



KENYA BANKERS
ASSOCIATION



Micro, Small & Medium Enterprises

MSME

SURVEY REPORT – 2021

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CENTRE FOR RESEARCH ON
FINANCIAL MARKETS AND POLICY®

Micro, Small & Medium Enterprises (MSMEs) Survey Report – 2021

This Micro, Small and Medium Enterprises (MSMEs) Survey Report is a joint publication of the *Kenya Bankers Association (KBA) Centre for Research on Financial Markets and Policy®* and *Japan International Cooperation Agency (JICA)*.

In recognition of the contribution of MSMEs to the economy, KBA conducted a survey of the MSMEs to contribute to a better understanding of their ecosystem and to bridge the information gap that exists between MSMEs and financial service providers. In this regard, the information contained in this report is essential for stakeholders seeking a better appreciation of the MSMEs operating environment and financial sector players' design and deployment of financial products customised to the needs of enterprises.



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ABOUT THIS REPORT

The Micro, Small and Medium Enterprises (MSMEs) Survey Report is a joint publication of the Kenya Bankers Association (KBA) Centre for Research on Financial Markets and Policy® and Japan International Cooperation Agency (JICA). Micro, Small and Medium-Enterprises (MSMEs) play an instrumental role in the Kenyan economy, employing over 15 million people and contributing about 30% to the national value-added. Yet, they continue to face substantial challenges, key among these being limited access to finance.

This report aims to contribute to a better understanding of the MSMEs ecosystem by bridging the existing information

asymmetry between MSMEs and financial service providers. The information, therefore, contained in this report is essential to stakeholders in enhancing a better understanding of the MSMEs operating environment, and thus guiding financial sector players' design of financial products customised to the needs of enterprises.

The analysis and inferences contained in the report are entirely those of the authors. Therefore, they should not be attributed to the KBA Governing Council and/or its General Body of members. We acknowledge with appreciation the support provided by JICA.

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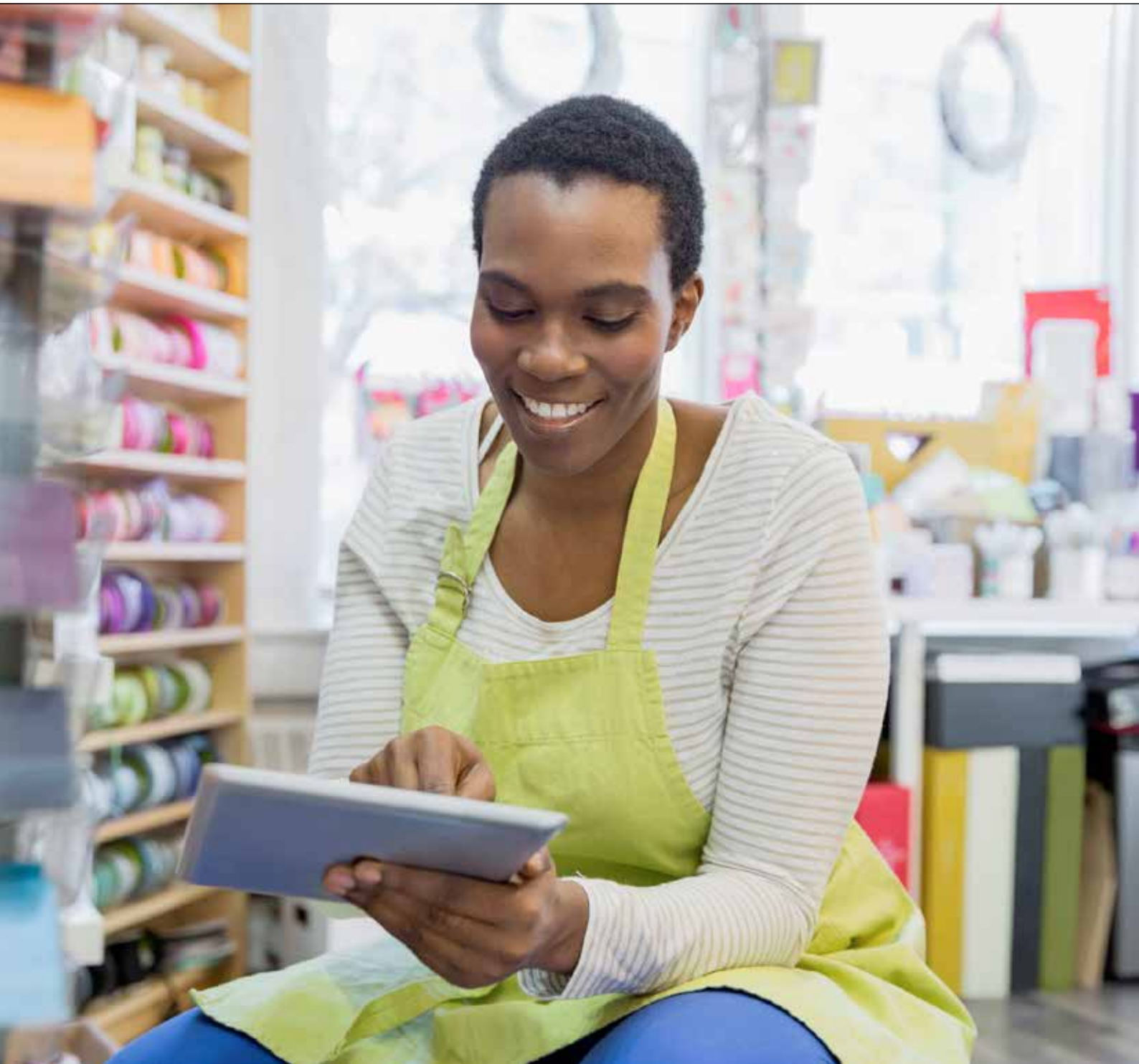


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FOREWORD

FROM THE CEO'S DESK

It is my singular pleasure to present to you the Micro, Small, and Medium Enterprises (MSMEs) Survey Report, a joint publication by the *Kenya Bankers Association (KBA) Centre for Research on Financial Markets and Policy*® and *Japan International Cooperation Agency (JICA)*. As highlighted in this Report, MSMEs play an instrumental role in the Kenyan economy; employing over 15 million people and contributing about 30% to the national value-added, yet they continue to face substantial challenges. Key among these challenges is their limited access to finance, that continues to impede their growth.

Two years into the COVID-19 pandemic, the domestic economy remains depressed, and economic recovery uneven and unanchored. Moreover, the pandemic has made MSMEs fragile, further aggravating the challenges they face. Recognizing that a strong and sustainable economic recovery going forward will be underpinned by a vibrant MSME sector, addressing the existing information asymmetry between financial service providers and MSMEs is critical in unlocking credit towards the sector.

In this regard, the KBA 2021 MSMEs Survey was conducted to capture necessary information to bridge the information gap. In pursuit of this, the report seeks to shed light on the MSMEs ecosystem by collecting data on entrepreneur and enterprise characteristics, supply chain and customer engagements, and utilization of formal and informal financial instruments.

I hope that this report, by providing insights critical in tackling the pressing development challenges faced by MSMEs, will contribute to further policy discussions geared towards enhancing growth in credit to MSMEs.

Any comments and inquiries on this Survey, can be sent through research@kba.co.ke.

Dr. Habil Olaka,
Chief Executive Officer,
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ABBREVIATIONS



| | |
|---------------|---|
| FIs | Financial Institutions |
| GDP | Gross Domestic product |
| ICT | Information and Communication Technology |
| KAM | Kenya Association of Manufacturers |
| KBA | Kenya Bankers Association |
| KNBS | Kenya National Bureau of Statistics |
| Kshs | Kenya Shillings |
| MFIs | Micro-Finance Institutions |
| MSME | Micro, Small and Medium Enterprises |
| SACCOs | Savings and Credit Cooperatives Societies |
| USD | United States Dollars |





EXECUTIVE SUMMARY

Micro, Small and Medium-Enterprises (MSMEs) play an instrumental role in the Kenyan economy, in creating employment and supporting livelihoods. It is estimated that the sector employs over 15 million people and contributes about 30% to the national value-added. Despite this, MSMEs continue to face substantial challenges, key among them limited access to finance that impedes their growth.

In this regard, this Survey was conducted to capture necessary information to bridge the information gap between financial service providers and MSMEs, focusing on three main objectives. First, to describe entrepreneurs and enterprise characteristics. Second, to assess MSMEs' supply chain and customer engagements; and third, to examine the utilisation of the existing formal and informal financial instruments.

The survey, administered online between May 7-21, 2021, targeted to reach all 2,949 MSMEs under the KBA's Inuka Enterprise Program. The analyses contained in this report are based on the views of 279 randomly selected MSMEs spread across the country.

A summary of the survey report results shows that:

- Based on entrepreneur characteristics, majority of MSMEs owners are males (77%), highly educated with 54.5% having a bachelors degree level of education. In addition, close to two-thirds (63%) of enterprise owners had been in employment for more than six years before starting their enterprises.
- Based on enterprise characteristics, the main host sectors include trade and ICT that account for 59% of the MSMEs, agriculture, manufacturing, and construction. In terms of employment patterns- that define the size of the enterprise- most of the enterprises surveyed (85%) are micro, with less than ten full-time employees; only 9% of the enterprises are small (10-49 full-time employees), while the rest (6%) are medium-sized (50-99 full-time employees). Further, nine in every ten (90%) are registered, with about half (53%) of them being incorporated companies and 35% operated as sole proprietorship. In addition, a sizeable proportion of MSMEs indicate that they are risk-averse, with 80% actively avoiding risk in their business operations. This feature is prevalent among female-owned enterprises.
- Analyses of record-keeping among enterprises revealed that about seven in every ten enterprises keep financial records, with about two-thirds of them maintaining their records electronically (using a computer-based software) while the rest use paper-based and mobile phone applications.

- There is limited diversity of MSME's supplier and customer engagement. Most MSMEs (41%) have less than five suppliers, and an additional 35% have between six and ten suppliers who are largely small and informal entities. Two-thirds of enterprises source their supplies locally, and those that source from foreign countries predominantly do so from Asian countries. In terms of payment for supplies, 51% of MSMEs pay promptly, 8% use trade credit, and 41% use both prompt payments and trade credit. Eight in every ten enterprises that use trade credit, are not charged any interest and the repayment period for trade credit is predominantly within 30 days. In terms of customer diversity, seven in every ten enterprises (72%) have direct customers outside Kenya. MSMEs' customers are mainly individuals (listed by 42% of enterprises) and other small enterprises (36%), with public institutions cited by only 5% of the enterprises as their major customers. Moreover, the top three customers account for over 50% of total sales. With respect to the mode of payments to suppliers, about one-third of enterprises (34%) use a combination of payment forms, i.e. cash, bank transfers and mobile money payment service. Slightly more than half (53%) of these enterprises use all forms of payments primarily citing these modes' user-friendliness. The use of both bank and mobile money service for payments to suppliers was the second most important form of payments indicated by about a quarter (24%) of the enterprises.
- Further, most of the enterprises (80%) operate a bank account in the business name, while the rest (20%) use personal accounts for their business operations. Nonetheless, there is a narrow distinction between borrowing on a personal capacity and for business reasons among enterprises, as 54% of enterprises apply for personal loans and 46% apply for business loans both to support their businesses. Access to credit for start-up, however, remains limited, and approval duration perceived by enterprises as short, though these perceptions differ by enterprise age, sector and turnover. In addition, it is observed that only 22% of the enterprises applied for a loan to start-up their business. Out of these, only 9% was from banks; the third most important source after own savings (64%) and non-loan support from family /friends (12%). Moreover, 83% of MSMEs reported that their loan applications are approved within three months, while 49% indicated that their borrowing from the different credit providers required collateral to access finance.
- On utilisation of both formal and informal financial instruments, most enterprises have and /or have previously operated a savings account, with only 29% not having had a savings account before. Ranked from the topmost utilised financial instrument, a bank savings account was ranked first followed by bank loan, loan from a friend / family member, a savings account in a SACCO, mobile money loan from a bank, and mobile money loan from a non-bank digital provider. Even then, 41% of enterprises prefer loan tenures of 1-3 years, while 31% prefer tenures of 3-5 years, but only 10% of the enterprises prefer facilities with over six-year maturity.
- In addition, MSMEs indicated difficulty in accessing credit, whether formal or informal, attributing this to challenges in obtaining / preparing documents that lenders need, poor financial position of the borrowers and lack of collateral. Even so, the demand for bank loans among MSMEs is found to be primarily determined (ranked from most important to least important) by suitability to the needs of MSMEs, awareness of loan opportunities availed by banks, loan amount sought, cost of credit, product design features, room for negotiation with a bank, availability of credit guarantee services and collateral requirements.
- MSMEs' perception on interest rates charged by different service providers reveal that non-bank digital loans are the most expensive as reported by 8 in every 10 enterprises, followed by bank loans (including digital loans). Enterprises perceive loans from *Chamas* and SACCOs to carry low-interest rates.
- Analyses of adoption of Mobile money among MSMEs show that about two-thirds (66%) of the enterprises use mobile money services daily, predominantly to pay business bills such as electricity/water, etc (94% of enterprises), pay suppliers (90%), rent (64%) and employee salaries (63%) and receive payments from customers (88%). The rate of utilization of internet banking services is lower, with one in every two (50%) of the enterprises using internet banking, mainly to pay suppliers and receive payments from customers.

Chapter 1

INTRODUCTION

Micro, Small and Medium-Enterprises (MSMEs) play an instrumental role in the Kenyan economy. It is estimated that there are over 7.4 million MSMEs in Kenya, employing more than 15 million people and contributing about 30% to the national value-added (KNBS, 2016). Despite this, MSMEs continue to face several challenges; key among them is constrained access to finance, which is attributed mainly to financiers' widespread lack of clear information on the operations of MSMEs.

