

PROCUREMENT AND SUPPLY IN KENYA

THE MARKET FOR SMALL AND MEDIUM ENTERPRISES

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Acronyms

ASCA	Accumulating Savings and Credit Association
BDS	Business Development Services
CBO	Community Based Organisations
DCA	Development Credit Agency
ERS	Economic Recovery Strategy
FSA	Financial Service Associations
GOK	Government of Kenya
ICB	International Competitive Bidding
KDA	K-Rep Development Agency
KISM	Kenya Institute of Supplies Management
KMA	Kenya Manufacturers Association
LPO	Local Purchase Order
LSO	Local Service Order
MFI	Micro Finance Institution
MSME	Micro, Small and Medium Enterprise
NCB	National Competitive Bidding
NGO	Non-Governmental Organisation
PO	Purchasing/Procurement Officer
PPARB	Public Procurement Administrative Review Board
PPDA	Public Procurement Disposal Act
PPOA	Public Procurement Oversight Authority
PPOAB	Public Procurement Oversight Advisory Board
ROSCA	Rotating Savings Credit Associations
SACCO	Saving and Credit Cooperative Organisations
SME	Small and Medium Enterprises

EXECUTIVE SUMMARY

THE STUDY: SCOPE AND AIM

The Kenya Institute of Supplies Management (KISM) commissioned the 2008 Operations of Procurement in Kenya study in order to research and document the policies, practices and procedures followed by supply chain practitioners in the public, private, Non-Governmental Organisation (NGO) and donor sectors regarding procurement. In particular, this study focused on identifying and documenting key processes used in procurement of supplies from small and medium sized enterprises (SMEs), as well as identifying and documenting the key challenges faced by SMEs in securing and fulfilling orders for goods, works and services. The aim of the report is that interventions can be identified and documented that would be useful in assisting Kenya's SMEs to be more competitive in bidding for and winning tenders and delivering products, works and services on a sustainable basis.

STUDY METHODOLOGY

The study was carried out as follows:

Review of existing documentation and legislation

Assessment commenced with a review of existing policies and legislation concerning procurement in Kenya.

Defining target group

The target group – SMEs – was defined as companies employing between 5-50 employees.

Interviewing participants

An interview process was initiated that focused on the demand, supply and support environments. Interviews were conducted utilising a questionnaire as a base document.

Stakeholder's workshop and feedback

A draft version of this report was submitted and discussed at a stakeholders' workshop in order to highlight the key findings of the report on 15th November 2007, and was attended by stakeholders from the public, private and NGO sectors.

CURRENT LEGISLATION AND POLICIES

The following legislation and policies are currently in place to regulate procurement in Kenya:

1. The Public Procurement and Disposal Act, 2005 (PPDA)

The PPDA, effective as of 1st January 2007, applies to all procurement of goods, works and services, as well as the disposal of assets by public entities. Public entities are those that procure goods, services or works utilising public funds. As such, public entities include the central and local governments, courts, commissions, state corporations, cooperatives, and educational institutions such as colleges, schools and universities.

This Act does not directly seek to regulate the private sector, though it does regulate its interaction with public entities. The PPDA was established in order to:

- Maximise economy and efficiency,
- Promote competition and ensure that competitors are treated fairly,
- Promote the integrity and fairness of procurement procedures,
- Increase transparency and accountability in those procedures,
- Increase public confidence in those procedures,
- Facilitate the promotion of local industry and economic development.

In order to achieve these objectives, the Act establishes procurement and disposal procedures, and sets up the necessary structures to ensure that the procedures are followed and there is provision of oversight and compliance. The Act also establishes the Public Procurement Administrative Review Board, which handles complaints, reviews and appeals stemming from procurement practices.

2. The Public Procurement and Disposal Regulations, 2006.

These regulations, read together with the PPDA, outline the various processes and procedures to be followed when goods, services or works are procured. A threshold matrix is outlined, as are the duties and functions of the various participants.

3. The Supplies Practitioners Management Act, 2007

This Act was assented to law on 22nd October 2007 and commenced on 30th October 2007. This Act regulates both public and private sector procurement practitioners and strives to professionalise procurement practice in Kenya.

PROCUREMENT IN THE PUBLIC SECTOR

Public sector procurement can be broken down into two categories, namely project specific procurement and general consumable procurement.

In project specific procurement, goods, works or services are sought for a particular initiative (e.g. a new road, a hospital, plant and equipment), whereas general consumable procurement relates to items that are required for a ministry or authority to perform its duties (e.g. fuel, stationery, vehicle parts, road maintenance, and security). The focus of the study was on general consumable procurement, as this is the area in which most small and medium enterprises are active.

It is difficult to estimate the volumes and values of procured goods. It is understood that the Government of Kenya (GOK) procured about KSh. 300 billion worth of goods and services in the 2006 financial year. It is not clear if this includes parastatal and local authority procurement, as they are dependent in part on their own revenue streams. Interviews at district and local authority levels indicate that larger town/district procurement ranges from between KSh. 100 million to KSh. 500 million annually.

In its own way the current system is working. It is working broadly along prescribed formats, but in an inefficient manner. The public sector is engaging and procuring from small and medium sized enterprises and is receiving the sought-after goods, works and services. On a positive note, it appears that much of the general consumable procurement is done with the small and medium enterprise sector. If one were to look at the total number of transactions in a fiscal year, it is estimated that about 90% are with the SME sector. This will not apply to the total value of the transactions, as many large value infrastructural procurements distort the picture. An estimate of the value of transactions with SMEs could not however be made. If one considers procurement patterns on the provincial, district and local authority levels, it appears that about 55% of the value of the procurement is project specific procurement (i.e. larger procurements probably not with SMEs), and the balance is with the SME sector. If this pattern is repeated across public procurement, it suggests that at least KSh. 135 billion worth of goods, services and works are being procured from the SME sector.

PROCUREMENT IN THE PRIVATE SECTOR

Private sector procurement is functioning well and appears to be running efficiently. Procurers and suppliers have settled into long-term relationships and a culture of mutual dependence appears to

have developed. The corporates engage well with the SME sector, and there do not appear to be major constraints. While corruption probably does play a role in private sector procurement, it does not appear to be as obvious as in the public sector. Furthermore, management has a vested interest in ensuring that corruption induced inefficiencies are rooted out as they influence results and hence management's prospects within the company.

The primary concern of the corporates is the level of professionalism within the SMEs and their ability to deliver on time to specification. The corporates indicate that this is the single largest constraint on expanding their business with the SME sector. For the SMEs, the private sector market, while more diverse and responsive, is more difficult to get into, as it requires them to be more efficient and cost effective. Margins are also lower as corporates see the supply side as a primary cost-cutting area. Furthermore, the long-term relationships corporates establish with their suppliers make the possibility of change remote, unless those relationships breakdown. This does happen, and corporates are in the habit of testing the market from time to time to see who is out there and at what price points they can deliver their goods and services.

DONOR AND NGO PROCUREMENT

Donor and NGO procurement systems work well, though they tend to be over-bureaucratised. This is a constraint to SMEs that have the potential to supply components of their procurement requirements. Attempts by the donor and NGO community to explain its procurement procedures through conferences and supplier gatherings are welcome, though the procedures remain formal and difficult for SMEs to participate in. That said, the community is sourcing from the SME sector in Kenya. One of the agencies interviewed had in excess of 200 SME suppliers registered.

The donor and NGO community has a perception that SMEs are unable to deliver the correct product at the correct time. Donors and NGOs expressed their frustrations at constant late deliveries from the SME sector. What SMEs do not realise is that donors and NGOs have set up a whole supply chain of which they are only a small part. Late delivery disrupts the supply chain and logistical component and can have dire consequences at the end user level. It is for this reason that Donors and NGOs tend to source only non-emergency items from the SME sector.

SMEs supplying this sector mentioned low margins and difficulty in understanding the supply contracts. However, the volumes procured made up for the lower margins. Payment was not mentioned as an issue. Procurement documents also tend to be highly complex and there is a need for them to be simplified.

Chapter 1**INTRODUCTION****1.1 THE STUDY: SCOPE AND AIMS**

The Kenya Institute of Supplies Management (KISM) commissioned the 2008 Operations of Procurement in Kenya study in order to research and document the policies, practices and procedures followed by supply chain practitioners in the public, private, NGO and donor sectors regarding procurement. In particular, this study focused on identifying and documenting key processes used in procurement of supplies from small and medium-sized enterprises (SMEs), as well as identifying and documenting the key challenges faced by SMEs in securing and fulfilling orders for goods, works and services. The aim of the report is that interventions can be identified and documented that would be useful in assisting Kenya's SMEs to be more competitive in bidding for and winning tenders and delivering products, works and services on a sustainable basis. In addition, this report highlights potential or existing links that could be exploited to increase access to finance for SMEs.

1.2 STUDY METHODOLOGY**1.2.1 Review of existing documentation and legislation**

The study team began the assessment by reviewing existing documentation and legislation concerning procurement in Kenya, which is summarised in Chapter 2, Policy Framework and Current Legislation (and presented in more detail in Appendix I).

1.2.2 Defining the target group

The team and KISM agreed to define the target group – SMEs – as companies employing between 5-50 employees. Medium-sized enterprises are at times regarded as entities employing over 50 people in the Kenyan context.) Micro enterprises are excluded as they fall below the five person threshold and are generally not expected to participate in formal procurement processes. More information on the issues facing SMEs and how they operate can be found in Chapter 3, The SME sector.

1.2.3 Interviewing participants

Interviewers were selected and an interview process was initiated that focused on the demand, supply and support environments. Interviews were conducted utilising a questionnaire as a base document. In instances where there was a reticence to be interviewed (a common occurrence in both the private and public sectors concerning procurement issues), the interviewee was sent the questionnaire by email or post and asked to complete and submit it. Given the nature of the subject matter, many respondents insisted on confidentiality, or in certain instances declined to provide names or contact details. (A copy of the interview documents was provided to KISM on a confidential, internal use only basis.) The interviews were written up and analysed, and this analysis forms the basis of this report. Chapters 4, 5, and 6 present this analysis regarding the public, private and NGO and donor sectors respectively.

1.2.4 Stakeholders' workshop and feedback

A draft version of this report was submitted and discussed at a stakeholders' workshop in order to highlight the key findings of the report. The workshop took place at the Nairobi Safari Club, Lillian Towers, Nairobi on 15th November 2007, and was attended by stakeholders from the public, private and NGO sectors (a list of attendees is presented in Appendix III). The findings as documented in the draft report were presented to the stakeholders, who sought clarifications and made comments and suggestions, which constitute the contents of Appendix IV.

1.2.5 Our recommendations

Chapter 8 of this report presents a list of suggestions and recommendations for actions to be taken that could help improve the current situation for SMEs regarding procurement.

Chapter 2

LEGAL AND REGULATORY FRAMEWORK

2.1 BACKGROUND

Specific legislation has been passed by the Government to structure and regulate procurement and disposal in the public sector. Although this legislation is aimed at the public sector, it affects the private sector as well, since it regulates processes applicable to the private sector in its interaction with the public sector.

The private sector operates within the general laws of commerce in Kenya. There are no set government policies relating to its specific procurement processes (apart from relevant legislation relating to public sector procurement or relevant clauses of the Supplies Practitioners Management Act 2007, which are more administrative in nature). Each company has developed its own set of policies, structures and controls for procurement. The SME sector operates within an enabling environment that has targeted it as an engine of economic growth. It is also the beneficiary of legislated public sector preferences.

The following legislation and regulatory structures currently regulate procurement in Kenya. More detailed information on them can be found in Appendix I.

