

## Unleashing the full potential of the Kenyan SME sector

Launch of an update study on the key challenges faced by the 'missing middle' in Kenya

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The first report in the [Dutch Good Growth Fund #ClosingTheGap](#) series has identified four main gaps in the Kenyan entrepreneurial ecosystem that hamper the growth of local enterprises. The study shares insights about the challenges and obstacles the different sub segments of the small and medium-sized enterprise (SME) sector face in Kenya.

The new report **#ClosingTheGapKenya - Update on key challenges for the "missing middle" in Kenya** provides a diagnosis of the Kenyan entrepreneurial ecosystem with a particular focus on the financial service offering for local SMEs. By gathering a better understanding of the Kenyan enterprise landscape, the study establishes several disconnections between the entrepreneurs' needs and the financial and non-financial services that are available to them towards growing their business. The report identifies four areas to improve the conduciveness of the entrepreneurial ecosystem: 1) to seed new efforts to unlock seed and angel funding, 2) to increase the supply of long-term growth capital, 3) to provide quality business development support services in a sustainable way as well as 4) facilitating access to the support ecosystem.

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<sup>1</sup> A consortium consisting of Triple Jump and PwC is responsible for the management of the Dutch Good Growth Fund (DGGF) Part: Financing local SMEs in up to 68 selected countries. The consortium manages the DGGF on behalf of the Dutch Ministry of Foreign Affairs. In this framework, Julia Brethenoux - Sr Advisor for the SCBD program and Marnix Mulder - Head of Advisory Services, from Triple Jump, have authored this article.

In an effort to better understand the factors that hamper SMEs from securing the financial backing they need to grow, DGGF in collaboration with [ANDE](#) and [EAVCA](#) commissioned an assessment of the Kenyan entrepreneurial ecosystem. The research was undertaken following the ANDE entrepreneurial ecosystem diagnostic toolkit. Primary data was gathered through interviews with 30 entrepreneurs and financial and non-financial support service providers and a multi-stakeholder *SME Expert Forum* that gathered 100+ practitioners in Nairobi in June 2015. Secondary data consisted of the *World Bank Enterprise Survey 2013* data covering the country's three economic hubs and existing research compiled through a literature review. The preliminary findings were refined based on the feedback of the local stakeholders and captured as part of a more detailed assessment of the existing SME finance offering in Kenya which forms an integral part of the final report, along with a sub segmentation of the SME sector which highlights the key challenges faced by each sub-segment.

### The leading entrepreneurial ecosystem in East Africa

With a rather developed support ecosystem that offers a variety of financial and non-financial services, Kenya leads the East African region in SME development support and is recognized as the entrepreneurship and innovation hub of the region.

However, like their peers in neighboring countries, Kenyan entrepreneurs – in particular those operating outside of the capital city - still face important challenges. Accessing appropriate finance and adequate business support as well as attracting qualified human capital remain a struggle for local SMEs who see their growth constrained (figure 1). The SME finance offering remains an issue, especially with respect to access to debt. The credit gap per enterprise is actually the highest in the region.