While this challenge has continued to impede MSMEs' growth, it has been aggravated by the adverse effects of the pandemic that has made them more fragile and their growth more uneven.

In recognition that the MSMEs' activities shall underpin a strong and sustainable recovery of the economy, the need to better understand and characterise the environment they operate in would be paramount to support appropriate interventions. Most importantly, a comprehensive capture of information about MSMEs operations would facilitate a bridge in the information gap between MSMEs and financial service providers and facilitate growth in credit to MSMEs. In this regard, the

objectives of the MSMEs Survey are three-pronged:

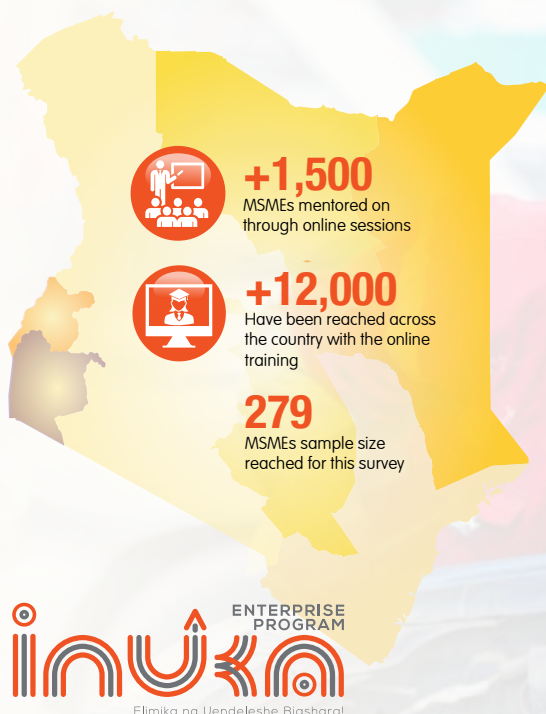
- Describe the entrepreneur and enterprise characteristics;
- Assess the MSMEs' supply chain and customer engagements; and
- Examine the utilisation of the existing formal and informal instruments of finance.

The contents of this Report are essential for those seeking a better appreciation of the MSMEs ecosystem, more so for the design and deployment of financial products customised to the needs of enterprises.



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Direct employment opportunities contributing 30% to the national value-added.



1.2 Description of sample and analytical strategy

The study sought responses mainly from 2,949 MSMEs enlisted in the KBA's Inuka Enterprise Program¹. An online survey questionnaire was made available to MSMEs between May 7-21, 2021. The survey attracted 279 random responses from across the country, which forms the basis of the analyses presented in this Report.

The survey questionnaire consisted of three main components:

- (i) Information on enterprise and entrepreneur characteristics, and especially relating to ownership status, age of enterprise, registration status, turnover, and profitability before and during the COVID-19 pandemic, the extent of enterprise owner's risk aversion, sector of operations, start-up capital and sources of financing for the enterprises;
- (ii) MSMEs' customer and supplier engagements, focusing on the supplier and customer diversity, and channels of payments to suppliers and from customers and an assessment of the choices made.
- (iii) The utilisation of formal and informal financial instruments, covering access to finance, and its drivers/constraints, MSMEs perceptions on interest rates on loans from formal and informal service providers, loan tenure preferences, as well as their level of utilisation of mobile and internet banking.

All the responses are summarised based on the size classification of MSMEs consistent with the Micro and Small Enterprise Act No. 55 of 2012, the World Bank's international definition and the SMEs Working Group².

BOX 1



The MSME working group defines MSMEs as follows:

- **Micro-enterprises:** May be formerly registered (but likely not); annual turnover of less than Kshs.1 million; less than 10 employees, up to 5 permanent employees (including owner), and at least 1 year in business operation.
- **Small enterprise:** formerly registered, annual turnover between Kshs.1 million and Kshs. 50 million, asset base of over Kshs. 3 million, general workforce of between 6 and 30 employees, between 2 and 20 permanent employees, and at least 2 years in business operation.
- **Medium enterprises:** formerly registered, annual turnover between Kshs. 50 million and Kshs. 250 million, asset base of over Kshs. 4 million, general workforce of between 31 to more than 150 employees, between 10 and 50 permanent employees, and at least 3 years in business operation.

¹ This program, sponsored by KBA, seeks to support MSMEs (business clients) across the country to uplift their businesses and gain the most from the banking sector through an increased access to finance and enhanced ability and capacity to leverage on market opportunities to grow their businesses.

² The MSME Working Group consists of the KBA Secretariat, local and regional banks, entrepreneurs, Micro and Small Enterprise Authority, Ministry of Industrialization, Trade and Enterprise Development, Kenya Institute of Management (KIM) and the Kenya Association of Manufacturers (KAM).

Chapter 2

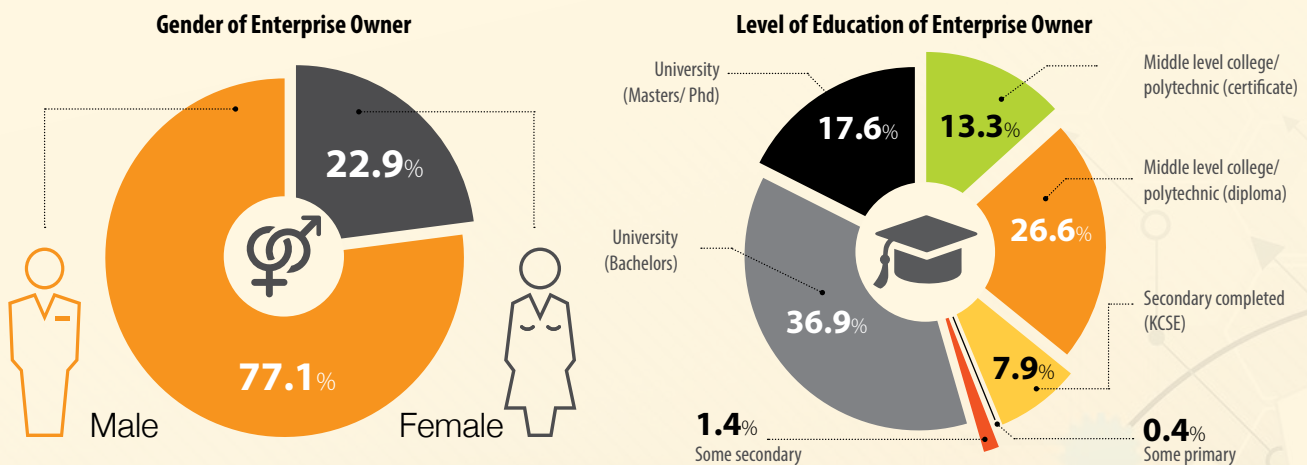
ENTREPRENEUR AND ENTERPRISE CHARACTERISTICS

2.1. Entrepreneur characteristics

2.1.1 Gender and educational attainment

Prominent entrepreneur characteristics show that a majority (77.1%) of MSMEs owners are male, with 54.5% highly educated having attained a bachelor's degree level of education. In particular, 36.9% have attained university bachelor's degree as the highest level of education and an additional 17.6% have an advanced university (Masters/PhD) education, as 22.6% have a middle-level college (diploma) education. In comparison, 13.3% of the enterprise owners have attained a middle-level college (certificate) education. Only 9.7% of the enterprise owners have less than secondary education (Figure 1).

Figure 1: Gender and educational attainment



2.1.2 Employment history

Close to two-thirds of enterprise owners had more than six years of employment history before starting up their business. **Figure 2** captures the expertise of the enterprises on account of accrued experience by the owner. The results reveal that 64.3% of owners had over six years of experience in employment before they ventured into business; the rest (36.7%) had less than five years of experience. About 20.1% of the surveyed MSMEs owners had been in employment for between 0 and 3 years as 16.5% of the enterprises had been in employment for 3-5 years, 23.6% of the surveyed enterprises had between 6-10 years of experience, while 39.7% had over ten years of experience.

Figure 2: Employment history

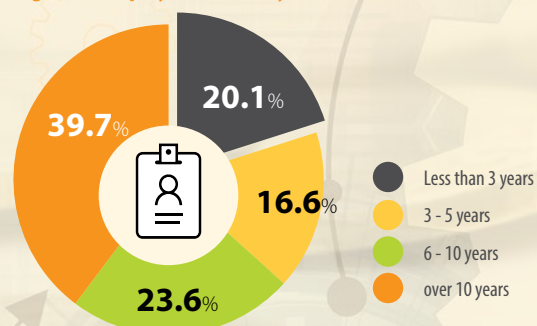
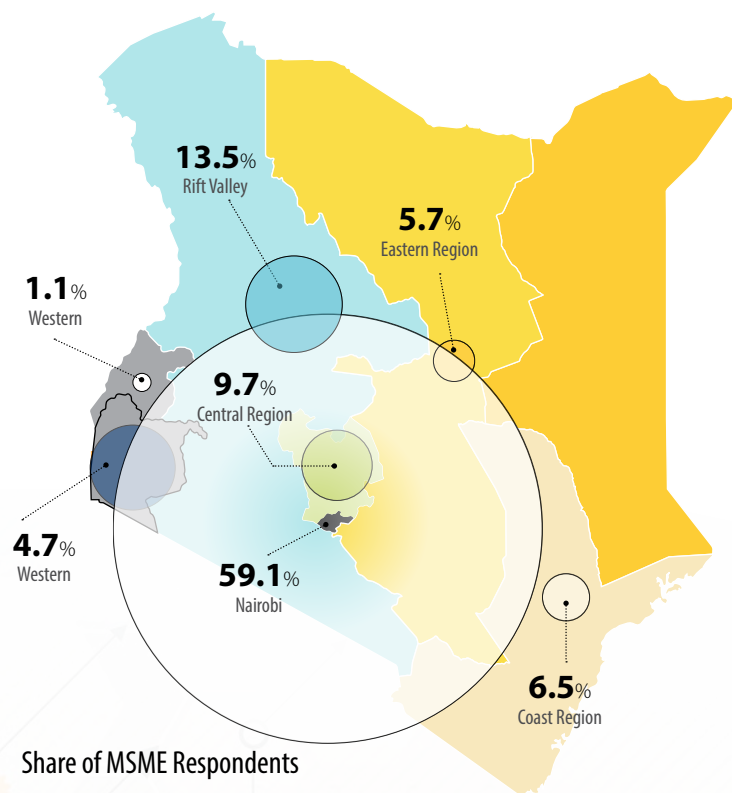


Figure 3: Regional distribution



2.2 Enterprise characteristics

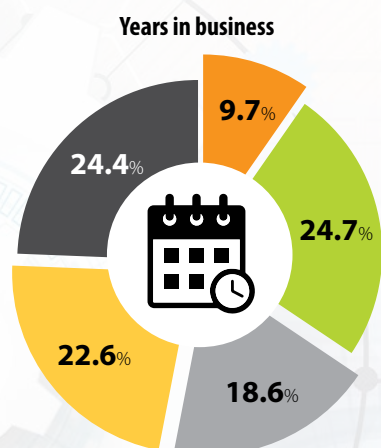
2.2.1 Regional distribution

Evidently, as **Figure 3** shows, most enterprises (59.1%) are concentrated in Nairobi, while 13.3% in the Rift Valley region, 9.7% in the Central region, 6.5% in the Coastal region, 5.7% in the Eastern region. Enterprises in Nyanza and the Western region accounted for 4.7% and 1.1% of the share of responding MSMEs, respectively.

2.2.2 Enterprise age distribution

As **Figure 4** shows, many enterprises are young start-ups, with 53% having been in operations for less than five years. This points to a limited experience in business management among enterprise owners. The rest of the enterprises are spread between the age of 6-10 years (22.6% of the enterprises) and over ten years (24.4%) in operation. In terms of years of MSMEs establishment, more than 75.9% of MSMEs in agriculture and information technology are less than 5 years old, retail, and wholesale (72%), construction (71.0%) and manufacturing sectors (57.1%) .

