



The KENYA INSTITUTE for PUBLIC
POLICY RESEARCH and ANALYSIS

Policy Brief

No. 16/2007

Improving public policy making for economic growth and poverty reduction

How Should MSEs be Supported to Access the Public Procurement Market in Kenya?

Whereas market access remains a major growth factor for enterprises, most micro and small enterprises (MSEs) in Kenya face formidable market-related constraints. This has been worsened by the shrinking domestic market in response to liberalization and globalization. However, the public procurement market in Kenya is huge, estimated at about 9 per cent of GDP, or equivalent of Ksh 71 billion annually. Yet, this market is dominated by large enterprises at the exclusion of MSEs. In view of this fact, *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction* introduced an affirmative policy of reserving 25 per cent of all government procurement and tenders to the MSE sector. However, this policy proposal is yet to be translated into implementable strategies and guidelines. In addition, it is not supported by an enabling business environment, and lacks an accompanying legislation as is the practice in countries with established affirmative public procurement programmes for MSEs. It is doubtful, therefore, that MSEs in Kenya would take advantage of the provisions in the Sessional Paper.

Public Procurement Barriers for MSEs in Kenya

Micro and Small Enterprises face a number of constraints that inhibit their ability to compete in government procurement markets. The following are some of the key barriers facing MSEs in accessing the public procurement market in Kenya.

Costly government procedures and technical documentation

In Kenya, the barriers to entry for MSEs into the public procurement market are quite evident from the standard tender documentation by the Directorate of Public Procurement. For instance, tenderers involved in procurement of "small works" are expected to provide: (1) A certificate of registration; (2) Monetary value of construction work for the past five years; (3) Five year past experience of works of similar nature and references, and equipment owned; (4) Experience and qualifications of technical personnel; and (5) Five year audited financial reports. Since most MSEs are informal (88.6% of MSEs have no business registration of any kind), the requirement of legal

capacity will keep them out of public contracts. The informality disadvantage will further worsen their ability to meet other requirements such as '5-year experience'.

Whereas these requirements are in the government interest of formalizing MSEs, the costs of formalization are phenomenal. To establish and operate a business in Kenya, investors have to undergo several stages of interaction with various government agencies to obtain all the necessary permits, licenses, approvals and clearances. These include registration for VAT, income tax (PIN), NHIF, NSSF and so on.

Slow payment cycles

Cash flow is a critical issue for the survival of small enterprises. Such enterprises are unable to obtain sufficient credit or surety to finance a procurement contract for more than just a few weeks. They lack the capacity to pursue debt collection beyond the

This policy brief is based on KIPPRA Discussion Paper No. 65 on Supporting MSEs Access to Public Procurement Market in Kenya, by Peter Njiraini and Eliud Moyi.

usual delivery of an invoice and may not be able to pursue delayed payment in formal legal proceedings. MSEs require a fast enough payment system to sustain their working capital and sales. For such enterprises, the slow process of payment is a major hindrance to participation in public contracts.

Contract aggregation

In order to achieve value for money in public procurement, contract aggregation or contract bundling is applied so as to achieve economies of scale. In Kenya, most government ministries invite tenders for pre-qualifications of numerous goods and services at the same time, especially at the end and beginning of the financial year. Obviously, this constitutes a barrier to MSEs' participation since they are not able to meet the financial costs.

Costly appeal system

The cost of seeking legal recourse against the government, and the cost of dispute resolution or litigation are relatively high. In Kenya, the cost of enforcing contracts for businesses takes on average 25 procedures and 360 days. Many MSEs constrained by human and financial constraints cannot afford such costs. Unlike large enterprises, MSEs are unable to hire legal experts due to the fixed cost effects. Such high costs prevent MSEs from seeking legal redress in case of, for example, slow or delayed payments.

Inaccessibility to procurement information

The various stages in a procurement process illustrate locations of particular barriers to MSEs accessing government contracts. For instance, MSEs find it difficult to get information on contract opportunities that are below the prescribed threshold for national advertising. The law requires procuring entities to advertise their tender requirements in at least two daily newspapers of nation-wide circulation or in their websites where they have a website. This requirement is, however, for tenders that are equal to or more than the prescribed threshold for national advertising. This means that access to procurement information for lower value contracts is not available to most MSEs. For most MSEs with limited resources and capacity, the lower value contracts are more important than the larger contracts. Secondly, important sources of information for most MSEs is not from newspapers but from other informal networks.

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Pre-qualification requirements

The volume of information required at the pre-qualification stage is enormous, yet there is no guarantee of moving to the invitation to tender stage. Each public sector institution asks for similar information but since it is given in different formats, an MSE has to spend a lot of time. Pre-qualification information can at times run into several pages. MSEs may lack resources to compile such onerous pre-qualification and tendering information. In such cases, government policy or procedures requiring pre-qualifications, that apply equally to all firms generate some fixed cost effects that in turn create a competitive disadvantage for smaller firms.

Past performance and experience requirement

One requirement for award of contract is "past experience and proven capability requirement". However, there is a difference between experience and past performance. For many MSEs, especially the start-ups, they may not have much experience and therefore such a requirement has an effect of locking out many of them. Furthermore, experience may not necessarily translate into good performance.

