African Journal of Emerging Issues
Peer reviewed | Double blind | Interdisciplinary

African Journal of Emerging Issues (AJOEI)
Online ISSN: 2663 - 9335
Available at: https://ajoeijournals.org

ENTREPRENEURSHIP

RETHINKING OPEN COMPETITION: HOW RESERVATION & PREFERENCE SCHEMES SHAPE MICRO, SMALL, AND MEDIUM ENTERPRISES (MSMES) PERFORMANCE DYNAMICS IN KENYA

[1]Paul Wanjora Kariuki, [2]Dr. Wycliff Arani & [3]Dr.Catherine Njoki

[1,2&3]School of Business and Economics, Zetech University

***Email of the Corresponding Author: kariukipaul@zetech.ac.ke**

Publication Date: July, 2026

ABSTRACT

Purpose of the study: This study examines the pathways through which preferential policies and reservation schemes influence the performance outcomes of Micro, Small, and Medium Enterprises (MSMEs). It specifically focuses on how these mechanisms shape enterprises dynamics within Kenya.

Problem statement: Reservation and preference schemes such as public procurement quotas, preferential credit, and targeted support policies have emerged globally as tools to enhance the performance of Micro, Small, and Medium Enterprises (MSMEs). Despite widespread implementation, theoretical explanations of how these mechanisms influence MSME outcomes remain fragmented and contextually uneven. The Access to Government Procurement Opportunities (AGPO) program, in Kenya reserve 30% of public tenders for marginalized groups, actual participation remains low (averaging 18%), highlighting a significant gap between policy intention and realized performance gains.

Methodology: The study employed a systematic theoretical literature review, synthesizing peer-reviewed research from 2000 to 2025 retrieved from Scopus and Web of Science. It integrated perspectives from Institutional Theory and the Resource-Based View (RBV).

Results: Findings indicate that these schemes improve market access and stabilize revenue, but their effectiveness is heavily dependent on institutional quality and firm-level absorptive capacity. Multi-dimensional policies combining financial support, capacity building, and market access produce the most sustained outcomes.

Conclusion and recommendation: Reservation schemes alone are insufficient; they must be embedded within broader enterprise development ecosystems. It is recommended that AGPO be integrated with capacity-building and financial support to translate market access into measurable growth and innovation

Keywords: *Open competition, Reservation and preference schemes, MSMEs, performance*

INTRODUCTION

Public procurement has become an important policy instrument for promoting inclusive economic growth, particularly through expanding market access for micro, small, and medium enterprises (MSMEs), women-owned firms, youth enterprises, and businesses owned by persons with disabilities. Governments increasingly use reservation schemes, set-asides, and preference margins to address structural barriers that exclude MSMEs from formal contracting opportunities (World Bank, 2024; UN Women, 2025). This shift reflects recognition that procurement is not only an administrative supply chain function, but also a mechanism for industrial development, employment creation, and social inclusion.

Institutional theory provides a useful lens for understanding these interventions. Rather than viewing markets as neutral spaces governed only by price competition, institutional scholars argue that markets are shaped by laws, norms, and administrative systems that determine which actors can participate and succeed (Scott, 2014).

Public procurement policies therefore influence competition by redefining eligibility criteria, evaluation standards, and access to state demand. In principle, such policies can help MSMEs overcome scale disadvantages; weak market linkages, and limited reputational capital. However, institutional support does not automatically translate into firm growth, because access may still be constrained by bureaucratic complexity, delayed payments, compliance costs, and weak implementation capacity (OECD, 2023).

Globally, public procurement accounts for a significant share of economic activity, estimated at between 12% and 15% of GDP in many economies, making it one of the largest channels through which governments influence private sector performance (World Bank, 2024). Evidence from developed and emerging economies shows mixed outcomes. In some contexts, preferential procurement has increased supplier diversity, local enterprise participation, and employment creation. In others, benefits have been limited by elite capture, low contract absorption, fronting practices, and overdependence on state contracts. This contradiction suggests that procurement preferences alone are insufficient unless accompanied by finance access, supplier development, and transparent enforcement systems (ILO, 2024; UNCTAD, 2023).