Figure 4: Enterprise age distribution



Less than 1 year 1 - 3 years 3 - 5 years 6 - 10 years Over 10 years

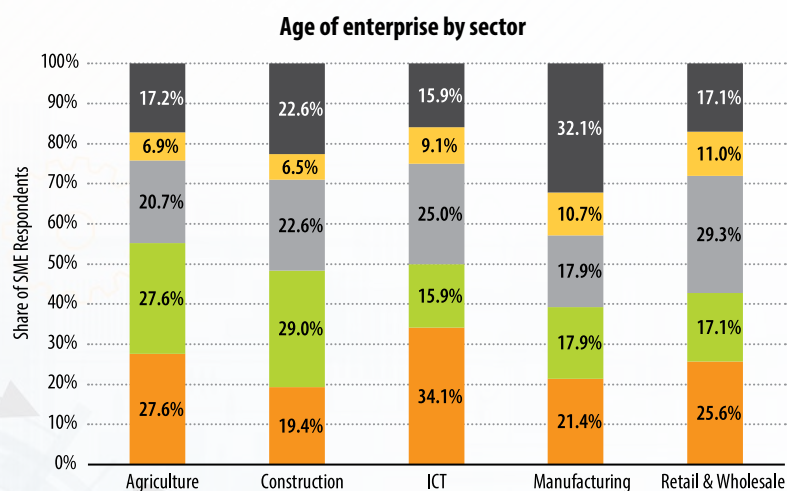
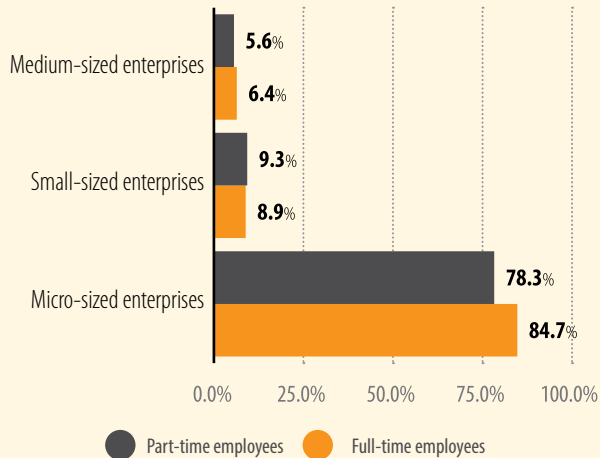


Figure 5: Enterprise size distribution

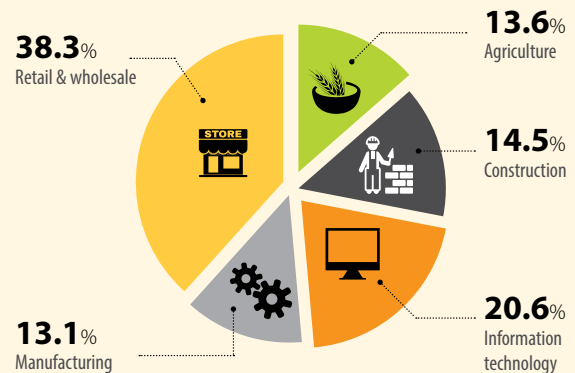
2.2.3 Enterprise size distribution

Based on the number of employees, a sizable proportion are micro-enterprises, with 84.7% and 78.3% having less than ten full-time and part-time employees, respectively. Other enterprises (9%) are characterised as small (with 10-49 full-time employees) while 6.4% are medium enterprises with 50-99 full-time employees (Figure 5).

2.2.4 Sector of operation

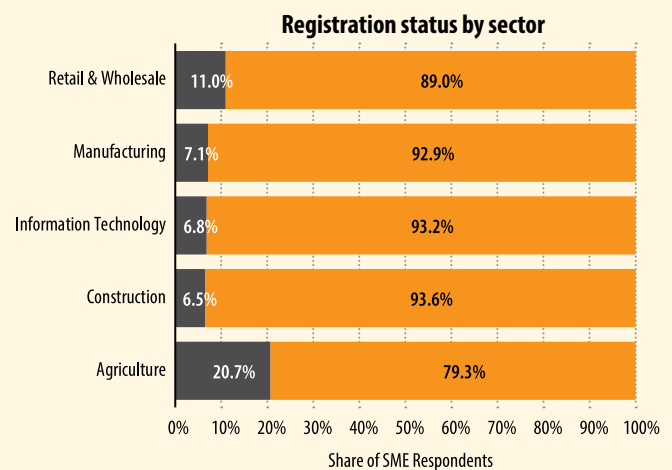
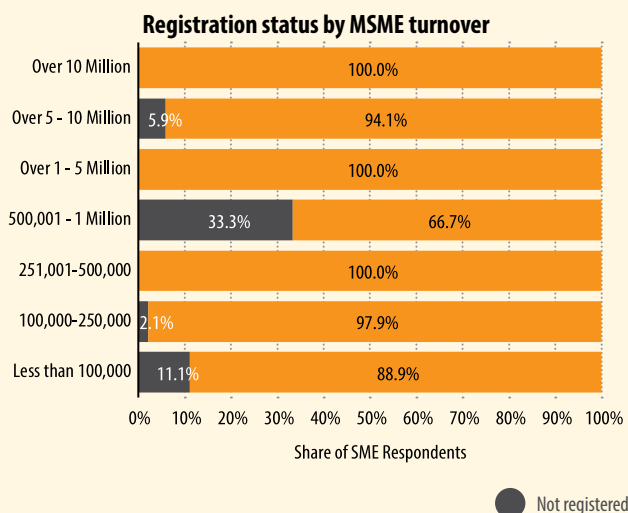
Regarding the enterprise characteristics, most of the enterprises are domiciled in trade and ICT, with the two sectors accounting for 58.9% of all the

enterprises. Figure 6 shows that the wholesale and retail trade sector is the sector with the largest concentration of enterprises, accounting for 38.3%, followed by Information and Communication Technology (20.6%), agriculture (13.6%), manufacturing (13.1%), and construction sector (14.5%).

Figure 6: Sector of operation

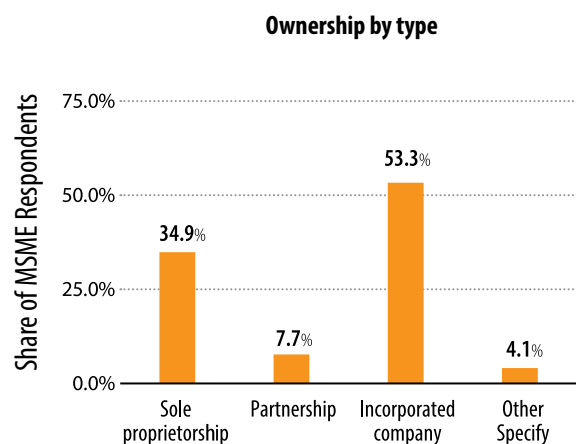
2.2.5 Registration and ownership status

Nearly nine in every ten are registered, which is not surprising since the primary target for the survey were MSMEs under the Inuka Enterprise Program; most of whom are registered entities. By sector, MSMEs in construction sector have the highest level of registration (93.5%), followed by those in information and technology (93.2%), manufacturing (92.9%), retail and wholesale sector (89.0%), and agriculture (79.3%). Further, on average registered enterprises have higher turnover (Figure 7).

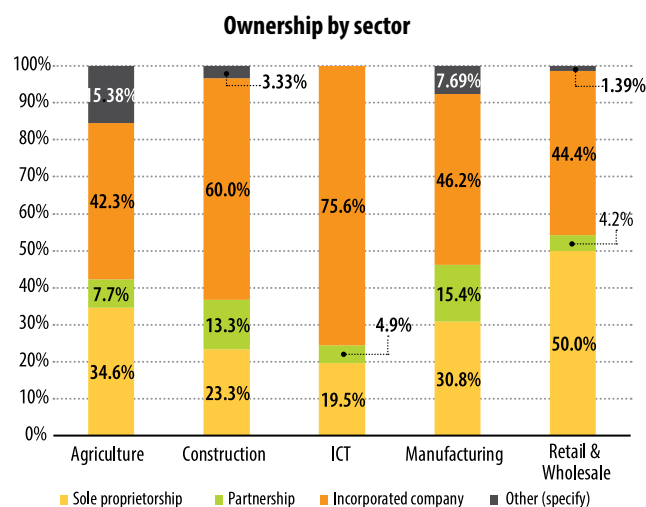
Figure 7: Registration status of enterprise by turnover and sector

Share of MSME Respondents

Figure 8: Ownership



From **Figure 8**, over half (53.3%) of the enterprises surveyed are incorporated companies, and a sizable proportion (34.9%) are operated as a sole proprietorship, and partnerships account for 7.7% of enterprises surveyed. By sector, while sole proprietorship is dominant in the wholesale and retail sector (50.0%), incorporated enterprises dominate operations in three out of the five sectors: information and technology (75.6%), construction (60%), and agriculture (43.3%).



2.2.6 Performance of enterprises

In terms of performance, profitability was noted to differ considerably across enterprises but dominated by profit levels of between Kshs. 10,001–30,000 as reported by 21.0% of MSMEs (**Figure 9**).

Figure 9: Performance of enterprises

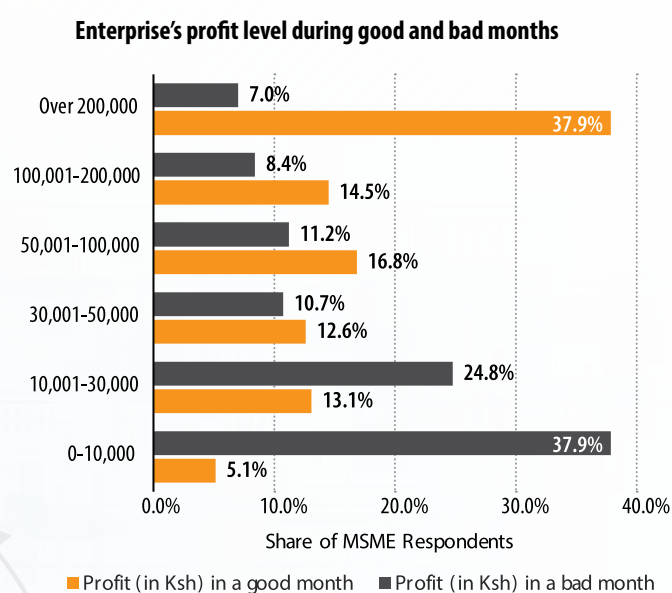
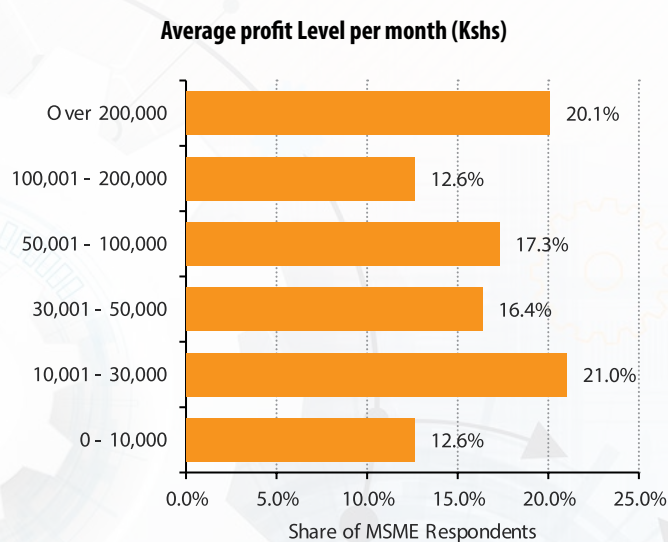
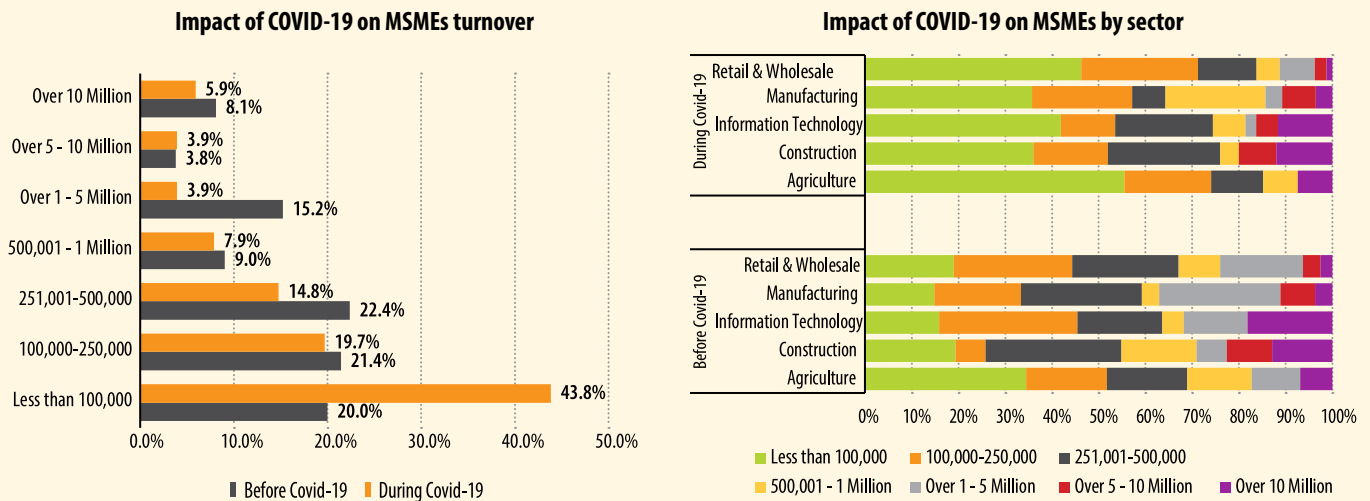
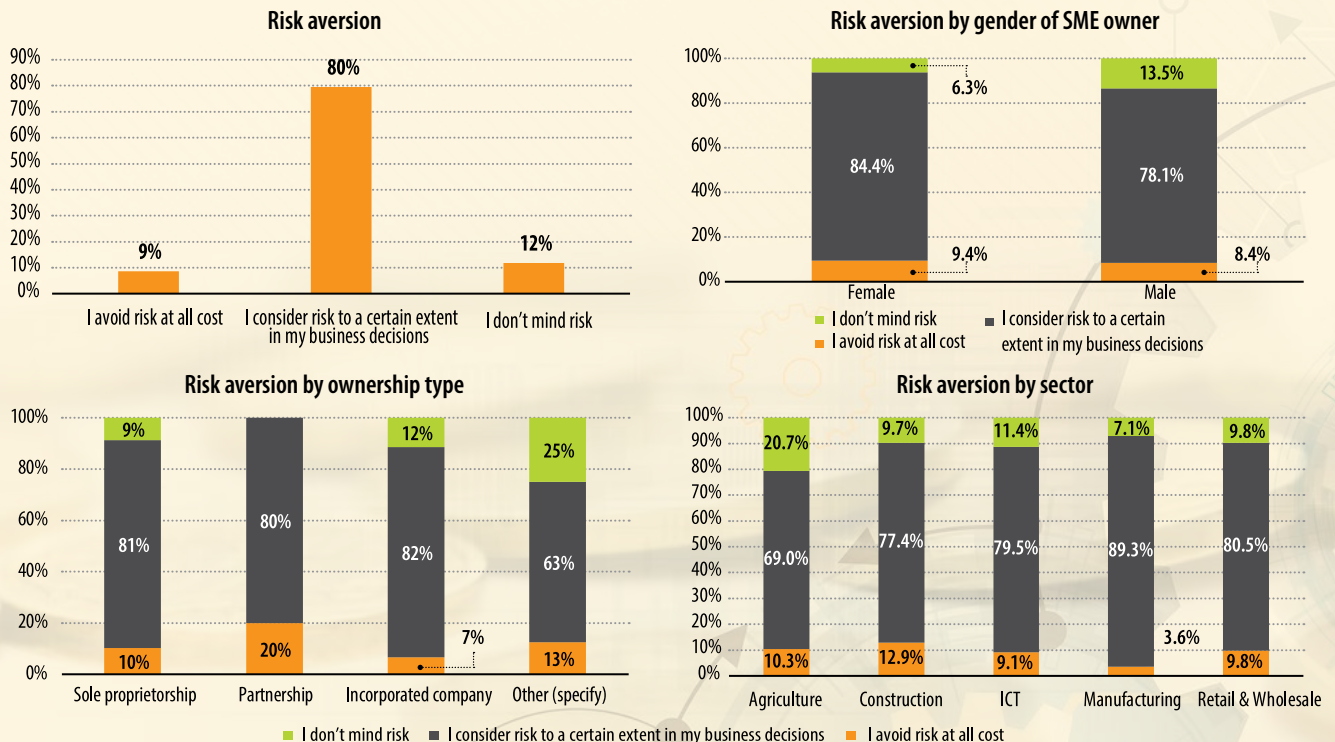