2.2 THE PUBLIC PROCUREMENT AND DISPOSAL ACT, 2005

The Public Procurement and Disposal Act (PPDA), effective as of 1st January 2007, applies to all procurement of goods, works and services, as well as the disposal of assets by public entities. Public entities are those entities that procure goods, services or works utilising public funds. The definition of public funds includes donor funds in so far as donor stipulations do not supersede the Act. If they do, the donor terms and conditions take precedence. As such, the definition includes the central and local governments, courts, commissions, state corporations, cooperatives, and educational institutions such as colleges, schools and universities. This Act does not directly seek to regulate the private sector, though it does regulate its interaction with public entities.

The PPDA was established in order to:

- Maximise economy and efficiency,
- Promote competition and ensure that competitors are treated fairly,
- Promote the integrity and fairness of procurement and disposal procedures,

- Increase transparency and accountability in those procedures,
- Increase public confidence in those procedures,
- Facilitate the promotion of local industry and economic development.

In order to achieve these objectives, the Act establishes procurement and disposal procedures. It also sets up the necessary structures to ensure that the procedures are followed and to provide oversight and compliance.

2.2.1 Oversight and review structures

The PPDA establishes the Public Procurement Oversight Authority (PPOA). Its primary role is to ensure that procurement procedures established under the Act are adhered to. In doing this, the PPOA is required to advise, establish standards, and train procurement entities and persons, as well as advise government on policy issues. Currently the PPOA is:

1. Monitoring implementation of procurement policies to ensure that SME are accorded opportunities to participate in public procurement;
2. Building capacities of procurement personnel to ensure that procurement is carried out effectively and efficiently;
3. Building suppliers' capacity so that they are better able to transact business within the public sector;
4. Arranging public forums to solicit feedback from stakeholders on the implementation of procurement policies;
5. Improving provision of information about procurement opportunities by putting in place communication channels such as web sites at the PPOA and within the procuring entities;
6. Ensuring e-procurement is practiced in collaboration with the e-Government Secretariat in the Office of the President;
7. Consulting banks to ease SME access to financial resources;
8. Benchmarking policies practiced by other countries to enable SMEs to access procurement opportunities. (The South African model is one of the policies being considered. A Public Procurement Oversight Advisory Board is also established to advise the PPOA.)

The Act also establishes the Public Procurement Administrative Review Board, which handles complaints, reviews and appeals stemming from procurement practices.

2.2.2 Preferences

Section 39 of the PPDA confers upon the Minister of Finance the capacity to prescribe preferences or reservations, after taking into consideration economic and social development factors. Specifically, the Act makes provision for preferences and reservations targeting disadvantaged groups and micro, small and medium enterprises. Regional factors may also be taken into account. Where the funding is 100% Kenyan and the procurement falls below the prescribed thresholds, exclusive preference is given to citizens of Kenya. (Presumably this also applies to “citizen contractors” as well.) Applicable thresholds for citizens of Kenya:

- Goods and services: KSh. 50 Million
- Works: KSh. 200 Million

Prescribed margins of preference may apply where the goods are manufactured, mined, extracted or grown in Kenya. A preference also may be applied depending on the percentage of shareholding of the locals. Such margins of preference ought to be delineated in the tender documents.

For goods manufactured, mined, extracted and grown in Kenya, the margin of preference is 15%, or, for works, goods and services where preference may be applied depending on shareholding the margin is as follows:

- Less than 20% shareholding: Margin of preference: 6%
- Less than 50% shareholding: Margin of preference: 8%

2.3 THE PUBLIC PROCUREMENT AND DISPOSAL REGULATIONS, 2006

The Public Procurement and Disposal Regulations, read together with the PPDA, outline the various processes and procedures to be followed when goods, services or works are procured. A threshold matrix is outlined, as are the duties and functions of the various participants. Relevant portions of the Regulations are incorporated in the Legislation Appendix I.

2.4 THE SUPPLIES PRACTITIONERS MANAGEMENT ACT, 2007

The Supplies Practitioners Management Act was assented to law on 22 October 2007 and commenced on 30th October 2007. This Act regulates both public and private sector procurement practitioners and strives to professionalise procurement practice in Kenya.

In terms of the Act, KISM is tasked with registering and licensing all supplies practitioners operating in Kenya. A supplies practitioner is defined as any person or procuring agent engaged in public or private procurement, purchasing, stores management, logistics, supply chain or related activities. In order to be registered, supplies practitioners are required to satisfy the registration board that they are of good conduct, have paid the registration fee and have undergone and passed a certificate, diploma or research course of instruction in the prescribed field. Persons engaged in supplies practice immediately before the enactment of the Act will be eligible to be registered if they convince the council they are of good conduct, have met the professional qualifications prescribed by the council and have paid the prescribed fee.

From 30 October 2008 no person may engage in the business of a supplies practitioner unless they have been issued with a registration certificate and practicing licence. A licence will be granted if the person holds a Registration certificate and meets other requirements as set by the Council. Should the person practice without a licence or, a company employ an unlicensed person, criminal penalties may be imposed.

The Act utilises a broad definition of those deemed to be supplies practitioners. This may lead to confusion and difficulty in applying the law. As the definition stands anybody involved in procurement, purchasing, stores, logistics and supply chain is required to be registered. No limiting factors are set on the definition and as such the Act could apply to secretaries, drivers, salespeople and manual labourers. KISM will need to refine the definition in practice so that only key personnel are required to be registered. Furthermore, the registration requirement may lead to anomalies such as where a sole trader is required to register and be licensed in order to stock their own store. It is hoped that this is not the intention of the legislation as this could be a major impediment for many small businesses. It is also not certain if the Act will apply to the international NGOs and Donors both of whom have a strong presence in Kenya for their regional activities.

The roll out of the legislation will also be onerous and administratively complex as several thousand people would need to be registered in a relatively short time. Administrative systems will need to be established and put in place as well as establishing appropriate curricula and testing processes. KISM will require substantial resources in order to achieve this. The criminalisation of non-compliance is of concern until such time as the definition of supplies practitioners is more tightly defined as it may result in arbitrary prosecution.

Chapter 3

THE MICRO, SMALL & MEDIUM ENTERPRISE SECTORS

3.1 BACKGROUND: POVERTY IN KENYA

Over the last 15 years, Kenya has been experiencing a consistent rise in its poverty levels. In 1997, the Kenyan Central Bureau of Statistics estimated that 52.3% of households were living below the absolute poverty line. By 2000, this had increased to 57%.¹ In 2005, the Kenyan Central Bureau of Statistics published political constituency level poverty and inequality estimates based on the 1997 Monitoring Survey and the 1999 Population and Housing Census. The poverty incidence ranged from 16% to 84%, representing the least poor and the poorest constituencies respectively.² The latest statistics do show an improvement in terms of poverty rates although there is no clear analysis available of the reasons for the change. The Kenya Integrated Household Budget Survey of 2005–2006 shows that the number of people living below the poverty line is significantly lower than in previous years. The figures are as follows:

Level	Percentage under poverty line (2005)
National	46%
Rural	49%
Urban	34%

3.2 CHALLENGES FACING SMEs

Poorer Kenyans earn their living in Kenya's informal sector without easy or full access to formal financial and business support systems. Although MSMEs in the formal and informal sectors do not exist independently of each other and there is overlap and exchange between them, this tends to be of an ad hoc nature and not in the form of sustained business links. Several donor-funded activities for financial and non-financial services facilitation for Kenyan MSMEs address this issue of creating business links and markets. These also support the capacity development of microfinance institutions (MFIs) that use social collateral to offer financial services to micro enterprises, and show high repayment rates. Also, NGOs are being supported in working with financial institutions to develop innovative mechanisms for mediating financial risk.

According to the most recent national baseline study undertaken in Kenya in 1999, MSMEs 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. Women own half of these businesses.³ In 1999, MSMEs contributed 18.4% of the Gross Domestic Product, which was more than double the contribution of the larger formal manufacturing enterprises. More than half of the MSMEs were located in rural areas, and most (70%) were owner-operated micro enterprises in the informal sector.

Given the broad base of micro enterprises in Kenya, there is a strong overlap between the informal sector and formal small and medium enterprises (SMEs). Informality, however, does not imply illegality. There is what might be termed "a progression of legality" among the MSMEs in their varying levels of adherence to licensing, registration and other legal requirements for doing business. Small and medium sized enterprises (SMEs), i.e. those that employ between 5 to 50 people and are registered as companies, are the ones that fall squarely into the formal sector in that they are liable to taxation. Kenya's informal enterprises are those that are "unincorporated enterprises". The focus of this study has been on these formal SMEs.

3.3 RECENT POLICY AND LEGISLATION CONCERNING MSMEs

Over the last four years, two new policies of importance to the SME sector have been drafted:

3.3.1 Policy

In 2005, Sessional Paper No. 2 laid out the policy framework for support to MSMEs. In it, the government of Kenya (GOK) recognises MSMEs as dynamic private sector players and not a residual sector. It expands the scope to include small farms as well. There is a provision in the Paper for 25% of public procurement to be allocated to MSMEs. The Paper also proposes the establishment of a National Council for Small Enterprises to give advice on the sector and fundraise for its capacity development. However, the recommendations of the Sessional Paper (a policy document) has yet to give rise to specific legislation. Meanwhile, the Kenya Private Sector Alliance, an umbrella body of larger players in the formal sector, has been charged by the Ministry of Labour to design an implementation framework for some sections of the Paper. This relates to the development of a viable institutional structure for self-regulation of the MSME sector.

¹ Kimalu P. et al, *A Situational Analysis of Poverty in Kenya*, KIPPRA Working Paper No.6, Kenya Institute for Public Policy Research and Analysis, Nairobi, 2002.

² Central Bureau of Statistics, *Geographic Dimensions of Well-Being in Kenya: Who and Where are the Poor?*, Volume 11, Nairobi, 2005.

³ Central Bureau of Statistics, ICEG and K-Rep, *National SME Baseline Survey 1999*, Nairobi, 1999.

The Private Sector Development strategy (PSDs) provides a broad framework for government support to the private sector. One of its objectives is the enhanced competitiveness of small and medium sized enterprises through increased vertical linkages. Sector specific capacity development is proposed. An Implementation Plan (PIP) for the PSDs has been developed and includes significant support measures for the MSME sectors.

3.3.2 Financial sector regulation

The Microfinance Act was passed in 2006 and commenced in the second quarter of 2008 with the gazetting of the relevant regulations. It lays out the regulatory framework for deposit taking MFIs which will be licensed or regulated by the Central Bank of Kenya. While there are fewer than 10 MFIs with a reputation for sound organisational processes and governance structures, there are several thousand savings and credit cooperative organisations (SACCOs) serving both rural and urban households. This sub sector is also to be regulated through a proposed SACCO Bill.

3.4 DEVELOPMENT OF THE SME SECTOR

Formal procurement is an ideal vehicle for developing growth strategies as formal procurement ensures the existence of an established market for defined products. In the 1999 Kenyan Baseline Survey,⁴ sampled micro and small-sized enterprises ranked

marketing as their main problem followed by credit as the next most common constraint to growth. The procurement market sector is attractive to MSMEs in the light of these constraints in that the MSME is not required to market itself when responding to a tender opportunity, and specific financial mechanisms could be made available to support the MSME in the process.

Other objectives relate to improving the business environment and labour market institutions and processes. Risk mediation is a fundamental concern in making markets more inclusive of SMEs. Formal institutions and firms both large and small are essentially risk averse in the absence of adequate investor protection commercial justice or social safety nets. So far, the mediation between large and small businesses is provided by guarantees through contractual and financial arrangements facilitated by credible intermediaries such as donors and NGOs. The GOK's new Private Sector Development Support Strategy and the value chain approach proposed could offer new methods of support through value chain financing supported by private and public players in that chain.

⁴ Central Bureau of Statistics, ICEG and K-Rep, *National MSE Baseline Survey 1999*, Nairobi, 1999.