In Kenya, this debate is particularly relevant because MSMEs remain central to employment generation and local economic activity. The Access to Government Procurement Opportunities (AGPO) programme, introduced under the Public Procurement and Asset Disposal framework, reserves 30% of public procurement opportunities for youth, women, and persons with disabilities. The policy sought to correct historical exclusion and integrate disadvantaged enterprises into public markets. While AGPO has increased registration and awareness, empirical evidence indicates that many eligible enterprises still struggle to secure, execute, or scale from awarded contracts due to financing constraints, delayed payments, information asymmetry, limited technical capacity, and administrative burdens (PPRA, 2024; KNBS, 2024).

A study conducted by Kinyua and Gathenya (2022), concluded that an inclusive public procurement expanded procurement access, institutional support and technical capacity for MSMEs. Additionally, there exist a positive relationship between access to public procurement opportunities and income growth, employment creation, and business sustainability by youth-owned enterprises (Mwangi and Kariuki (2019). Empirical evidence consistently shows that reservation and preference schemes promote inclusivity and expand MSME access to government procurement (Mwangi & Kariuki, 2019; Kinyua & Gathenya, 2022). However, the effectiveness of these schemes is conditional on institutional and procedural efficiency. MSME access but is constrained by procedural barriers and weak institutional support.

Despite substantial policy attention, existing studies in Kenya remain heavily descriptive, focusing on uptake levels, registration numbers, or general implementation challenges. Less attention has been given to whether procurement preferences translate into measurable MSME performance outcomes such as revenue growth, innovation, business survival, asset accumulation, or competitive capability. There is limited empirical evidence on whether reservation and preference procurement policies in Kenya improve MSME performance or merely expand nominal access without sustained business growth.

Accordingly, the key analytical issue is not whether procurement preferences exist, but whether they generate meaningful enterprise outcomes. Examining this relationship helps move the discussion beyond policy rhetoric toward evidence on how inclusive public procurement shapes MSME competitiveness, resilience, and long-term growth in Kenyan context.

STATEMENT OF THE PROBLEM

MSMEs are vital to Kenya's inclusive economic growth, but despite policies like AGPO that reserve 30% of public tenders for youth-, women-, and PWD-owned enterprises, actual participation and resulting performance improvements remain low sometimes only 18–20% highlighting a gap between policy intentions and real outcomes (Otieno & Kiraka, 2023).

In Kenya, special groups constitute over 85% of the population but account for less than 10% of public procurement participation, limiting progress toward Vision 2030 (Transparency International, 2010).

Preference and reservation schemes, particularly the Access to Government Procurement Opportunities (AGPO) program, in Kenya, was initiated in 2013 to economically empower women, youth, and persons with disabilities (PWDs) by allocating 30 per cent of all public procurement budget to them however, actual uptake averages only 18% nationally remains significantly below this target, revealing a gap between policy intention and realized outcomes (Murunga *et al*., 2021; PPRA, 2023; KAM, 2019). MSMEs despite the legal framework of the AGPO program in Kenya, which mandates a 30% reservation for youth, women, and persons with disabilities (PWDs), actual uptake remains stagnant at approximately 18%. While these special groups constitute over 85% of the population, they account for less than 10% of total public procurement participation.

In Kenya, MSMEs faces structural inequalities that suggest a reliance on open competition may deepen exclusion. This disconnect indicates that current procurement opportunities are not effectively translating into meaningful performance improvements or socio-economic impact. If this problem remains unresolved, inclusive public procurement policies may continue to yield limited socio-economic impact, perpetuating inequality and enterprise stagnation. Although prior studies have examined MSME support and public procurement, existing literature is fragmented in theory and context, with limited empirical focus on how preference and reservation schemes specifically influence MSME performance in Kenya. This study, therefore, seeks to examine the influence of preference and reservation schemes on the performance dynamics of MSMEs in Kenya.