Figure 10: Impact of COVID-19 on Enterprises

As shown in **Figure 10**, COVID-19 had an adverse impact on MSMEs across different levels of turnover. For instance, the proportion of those earning less than Kshs. 100,000 during the pandemic period increased to 43.8% of MSMEs from 20.0% pre-pandemic. A similar pattern is evident across the other levels. Moreover, the impact was highest among service oriented MSMEs, and particularly those in the retail and wholesale sector.

2.2.7 Degree of risk aversion

By gender however, female-owned enterprises are noted to be more risk-averse. The degree of risk aversion also varies across sectors and ownership type of enterprises (**Figure 11**).

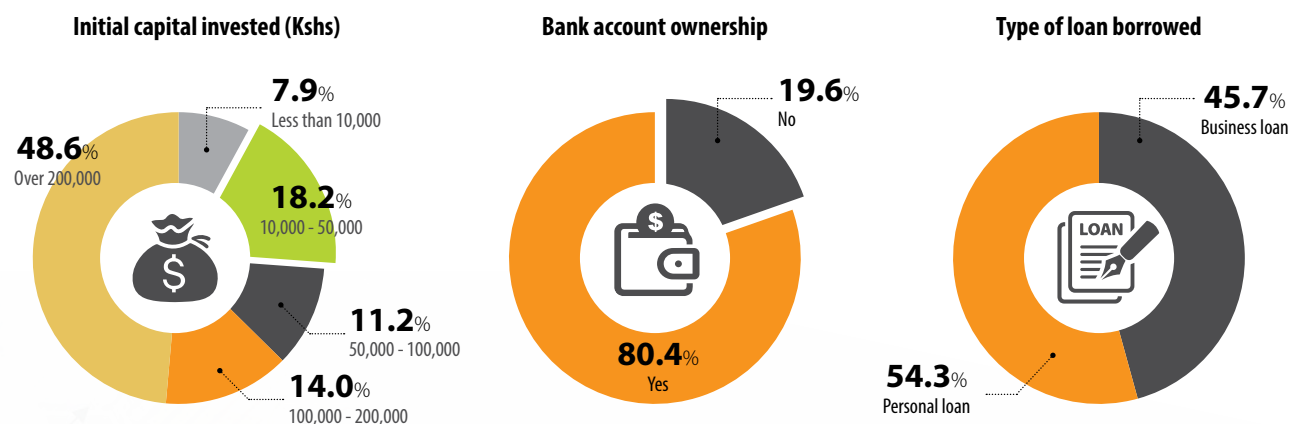
Figure 11: Degree of risk aversion

2.3 Start-up capital amount, sources, and collateral requirements

About half of enterprises (48.6%) started their business with capital of over Kshs. 200,000, with the rest of the enterprises somewhat evenly distributed across start-up capital values below Kshs. 200,000 (**Figure 12**). Most of the enterprises (80.4%) operate a bank account in the business name,

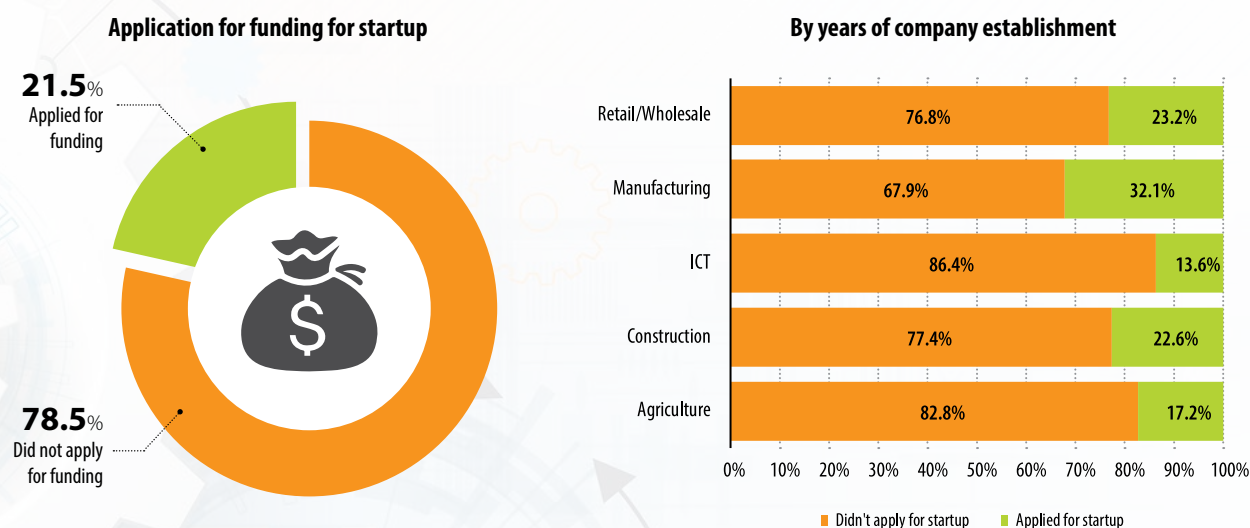
while the rest use their personal accounts for the business. Nonetheless, there appeared to be a narrow distinction between borrowing on a personal capacity and for business reasons, with 54.3% of the enterprises indicating that they borrow using a personal account to support their business.

Figure 12: Initial investment, bank account ownership and type of borrowing



During the start of the business, only 21.5% of the enterprises applied for a loan to start their operation. Even so, heterogeneity across sectors exists. For instance, at the sector level, application for start-up capital was highest among those in the manufacturing sector (32.1%) and least among enterprises in information technology sectors (13.6%) as shown in **Figure 13**.

Figure 13: Start-up loan application by industry, age, and annual turnover

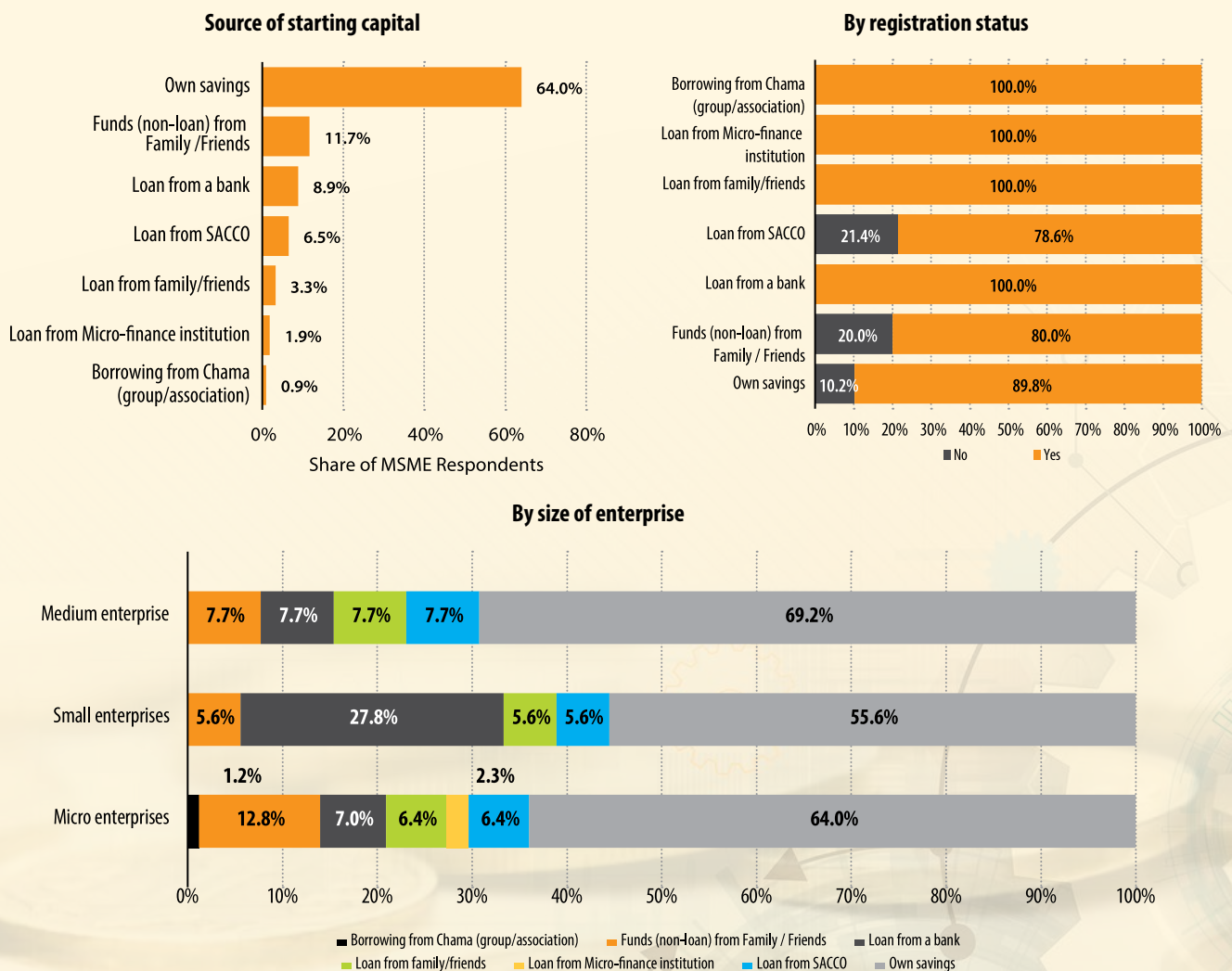


The starting capital financing options of MSMEs are primarily skewed towards non-formal financial instruments. For instance, two-thirds (64.0%) of the enterprises use their savings as starting capital. It is also observed that 11.7% of the enterprises use non-loan sources from family and friends, making it the second most important source of starting capital. Bank loans are the third most important channel as a source of capital, cited by 8.9% of enterprises, while loans from SACCOs and family & friends was cited by 6.5% and 3.3% of the enterprises, respectively. Borrowing by enterprises from micro-finance institutions and borrowings from a *Chama* was cited by 1.9%, and 0.9% of the enterprises, respectively. There are

differences across enterprises based on registration status, and size of the enterprise (Figure 14).

The survey results showed four main drivers of the MSMEs' choice of funding option: i) low cost of credit, iii) no collateral or security requirements, iii) ease of access, and iv) concerns about MSMEs ability to take a bank loan at the initial stage of business start-up. The MSMEs that borrowed start-up capital from a bank were primarily influenced by huge investment outlays required to set up and grow the enterprise and the low cost of credit relative to other forms of financing.