Chapter 4

PROCUREMENT IN THE PUBLIC SECTOR

4.1 BACKGROUND

The 2008 Procurement Operations in Kenya study assessed public entity procurement at central, provincial, district and local authority levels. Other state entities were also interviewed. The essential difference between the different levels is the value and volume of procurement on an annual basis. (The PPDA classifies procurement entities into Classes A, B and C14. See Appendix I for further details.)

4.2 PRODUCT TYPE

Public entity procurement is wide ranging and encompasses most goods, works and services available. Items most often procured include food, pipes, vehicles and vehicle supplies, electrical items, pharmaceuticals, chemicals, uniforms, IT requirements, stationery, tools, fuel, and services such as security, catering and vehicle repairs. Works most often concern building or road maintenance and construction.

4.3 VOLUMES OF PRODUCTS

Given that infrastructural procurement is lumped with other item procurements, it is difficult to estimate the volumes and values of procured goods. It is understood that the GOK procured about KSh. 300 billion worth of goods and services in the 2006 financial year. It is not clear if this included parastatal and local authority procurement, as they are dependent in part on their own revenue streams. Interviews at district and local authority levels indicate that larger town/district procurement ranges from between KSh. 100 million to KSh. 500 million annually. In Mombasa, where they recently upgraded all the town's roads in preparation for the World Cross Country Championships, this figure probably is substantially higher.

4.4 PROCUREMENT POLICIES

All the public sector procurement entities approached by the study apply and adhere to the provisions of the PPDA. The extent of their application of the PPDA is constrained by their knowledge of the various provisions and, in some cases, by their financial ability. Though the central government procuring entities indicate that they implement the preferences contained in Section 39, it is not always clear that these have in fact been consciously applied. On the provincial, district and local authority levels, many Purchasing Officers (PO) were not aware of these provisions and did not appear to apply them. However, the provisions are applied by default across

the board, as suppliers of goods, services and works generally tend to be local small and medium entities. With larger procurements, particularly of specialised goods, works or services, the situation changes and larger, or in certain instances, foreign entities are utilised. There is, however, a need for enterprises to be classified so that they may compete more effectively. The classifications also help the GOK determine if it is meeting the development targets it has set itself.

4.5 PROCUREMENT PROCEDURES

The PPDA makes provision for the following forms of procurement:

1. Open tendering
2. Alternative procurement procedures, under which fall:
 - Restricted tendering
 - Direct procurement
 - Request for proposals
 - Request for quotations
 - Procedures for low-value procurements
 - Specially permitted procurement procedures

The procedure to be followed is in a large part determined by the thresholds outlined in the Regulations (Public Procurement and Disposal Regulations, 2006). Thresholds and provisions for the various forms of tendering are broken down in Appendix I.

Public sector procurement can be broadly divided into two categories:

1. **Project specific procurement.** In the instance of project specific procurement, goods, works or services are sought for a particular initiative (e.g. a new road, a hospital, plant and equipment).
2. **General consumable procurement relates** to items that are required for a ministry or authority to perform its duties (e.g. fuel, stationery, vehicle parts, road maintenance and security).

The rationale for the distinction is that generally project specific procurement is irregular and generally put to open tender, whereas consumable procurement involves short-listed suppliers identified in an annual open tender procurement process. The focus of the study was placed on general consumable procurement, as this is the area in which most small and medium-sized enterprises are active. These enterprises are also active in project specific procurement but on a lesser scale, as the requisite expertise and financial capacity are much greater and therefore more suitable for larger enterprises.

4.5.1 The process of general consumable procurement

The process of general consumable procurement followed by all levels of public procurement entities is much the same. The relevant Procurement Officer (PO) advertises annually for suppliers of goods, services and works. These advertisements are made in the national daily papers. Prior to this, various ministries and departments provide information on what goods, services and works they require and to what specification. Tender documents are drawn up accordingly. Potential suppliers then purchase tender documents and bid. The PO adjudicates the bids, verifies support documentation, and makes recommendations to the tender committee that awards the tender. In certain instances, tenders may be split amongst several suppliers, each of whom may be more competitive than another in a certain area. The supplier is then notified that he has won the tender and will be a preferred supplier of those items, services or works for the year under a term contract. A register of suppliers is kept, and actual procurement is made through a quotation process from the registered suppliers, or where there is only one short-listed supplier, directly from it.

An order is then generated by the user ministry or department. It obtains quotations from the pre-qualified supplier(s) and forwards this to the PO. The PO checks that the suppliers are pre-qualified, and that the price range is within the original tender submission. He/she then forwards his/her recommendations to the tender committee, which will make the award final. The PO notifies the user department or ministry which then issues a Local Purchase Order (LPO) (or Local Services Order if it pertained to works or services), as well as an Immediate Letter of Communication to the supplier so that it can begin processing the order.

In instances where the goods or services required fall outside the gambit of the annual tenders, an open tender is placed in the daily newspapers. Tenders are then adjudicated by the PO and submitted to the tender committee for decision. For low value procurement, cash requisitions are made and the supplier is paid accordingly at the user department level.

4.6 PAYMENT

The prevailing legislation mandates that payment for goods, works and services should be made within 30 days of the submission of invoices. The onus is upon the accounting officer to ensure that procurement does not take place unless sufficient funds are available. Penalty interest is incurred at commercial bank rates on payments that are overdue. Payment usually is made by the user ministry or department.

4.7 CURRENT STATUS

On a positive note, it appears that much of general consumable procurement is being done with the small and medium enterprise sector. The public sector is engaging and procuring from small and medium-sized enterprises and is receiving the sought after goods, works and services. These are, however, coming at a cost. In its own way the current system is working. It is working broadly along the prescribed formats, but in an inefficient manner. It is estimated that inefficiencies in procurement cost Kenya about KSh. 30 billion annually.⁵ The study noted the following factors below that contribute to these inefficiencies:

4.7.1 Poor planning

Despite being required by the PPDA, very little procurement planning seems to take place. This is particularly evident at provincial, district and local authority levels. It should be noted, however, that in many instances this is not the fault of the PO. POs rely on the various departments or ministries for their procurement plans and often do not receive them. In instances where they do receive them, procurement often does not take place as laid out in the plan, but rather occurs on an ad hoc basis. The resulting multiple small volume procurement not only significantly adds to the cost of goods, works and services, but also puts tremendous strain on the procurement and financial bureaucracy. Overall this results in high acquisition costs in both price and effort.

The procurement of stationery is a prime example of poor planning practices. Each department/ministry submits a procurement request for stationery as and when it runs out of items. The PO as a result may be confronted with as many as 40 LPOs a week, each for small quantities of regularly used items. Considering that these LPOs may go through as many as 16 processes from requisition to payment, all requiring signatures, the paper work load going through the procurement and payment bureaucracy is immense. Also, as each LPO is for a smaller volume of product, the suppliers charge higher prices for the items than they would for bulk purchases. For regularly consumed items, it is far more efficient for orders to be consolidated on a monthly or bi-weekly basis. Poor planning is exacerbated by a general policy of 0% stockholding. This policy, while effective on high-cost items, is counter-productive when it comes to low value, regularly consumed items. Stockholding these items would allow for bulk purchases and volume discounts.

4.7.2 Corruption

Corrupt practices are clearly evident in the procurement process. These practices permeate the systems and occur at every level. Confidential interviews with enterprises indicate that in some

⁵ KISM Supplement, *Standard Newspaper*, 31 October 2007

instances it is the only way they are able to participate in the process. Officials all give the impression that their procurement processes are above board, yet meetings with suppliers waiting in corridors outside the offices give a totally different perspective. These enterprises often indicate that this is the cost of doing business with public entities, and the amounts they pay are all factored into their quotations. That this happens often is indicated by the numbers of suppliers found in POs' offices. In many offices visited, ten or more suppliers would be waiting to meet with POs or other officials involved in the process. Strictly speaking, there is no need for a supplier to meet with a PO. All processes should be documentary and at an arm's length, but this was not the case in many of the offices visited. In one instance, a supplier had come to meet a PO in order to determine whether his company had been successful on a tender awarded three months prior. The PO had refused to divulge if the company had been successful or not, but suggested that the company owner drive from Nairobi to discuss the matter with him personally. It is also clear that corruption happens on many levels and a single transaction may involve three or more payments. In the case of pre-qualified suppliers, the enterprise may work at the department level with an official to ensure that its quote is the lowest (after the official has had sight of the other quotes).

This aspect is a flaw in the procurement process, as there do not seem to be controls in place at this point. A department official merely has to supply three quotes from approved suppliers, and there is no control on the quote process, thus an official may inform a supplier of the prices, etc. so it may submit a competitive quote. The enterprise may have worked at the PO level to either get short-listed originally or to expedite this particular order. On delivery, the enterprise may have to work at the accounting level to expedite payment for the goods, service or works. Given the current delays in payment, this is becoming more prevalent. One supplier indicated that it was cheaper to expedite the payment than to raise a bank loan.

There are legislative provisions for the rotation of contracts to prequalified suppliers, but these do not appear to be applied, and the same enterprises seem to get regular orders. This is also indicative of other forces at play. In the limited scope of the study, it was difficult to determine what role nepotism and ethnic affiliation played in the award of contracts. These factors were however mentioned by enterprises as a major constraint to their access to business. Much of this corruption can be dealt with by the application of political will. The legislation is sufficient; it just needs to be applied vigorously. The enforced publication of successful tenders would also go a long way in addressing this issue. Improved salaries may also help alleviate the problem, though international experience indicates that this has not deterred corrupt practices.

4.7.3 Payment delays

As legislated, payment should take place within 30 days. The reality is that payments may take as long as 180 days. There were several reports of even longer payment periods on non-disputed deliveries. Delays are a result of several factors that work together. Failure to adhere to legislated accounting stipulations, excessive bureaucracy, insufficient funds, quarterly draw-downs by public institutions (procurement is done in one quarter and the entity has to wait for the next quarter to receive government funds to pay the supplier), corruption, staff absences, and poor work ethics all contribute to delays in payment. Suppliers tend to factor in these delays in their quotations and raise their prices as a result. The general consensus from both POs and suppliers is that the Prisons Service is one of the worst payers. No instance was noted where penalty interest was applied to outstanding payments. Given the bureaucracy attached to payments, the authorisation of this portion would take as long as the primary payment. Most suppliers are not aware of the penalty provision. Even those suppliers who know of the provision do not try to enforce it. They feel that it would prejudice future business with the entity.

4.7.4 Personnel constraints

Personnel capacity constraints were noted in many of the public procurement entities. Constraints related to knowledge of the PPDA and its application. At central government level, the POs generally have received training on the application of the PPDA and Regulations, but on other levels training appears to have been sporadic. This aspect needs to be addressed through a comprehensive training programme. The advent of the Supplies Practitioners Management Act could here encourage a more professional approach to procurement and supplies management, as it requires all personnel involved to be registered and licensed by KISM. This will bring about an improvement in skills, as POs will be required to show that they have the necessary qualifications. Out of 12 district and local authority POs interviewed, only one was a KISM member.

It was also noted that the administrative staff play an extensive role in the procurement process, often doing most of the work. Where possible, they should be accommodated in terms of the Supplies Practitioners Management Act, as should the accounting officers who will bear ultimate responsibility for the implementation of the Act.

Absenteeism also plays a role. Staff members are either not in office due to attendance at workshops, or they arrive late and leave early. While this relates to the management of their functions, it should be stressed to management that this causes payment delays.

4.7.5 Limited use of information technology

An issue at all levels of the public entity procurement process is the limited use of information technology to record and manage the procurement process. The use of information technology is more advanced at the central government level, but is less so at the provincial, district and local authority levels. Computers are most often used to draft letters, prepare spreadsheets, and compile tenders. The use of procurement software as a management tool was not noted. Software that links the procurement process to the accounting authority would make the process much more efficient.

