the international market. Current efforts by the government of Kenya to promote the SME sector were necessary but not sufficient for the sector’s active participation in the international market. The participation of Kenyan SMEs in the international economy was constrained by lack of a coordinated strategy and approach by the government. Further, government bureaucracy potentially negatively influenced the SME sector participation in the international market.

5.4 Academic Justification

The current study focused on international market factors affecting Kenyan SME performance in the international economy; the findings of which are informative towards understanding the SME sector as it pertains to today’s increasingly globalizing and integrating economy. However, since the list of factors was not exhaustive, a study should be carried out to investigate the full range of factors affecting the participation of SMEs in the international economy.
5.5 Policy Recommendation

If Kenya wants a strong economy and a great future, the following key points require appropriate attention by the government. Kenya needs to review its foreign relations and include an objective specifically geared towards the promotion of its SME sector interests in the international market. This would help draw attention by policy makers to bilateral and multilateral agreements that do not favour the SME sector with the intention to renegotiate them accordingly. However, this is not all that there is to change the SME sector.
REFERENCES


69


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KNBS (2014). *Small and medium size businesses in Nairobi County.* 2014 Report


Micro and Small Enterprises Act 2012


ANNEX I: QUESTIONNAIRE
SECTION A - PERSONAL INFORMATION

SECTION A: GENERAL INFORMATION

<table>
<thead>
<tr>
<th>statement</th>
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<th>A</th>
<th>N</th>
<th>D</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs face challenges in during global economic crisis periods that affect their resilience</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due to limited resources, customers and product lines, SMEs are particularly vulnerable to external shocks that make them vulnerable in the international economy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SMEs have inadequate resources, in particular financial and information resources, necessary to cope with crisis</td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<td>Banks have difficulty providing long-term capital to SMEs when faced with financial crisis</td>
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<td>Banks have difficulty providing tailored foreign exchange products</td>
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<td>Increased insolvency lead to SMEs’ increased inability to obtain short-term financing</td>
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<td>lack of adequate government support lead to failure of SME sector to participate in the international market</td>
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<td>The government in some way has failed in providing SMEs players with relevant skills to facilitate value addition activities</td>
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<td>In Kenyan government there is lack of coordinated strategies and approaches to stimulate SMEs development in Kenya</td>
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<td>SMEs are affected by tedious registration and certification processes in Kenya which negatively impacts on their competitiveness in the international market</td>
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By the means of tick (✓) kindly indicate an option that best describes you where appropriate. Also fill in the blanks where necessary.

1. Gender  (a). Female  ☐
   (b). Male  ☐
2. Age Bracket
   a) 20 - 30 years
   b) 31 – 40 years
   c) 41 - 50 years
   d) 51-60
   d) 60 and above

3. Level of Education
   a) Secondary Education
   b) Diploma
   c) Bachelor’s Degree
   d) Master’s Degree

Thank you for your participation.
ANNEX 2: INTERVIEW GUIDE

1. Generally what are the External factors affecting SMEs?

2. What’s your understanding on Global Economic Trends?

3. In your own opinion does global crisis affect SMEs performance if yes how?

4. Globally what are some of the specific Factors influencing growth of SMEs?

5. On Global economic crisis how does financing gap affect growth of SMEs?

6. What’s your view on The Institutional Framework for SMEs in Kenya?

7. What’s your concluding remark on external and internal factors affecting performance of Kenyan SMEs in international economy?