Figure 14: Source of starting capital by industry, age, and turnover

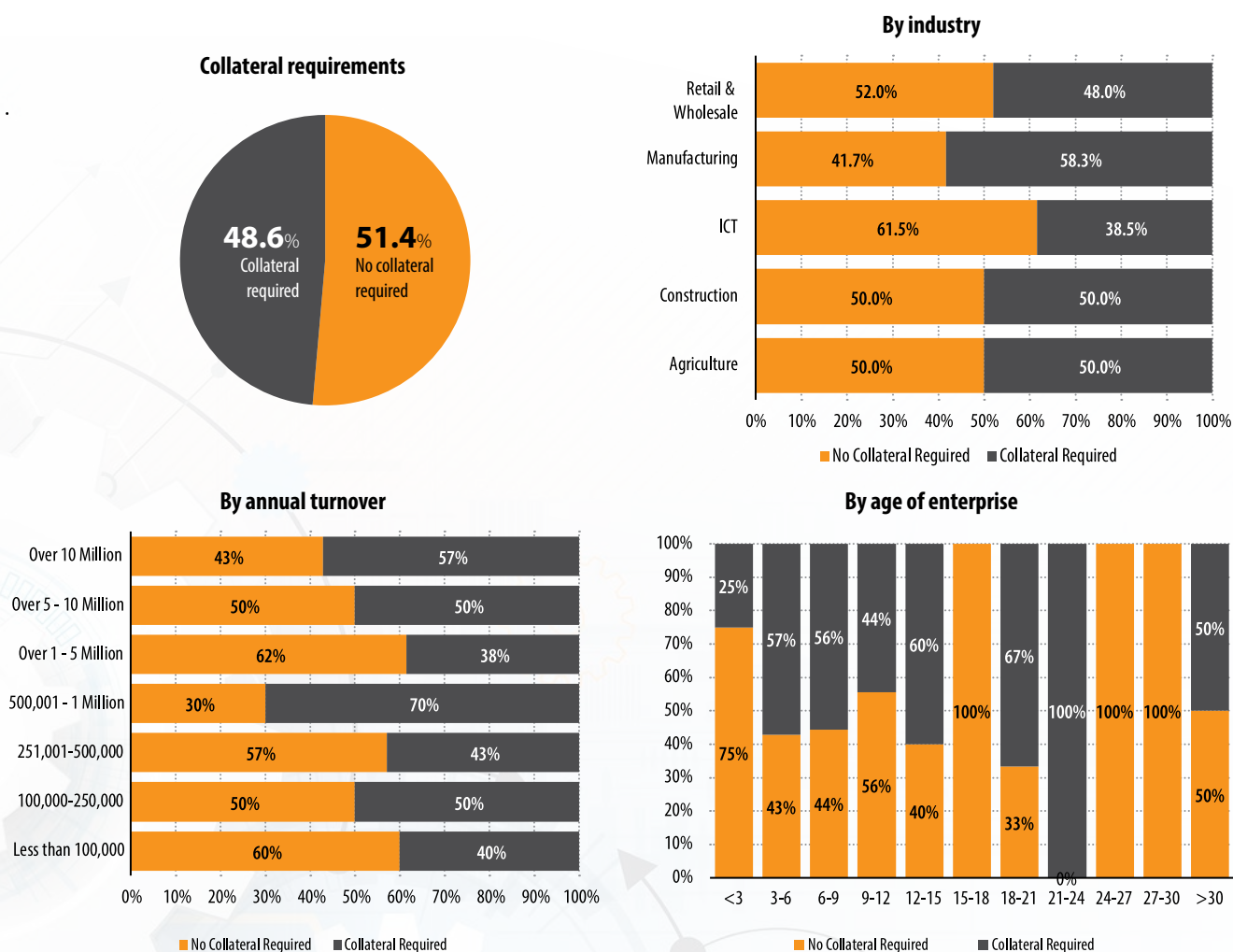




In terms of collateral requirements for borrowing, about half of enterprises (48.6%) required collateral for borrowing. While this differed narrowly across the sectors, considerable variations were noted across levels of turnover and age of enterprise (**Figure 15**).

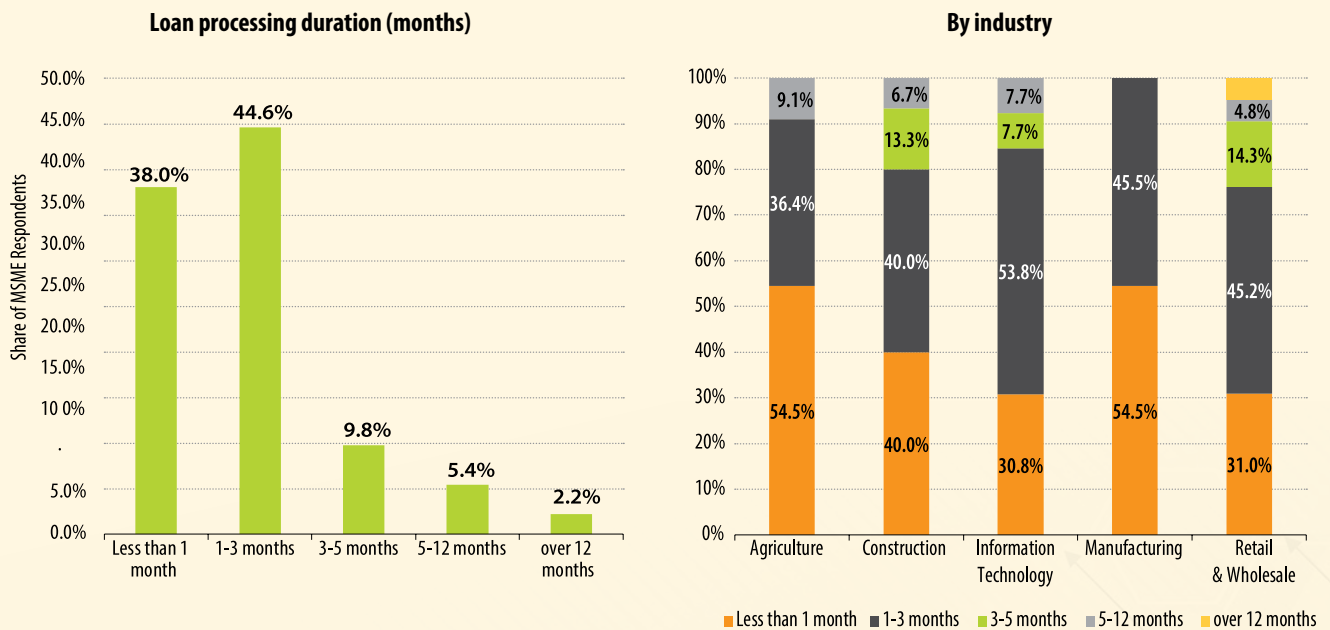
A breakdown by enterprise characteristic, however, show the existence of variances in collateral requirements. MSMEs, especially in the information and technology sector reported lower collateral requirements than enterprises in the manufacturing. On average, enterprises with significantly larger annual turnover tend to access credit with fewer collateral requirements than MSMEs with lower annual turnovers. Overall, older MSMEs also reported lower collateral requirements compared to younger firms.

Figure 15: Collateral requirements of start-up capital by industry, age, and turnover



Loan application process duration are relatively short, with about 83% of enterprises reporting that it takes less than three months to obtain a bank loan. However, differences across sectors are also evident (Figure 16).

Figure 16: Duration of loan processing by industry, age, and enterprise turnover



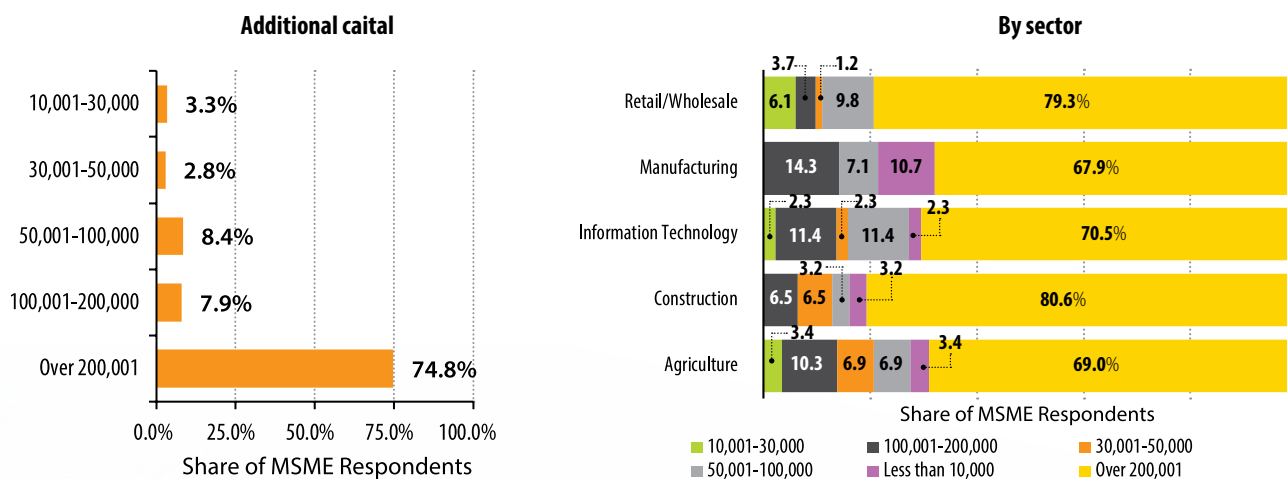
On average, enterprises with significantly larger annual turnover tend to access credit with fewer collateral requirements



2.4. Enterprise willingness to inject additional capital

A majority of enterprises (75%) across all sectors indicated willingness to inject additional capital (over Kshs. 200,000) into their business (Figure 17), signalling strong confidence in their business going forward and the existing financing gap for scaling up their operations.

Figure 17: Enterprise willingness to inject additional capital

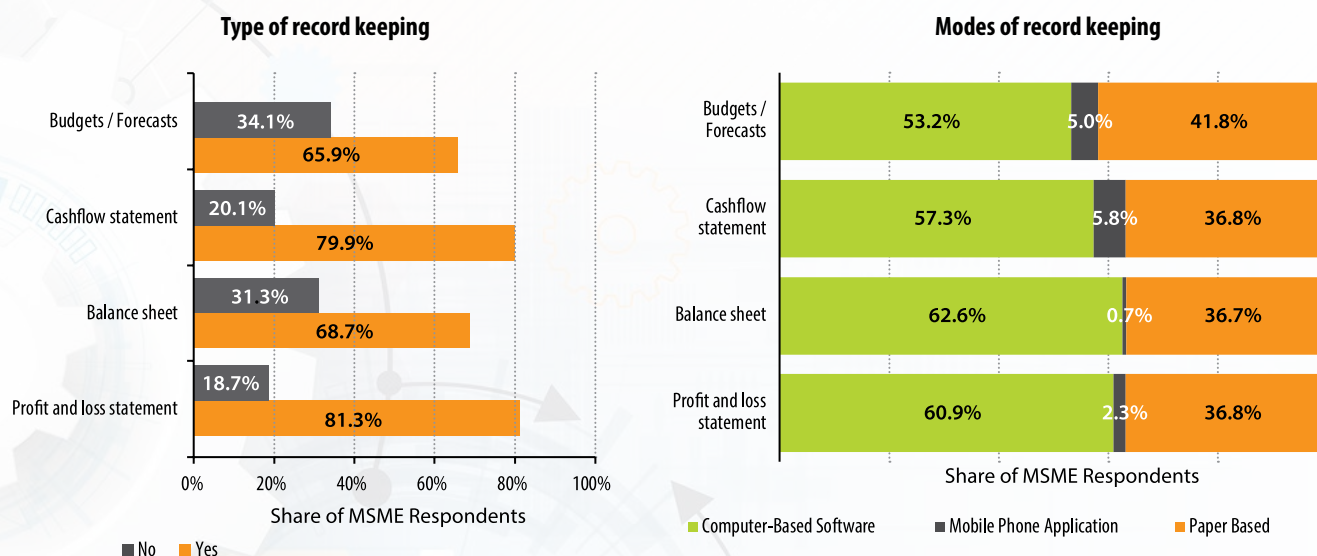


2.5. Financial record-keeping

Regarding financial record-keeping, it was observed that, on average, close to seven out of every ten enterprises keep financial records, with the rest indicating that they do not keep any records

at all. Notably, about two in every three of the enterprises surveyed indicated that they keep their records using computer-based software, while the rest use paper-based and mobile applications (Figure 18).

Figure 18: Financial record-keeping



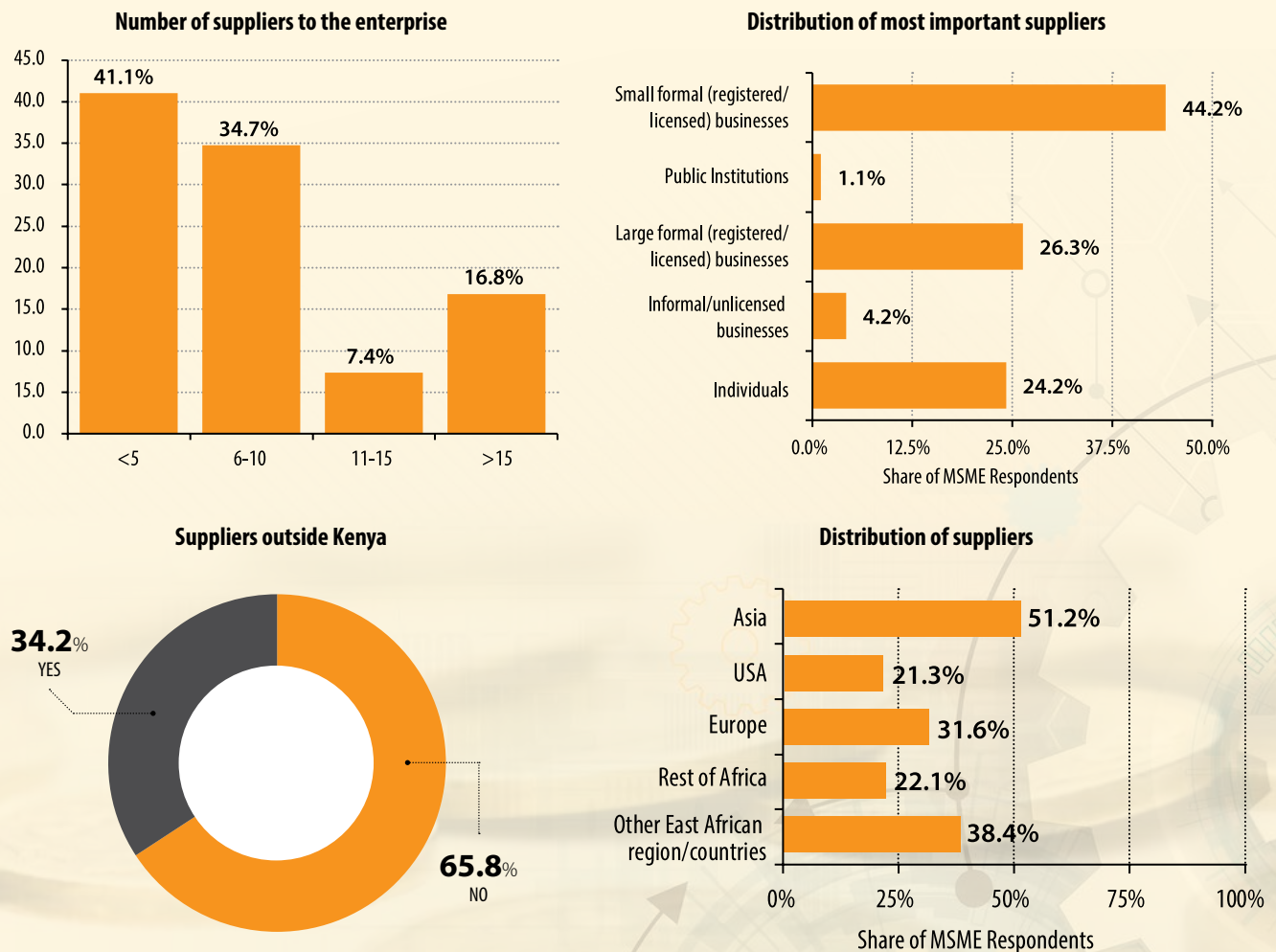
Chapter 3

MSMES SUPPLY CHAIN AND CUSTOMER ENGAGEMENTS

3.1. Supplier engagements

Regarding supplier engagements, 41.1% of MSMEs have less than five suppliers, with an additional 34.7% having 6-10 suppliers. While it was also noted that the most important suppliers include small and formal (registered/licensed) businesses, close to two-thirds of enterprises only have local suppliers, and the rest have both local and foreign suppliers predominantly from Asia (Figure 19).