4.8 ENGAGEMENT WITH THE SME SECTOR

As noted previously, the public sector is in constant engagement with the SME sector. Given the structure of enterprises in the Kenyan context, where the majority of enterprises are SMEs, this is not surprising. No hard data was available from the GOK on the distribution of tenders in terms of enterprise type, volumes and values. Recording of this kind of data would be relatively simple and would contribute greatly in terms of determining whether the GOK is meeting its targets in terms of support for the SME sector. In the absence of hard data, it was observed, however, that most of the volume of transactions occurs between the public sector and the SME sector. It is estimated that about 90% of the total number of transactions in a fiscal year are with the SME sector, based on the multiple small procurements that take place for consumable items, or those items that facilitate the running of the public sector.

This is not the case when one considers the value of the transactions, as much large infrastructural procurement distorts the picture. An estimate of the value of transactions with SMEs could not be made. However, if one considers the procurement patterns at the provincial, district and local authority levels, it appears that about 55% of the value of procurement occurs on project specific procurement (i.e. larger procurements probably not with SMEs), and the balance is with SMEs. If this pattern is repeated across all public procurement levels, it indicates that at least KSh. 135 billion worth of goods,

services and works are being procured from the SME sector. This is based on KSh. 300 Million procurement in 2006. This figure may be higher as it may not include non-central government funded procurement (e.g. local authority rates), or sub-contracted procurement to the sector on large projects by the principal contractor.

At provincial district and local authority levels, POs source goods from anywhere between 100 and 500 enterprises. The vast majority of them are SMEs. Notable exceptions are fuel and bitumen suppliers. At the central government level, POs deal with about 500 suppliers, the majority being SMEs. As transaction values tend to be higher at this level, a higher proportion of larger companies are involved as suppliers.

4.9 PERCEIVED ADVANTAGES AND DISADVANTAGES OF PROCURING FROM SMEs

Public procurement entities' perceived constraints experienced when procuring from SMEs include:

- High pricing,
- SMEs' restricted access to finance,
- The ability to provide bid security,
- The ability to provide performance guarantees,
- SMEs' access to information,
- Barriers to human and capital investment,
- Late delivery.

Public procurement entities' perceived advantages of dealing with SMEs include:

- Flexibility,
- Innovation,
- Lower costs,
- Potential for decentralised supply opportunities,
- The existence of GOK programmes that support SMEs.

On the whole, feedback was positive regarding SME supply.

Chapter 5

PROCUREMENT IN THE PRIVATE SECTOR

5.1 BACKGROUND

Kenya has an established and well-developed large corporate sector. The sector has developed and refined its procurement systems over the course of time and has established extended working relationships with many of its suppliers. Private sector corporations in the manufacturing, mining, tourism, services and retail sectors were interviewed in order to determine their approach to procurement and their engagement with the SME sector. Focus was placed on the large corporates as their systems tend to be more formalised and established. This is not to say that they are the only private sector entities that are procuring goods, works and services. There is substantial procurement taking place within the SME sector itself.

Many SMEs are traders, and the sourcing of goods for sale is a form of procurement in itself. However, the scope of this study did not include intra-SME procurement, though it is potentially a very large sector of the procurement market. Private sector procurement is not governed by legislation, but is guided by profitability and governance factors. Large corporations attempt to source at the best price and in the most efficient way.

Management of the procurement process tends to be more vigorous and is normally informed by the extensive use of information technology. Management is accountable to shareholders, and if managers fail to perform in the most efficient manner, they are penalised.

5.2 PRODUCT TYPE

Corporates procure a full range of goods, services and works. Items most often procured from SMEs include stationery, repairs and maintenance, IT consumables, transport (both for products and for staff), and professional services such as architectural and engineering support. Nakumatt, Uchumi and other retailers procure the highest volumes from SMEs since they control the fresh produce market in Kenya and are major actors in the production of other “fast moving consumer goods” such as condiments, detergents and soaps, paper products, and household and garden items. Even informal businesses such as *jua kali* artisans supply these stores. Retail opportunities are growing at a very fast pace, and consumers appreciate the variety and cheaper SME product lines (manufactured or just packaged and branded, e.g. fish and tea).

As the corporate sector is disparate and secretive, no determination could be made as to the total size of the private sector procurement market. It is clear, however, that it is large. One bank alone procures in excess of KSh. 4 billion worth of goods, services and works. The size of the market is likely to exceed public sector procurement.

5.3 PROCUREMENT POLICIES

All the firms interviewed have established procurement policies and procedures. These are normally recorded in an operation manual, which informs the procurement officer of the exact process and procedures to be followed. Failure to comply with the procedures could result in disciplinary measures. Each company has its own policies and procedures though there are many similarities. Policies and procedures are informed by best practice approaches and experience in that particular sector. Some companies indicated that they had a pro-active approach to SME procurement. However, they insist that the SMEs should be formalised and registered. These companies generally are pro-active because the SMEs are operating in their area and they feel that it enhances the company’s community standing and efficiency. In certain instances, the SMEs have grown with the company and are now sizeable companies in their own right. This symbiotic relationship is a positive aspect of informed procurement. However, while the companies may have a pro-active stance on SME procurement, they do not have structures in place to assist the SMEs to grow, nor do they provide non-financial support and expertise to them. The companies expect that a combination of their orders and limited financial assistance should result in SME growth, but this is not always the case. A programme in conjunction with identified corporates to provide support to preferred supplier SMEs could have a positive impact on SME growth.

Generally though companies procure from the most competitive supplier irrespective of its size, corporate planning helps companies maximise efficiencies and procure in larger volumes, thereby excluding many SMEs. Corporates also emphasise the need for on-time delivery and a consistent quality of goods. Many have been let down by SMEs in these areas, and have therefore turned to larger companies that have more control over these operations. Thus, there is a tendency for large corporates to source from other large corporates as a way to mitigate risk.

5.4 PROCUREMENT PROCEDURES

All the companies interviewed kept databases of preferred suppliers. These suppliers had generally been identified over the course of time and had all proved themselves as reliable and efficient suppliers. The company generally identifies new suppliers either through a tender process, or if the supplier approaches them directly. In certain instances, third party referrals from other corporates or associations such as the Kenya Association of Manufacturers (KAM) are used.

Procurement with preferred suppliers is usually ongoing, with contracts made on a regular basis. A company may request that three to four preferred suppliers bid on a particular supply contract. These bids are adjudicated, and contracts are given to the lowest evaluated bidder. Contracts are on a monthly basis or are ongoing for up to two years.

In most cases no long-term contract is issued, and procurement is on an indent/invoice basis. Payments are made in tranches, with portions retained to act as a performance guarantee. Such portions are then paid on submission of the next invoice, from which a portion is then withheld.

Above set internal thresholds, the companies use the open tender process. The usual adjudication processes are followed including the use of tender committees. Supermarkets and tourism operators generally have a degree of centralised procurement for bulk items, and allow the branches/hotels to make their decisions regarding procurement of other items. In the case of supermarkets and hotels, much of the fresh produce is purchased locally by the branch/hotel. Generally these suppliers of fresh produce are small, informal growers. Formal supply contracts between corporates and SMEs are the exception rather than the rule. Formal contracts are used for large or long-term supply contracts. These include penalty clauses for non-performance.

5.6 PAYMENT

Payment terms vary according to the corporate, item supplied or form of supply contract. For smaller non-cash procurements, payment is usually within seven days. 30 days appear to be the norm, and 180 days the absolute limit. Suppliers have not indicated problems with payment delays. When they perform according to specification, they tend to get paid on time. Discounts on payments

are sometimes made if the product is sub-standard. This is particularly true in the supermarket sector. In the hotel sector, cash payments are made for fresh produce in order to ensure the best quality and a regular supply.

An interesting feature of the private sector is its willingness in certain instances to provide suppliers with advances to help them perform. Large supermarkets advance their trusted suppliers between KSh. 100,000 to 1 million. One of the largest mining companies regularly provides its transporters with advances to allow them to fuel their tanks at the company's pumps. The advances are then deducted from payments due. Administration of advances is both costly and time consuming. There may be a niche for a credit provider, working with a corporate, to administer this process for a fee. An arrangement of this nature may also open up other avenues for supplier credit, as the service provider would have an understanding of the supplier's cash flow and contract history.

5.7 CURRENT STATUS

Private sector procurement is functioning well and appears to be running efficiently. Procurers and suppliers have settled into long-term relationships, and a culture of mutual dependence appears to have developed. The corporates engage well with the SME sector, and there do not appear to be major constraints. While corruption probably does play a role in private sector procurement, it does not appear as obvious as in the public sector. Furthermore, management has a vested interest in ensuring that corruption induced inefficiencies are rooted out as they influence results and hence management's prospects within the company. The primary concern on the part of corporates is the level of professionalism within the SMEs and their ability to deliver on time to specification. The corporates indicate that this is the single largest constraint to expanding their business with the SME sector. The SMEs find the private sector market more diverse and responsive, but more difficult to get into because it requires them to be more efficient and cost effective. Also, margins are lower as corporates see the supply side as a primary cost-cutting area. Furthermore, the long-term relationships corporates have established with their suppliers lowers the possibility of change, unless there is a breakdown in those relationships. This does happen, and corporates are in the habit of testing the market from time to time to see who is out there and at what price points they can deliver.

Chapter 6

DONORS AND NGO PROCUREMENT

6.1 BACKGROUND

The donor and Non-governmental Organisations (NGO) community is very active in Kenya, with a wide range of operations including work in infrastructure, health, education, and policy development. Kenya is also a procurement base for regional relief and development activities in Somalia, Sudan and Rwanda. Multilaterals such as the World Bank group, the African Development Bank (AFDB), and the European Union (EU) generally operate through and in conjunction with the GOK. They operate at different levels and through different procurement mechanisms. Bilaterals such as USAID, DFID and JICA operate in conjunction with the GOK and have different procurement methods, usually project-based or delegated through institutions such as Crown Agents. UN Agencies generally have their own procurement network, as do large NGOs such as CARE. UNICEF, UNHCR and HABITAT all have large procurement offices in Nairobi. Larger local NGOs usually function with funds received from donors, and procurement is done according to the donor's stipulations.

6.2 PRODUCT TYPE

The donor and NGO community procures a full range of goods, services and works. Works and services are standard requirements for infrastructural development. Development and relief agencies have extensive procurement lists that are usually divided into food and non-food items. Food items include bulk grains and high protein biscuits. Non-food items include water and sanitation equipment, blankets, seeds, agricultural tools, vehicles, office equipment, bicycles, school desks, bags, and communications equipment. The agencies usually have standardised items listed in their catalogues and procurement is made against these specifications. Certain agencies procure kits. These kits are made up of various items sourced by the supplier and put into a bag. For example, a refugee/internally displaced person kit may contain blankets, seeds, agricultural tools, pots, soap, and shelter items. Transport contracts are often placed with SMEs.

6.3 VOLUMES OF PRODUCTS

Donors and NGOs procure vast amounts of goods, services and works to support their operations and interventions. One UN agency alone procures about KSh. 500 million worth of goods in Kenya annually.

6.4 PROCUREMENT POLICIES

Procurement policies vary greatly among the donors and NGOs. They generally indicate that they support the SME sector, but in practice very few SMEs are able to benefit from their procurement as the thresholds are too high or the performance parameters are too great.

Donors and NGOs normally stipulate the use of local sub-contractors where possible for the procurement of works and services. This, however, is not a condition for disqualification if it does not occur. There does appear to be a change in thinking amongst development and relief agencies. Many are now actively promoting local procurement as a way of stimulating growth in the local economies and eventually reducing their levels of assistance. Agencies involved in emergency relief operations indicate that they are not able to rely on the SME sector as they need to be sure that supplies arrive on time and on specification every time as lives are dependent on the items.

6.5 PROCUREMENT PROCEDURES

Procurement procedures vary depending on what institution is funding the procurement, and what type of goods, works or services are required. Procurement takes place on an annual basis or as and when required. Procurement notices are placed in the daily national newspapers and the respective agencies' websites.