Tender security guarantee

Securing a performance guarantee implies that financial institutions warrant that the contractor

will perform all the terms of the contract. In the event that the contractor fails to successfully fulfill the contract, the guarantor has an option of either paying the government the guaranteed amounts or looking for another contractor to complete the contract. Financial institutions normally have very limited faith in MSEs and are unwilling to offer them guarantees due to the perception that they pose high performance and liquidity risks. The requirement for a bank guarantee from a reputable bank effectively excludes many MSEs who cannot obtain bank guarantee. Even those that are able to obtain one are likely to get it from some of the non-reputable or small banks.

Policies to Lower Procurement Barriers

Different governments have applied varied approaches to enhance the involvement of MSEs in public procurement. The following interventions could open up public procurement opportunities for MSEs in Kenya.

Establish the National Council for Small Enterprise (NCSE)

Case studies indicate that flexible institutional coalitions involving public, private and MSE organizations are important. Kenya should, therefore, enact the MSE Bill in order to establish the National Council for Small Enterprise (NCSE). The NCSE would cope with the inefficiencies of poorly functioning public procurement systems by absorbing significant amounts of the transaction costs for both the MSEs and the government. This should institutionalize the standard practice in countries such as India, United States or Brazil where "one-stop-shop" institutions serve as intermediaries between the small enterprises and public entities. It is, however, important to create NCSE at the national level as well as at devolved levels to avoid the pitfalls of over-centralized institutions. The NCSE would remove barriers to MSE participation in public procurement by lowering bureaucratic red tape, target procurement related assistance to MSEs, establish taskforces and create MSE specific sub-institutions.

Establish Tender Advice Centres under the proposed NCSE

The centres should mobilize tenders, encourage formalization of MSEs and enhance the capacity

of MSEs to access government procurement opportunities. The centres should store and disseminate information, facilitate timely availability of tenders, demystify tender regulations and procedures, and counsel MSEs on government tendering. The centres should set up group-purchasing schemes for MSEs that will enable them to purchase raw materials at discounted prices.

Similarly, tender advice centres could implement the tender break-out and set-aside policy. Ideally, NCSE Procurement Representatives could be stationed within the government purchase departments. Their work would be to collect data and advocate for contracts breakout into items for full and open competition, thereby enhancing participation of MSEs. In addition to the breakouts, the NCSE Procurement Representatives should promote MSE set-asides that encourage reserving some contracts for MSEs.

Establish preferences, sub-contracting thresholds and incentives

MSEs participate in public procurement either as prime contractors or as sub-contractors, suppliers, manufacturers or service providers to the prime contractors or in some point in the delivery chain. Policy should establish clear benchmarks (or thresholds) of contract amounts that must be subject to sub-contract. It should encourage prime contractors to sub-contract part of the contracts to MSEs by, for instance, requiring that a large firm is awarded a contract on the requirement that a specific percentage of the contract will be

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sub-contracted to small enterprises. Thus, bidders would score higher points for proposing adequate sub-contracting plans involving MSEs as well as higher points for bidders forming consortia that include MSEs as partners. Alternatively, the contract could specify the purchase of a certain proportion of intermediate inputs from MSEs.

Where compulsion is not appropriate, the government can use incentives such as "Awards of Distinction or Award for Excellence" for large enterprises that have established sub-contracting arrangements with small enterprises. In addition, the government should develop guidelines that ensure contracts are unbundled by ensuring larger companies procure works in the smallest practicable quantities, obligating prime contractors to engage MSEs in the performance of their contracts in terms of resource specifications, enhancing structured joint venture between smaller and large enterprises, engagement of third party management support to enterprises that are not capable of operating as stand-alone or prime contractors.

In addition, it is possible to establish price preference programmes. Such programmes give preferential treatment in purchases and prices for goods produced by MSEs. Price preferences may target wholly or partially locally produced goods and goods and services produced by MSEs. Under this approach, MSEs could be entitled to, say, price preferences of up to 15 per cent on merit when competing with large enterprises. The price preferences are, however, dependent on the circumstance and the

merit of each case. A standing committee at the level of the NCSE should be established with the mandate of continuously reviewing the reserved list.

Electronic procurement

Establishment of electronic databases for prospective MSE bidders should reduce the government transaction costs. The government, through the NCSE, should advertise public tenders on-line. On receipt of a call for tender proposals from the government, the proposed NCSE should immediately notify the MSEs through various means, including: (i) one minute daily radio announcements; (ii) posting it to its own website; (iii) or posting it on its premises. Failure by government agencies to notify the NCSE in time should lead to challenge and eventual cancellation of tender awards. The NCSE should host an Internet-based database containing profiles of registered MSEs, government, quasi-government agencies and public prime contractors. The database should be available to central and local government agencies as well as prime and other contractors free of charge. It should be updated weekly. It should facilitate and expedite procurements from MSEs at low cost for the seller and the buyer.

Guarantee Fund

The government should establish a National Guarantee Fund, classifying contracts according to risk exposure thereby tying bond levels to risks, and underwriting of guarantees by development agencies and contractor associations.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity of public policy makers in Kenya. KIPPRA acknowledges support from the Government of Kenya, the European Union (EU), the African Capacity Building Foundation (ACBF), and all other development partners who have supported the Institute's activities.

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