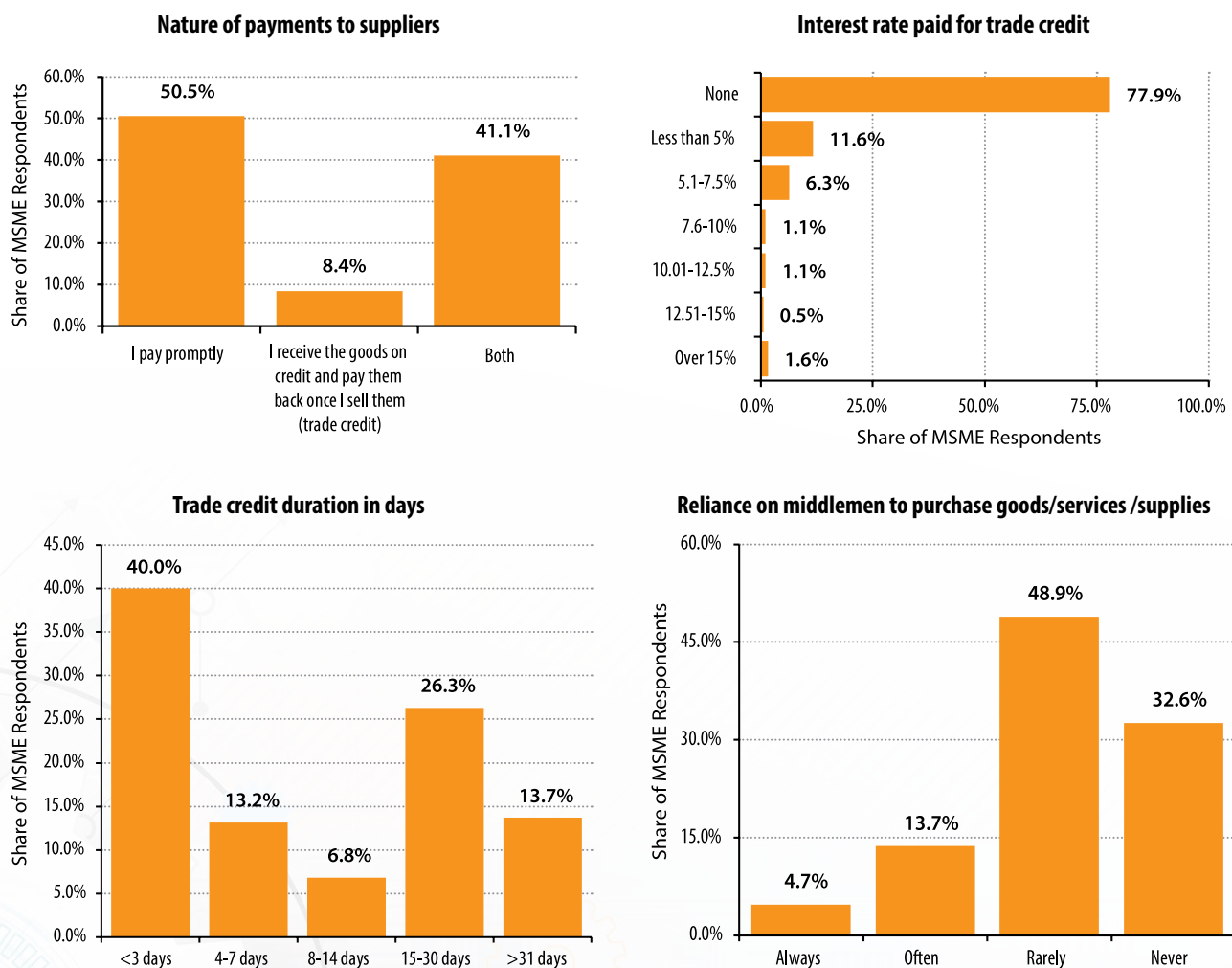
Figure 19: Supplier engagements



With respect to payments for supplies, prompt payments are made by 50.5% of the enterprises, while the rest use both prompt payments and trade credit (41.1%) as only 8.4% of the enterprises use trade credit

exclusively. It is indicated that about 8 in every 10 of the enterprises that use trade credit are not charged any interest on the trade credit whose repayment period is largely within 30 days (Figure 20).

Figure 20: Payments to suppliers

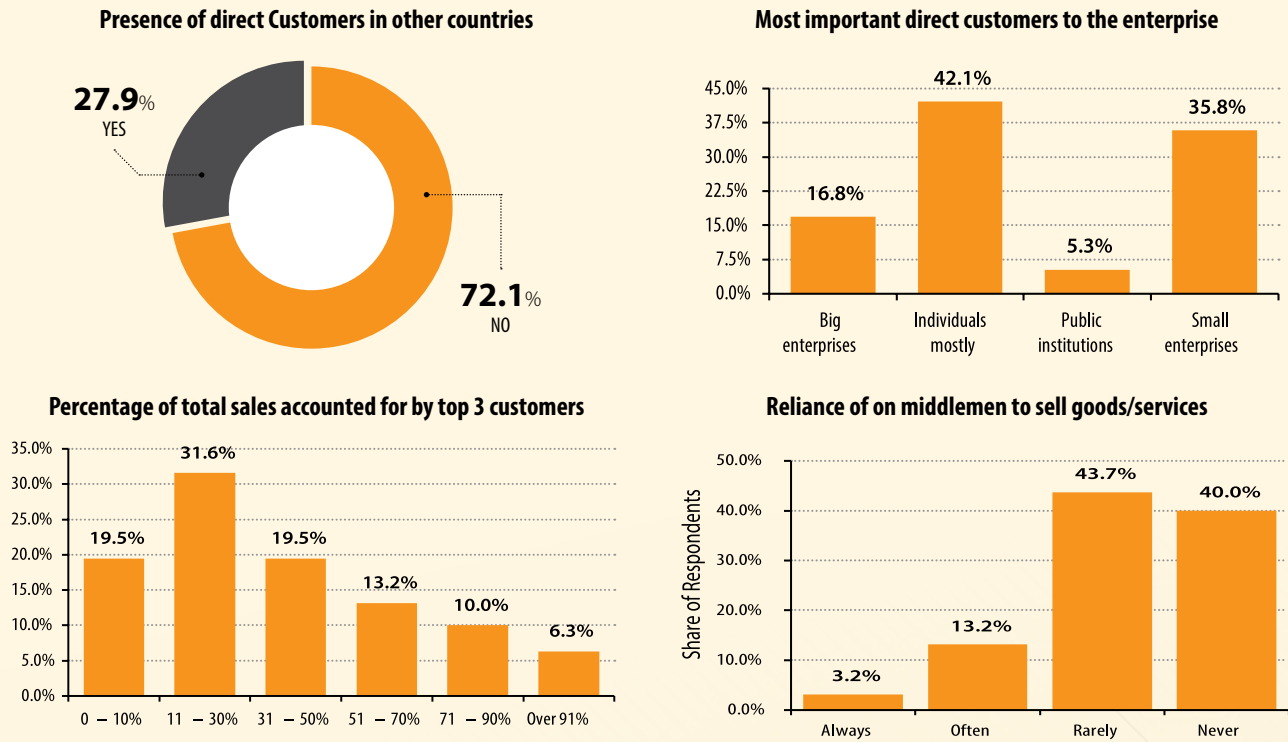


3.2 Customer engagements

It is shown that while close to seven in every ten enterprises have direct customers in other countries, most of enterprise customers in general include individuals (listed by 42.1% of enterprises) and small enterprises (35.8%), as public institutions were listed by 5.3% of the enterprises. The top three customers account for over 50% of total sales. As was the

case in the enterprises' supplier relationship, the use of middlemen to sell goods/services is limited. Notably, 43.7% revealed that they rarely used intermediaries to sell goods/services. Only 3.2% of the enterprises reported that they always use middlemen (Figure 21).

Figure 21: Customer engagements

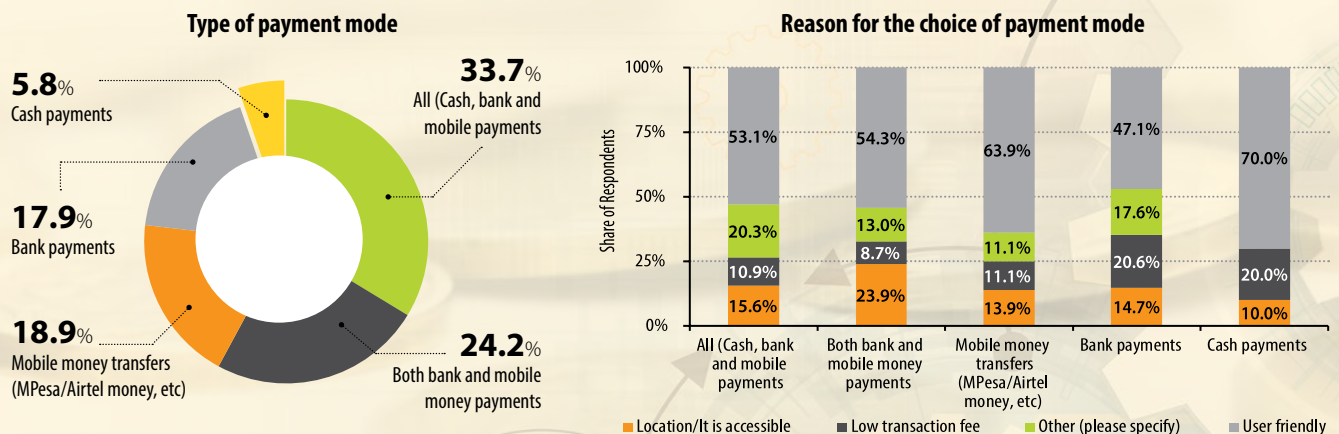


3.3. Payments to suppliers

Regarding the mode of payments to suppliers, and as Figure 22 shows, it was established that about one-third of enterprises (33.7%) use a combination of payment forms, that is cash, bank transfers and mobile money payment service. In addition, slightly more than half (53.1%) of these enterprises chose all forms of payments primarily because of their

user-friendliness. Other reasons include proximity, convenience, and low transaction costs. The use of both bank and mobile money service for payments to suppliers was the second most important form of payments indicated by about a quarter (24%) of the enterprises.

Figure 22: Modes and reason of payment choice







Difficulty in accessing credit, whether from formal or informal sources, remains a significant constraint faced by MSMEs.

Chapter 4

UTILISATION OF FORMAL AND INFORMAL FINANCIAL INSTRUMENTS

4.1. Access to formal and informal financial instruments

The utilisation of both formal and informal financial instruments, as Figure 23 shows, most enterprises have and /or have previously operated a savings account, with only 29% not having had a savings account before. Ranked from the topmost utilised financial instrument, a bank savings account is ranked first followed by bank loan, loan from a friend / family member, a savings account in a SACCO, mobile money loan from a bank, and mobile money loan from a non-bank digital credit provider..