RESEARCH OBJECTIVES

The general objective of this study is to examine how preference policies and reservation schemes shape the performance dynamics of Micro, Small, and Medium Enterprises in Kenya.

RESEARCH HYPOTHEIS

H01: Reservation and preference schemes have no statistically significant effect on the performance dynamics of Micro, Small, and Medium Enterprises in Kenya.

THEORITICAL REVIEW/ FRAMEWORK

The influence of preference and reservation schemes on MSME performance can be explained through Institutional Theory and the Resource-Based View (RBV). Institutional

Theory argues that organizations operate within regulatory and normative environments that shape their legitimacy and access to opportunities (Meyer & Rowan, 1990; Scott, 2014). Reservation and preference procurement schemes act as formal institutional mechanisms that reduce structural barriers for marginalized enterprises by granting them recognized status within public markets. Through policy-backed legitimacy, MSMEs gain improved visibility, credibility, and access to government contracting systems that were previously difficult to penetrate.

Resource-Based View (RBV) focuses on how firms convert opportunities into competitive advantage. While reservation schemes provide the opportunity structure, the RBV suggests firms must develop internal strategic resources such as managerial expertise and financial capital to effectively utilize these contracts (Barney, 1991).Participation in public procurement can enable MSMEs to accumulate strategic resources such as financial capital, managerial expertise, reputational assets, and relational networks (Kamasak *et al*., 2020). However, RBV suggests that access alone is insufficient; firms must possess or develop internal capabilities to effectively utilize procurement opportunities. Thus, reservation schemes create the opportunity structure, while firm-level capabilities determine performance outcomes.

EMPIRICAL REVIEW

Reservation and preference schemes have been widely adopted to promote inclusivity in public procurement by expanding opportunities for historically disadvantaged groups and smaller enterprises. In Kenya, the Access to Government Procurement Opportunities (AGPO) initiative was established to reserve at least 30% of public procurement opportunities for youth, women, and persons with disabilities. Similar approaches in other jurisdictions suggest that procurement preferences are most effective when combined with complementary support systems such as financing, supplier development, and institutional capacity building rather than operating as stand-alone access measures.

Global experience illustrates this pattern. The United Kingdom’s Procurement Act 2023 links SME participation in procurement to broader objectives of economic growth, innovation, and community benefit. In Brazil, procurement reforms that favoured micro and small enterprises were strengthened by enterprise support measures, contributing to increased SME participation and competitiveness. Comparable initiatives in the Netherlands and the United States have also integrated procurement access with labour market inclusion programs, supplier diversity systems, financing channels, and technical assistance. Across these contexts, evidence suggests that access to contracts alone rarely guarantees enterprise growth; outcomes depend on whether firms possess the resources needed to execute contracts, scale operations, and remain competitive (OECD, 2024; UNCTAD, 2023).

In Kenya, AGPO has improved formal access to government tenders by increasing registration and awareness among eligible enterprises. However, evidence on its effect on MSME performance remains mixed. Many firms continue to face delayed payments, procedural complexity, information gaps, limited managerial capacity, and weak institutional support, all of which reduce the ability of enterprises to convert awarded tenders into sustained growth, employment expansion, or innovation (PPRA, 2024; KNBS, 2024). This indicates that policy access and actual enterprise performance are not synonymous.

Empirical studies support this distinction. Kinyua and Gathenya (2022), using mixed methods across several Kenyan counties, found that although AGPO expanded procurement access, institutional support and technical capacity were more decisive for firm performance than the policy itself. Procedural barriers, inadequate information, and administrative inefficiencies limited outcomes for many SMEs. Similarly, Mwangi and Kariuki (2019), examining youth-owned enterprises in Nairobi County, reported a positive relationship between tender access and income growth, employment creation, and business sustainability, but noted that delayed payments and inconsistent implementation weakened these gains.