Procurement can be broadly split into two types:

6.5.1 Public sector type procurement (health, education and infrastructure)

This type of procurement is normally of high value and funded through institutions such as the World Bank or AFDB. Procurement either emanates directly from the institution or from the beneficiary ministry, depending on the institutions' procurement rules. International Competitive Bidding or National Competitive Bidding usually applies. These processes usually do not allow much scope for SME participation unless on a delegated or sub-contractual basis. The World Bank, for instance, requires contractors to be registered on its Database of Consulting Companies (DACON database). This in itself is a laborious and expensive process. In certain instances, community-based projects are included as a component, which may allow for local SME procurement. This situation could be improved should the government (the borrower) negotiate the inclusion of the

SME sector in its Development Credit Agreement with the World Bank. As such it would be up to the GOK to negotiate improved access for SMEs.

6.5.2 Procurement of goods

While the World Bank and AfDB may fund the procurement of goods from time to time, this is usually related to a particular public sector type procurement, and as such is included in the overall tender process.

Development and relief agencies have highly formalised procurement processes (similar in nature to the PPDA). They all require that suppliers register with them before procurement processes can proceed. The registration process is stringent and normally includes checking the companies' financial standing, capacity to supply, and logistical ability. It may also involve premise checks as part of a due diligence process. Product compliance with agency standards will also be checked. UN agencies have specifications for all the products they procure, and suppliers need to know these specifications and comply with them.

Potential suppliers are asked to register either annually or every three years. The agencies place a public notice requesting potential suppliers to come forward. Some agencies such as UNICEF hold supplier conferences every three years where they explain their procurement processes. The International Trade Centre in Geneva also holds regular buyers/sellers conferences where they assist development and relief agencies identify new suppliers, and explain the procurement workings of the various agencies.

Once suppliers are short-listed, they are asked to quote on particular orders. The lowest evaluated quote is accepted and the order placed. Country offices have fixed thresholds, over which they are required to go to national or international tender. UN Agencies have global procurement agreements with companies such as Toyota or Hewlett Packard for the supply of high volume items such as vehicles, spares, computers and peripheries. Toyota in Kenya supplies UN agencies with vehicles at an internationally agreed price. Development and relief agencies allow delegated procurement by their field offices up to certain thresholds. SMEs are well placed to supply these offices, as procurement values are lower.

Bilateral donors will either delegate procurement to the project level (according to their normal terms and conditions of procurement), or

will engage a procurement agency such as Crown Agents. Crown Agents is paid a fee for the successful procurement of items. It too needs to conform to the bilateral terms and conditions. This includes requirements such as the provision of bank guarantees. It should also be noted that tender documents are extremely complex and may run to 50 pages. Many SMEs find it difficult to understand the complex legal requirements and stipulations included in the tender documents, as well as the rights and duties that flow from them. Severe penalty clauses also apply.

6.6 PAYMENT

Payment processes are formalised and usually efficient. Payment in 30 days is usual. On infrastructural projects, staggered payments are made dependant on bills of completion.

6.7 CURRENT STATUS

Donor and NGO procurement systems work well, though they tend to be over-bureaucratised. This is a constraint to the SMEs that have the potential to supply components of their procurement requirements. Attempts by donors and NGOs to explain their procurement procedures through conferences and supplier gatherings are welcome, though the procedures remain formal and difficult for SMEs to adhere to. That said, the community is sourcing from the SME sector in Kenya. One of the agencies interviewed had registered more than 200 SME suppliers.

The donor and NGO community has a perception that the SME community is unable to deliver the correct product at the correct time. Donors and NGOs expressed their frustration at the constant late deliveries from the SME sector. What SMEs often do not realise is that donors and NGOs have set up whole supply chains of which SMEs are only a small part. Late delivery disrupts the supply chain and logistic component and can have dire consequences at the end user level. It is for this reason that the donors and NGOs tend to source only non-emergency items from the SME sector.

SMEs supplying the sector mentioned the low margins and the difficulty in understanding the supply contracts as problems. However, the volumes procured made up for the lower margins. Payment was not mentioned as an issue. Procurement documents also tend to be highly complex, and there is a need for them to be simplified for SME procurement.

Chapter 7

SME PARTICIPATION IN PROCUREMENT

7.1 SOURCES OF INFORMATION FOR SMEs

The primary source of information for SMEs is tender notices placed in the daily papers. Given the financial constraints faced by some of the procuring entities and the cost of advertising, these notices are generally only posted once. As a result, many SMEs miss them.

The SMEs are also often unaware of website postings and many do not have Internet access. Furthermore, it was noted that many procuring entities do not post tender notices outside their offices or in a prominent place relating to that entity. Where notices are posted, the information is generally six months old. Procuring entities also tend not to publish the results of tenders, which enhances the opportunity for corrupt practices. Cost was cited as the main reason for not doing this.

In areas where banks have pro-active management, it is noted that SMEs are well aware of the financial instruments available to them to support their businesses. Sadly this is the exception rather than the rule. Many SMEs are not aware that there is Local Purchase Order (LPO) financing or Invoice Discounting available to them. More sophisticated SMEs, however, know the systems well. They interact with all levels of the procuring entity and know which department wants what item when. They follow the procurement process through the system and agitate for their cause at every level through to payment. These SMEs realise that procurement is an important part of their business, and as a result ensure that they have the relevant information and contacts. Often these SMEs have a dedicated staff member working on procurement issues.

7.2 ABILITY TO RESPOND TO PROCUREMENT OPPORTUNITIES

The SME sector appears to respond well to procurement opportunities. Given the number of participants in procurement from the SME sector, it is obviously an attractive market for them. The SME sector is able to complete the necessary documentation for public and private sector opportunities easily, but have difficulties responding to the documentary requirements of the donor and NGO sector. On the supply side, prequalified suppliers generally have stock-in-hand for the goods they are listed for. The GOK's policy of 0% stockholding is an opportunity for these SMEs, even though there is a cost attached. GOK entities absorb that cost through higher prices.

Where there is a new tender for items SMEs may not necessarily hold, they are usually able to obtain the items within a week. Despite poor roads in certain areas, the distribution network appears to work well, and SMEs are able to obtain their goods in a timely manner. SMEs engaged in this form of supply are also aware of finance options from banks, and often mentioned Equity Bank as a provider of credit against an LPO.

It should be noted that a requirement in the prequalification process is that the SME states its financial capacity and ability to respond to orders up to a certain level. As such, the procuring entity will rarely request the SME to supply goods over its stated limit. This ensures that undue financial strain is not put on the SME, thus its requirement for finance is reduced. However, a problem occurs when multiple orders are placed with a SME and payments are delayed. Its working capital is severely depleted as a result, and it usually requires financing to proceed. In certain instances, SMEs refuse to proceed with new orders until backlog payments are resolved.

In certain instances, poorly structured tender documents hinder the SMEs' ability to respond. This was noted, for example, with a prequalified bulldozer operator. The tender documents called for an hourly rate on the use of the bulldozer, but had not stipulated the minimum usage. An order was placed for eight hours' work. The operator declined, as this would not cover the cost of his transport to and from the site. This type of issue reflects on both the procuring authority and the level of sophistication of the SME.

7.3 ACCESS TO CREDIT

As mentioned previously, financial instruments pertaining to the procurement sector are available from various institutions. Lack of take up is more often because of lack of knowledge of availability and the perceived high collateral requirements. SMEs are usually loath to put up collateral, as they know that if they fail to pay back the loans, these items will be attached. Unfortunately there is no reward without risk. SMEs need to understand that if they want to participate in the procurement sector and they require finance, there are risks attached.

The procurement sector is an ideal vehicle for SME sector growth as SMEs are paid if they perform to specification. Procurement is the lowest risk format for SMEs. They are not reliant on multiple clients

who may or may not pay; their marketing is targeted and focused; and they know what products are required and at what price (assuming they are prequalified). Their risk is usually limited to payment delays, but they are able to mitigate this by choosing their clients carefully. Furthermore, the PPDA should help ensure that payments are made on time. As a result, the main risk SMEs face is their own ability to perform. If they have confidence in their abilities, they should be willing to provide collateral for loans.

In the SMEs' perception, market demand is not the problem, but working capital is. In the "market's" perception, however, the problem of working capital is seen as secondary to the lack of business skills, and the ability to present and package products or to strategise in terms of product development or diversification. In other words, the "market" perceives the problem as being the ability of the SME to focus on its core activities.

7.4 CREDIT AVAILABILITY

In the 1999 Baseline Survey, sampled MSMEs ranked marketing as their main problem followed by credit as the next most common constraint to growth. The two are not unrelated. The growth of businesses relies on both marketing and credit to generate the extra capital required for expansion. A major factor inhibiting both banks and MFIs from increasing their lending to small business is the absence of credit referencing systems in the country. A common register to provide financiers with the credit history of any enterprise big or small would be an important contribution to the opening up of financial services to SMEs.

There are several sources of credit for SMEs: banks, MFIs, SACCOs, Rotating and Savings Credit Associations (ROSCAs), Accumulated Savings and Credit Associations (ASCAs), Village Banks, friends and family, and informal lenders.

7.4.1 Banks and MFIs

There are a number of banks that specifically focus on providing small loans, including those to SMEs: K-Rep Bank, Equity Bank, Family Bank, Cooperative Bank and FINA Bank.

K-Rep Bank grew out of the micro-finance component of the Kenya Rural Enterprise Programme (K-Rep) that was designed and supported by USAID initially in 1984 and then by a number of other donors through the 1990s. In 1989, it expanded into direct service provision, and in 1998 was transformed into a private commercial bank in order to capture savings and offer financial services beyond micro-lending. K-Rep Bank uses both the group-based approach and

individual lending. About 50% of its total portfolio is for groups and the rest is for retail or individual lending. The collateral under the group approach is "social collateral" or a group guarantee. After K-Rep Bank showed the success of this approach, the Central Bank of Kenya became more open to it, rather than only accepting more tangible or physical assets. Those enterprises that can offer physical collateral, cash receivables and assets are also accepted. Given the status of land registration in Kenya, few banks take land title deeds outside the major urban centres as collateral without other complementary sources of collateral.

Equity Bank developed from Equity Building Society, which began in the 1980s as a rural microfinance institution. Equity Bank has grown to become the leading bank catering to small-scale rural enterprises. It has a recorded client base of over 2 million that is growing at a fast rate. For SMEs⁶, Equity Bank offers LPO financing of up to 80% of the value of the order. The Bank charges a flat 2% commission on the total value of the LPO for this facility. This facility is offered on a 30-day basis. Should repayment be delayed, the Bank is prepared to convert it to a term loan. Equity Bank requires the applicant to have had an account with it for six months, but if the applicant's cash flow is good, the Bank will consider the facility three months after the applicant has opened an account. Equity will take the following as collateral:

- Land
- Cash
- Debentures
- Motor vehicles
- Household chattels
- Stock in trade

Equity also offers an invoice discounting facility, charged at 1% of the invoice value, and the facility is discounted at 80%. The Bank also has a bill discounting facility for SME with multiple debtors. This is secured by collateral.

Co-operative Bank Trade Finance does not offer loans on the basis of a confirmed order alone. Applicants need to back the loan with bank statements (the loaned does not have to bank at Coop), and security in the form of chattels, property, or receivables that can be assigned to the loan. Receivables are a common form of security for loans based along lines of credit of government ministries and parastatals. If the government department is willing to assign the Bank receivables via its lines of credit, then the Bank can offer back-to-back credit. Kenya Power and the Ministry of Health have been quite willing to do this to get supplies from SME that trade in small hardware and medical equipment. Orders can be worth KSh. 10 to

⁶Defined by Equity Bank as employing 5-50 persons and with a turnover of KSh. 3-49 million

KSh. 100 million. Getting paid by government is not a challenge, according to an official of the Coop Bank, since the GOK is now liquid, and before orders are placed, the source of funds is confirmed. SMEs that are successful are keen to get to the next level, which in banking terms is the "corporate" level. Anyone who borrows more than KSh. 5 million is considered "corporate," and some SMEs have successfully managed credit of that amount. According to the Coop Bank, SMEs are those that borrow between KSh. 1-5 million.