Figure 23: Access to formal and informal financial instruments

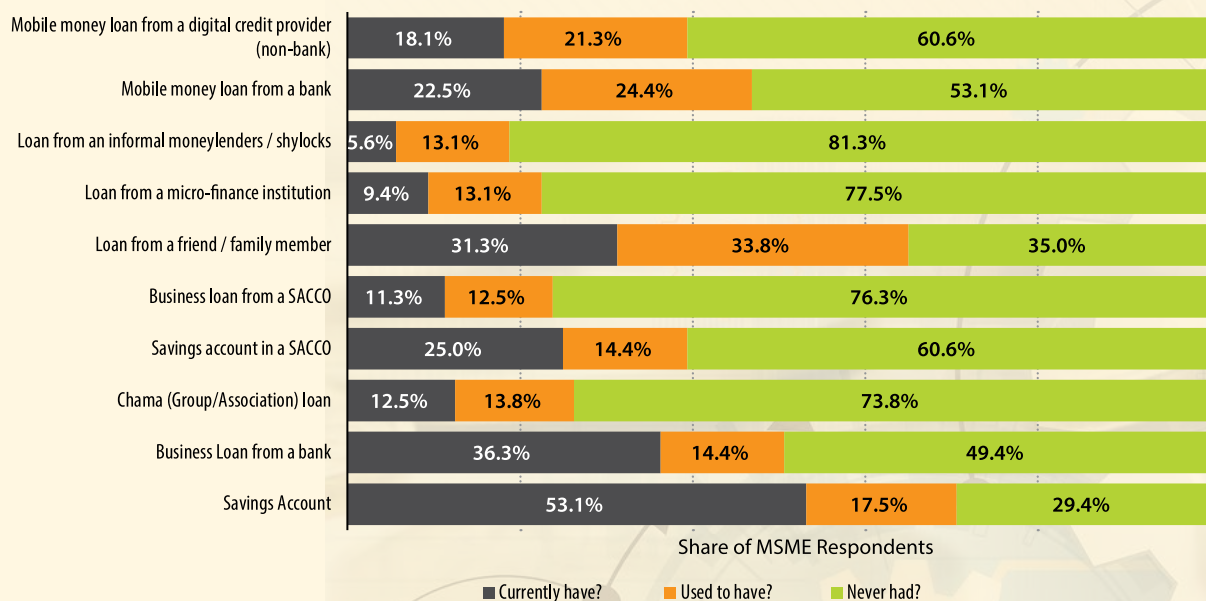
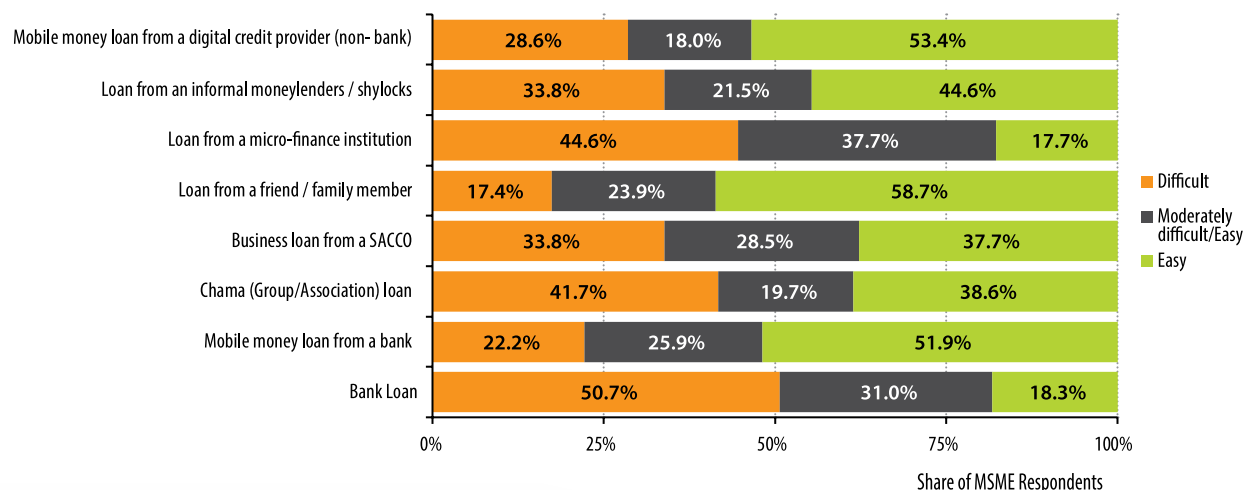


Figure 24: Ease of access to formal and informal financial instruments

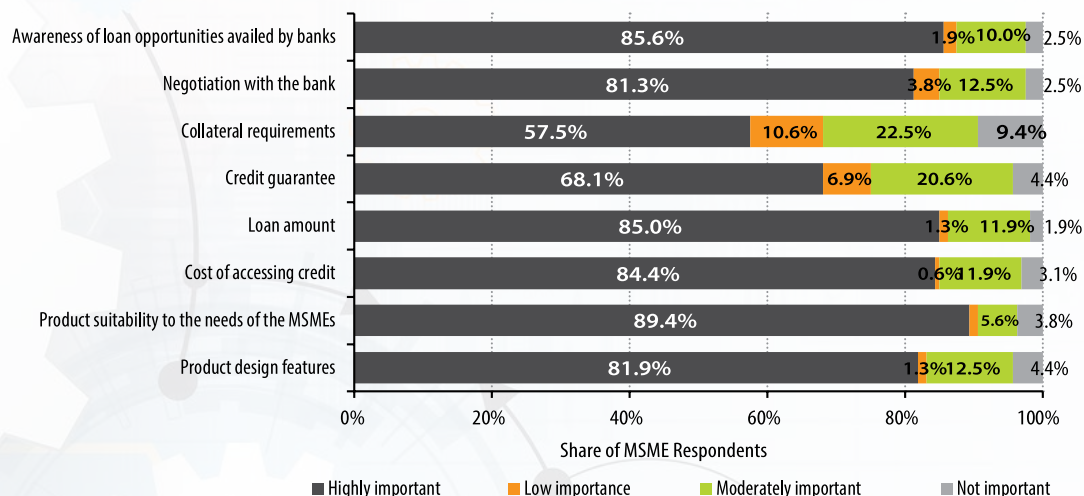
4.2 Ease of access to formal and informal financial instruments

Difficulty in accessing credit, whether from formal or informal sources, remains a significant constraint faced by MSMEs (Figure 24). For instance, on the one hand, 50.7% of enterprises report that accessing bank loans is difficult. On the other hand, 51.9% indicate that accessing mobile loans from banks is easy. Moreover, access to mobile loan from a digital provider is reported by 53.4% of the enterprises to be easier relative to the other sources, while 44.6% of the enterprises reported ease in accessing a loan from informal moneylenders/shylocks. For micro-finance loans, 44.6% of the enterprises indicate that they are difficult to access as loans from friends and family is reported to be the easiest to obtain by 58.7% of the enterprises. In addition, close to four out of ten enterprises indicated that it is easy to obtain

loans from a SACCO. Access to loans from *Chamas* is reported by 38.6% of the enterprises as being easy.

4.3 Drivers of MSMEs' demand for bank loans

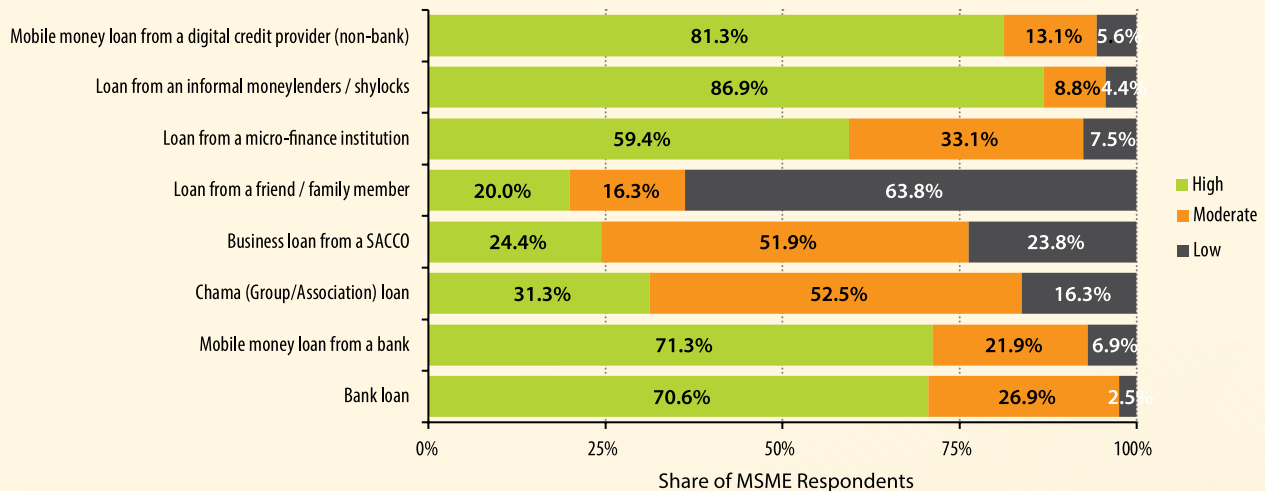
MSMEs demand for bank loans is primarily determined by (ranked from most important to least important) suitability to the needs of MSMEs and awareness of loan opportunities available by banks. Other important factors include loan amount sought, cost of credit, product design features, room for negotiation with a bank, availability of credit guarantee services and collateral requirements (Figure 25).

Figure 25: Drivers of MSMEs' demand for bank loan

4.4 Perceptions on interest rates of financial instruments

Figure 26 summarises the MSMEs' perceptions on interest rates charged on financial instruments (both formal and informal). On the one hand, interest rates on non-bank digital loans are perceived to be high by 81.3 % of the enterprises, followed by bank loans and digital loans at 70.6 % and 71.3 %, respectively. On the other hand, loans from *Chamas* and SACCOs, are perceived to have low-interest rates by 31.3 % and 24.4 % of the MSMEs, respectively.

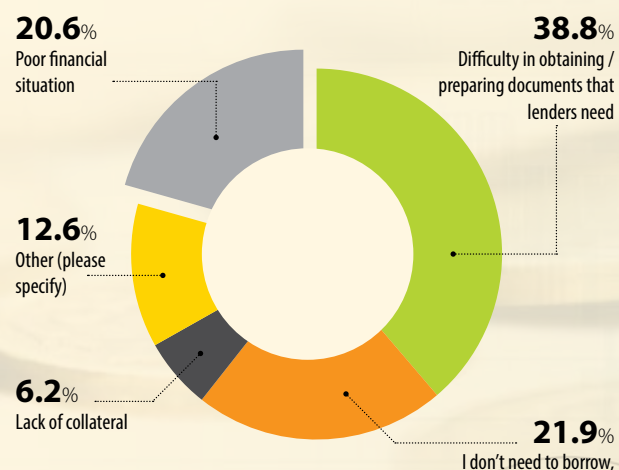
Figure 26: MSMEs' perceptions on interest rates of financial instruments



4.5 Reasons for enterprises' constrained access to finance

Figure 27 presents a breakdown of reasons reported by MSMEs as constraining access to finance. The results show that while 78.1% of respondents need a loan, they cannot borrow enough money because of difficulty in obtaining/preparing documents that lenders need (as indicated by 38.8 % of the enterprises); poor financial situation of the borrowers (20.6 %), and lack of collateral (6.2%).

Figure 27: Reason for enterprise's constrained access to finance

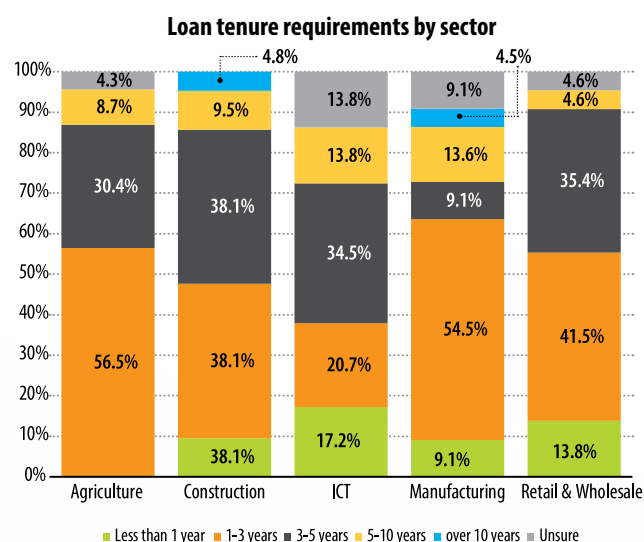
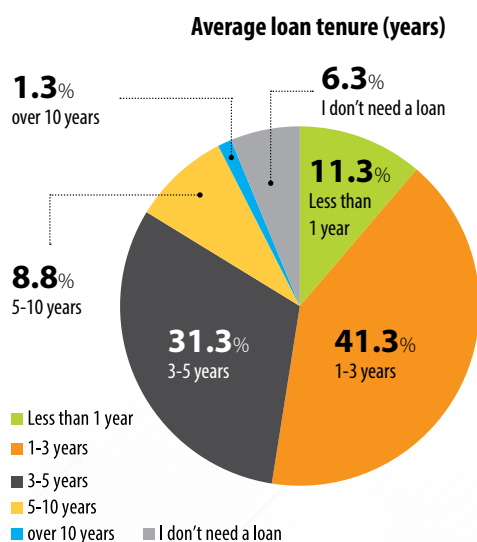


4.6 Loan tenure requirements

Figure 28 presents enterprises' loan tenure requirements for the credit facilities preferred by enterprises. While 6% of the enterprises report that they do not need a loan, most enterprises prefer short-term loans, with 41% preferring tenures within 1-3 years, while 31% prefer loan tenures

of 3-5 years. A small proportion of the enterprises prefer long-term loan tenures, with only 10% preferring facilities over a six-year maturity period. By sectoral distribution, majority of the enterprises also prefer short tenures.

Figure 28: Loan tenure requirements



4.7 Usage of mobile money transfer services and internet banking

About 66.3% of the MSMEs use mobile money transfer services daily, 21.9% use it a few times a week, 1.9% use it once a week, and 6.3% use it a few times a month, while 3.8% only use it every few months. On average,

55.5% of the MSMEs transact less than Kshs. 100,000 in a month, while another 28.7% of them transact between Kshs. 100,001 and Kshs. 500,000 in a month (**Figure 29**).