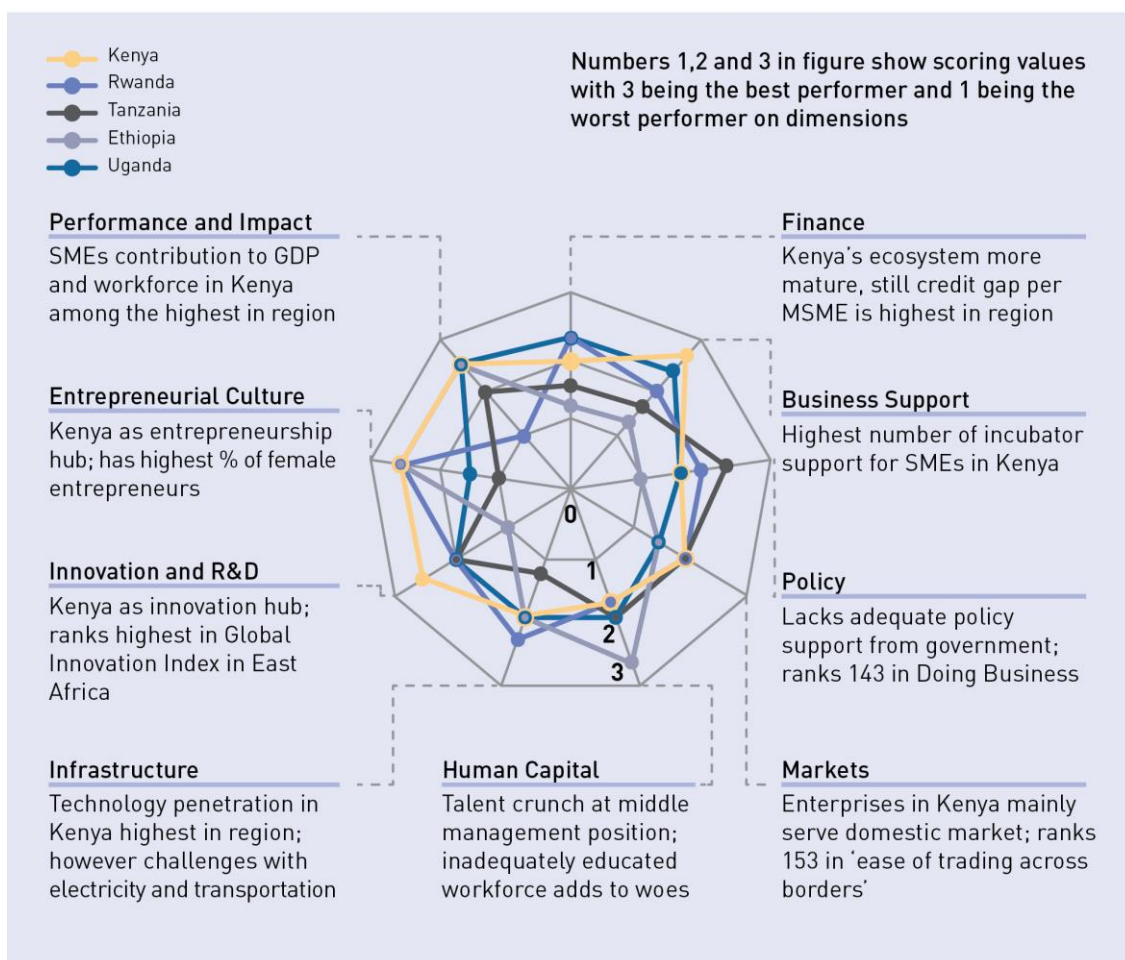


Figure 1. Ecosystem benchmarking Kenya vs. the East African region

### A sub-segmentation of the Kenyan SME sector is needed...

When deepening the analysis of the SME market, its heterogeneity called for a sub-segmentation which resulted in the identification of six categories of SMEs (figure 2).

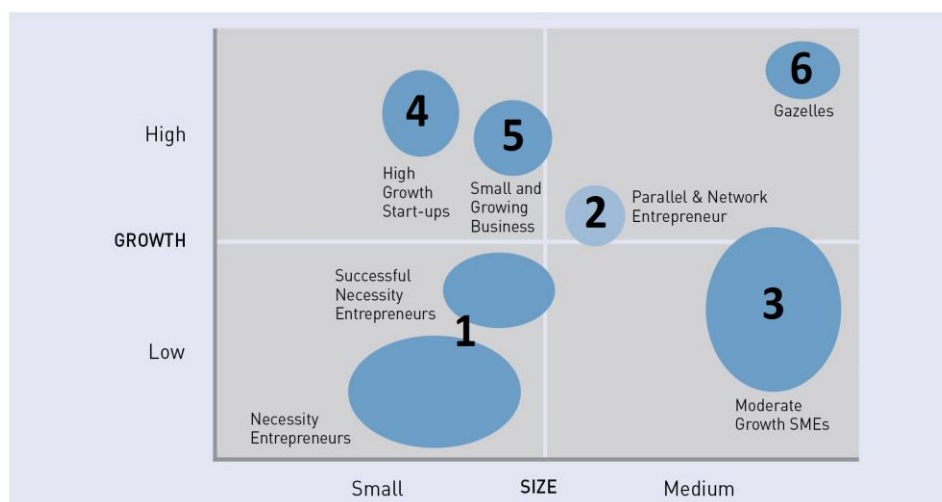


Figure 2. Kenyan SME sector sub-segments

- 1. Necessity Entrepreneurs:** small enterprises often operating in rural areas and asset light sectors such as retail, trade, agriculture (as subsistence farmers). They are focused on subsistence and income generation for their family and experience low growth. Many of them are not registered. A minority sub-set of this category succeed in growing their business over a long time but very rarely employ other people than the owner (they are referred as successful necessity entrepreneurs in figure 2).
- 2. Parallel and Network Entrepreneurs:** as they see growth in their first venture, entrepreneurs that grow horizontally by setting up other ventures addressing opportunities arising in (non)related industries.
- 3. Moderate Growth Entrepreneurs:** often family businesses having been operating in the manufacturing, agribusiness and trade sectors for more than 10 years and characterized by a low or moderate growth. They remain small to medium in size (i.e. employing between 5 and 50 employees) and are often driven by a need for stability.
- 4. High Growth Startups:** although the most surveyed and studied due to their often innovation-driven high growth rates, they actually represent a small segment of the Kenyan SME landscape. They can be micro or small in size (having usually been in operation for less than 5 years) and they are often owned by young entrepreneurs (i.e. below 35 years old), generally internationally educated or with previous work experience abroad. The fastest growing ones usually operate in the tech- and financial services sectors out of the capital city of Nairobi.
- 5. Small and Growing Businesses:** a small sub-segment composed of small or medium in size enterprises usually driven by market opportunities in the service or trade sectors in which they have been operating for more than 5 years.
- 6. Gazelles:** mature, medium-sized, high growth businesses that boast of high revenue and employment growth. Often operating in the manufacturing sector, they show continuous annual growth rates of 20% or more and constitute a very small segment of the SME sector.