The MFIs generally have a smaller client base than the commercial banks. The largest institution's membership is in the region of 120,000. Most MFIs have fewer than 20,000 members. Many are focused on providing loans to informal, micro business and only provide limited services to the formal small scale segment. Although now starting to change, there has been a focus on the use of group based lending where use of group based lending, where 'social capital' replaces tangible assets as the form of collateral. By contrast the SME oriented banks provide loans on an individual basis to the larger more formal segment.

7.4.2 ROSCAs, ASCAs and FSAs

The smallest loans and the largest number of savings and credit institutions are at the community level. They are the ROSCAs, the ASCAs, and the FSAs (Financial Service Associations), which are also called Village Banks. All of these are registered as associations with the Ministry of Culture and Social Services through district social development officers. ROSCAs and ASCAs are community-based and often informal groups for lending and saving. They reach more people than all the others. They informally pool together savings and in turn lend to their members. The most common use of such money is for welfare purposes: household emergencies, weddings, funerals, medical expenses, etc. FSAs are also owned by the villagers and can lend on average KSh. 10,000 per loanee. There are 70 FSAs in the country at present and the demand is growing. Their biggest challenge, K-Rep Fedha Services (KFS) has been established as a specialist provider of management and technical services to FSAs on a fee-per-service basis. These informal and semi-formal sources while ubiquitous in Kenya, are unlikely to meet the financing needs of many MFIs given the limits on their financial resources and products.

7.4.3 SACCOs

A rung above the associations are the SACCOs, which are registered with the Ministry of Co-operative Development and Marketing. SACCOs have traditionally been linked to either large-scale employers or small-holder agricultural production. There are now a

growing number of SACCOs which are either specifically addressing non agricultural micro business or opening their 'common bond' to include a broader customer base. There is little doubt that directly or indirectly, SACCOs provide a significant source of finance for SMEs.

In the future government policy is to regulate the movement reflecting its systemic importance and the vulnerability of many SACCOs, which need to strengthen governance, systems and risk management. A SACCO Bill has been drafted and is expected to be presented to parliament in 2008.

7.5 SME ACCESS TO NON-FINANCIAL SERVICES

In the past, technical support services have been the responsibility of public sector extension staff. Although increasingly it is private service providers who are the main agents for both inputs and technical advice, there is generally a lack of awareness about the existence and potential of private provision. At the same time, small-scale service providers, as SMEs themselves, are affected just as much as their clients are by constraints such as the lack of security of tenure, capital and infrastructure. The service gap is often picked up and responded to by NGOs who then either directly subsidise (ultimately through donor subsidies that make up their own financial base) the service provider and/or the farmer/SME in the transaction between them, or provide the support services themselves. Hence the observation that the BDS market in Kenya is by and large "about NGOs"⁶ Other than in horticulture, "embedded services" through linkages between large exporters and their suppliers are still an emerging and largely untried phenomenon. In sum, there is a scarcity of competitive and competent BDS providers in Kenya.

The prevalent perception is that the BDS market is not well developed in Kenya. One of the reasons is that SME needs do not get often translated into effective demand. A document from a Kenya-based BDS facilitator, Swisscontact, suggests that most SMEs lack the "capacity and confidence" to diagnose what is wrong with their businesses or what can be improved, and to seek technical advice and services.⁷ Swisscontact observes that when SMEs do get technical assistance, there is often a mismatch between what they want and what they get. Hence the comment of one entrepreneur with regard to BDS providers, quoted in the same document: "... they tell us what they want to teach rather than what is really needed."

Examples from the agricultural sector demonstrate the general status of BDS markets. Many of the service providers to small holders in Kenya are themselves small business owners who are informally established and very limited in their access to information, technology and finance. For example, the broker or the "middleman"

⁶ Kevin Billing, personal communication.

⁷ Swisscontact East Africa, *Identification, Stimulation, and Projection of BDS Demand through Action Learning*, August 2002.

who plays a crucial role in the horticultural supply chain is often a farmer who has gradually developed some expertise on what the wholesalers want. He or she depends on ongoing guidance from the buyer in transactions with the small-scale farmer. The broker is the main “bulking” (or collection) agent for several major vegetable and fruit exporters, and at the same time is the (rough) translator at the farm level of the European market’s demands and specifications. It is often the broker who informs smallholders what the French preference in avocado types is at any particular time, for example, or what the European import restrictions are for fresh produce or flowers. It is the broker who delivers to and picks from the farms cartons specially inscribed by exporters with traceability codes (e.g. the exact location of fields the produce is picked from, the pesticides regime, etc.). (This was a finding in the Kenya BDS Programme’s high value fruits sub-sector.)⁸

These are essential BDS that could be carried out closer to the farm level by service providers specialised in the import market’s requirements for various products. Brokers who are trained and trusted by the major exporters are few and far between. The more usual practice to ensure standards is the use of out-grower schemes supported by major exporters where trained extension staff guide farmers according to the exporters’ needs.

Transport and storage facilities are supplied to rural enterprises by both formal and informal means. Accounting services are also available in small and large urban centres in Kenya, but a real gap exists in management and sector-specific technical advice and services. The main sources of technical information on all production and marketing issues are NGOs and Community Based Organisations (CBOs), private input suppliers, and other farmers. Agro-chemical outlets and agro-vets are perhaps the most active sources of technical information in the rural areas. But this information is targeted to the products being sold and therefore is what some farmers call “compartmentalised.” (For example, an agro-vet may offer information on what disease ails a cow and how to treat it, but has no advice on how to change its feeding habits, which might be causing the disease in the first place. For this, the farmer may need to find a forage expert). Hence there is a noticeable gap in terms of information delivered as part of an integrated advisory and technical support package.⁸

There is some incipient private sector activity in terms of integrated advice, but it is not necessarily of a quality that brings the most relevant or recent technical knowledge to the entrepreneur. However, it is clear that private advisory services are beginning to be established as businesses in Kenya.

⁸ Kapila S., *Report on the Sub-Saharan Consultation on the Role of Science and Technology in Improving Rural Livelihoods*, Addis Ababa, June 2003, web site: www.agassessMEnt.org

Chapter 8

KEY FINDINGS AND RECOMMENDATIONS

While the procurement and supply side systems appear to function reasonably well, there are constraints apparent that hinder the growth and efficiency of the sector. While KISM may not be able to address all these key constraints, it is suggested that a few targeted interventions may address some of the critical factors. Recommendations are made while understanding KISM resource constraints and the value of private sector assistance.

8.1 THE INFORMATION GAP

8.1.1 Findings

This constraint is present throughout the procurement and supply process and has an impact at both enterprise and procurement entity levels.

On the enterprise level, access to the following information could be improved:

- Information on what tenders are being placed and who has won the tenders,
- Information regarding what rights and duties suppliers have to public procurement entities,
- What financial mechanisms are in place to support their businesses.

On the procurement entity level, the information gap relates to:

- Knowledge of the procedures, processes, duties and obligations relating to the implementation of the PPDA and Regulations.

8.1.2 Recommendations

In the long term, training and publicity campaigns are resource heavy and take a long time to be effective. While there is a definite need to train public sector procurement personnel, the development of curricula and the actual training will not be quick. In the short term, the following measures could be used to address some of these constraints as stopgap measures until other mechanisms are developed:

8.1.2.1 *Setting up of tender notice boards countrywide*

It is suggested that KISM enters into discussion with one of the mobile phone operators in order to facilitate its setting up of tender

notice boards outside relevant institutions countrywide. Discussions would of course need to be held with the GOK on this issue, but as it is a no-cost initiative for the GOK, it may accept it. Mobile phone operators would be interested as the boards could be branded and may come to be known as the Ctel or Safaricom Tender Boards, for example. These boards would allow POs to place notices of tenders and their awards. The onus would be on the POs to ensure that the boards are updated. Some pressure from accounting officers in this regard would be welcome.

8.1.2.2 *Distribution of a calendar showing the workings of the PPDA, Supplies Practitioners Management Act and access to finance.*

It is suggested that KISM enter into discussions with Equity Bank to fund a calendar that would outline the provisions of the Act in a simplified manner, as well as indicate relevant financial mechanisms Equity has available to suppliers. It was noted that all the offices visited had calendars on their walls. A report or other document may simply be placed in a pile in the corner, while a calendar allows for visibility and immediate access.

Equity Bank has the most appropriate financial instruments, and would welcome the opportunity to use the calendar as a marketing tool. The attached legislation outline could be used as a base for the PPDA explanation. The calendar would also allow KISM to reach as many procurement and supply personnel as possible, and it would be a vehicle to promote KISM and its services.

8.1.2.3 *Supplier conferences.*

It is suggested that KISM lobby for procurement entities to hold annual supplier conferences at the time that they announce their annual tender requirements. These conferences need only be for a morning. They would provide an opportunity for POs to outline their requirements and procedures, as well as allow suppliers to collect tender documentation.

8.1.2.4 *Supplements in daily newspapers.*

It is suggested that KISM, in conjunction with a sponsor, take out a supplement in one of the daily newspapers. This would reach a large audience, and at the same time begin to instil some form of transparency in the procurement process. The text could then be laminated and placed on the tender notice boards as a permanent reminder.

8.2 PUBLIC ENTITY PROCUREMENT INEFFICIENCY

8.2.1 Findings

Inefficiencies in public entity procurement cost the GOK about KSh. 30 billion annually. Prime contributors to this inefficiency are:

- Poor procurement planning,
- Delayed payments,
- Corruption,
- Poor training (this aspect also relates to access to information).

While the legislation makes allowances for preferences to be made to certain classes of suppliers, these stipulations are rarely applied. As a result, suppliers find themselves competing with larger corporations to their detriment. Also, the GOK does not collect data on tender awards to the SME sector, and as a result, is not able to determine whether it is on target in terms of its stated goals.

In the GOK's negotiations on Development Credit Agreements, it has not been sufficiently vigorous in including the SME sector in the provision of procurement opportunities.

8.2.2 Recommendations

8.2.2.1 *Political will to enforce legislation*

The legislation as it stands is effective and reflects best practice processes. However, its implementation will only be effective if there is the political will to enforce it. It will be up to KISM and the PPOA to ensure that the GOK is made aware how much non-enforcement costs the country.

8.2.2.2 *Data collection on awarding of tenders.*

The opportunity exists to capitalise on change and bring about the professionalisation of supplies management. The opportunity could also be used to establish some form of data collection by the GOK on the award of tenders.

8.3 LACK OF SUPPLIER DEVELOPMENT MECHANISMS

8.3.1 Findings

In both the private and public sector, there are no mechanisms in place to assist existing suppliers improve their performance. This hinders growth on the part of the supplier and drives up costs to the procuring entity.

8.3.2 Recommendations

The generally long-term nature of procurement and supply relationships between private sector entities and suppliers provides an ideal opportunity to facilitate BDS to these companies. Many BDS providers are unaware that these relationships exist. Linking them to corporates so that they may assist the corporates' suppliers to grow and become more efficient would be in the interest of all parties.

8.4 CREDIT ISSUES

8.4.1 Findings

Access to credit is a generic constraint to SMEs.

8.4.2 Recommendations

In the procurement sector, specific products have been developed to assist and support SMEs. One area that is not currently served, however, is the corporate practice of giving advances to suppliers. It is felt that there is an opportunity for a financial institution to take over this function and run it on behalf of corporates. This would relieve the corporate of the administrative burden, and would give the financial institution the ability to sell other financial products.