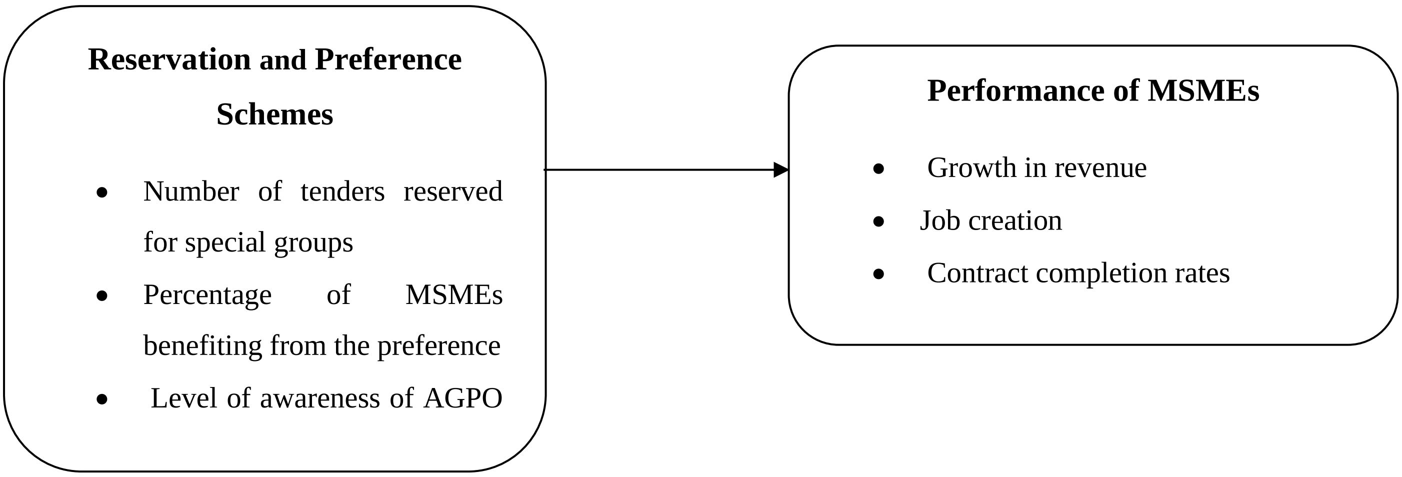
Firm-level capability studies reinforce the same conclusion. Kamasak *et al*. (2020) found that internal resources such as strategic planning ability, innovation capacity, and organizational competence significantly influenced procurement success among SMEs. Enterprises with stronger internal capabilities were better positioned to win contracts, meet delivery requirements, and translate procurement opportunities into broader performance gains. Their findings suggest that procurement preferences create openings, but firm capabilities determine whether those openings generate lasting value.

Despite these insights, much of the existing literature remains cross-sectional, descriptive, and localized. Most studies measure access indicators such as registration, tender participation, or contract awards, while giving less attention to long-term performance outcomes such as revenue growth, productivity, competitiveness, survival, or innovation. There is also limited theoretical integration explaining how institutional support systems and firm capabilities interact over time. This leaves an important gap in understanding whether reservation schemes produce sustained enterprise development or only short-term participation gains. The gap is particularly significant in Kenya where procurement opportunities are concentrated but competition, compliance demands, and operational costs are also higher than in many other counties

Overall, the literature suggests that reservation and preference schemes function as institutional and strategic tools that can expand access, confer legitimacy, and facilitate resource accumulation. However, their developmental impact depends on whether they are embedded within broader enterprise ecosystems that provide finance, managerial training, timely payment systems, and transparent governance. Without these complementary mechanisms, procurement preferences risk increasing participation statistics without producing measurable improvements in MSME growth, innovation, or long-term competitiveness

CONCEPTUAL FRAMEWORK

According to Kothari (2014) and Mugenda & Mugenda (2013), a conceptual framework illustrates the relationship between independent and dependent variables, often through a diagram. Independent variables are presumed causes or influencers—also known as predictors or antecedent variables while dependent variables are outcomes that rely on these influences. In this study, the conceptual framework consists of four independent variables, one moderating variable, and one dependent variable, with the framework helping visualize how these variables interact.