### ... to fully understand the specific challenges faced by the different types of local SMEs

The majority of Kenyan SMEs – and this applies across the six sub-segments outlined above - state access to finance as a challenge and self-finance their business (using retained earnings for financing fixed assets and for meeting their working capital demands). More specifically, each sub-segment faces specific challenges (table 1):

Table 1. Challenges of Kenyan SME sub-segments

KEY CHALLENGES	1.Necessity Entrepreneur	2.Parallel & Network Entrepreneur	3.Moderate Growth Entrepreneur	4.High Growth Startup	5.Small & Growing Business	6.Gazelle
	Informality	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>			
Track record	<input checked="" type="checkbox"/>			<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	
<b>TALENT-RELATED CHALLENGES</b>						
Basic business skills	<input checked="" type="checkbox"/>					
Advanced business skills		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	
Access to talent			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
<b>FINANCE-RELATED CHALLENGES</b>						
Collateral/assets	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	
Finance & Accounting	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	
Governance			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Access to working capital	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>				
Access to early stage capital				<input checked="" type="checkbox"/>		
Access to growth capital			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
<b>MARKET-RELATED CHALLENGES</b>						
Supply chain/distribution management			<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Access to networks				<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>

### A still fragmented entrepreneurial ecosystem that needs to be scaled up

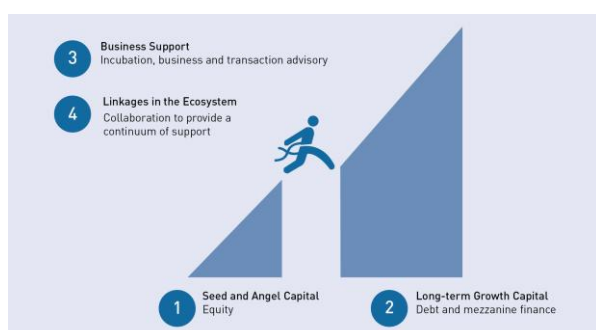
High growth enterprises in the early stages of their life cycle self-finance their business and use retained earnings. This is particularly true for young entrepreneurs without a track record, who find it difficult to get serious attention by banks or current investors. Estimates record that up to 80% of Kenyan startups do not survive beyond the first year. Angel networks and investing platforms have been mentioned as important attempts to fill the seed and early-stage finance gap.

Small and growing enterprises that are more than five years old find it difficult to access long-term growth capital to expand their operations. In the absence of long-term finance on favorable terms, they experiment with different options; many such entrepreneurs use their own resources or start a parallel business in a different sector to increase liquidity. Others take loans from informal sources at very high rates to be able to buy collateral that is

needed to get a loan from a bank. Only a few are successful in accessing debt or equity finance for long-term growth, partly from innovative finance providers that provide mezzanine finance.

The supply of business development support services has improved in recent years. However, this non-financial offer remains nascent and geographically restricted to the capital city of Nairobi. Given the increased demand for such services notably from other parts of the country, the need for a wider, affordable, accessible and relevant non-financial service offering in fields such as financial management, accounting and transaction advisory, legal advice, human resources, marketing and other business functions is critical.

Actually, entrepreneurs are often unaware about the services dedicated to them and take time to navigate the support ecosystem, which resembles more of a maze to them. Specialization of service offerings, greater awareness raising and pro-active marketing towards attracting target clienteles – including outside of Nairobi - would help service providers position themselves within the continuum of financial and business support services from the early to growth stages of enterprise development. A few initiatives currently aim at bringing entrepreneurs and ecosystem stakeholders together through networks and platforms; however, these efforts remain limited and need to be scaled up.



**Figure 3. Key gaps for the 'missing middle' in Kenya**

Initiatives to seed new efforts to unlock seed and angel funding, increase the supply of long-term growth capital, provide quality business development support services in a sustainable way as well as facilitating access to the support ecosystem (figure 3) are as many solutions to empower further local entrepreneurs.

With an estimated contribution to 80% of the country's employment and 20% of its GDP, SMEs are a major contributor to the country's socio-economic development. Initiatives that effectively support local SMEs are poised to unleash the full potential of the Kenyan SME sector.