Chapter 9

CONCLUSIONS

The procurement sector is growing in terms of personnel and volume of trade. The SME sector is performing as well as can be expected and is reasonably well integrated into the procurement mechanisms of the public, private, donor and NGO sectors. However, while the procurement and supply side systems currently appear to function reasonably well, there are constraints apparent that hinder growth and efficiency. Access to finance, however, is generally not the major constraint to SMEs in accessing the procurement market. Rather, very basically, there are two main issues that need to be addressed.

Firstly, the information gap must be narrowed. Information regarding when and what is being procured, and the procedures around this and, in particular, what the SME's rights and duties are, and what financial products exist to support them needs to be more widely available.

Secondly, the efficiency of procurement needs to be improved. This would free up resources that could be applied usefully to other tasks. Currently this inefficiency is caused by poor procurement planning,

payment delays, corruption, and poorly trained staff. Current legislation and policies concerning procurement are more than adequate, but what is needed is a strengthening of political will to ensure that their provisions are met.

While KISM may not be able to address all these key constraints immediately, this report has suggested a few targeted interventions that may address some of the critical factors. In the long term, interventions such as training and publicity campaigns are resource heavy and take a long time to be effective, and while there is a definite need for such long term measures as training public sector procurement personnel, these measures will not produce a quick effect. However, in the short term, stopgap measures could be put into place until other mechanisms are developed.

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APPENDIX I: LEGISLATION

PUBLIC ENTITY STRUCTURES

The PPDA stipulates that the following structures be in place for procuring public entities:

- A procurement committee
- A procurement unit
- A tender opening committee with a minimum of 3 persons
- A tender committee consisting of 5 or more persons, with the procurement officer as secretary
- A record keeping structure to ensure that procurement records are kept for 6 years
- A finance liaison structure to ensure that sufficient funds are available for procurement

The PPDA also stipulates that all procurement is done in accordance with an annual procurement plan. The onus for compliance with the Act falls primarily on the accounting officer of the public entity.

PUBLIC ENTITY PROCUREMENT PROCEDURES

The Act makes provision for the following forms of procurement:

- Open tendering,
- Alternative procurement procedures, namely:
 - Restricted tendering,
 - Direct procurement,
 - Request for proposals,
 - Request for quotations,
 - Procedures for low-value procurements,
 - Specially permitted procurement procedures.

The procedure to be followed is in a large part determined by the thresholds outlined in the Regulations (The Public Procurement and Disposal Regulations, 2006).

Procurement entities are classified into different categories:

Class A

State Corporations
Ministries

Class B

City Councils (Nairobi, Mombasa, Kisumu)
Cooperative Societies
Universities
Colleges
Districts
Provincial Hospitals
Semi-Autonomous Government Agencies
Commissions
Judiciary

Class C

Other Local Authorities (Municipal, County, Town Councils)
Schools
District Hospitals, Sub-District Hospitals
Health Centres /Dispensaries
Polytechnics
Constituency Development Fund Committees

Open tendering

Open tendering applies where procurement is above the following stipulated thresholds:

Class A Procuring Entities

Goods	KSh. 6 Million
Works	KSh. 6 Million
Services	KSh. 3 Million

Class B Procuring Entities

Goods	KSh. 4 Million
Works	KSh. 4 Million
Services	KSh. 2 Million

Class C Procuring Entities

Goods	KSh. 3 Million
Works	KSh. 3 Million
Services	KSh. 1 Million

The tender has to be advertised at least twice in a national newspaper as well as in other relevant places (e.g. web sites, signboards). The basic processes to be followed for open tendering include:

- Invitation to tender: this sets out which procurement entity is tendering for what goods, services or works; where the tender documents may be obtained; and the relevant dates and times,

- Tender documents: these set out what is required and in what specifications in terms of product, supplier and contract,
- Advertising of the invitation to tender,
- Preparation of tenders by suppliers,
- Provision of tender documents to the procuring entity (and stipulated tender security if required),
- Submission of tenders,
- Opening of tenders by a tender opening committee,
- Evaluation of tenders in an objective and quantifiable manner, and award to the tender with the lowest evaluated price. This includes technical evaluation as well as responsiveness to the tender document,
- Notification of award of contract to the successful candidate, and notifying other suppliers that they have not been successful,
- Creation of a contract between the procuring entity and the supplier.

The open tendering procedure may be used to pre-qualify suppliers.

Alternative procurement procedures

These procedures may be employed as an alternative to the open tender process if specific conditions are present. The underlying principal is that they should not be used to obviate competition.

Restricted tendering

Restricted tenders may be used where:

- Competition for the contract is limited to prequalified contractors because of the specialised nature or complexity of the goods, services or works.

Class A Procuring Entities

Goods	Below KSh. 20 Million	- Use Open Tender
Works	Below KSh. 20 Million	- Use Open Tender
Services	Below KSh. 20 Million	- Use Open Tender

Class B Procuring Entities

Goods	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Works	Below KSh. 2 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Services	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender

Class C Procuring Entities

Goods	Below KSh. 500,000	- Request Quotations
Works	Below KSh. 500,000	- Request Quotations
Services	Below KSh. 500,000	- Request Quotations

- The time and cost required to evaluate a large number of bids is disproportionate to the value of the procurement.

Class A Procuring Entities

Goods	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Works	Below KSh. 2 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Services	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender

Class B Procuring Entities

Goods	Below KSh. 1 Million Over KSh. 4 Million	- Request Quotations - Open Tender
Works	Below KSh. 2 Million Over KSh. 4 Million	- Request Quotations - Open Tender
Services	Below KSh. 1 Million Over KSh. 4 Million	- Request Quotations - Open Tender

Class C Procuring Entities

Goods	Below KSh. 500,000 Over KSh. 3 Million	- Request Quotations - Open Tender
Works	Below KSh. 500,000 Over KSh. 3 Million	- Request Quotations - Open Tender
Services	Below KSh. 500,000 Over KSh. 3 Million	- Request Quotations - Open Tender

- There are only a few known suppliers of the goods, works or services.

Class A Procuring Entities

Goods	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Works	Below KSh. 2 Million Over KSh. 20 Million	- Request Quotations - Open Tender
Services	Below KSh. 1 Million Over KSh. 20 Million	- Request Quotations - Open Tender

Class B Procuring Entities

Goods	Below KSh. 1 Million Over KSh. 4 Million	- Request Quotations - Open Tender
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Works	Below KSh. 2 Million	- Request Quotations
	Over KSh. 4 Million	- Open Tender
Services	Below KSh. 1 Million	- Request Quotations
	Over KSh. 4 Million	- Open Tender

Class A Procuring Entities

Goods	Below KSh. 500,000	- Request Quotations
	Over KSh. 3 Million	- Open Tender
Works	Below KSh. 500,000	- Request Quotations
	Over KSh. 3 Million	- Open Tender
Services	Below KSh. 500,000	- Request Quotations
	Over KSh. 3 Million	- Open Tender

Direct procurement

Direct procurement is the process where the procuring entity deals directly with a single supplier. This process may be used where:

- There is only one supplier of the goods, works or services, and
- There is no reasonable alternative or substitute for those goods, works or services

Direct procurement may also be used when supply needs are urgent. No thresholds apply as long as the conditions of the clause are met.

Request For Proposals (RFP)

This process may be used when the request relates to services or a combination of goods and services (e.g. the design and installation of waterworks). It may also be used if the services are mainly advisory, such as consultancy.

No thresholds apply as long as the conditions of the clause are met.

Request For Quotations (RFQ)

This process may be utilised where the goods are readily available and the estimated value is less than the prescribed maximums. The process may also be used in conjunction with restrictive procurement where, for instance, suppliers have prequalified on an annual basis and quotations are sought from those prequalified suppliers.

Class A Procuring Entities

Goods	KSh. 1 Million
Works	KSh. 2 Million
Services	KSh. 1 Million

Class B Procuring Entities

Goods	KSh. 1 Million
Works	KSh. 2 Million
Services	KSh. 1 Million

Class C Procuring Entities

Goods	KSh. 500,000
Works	KSh. 500,000
Services	KSh. 500,000

Low Value Procurements

This form of procurement applies when the value of goods, services or works equals or falls below prescribed thresholds.

Class A Procuring Entities

Goods	KSh. 30,000
Works	KSh. 30,000
Services	KSh. 30,000

Class B Procuring Entities

Goods	KSh. 10,000
Works	KSh. 10,000
Services	KSh. 10,000

Class C Procuring Entities

Goods	KSh. 5,000
Works	KSh. 5,000
Services	KSh. 5,000

Specially permitted procurement procedures

This only applies to concessions and design competitions.

THE PUBLIC PROCUREMENT AND DISPOSAL REGULATIONS, 2006.

These regulations, read together with the PPDA, outline the various processes and procedures to be followed when goods, services or works are procured. A threshold matrix is outlined (summarised above), as are the duties and functions of the various participants.

THE SUPPLIES PRACTITIONERS MANAGEMENT ACT, 2007

This Act was assented to law on 22 October 2007 and commenced on 30th October 2007. This Act regulates both public and private sector procurement practitioners and strives to professionalise procurement practice in Kenya.

In terms of the Act, KISM is tasked with registering and licensing all supplies practitioners operating in Kenya. Supplies practitioners are defined as any person or procuring agent engaged in public or private procurement, purchasing, stores management, logistics, supply chain or related activities. In order to be registered, supplies

practitioners are required to satisfy the registration board that they are of good conduct, have paid the registration fee and have undergone and passed a certificate, diploma or research course of instruction in the prescribed field. Persons engaged in supplies practice immediately before the enactment of the Act will be eligible to be registered if they convince the council they are of good conduct, have met the professional qualifications prescribed by the council and have paid the prescribed fee.

From 30 October 2008 no person may engage in the business of a supplies practitioner unless they have been issued with a registration certificate and practising license. A license would be granted if the person holds a Registration certificate and meets other requirements as set by the Council. Should the person practice without a licence or, a company employ an unlicensed person, criminal penalties are imposed.

RESERVATIONS AND PREFERENCES

Section 39 of the PPDA makes provisions for preferences and reservations as determined by the Minister of Finance.

Section 39 (4) stipulates that preferences and reservations may be made in favour of candidates such as disadvantaged groups, and micro, small and medium enterprises in consideration of economic and social development factors.

The extracts from the PPDA when read together with the Regulations allow for the following:

Section 39 (5) The procuring entity shall when processing procurement comply with the provisions of the Act and the Regulations in respect to preferences and reservations.

Section 39 (6) To qualify for a specific preference or reservation, a candidate shall provide evidence of eligibility.

Section 39 (8) (a) Exclusive preference shall be given to citizens of Kenya where funding is 100% from the Government of Kenya or a Kenyan body and the amounts are below the prescribed thresholds.

Section 39 (8) (b) A prescribed margin of preference may be given as follows:

- (i) in the evaluation of bids to candidates offering goods manufactured, mined, extracted and grown in Kenya, or
- (ii) for works, goods and services where a preference may be applied depending on the percentage of the shareholding of the locals on a graduating scale as prescribed.

The Public Procurement and Disposal Regulations, 2006 prescribe as follows:

Pursuant to section 39 (8) of the Act, Regulation 28 (1) prescribes as follows:

The threshold below which exclusive procurement preference shall be given to citizens of Kenya shall be:

Reg. 28 (1) (a): Goods and services	KSh. 50 Million
Reg. 28 (1) (b): Works	KSh. 200 Million

MARGIN OF PREFERENCE

Reg. 28 (2) (a) Pursuant to Section 39 (8) (b) (i) of the Act, the prescribed margin of preference to be applied while evaluating bids for goods manufactured, mined, extracted and grown in Kenya is 15% of the evaluated price of the tender, or

Reg. 28 (2) (b) Pursuant to Section 39 (8) (b) (ii) of the Act, the prescribed margin of preference to be applied while evaluating bids for works, goods and services where preference may be applied depending on the shareholding of the locals is as follows:

- Less than 20% shareholding – margin of preference is 6% of the evaluated price
- Less than 51% but above 20% – margin of preference is 8%

Since according to Section 39 (5) of the Act, procuring entities shall when processing procurement comply with the provisions of the Act and Regulations in respect to preferences and reservations, the failure or reluctance to accord preferential consideration in favour of candidates such as disadvantaged groups, and micro, small and medium enterprises in consideration of economic and social development factors pursuant to Sections 39 (4) and 2 (f) of the Act is contrary to provisions of the procurement law.