Figure 29: Usage of mobile money transfer services

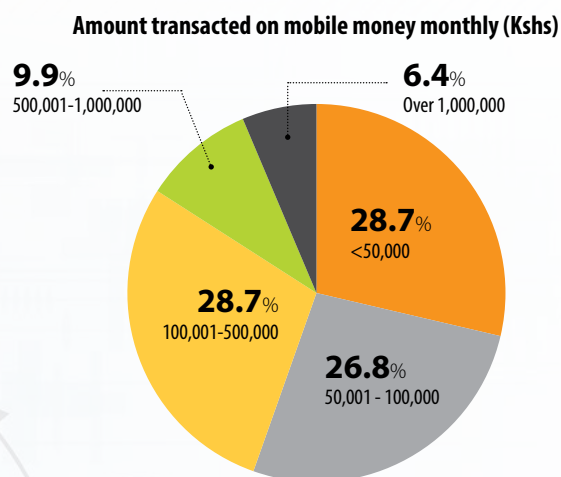
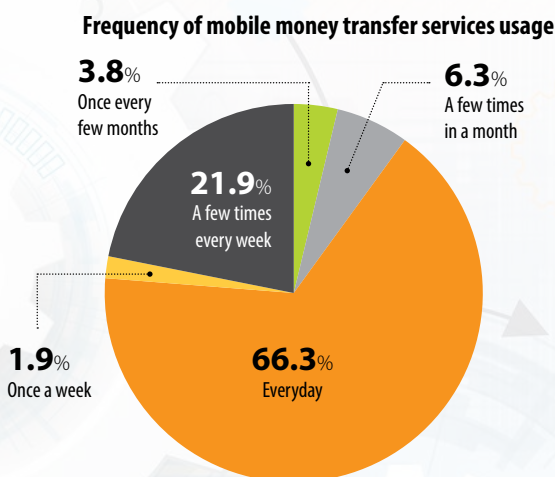


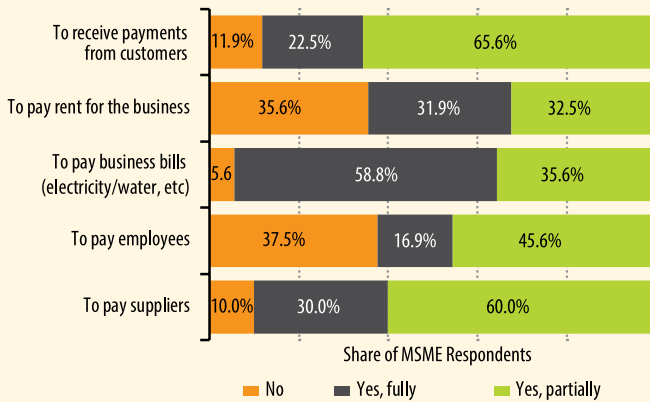
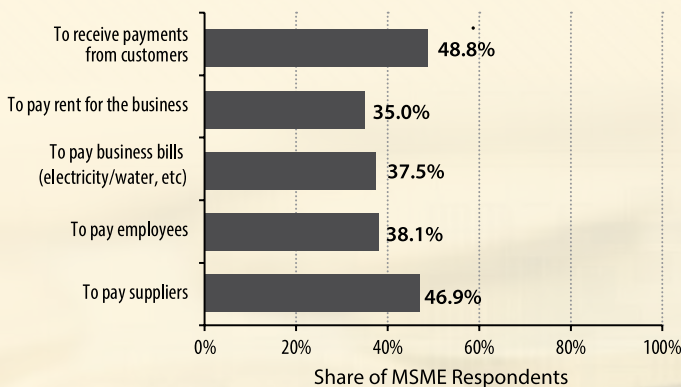
Figure 30: Reason of usage of mobile money transfer services

Figure 30 presents the reasons and the extent of the use of mobile money transfer transactions. It is noted that almost all (94%) MSMEs use mobile money to pay business bills (electricity/water, etc.), 90 % to pay suppliers, 88.1 % use it to receive payments from customers, while 64.4 % use it to pay rent for business premises, and 62.5 % report using it to pay salaries to their employees.

Additionally, nearly 50% of businesses use internet banking to pay suppliers and receive payments from customers. However, less than 40% of companies use internet banking to pay salaries, utilities, and rent. Overall, more than half of the companies are not likely to use internet banking (**Figure 31**).

Figure 31: Usage of internet banking





Chapter 5

CONCLUSIONS

Micro, Small and Medium Enterprises (MSMEs) continue to face several challenges; key among them constrained access to finance, attributed mainly to financiers' widespread lack of clear information on MSMEs' operations. While constrained access to finance continues to impede growth of MSMEs, it has been aggravated by the pandemic's adverse effects which has made them more fragile and their growth more uneven. At the same time, we recognise that the activities of MSMEs shall underpin a strong and sustainable recovery of the economy post-COVID.

In this regard, the need to better understand and characterise the MSMEs' environment would be paramount to support appropriate interventions. We believe that a comprehensive capture of information about MSMEs operations would bridge the information gap between MSMEs and financial service providers and facilitate growth in credit to MSMEs.

To that end, therefore, this report pursued three main objectives. First, to describe the entrepreneur and enterprise characteristics. Second, to assess the MSMEs' supply chain and customer engagements; and third, to examine the utilisation of the existing formal and informal finance instruments. The study targeted to reach all the 2,949 MSMEs enlisted in the KBA's Inuka Enterprise Program.

The results contained in this report represent the views of 279 MSMEs spread across the country that responded to the survey conducted between May 7-21, 2021. To the extent that the survey was online and not directly targeted to any enterprise within the population reached, the responding enterprises can be deemed as randomly selected.

“ We believe that a comprehensive capture of information about MSMEs operations would bridge the information gap between MSMEs and financial service providers and facilitate growth in credit to MSMEs

A summary of the results shows based on the most prominent entrepreneur characteristics that a majority (77%) of MSMEs owners are male, with 54.5% highly educated having attained a bachelor's degree level of education. In addition, close to two-thirds (64%) of enterprise owners have more than six years of employment history before venturing into business.

Regarding the enterprise characteristics, most of the enterprises are domiciled in trade and ICT, with the two sectors accounting for 59% of all the enterprises. Other major host sectors include agriculture, manufacturing, and construction. It was also noted that most of the enterprises surveyed are young start-ups with 53% of them having been in operation for less than five years.

Analyses of size of enterprise, based on the number of employees, a sizable proportion are micro-enterprises, with 84.7% and 78.3% having less than ten full-time and part-time employees, respectively. Other enterprises (9%) are characterised as small (with 10-49 full-time employees) while 6.4% are medium enterprises with 50-99 full-time employees. By registration, nearly nine in every ten (90%) are registered, with slightly over half (53.3%) of the enterprises surveyed reporting that they are incorporated companies. About a third of the enterprises (34.9%) are operated as sole proprietorship.

In terms of enterprise performance, profitability was noted to differ considerably across enterprises but dominated by profit levels of between Kshs. 10,001–30,000 as reported by 21.0% of MSMEs. Moreover, COVID-19 had an adverse impact on MSMEs across different levels of turnover. For instance, the proportion of those earning less than Kshs. 100,000 during the pandemic period increased to 67.9% of MSMEs from 32.1% pre-pandemic. Risk considerations by enterprises were also analysed. This showed that while many of the enterprises (80%) actively consider and avoid risk in their business operations, this feature is largely present among female-owned enterprises who are noted to be more risk averse.

Regarding start-up capital requirements, about half of enterprises (49%) started their business with capital of over Kshs. 200,000, with the rest of the enterprises somewhat evenly distributed across start-up capital values below Kshs. 200,000. During the start of the business, only 21% of the enterprises applied for a loan to start their operations. Nonetheless, only 9% of the enterprises borrowed from a bank with the rest from SACCO, family /friends, and micro-finance institutions. It was also noted that the source of capital differed across size, registration status of enterprise and turnover. In terms of collateral requirements for borrowing, about half of enterprises (49%) required collateral for borrowing. While this differed narrowly across the sectors, considerable variations were noted across levels of turnover and age of enterprise. Loan application process duration



is noted to be relatively short, with about 83% of enterprises reporting that it takes less than three months to obtain a bank loan. This, however, differed across the sectors, age of enterprise and turnover levels. Many enterprises (75%) across all sectors indicated willingness to inject additional capital (of over Kshs. 200,000) to their business.

Most of the enterprises (80%) operate a bank account in the business name, while the rest use their personal accounts for the business. Notably, there appears to be a narrow distinction between borrowing on a personal capacity and for business reasons, with 54% of the enterprises indicating that they borrow using a personal account to support their business.

Regarding financial record-keeping, it was observed that, on average, close to seven out of every ten enterprises keep financial records, with the rest indicating that they do not keep any records at all. Notably, about two in every three of the enterprises surveyed indicated that they keep their records using computer-based software, while the rest use paper-based and mobile applications.



It was also noted that most of the enterprises surveyed are young start-ups with 53% of them having been in operation for less than five years.

On supplier engagements, 41% of MSMEs have less than five suppliers, with an additional 35% having 6-10 suppliers. While it was also noted that the most important suppliers include small and formal (registered/licensed) businesses, close to two-thirds of enterprises only have local suppliers and the rest have both local and foreign suppliers predominantly from Asia.

An assessment of the mode of payments adopted by enterprises, prompt payments for goods supplied is done by 51% of the enterprises, while the rest use both prompt payments and trade credit (41%) as only 8.4% of the enterprises use trade credit exclusively. It is indicated that about 8 in every 10 of the enterprises that use trade credit are not charged an interest on the trade credit whose repayment period is largely within 30 days. Regarding the means of payments to suppliers, it was established that about one-third of enterprises (34%) use a combination

of payment forms, that is cash, bank transfers and mobile money payment service. In addition, slightly more than half (53%) of these enterprises chose all forms of payments largely because of their user-friendliness. Other reasons include proximity, convenience, and low transaction costs. The use of both bank and mobile money service for payments to suppliers was the second most important form of payments indicated by about a quarter (24%) of the enterprises.

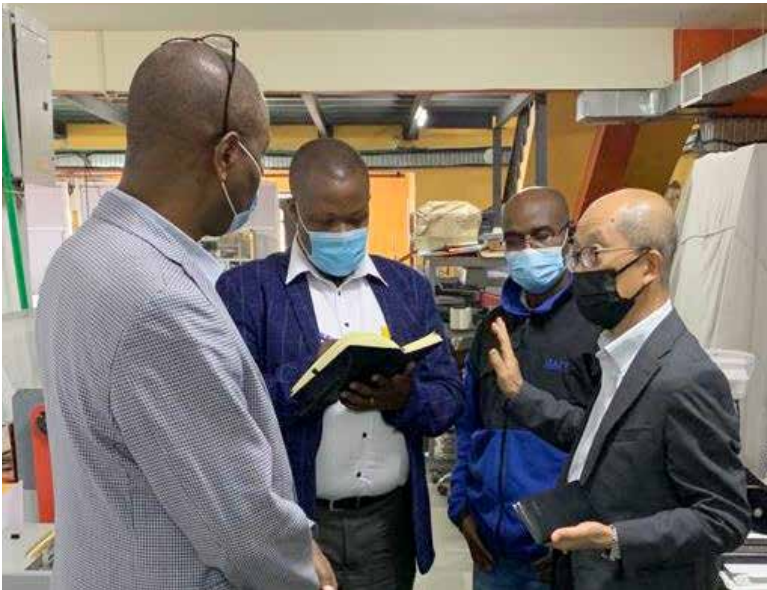
Customer engagements was also analysed. It is shown that while close to seven in every ten enterprises (72%) have direct customers in other countries, most of enterprise customers in general include individuals (listed by 42% of enterprises) and small enterprises (36%), as public institutions were listed by 5.3% of the enterprises. The top three customers account for over 50% of total sales.

The survey also assessed the utilisation of both formal and informal financial instruments, it was established that most enterprises have and / or have previously operated a savings account, with only 29% not having had a savings account before. Ranked from the topmost utilised financial instrument, a bank savings account is ranked first followed by bank loan, loan from a friend / family member, a savings account in a SACCO, mobile money loan from a bank, and mobile money loan from a non-bank digital provider. In addition, difficulty in accessing to credit, whether formal or informal, remains a significant constraint faced by MSMEs. Perceptions on interest rates charged on financial instruments show that non-bank digital loans are the most expensive followed by bank loans (including digital loans). Loans from *Chamas* and SACCOs are perceived by enterprises to carry low interest rates.

Moreover, MSMEs' demand for bank loans is determined largely by (ranked from most important to least important) suitability to the needs of MSMEs, awareness of loan opportunities availed by banks, loan amount sought, cost of credit, product design features, room for negotiation with a bank, availability of credit guarantee services and collateral requirements.

The main reasons given by enterprises, for what constraints their access to finance, highlight difficulty in obtaining /preparing documents that lenders need, poor financial position of the borrowers and lack of collateral. Nonetheless, the most preferred loan tenure by enterprises on credit facilities is 1-3 years reflected by 41% of enterprises and 3-5 years (31%), with only 10% of the enterprise preferring facilities with over six-year maturity.

The survey also attempted to examine the utilisation of mobile money and internet banking services. It was established that about two-thirds (66%) of the enterprises surveyed use mobile money services daily, as 57% of the enterprises transact less than Kshs. 500,000 per month, and another 27% of the enterprises transact between Kshs. 500,001 and Kshs. 1,000,000 per month. Mobile money is used predominantly (by 94% of enterprises) to pay business bills (electricity/water, etc), pay suppliers (90%), to receive payments from customers (88%), rent (64%) and employee salaries (63%). With regard to utilisation of internet banking, it was established that one in every two (50%) of the enterprises surveyed use internet banking to pay suppliers and receive payments from customers..



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