Independent variable **Dependent variable**

RESEARCH METHODOLOGY

Systematic theoretical literature review was conducted following a structured protocol. The researchers searched Scopus and Web of Science for literature published between

2000 and 2025 using terms related to "preferential procurement" and "MSME performance". In addition, grey literature such as PPRA reports, county records, theses, and policy documents were used.

RESULTS AND DISCUSSIONS

From an Institutional Theory perspective, reservation and preference schemes operate as formal rules that reshape competition by altering eligibility criteria, bid evaluation processes, and access to state demand. Quotas, set-asides, and stated preferences can lower entry barriers for historically excluded firms and provide official recognition that may enhance legitimacy, reduce perceived risk, and encourage formalization. However, evidence also shows that weak enforcement, administrative complexity, corruption risks, and low awareness frequently limit these intended benefits, particularly in developing-country settings.

From the Resource-Based View, procurement access matters because it can help firms accumulate strategic resources that support performance. Repeated contract opportunities may strengthen cash flow stability, improve reputational standing, expand market networks, and enhance managerial learning through contract execution. In some cases, firms use procurement revenues to invest in equipment, staff, and process improvements. Yet these outcomes are not universal. Many MSMEs struggle to convert contract awards into sustained growth because they lack working capital, technical capacity, production scale, or compliance systems required to deliver effectively.

The theory further suggests that multi-dimensional support models generate stronger outcomes than quota only systems. Where reservation schemes are linked to supplier training, quality assurance support, advance payments, credit access, and transparent monitoring, firms are more likely to achieve revenue growth, innovation, and long-term competitiveness. By contrast, schemes relying solely on quotas often produce weaker or short-lived gains, with some firms participating nominally while remaining financially fragile or operationally constrained.

Training in tendering procedures, financial management, reporting standards, and technical delivery can improve organizational readiness. Frequent engagement with public agencies may also increase institutional familiarity and confidence. However, when institutional systems themselves are weak through delayed payments, poor communication, inconsistent enforcement, or burdensome procedures even capable firms may underperform.

Current research remains uneven. Much of the stronger empirical literature comes from developed economies with more mature procurement institutions, while studies in developing economies are fewer, more localized, and often descriptive. This creates a need for context-sensitive evidence on how reservation and preference schemes affect MSME performance in Kenya.

CONCLUSIONS

The review concludes that reservation and preference schemes function as essential institutional tools that grant legitimacy and market access to MSMEs. Reservation and preference schemes can enhance MSME performance, but only when both institutions and firms possess the capabilities required to translate policy access into measurable and sustained business outcomes.

However, access alone does not guarantee performance; competitive advantage is ultimately determined by the organization's internal resources and how they are applied. Current evidence highlights a geographic bias toward developed economies, leaving a gap in longitudinal data regarding how these effects evolve in Kenya.

RECOMMENDATIONS

Reservation and preference schemes should be implemented as part of a broader support system rather than relying on quotas alone. Their effectiveness depends on simplified procedures, transparent governance, timely payments, and access to finance to enable MSMEs to execute contracts and manage cash flow. Capacity building in areas such as tendering, financial management, and technical skills is essential for translating procurement opportunities into sustained growth and innovation.

Policy design should also support firm progression from small contracts to competitive markets, while strengthening monitoring systems to focus on real outcomes such as revenue growth, employment creation, innovation, and business survival. Strong safeguards are needed to prevent misuse of the schemes. In Kenya, interventions should reflect local market conditions through digital procurement systems, faster approvals, and targeted supplier development. Overall, procurement preferences are most effective when combined with finance, skills development, and strong institutional governance.

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