APPENDIX II: LIST OF WORKSHOP ATTENDEES

The following persons attended a Stakeholders' workshop held on 15th November 2007 at Nairobi Safari Club:

	NAME	ORGANISATION
1	Sylvester Maina	Revive Concepts
2	Pascal Mulindwa Bukuru	FCE
3	Joseph K Ndungu	East Africa Resource Trainers
4	Pharis Njogu	Ndovu Nutrition
5	Kennedy Malinda	CFC Life
6	George Kania	Standard Chartered Bank
7	Oliver Eshitemi	Vapro Supplies General
8	Catherine Mugambi	Small and Medium Enterprise Programme
9	Mohammed Kerre	PERC-PACE International Ltd
10	Willy Gitau	Small Scale Farmer
11	Cliff Nyangoto	Kenya Institute of Development Studies
12	David Songoro	ARK Consultants
13	Eva Atieno	Federation of Kenya Employers
14	Ronald Njoroge	CEAFA
15	S. K. Kogo	Central Bank of Kenya
16	M. Ragui	Central Bank of Kenya
17	K.I Laibuta	Chartered Institute of Arbitrators
18	J.K. Njogu	Student
19	Sammy Kilonzo	Natural Resources and Environment Conservation Partnership of Kenya
20	Gideon Kirui	Kenya Data Networks
21	John M. O	University of Nairobi
22	Alfred Ondit	KGVI
23	Simon G	Zico Hard
24	Bernard Gathu	Research International (EA) Ltd
25	Duncan Mutuku	Pamatuta Ent.
26	Franklin Shitubi	East African Educational Publishers Ltd
27	Victor Nyangorora	East African Educational Publishers Ltd
28	Joy Mwihia	Architectural Association of Kenya
29	Fred Manyalleh	International Supply Chain Solutions
30	Joseph Maina Ngumi	Kenya Private Sector Alliance/National Association for Technology Transfer and Entrepreneurial Training
31	Dr. Aghan Oscar	A.J. Oscar
32	Mwacheda S.J Robert	SISDO
33	James Ngugi	ARCIN Kenya
34	Phillip Okumu	PPOA
35	Luke Ombati	TMS Consulting Group
36	Peter Majango	Mabati Rolling Mills
37	Martin Ngugi	
38	Gloria Ndekei	Federation of Kenya Employers –International Labour Organization
39	Jeffrey Kimeu	Carewell Society
40	Francis Mwangi Mungai	Rural Aid Kenya Training Institute
41	S.K Rugere	Sunrose Investment
42	Thomas Kipkorir Yego	Rural Aid Kenya Training Institute
43	Wyclief Onyimbo	Blue Print Tech
44	D. M. Nguyo	ISK

APPENDIX III: STAKEHOLDERS FEEDBACK

STAKEHOLDERS BRIEFING WORKSHOP

Study of the operations of procurement and supply in Kenya with respect to small and medium sized enterprises

Introduction

The workshop took place at the Nairobi Safari Club, Lillian Towers, Nairobi on 15th November 2007, and was attended by stakeholders from the public, private and NGO sectors.

The findings as documented in the draft report were presented to the stakeholders who sought clarifications and made comments and suggestions, which constitute the contents of this appendix.

Procurement Documents

It was observed that SME found procurement documents complex, particularly those used for donor and government-funded procurement. Most of the information and requirements sought in these documents are beyond the reach of the SME.

Recommendation

The documents for procurement targeting SME should be simplified. Negotiations for donor-funded procurement should cover simplification of the documents among other issues.

Information Gap

The major impediment to access to procurement opportunities by SME is the lack of information about the opportunities.

The foregoing scenario notwithstanding, evidence from the research shows that procuring entities in all the sectors have procurement policies, but they are not fully adhered to.

Recommendations:

- It was agreed that the recommendations in this regard that are documented in the draft report be considered for implementation by all procuring entities in the public, private and NGO sectors.
- Enforcement of the policies should be strengthened in all the sectors through training and simplification of policy instruments.

The Sessional Paper No 2 of 2005: Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction

The stakeholders observed that the Sessional Paper No 2 of 2005 directed that 25% of public procurement be set aside for SME. They asked whether the policy was being implemented or not.

In response, it was reported that this policy (as stated in the draft report) had not been enacted into an Act of Parliament. The particular preferences stipulated in the sectional paper were also not incorporated in the Public Procurement and Disposal Act, 2005.

However the PPDA provides for preferences and reservations that favour SME by providing different forms of thresholds, but they are not being applied by most of the procuring entities.

Recommendation:

The policy instruments prepared by different public institutions that address the plight of SME need to be harmonized by one SME oversight unit, which should ensure that such policies are enacted as Acts of Parliament or used to amend the existing law. For example, capital access should be incorporated into the Micro Finance Bill awaiting enactment. Also, procurement-related matters should be used to improve the PPDA and the Regulations.

It was suggested that there should be formative action in favour of SME for procurements valued at KSh. 1 million and below.

Protection of People who Refuse to take Corruption-Related Instructions from their Superiors

The general lack of good procurement governance, and in particular the problem of corruption-related instructions, warrants serious attention, according to the stakeholders, because procurement personnel do become vulnerable and are not protected against victimization. Questions arose as to how such personnel can be protected.

It was generally agreed that one major protection is adherence to documented procurement systems and procedures, and another is upholding unimpeachable integrity.

It was also noted that professionalism in procurement as underscored in the PPDA is already being enforced. The Supplies Practitioners Management Act, which was enacted recently through the initiative of the Kenya Institute of Supplies Management, will also enable the

enforcement of procurement professionalism in both the public and private sector.

Motivations of Procurement Staff

Better remuneration of procurement personnel was considered a motivating factor that could minimise procurement corruption. However, it is widely believed that high remuneration has not deterred procurement corruption.

To discourage undue influence arising from wide disparities in income between sellers and buyers, efforts are underway, particularly in the public sector, to review the scheme of service that spells out career and salary structures and professional qualifications for advancement. However, it was emphasized that corruption stems from an attitude that must be changed.

Public Procurement Oversight Authority (PPOA): Efforts in Support of SME

The representative of the Interim Director General of the PPOA reported that the PPOA is doing the following:

- Monitoring implementation of procurement policies to ensure that SME are accorded opportunities to participate in public procurement.
- Building capacities of procurement personnel to ensure that procurement is carried out effectively and efficiently.
- Building suppliers' capacity so that they are better able to transact business within the public sector.
- Arranging public forums to solicit feedback from stakeholders on the implementation of procurement policies.
- Improving the provision of information about procurement opportunities by putting in place communication channels such as web sites at the PPOA and within procuring entities.
- Ensuring e-procurement is practiced in collaboration with the e-Government Secretariat in the Office of the President.
- Consulting with banks to ease access to financial resources by SME.
- Benchmarking policies that have been put in place by other countries to enable SME to access procurement opportunities. The South African model is one of the policies being considered.

The Delegated Role of Kenya Institute of Supplies Management (KISM) as Stipulated in the Supplies Practitioners Management Act

The stakeholders observed that various provisions in the Supplies Practitioners Management Act seem to delegate oversight

responsibilities to KISM. The stakeholders recommended that KISM should have advocated for the establishment of an inspectorate unit for effective oversight function and enforcement of the Act. It was emphasised, however, that the Act encourages collaborative approaches to its enforcement through bodies established by the Act, which are composed of a wide spectrum of stakeholders' representatives. In most cases, the stakeholders will be involved in implementing the Act.

Inadequate Time for Realising Return on Investment Employed by SME, such as Hired or Leased Plant for Annual Works Contracts

A concern was raised by one of the stakeholders that a duration of one year for works contracts where plants and machinery are hired or leased is not enough to recover capital investment.

Recommendation:

Multi-year contracts should be formulated in line with the multi-year procurement planning provision of the Public Procurement and Disposal Regulations, 2006, Article 20 (3). Procuring entities should implement this provision so as to provide adequate time for the recovery of capital investment where heavy investments are involved.

Distribution of the Final Report for Action

Stakeholders wanted to know how copies of the final report will be distributed and who is expected to take action on the report.

In response, the audience was informed that the key decision makers will be given the final report for implementation, and that a forum will be organized at an appropriate time to provide feedback to the stakeholders, and to enable access to the document through agreed web sites.

Comments by the Finance Sector Deepening (FSD) Representative

The representative of the FSD informed the stakeholders that FSD is working with key partners to facilitate access to finance for Small and Medium sized Enterprises (SME). He added that FSD as a trust was formed in 2005 with the main objective of enabling the growth of the private sector. He said that to date, access to financial resources is still considerably low, hence the need for more efforts to realize the objectives.

In conclusion, the FSD representative expressed his appreciation for the findings and recommendations made in the draft report, which he said would be used for further research.

APPENDIX IV: SUMMARY OF KEY FINDINGS AND RECOMMENDATIONS

FINDING	RECOMMENDATIONS
A. The Information Gap	
<p>Access to the following information needs to be improved for SMEs:</p> <ul style="list-style-type: none"> • Information on what tenders are being placed and who has won the tenders, • Information regarding what rights and duties suppliers have to public procurement entities, • What financial mechanisms are in place to support their businesses, • Knowledge of the procedures, processes, duties and obligations relating to the implementation of the PPDA and Regulations. 	<ul style="list-style-type: none"> • Setting up of tender notice boards outside relevant institutions countrywide. These boards would allow purchasing/procurement officers (POs) to place notices of tenders and their awards. • Distribution of a calendar showing the workings of the PPDA, Supplies Practitioners Management Act and access to finance. It is suggested that KISM enter into discussions with financial sponsors like Equity Bank to fund a calendar that would outline the provisions of the Act in a simplified manner, as well as indicate relevant financial mechanisms Equity has available to suppliers. • KISM could lobby for procurement entities to hold annual supplier conferences at the time that they announce their annual tender requirements. • Supplements in daily newspapers.
B. Public entity procurement inefficiencies	
<p>The following inefficiencies are endemic in the public entity procurement process:</p> <ul style="list-style-type: none"> • Poor procurement planning, • Delayed payments, • Corruption, • Poor training (this aspect also relates to access to information). 	<p>Political will to enforce legislation needs to be strengthened. KISM and the Public Procurement Oversight Authority (PPOA) should ensure that the GOK is made aware of how much non-enforcement of policies costs the country.</p> <p>Some form of data collection could be established by the GOK on the award of tenders.</p>
C. Lack of supplier development mechanisms	
<p>There are no mechanisms in place to assist existing suppliers improve their performance. This hinders growth on the part of the supplier and drives up costs to the procuring entity.</p>	<p>The generally long-term nature of procurement and supply relationships between private sector entities and suppliers provides an ideal opportunity to facilitate business development services (BDS) to these companies. Many BDS providers are unaware that these relationships exist. Linking them to corporates so that they may assist the corporates' suppliers to grow and become more efficient would be in the interest of all parties.</p>
D. Access to credit	
<p>Access to credit is a generic constraint to SMEs.</p>	<p>One area that is not currently served is the corporate practice of giving advances to suppliers.</p> <p>There is an opportunity for a financial institution to take over this function and run it on behalf of corporates. This would relieve the corporate of the administrative burden, and would give the financial institution the ability to sell other financial products.</p>



