PROPOSED REGULATION OF MICRO FINANCING IN KENYA AND THE PROBABLE EFFECTS ON THE INDUSTRY- CASE STUDY APPROACH.

A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF BACHELOR OF LAWS (LL.B.) OF THE UNIVERSITY OF NAIROBI.

BY:

CHRISTINE M. KAMUNCHULUH

NAIROBI SEPTEMBER

2005

DEDICATION

THIS DISSERTATION IS DEDICATED TO MY FAMILY.

To my dearest mum, Margaret Kamunchulu, thank you for your immeasurable love and continued support throughout my life. You have always had faith in my abilities and that has got me this far. Your love and the sacrifices you have made for me is invaluable and I will never find the words to express my eternal gratitude to you.

To my dad, John Kamunchulu, you have taught me to be a responsible person and that the most important things in this world to a person are their hard earned achievements. I emulate you in many ways and that is why I am who I am today.

To my sister, Jacqueline kendi, to me you have always been the one I look up to for guidance whenever I am feeling lost thank you for providing the direction I needed at those times.

To my brother, Anthony Mutua, you have always been my dearest little brother whose love and support I appreciate more than anything in this world.

Thank you all for your love, support, kindness and for being there even when you did not have to be for that has made me who I am and got me this far.

MAY GOD BLESS YOU ALL.

ACKNOWLEDGEMENTS

I would like to greatly appreciate the contribution of the following individuals whose efforts have gone a long way in easing my work.

My sincere gratitude goes to my supervisor, Mrs. Joy K. Asiema an expert in Banking Law not only in this faculty but also in other banking tutoring institutions and a renown & recognised scholar, whose overwhelming support and guidance was indispensable to my work. She was able to squeeze me into her busy schedule which demonstrates her dedication.

Dr. Migai Akech who gave me guidance on my thesis which I applied in my paper.

Mr kimanthi Mutua for finding time in his very busy schedule to provide an insight and an in-depth understanding of the micro financing industry being a writer and expert in the same. In the same spirit I will not forget Harriet Karemi for providing me with the necessary material.

To all my friends: Fridah Akali, Ian Wahome, Jeniffer Mbaluto, Colleta Sigillai, Francis Kinyua, Eric Wanjohi, Nicholas Okemwa and everyone else who contributed directly or otherwise to the success of this paper my sincere gratitude and appreciation.

Last but not least I would like to thank my lord for the blessings that he has endowed me with including the wisdom, knowledge and opportunity to reach this far in my academic journey.

TABLE OF ABBREVIATIONS

MFIS ....Micro Finance Institutions

MSES....................................Micro and Small Enterprises

NGOS...................................Non-Governmental Organizations

K-Rep...................................Kenya Rural Enterprise Programme

AMFI....................................Association Of Micro Finance Institutions

ROSCAs...............................Rotating Savings And Credit Associations

SACCOs...............................Savings And Credit Co-Operative Societies

DTMFB................................Deposit Taking Microfinance Bill

CBK.....................................Central Bank

PFFs.....................................Private Financial Funds (Bolivia)

MFRC...................................Micro Finance Regulatory Council (SA)

BOU.....................................Bank Of Uganda

FIS.......................................Financial Institutions Statute

MDI.....................................Microfinance Deposit Taking Institution

NLR.....................................National Regulatory Council (SA)

TABLE OF CONTENTS

i. Title page

ii. Dedication

iii. Acknowledgements

iv. Table of contents

v. Table of abbreviations

vi. INTRODUCTION.....1

CHAPTER BREAKDOWN

CHAPTER ONE

1.1 Historical Background.....11

1.2 A Brief Look at K-Rep, A Leading MFI.....12

1.3 Services Offered By MFIs.....13

CHAPTER TWO

2.1 The Meaning of Regulation and Supervision.....18

2.2 When should MFIs be subject to regulation.....18

2.3 A look at the provisions of the Deposit Taking micro-finance Bill.....20

2.4 Likely overall effects of the proposed bill on the industry.....26

2.4.1 On the industry.....26

2.4.2 Donor perspective.....27

CHAPTER THREE

A look at case studies from various countries.

3.1 Bolivia..28

3.1.1 Comparison of Bolivia and Kenya................................30

3.1.2 Major Regulatory issues facing Banconsol.......................31

3.2 Bangladesh 33

3.2.1 Existing regulation- The Grameen Bank Charter................34

3.2.2 Comparison with Kenya..36

3.3 Case of South Africa...36

3.3.1 Existing Regulation..37

3.3.2 Comparison with Kenya..40

3.4 Case of Uganda 41

3.4.1 Comparison with Kenya...44

CHAPTER FOUR

4.1 RECCOMENDATIONS..45

4.1.1 Ownership and Governance risk..46

4.1.2 Management risk..47

4.1.3 New Industry...47

4.2 CONCLUSION...48

INTRODUCTION

Micro-financing institutions (MFIs) are organisations that avail financial services (mostly loans and deposits products) to the bulk of the population that has no access to conventional financial institutions such as commercial banks.

Micro finance itself may be defined as the practice of providing financial services to low net worth individuals, households or entrepreneurs (jua kali, mama mboga and the very small businesses operated by the masses in developing countries).

In Kenya small-scale enterprises are defined as those employing not more than 50 employees. According to the Gemini MSE 1993 survey enterprises with more than 50 workers play an insignificant role in job creation in fact they are virtually non-existent while those with 11-50 employees play a minor role and comprise 1% of enterprises nationally. It is the enterprises with between 1-10 workers that make up 99% of the enterprise population.[1] In Kenya it is best described by the *jua kali* activities, which were given presidential approval in 1986 after a visit to Gikomba market.[2]

The goals of micro-financing institutions as development organisations is to serve the financial needs of unserved or under served market as a means of meeting development objectives. These include:

- To reduce poverty.
- To empower women or other disadvantaged population groups.
- To create employment.
- To help existing businesses grow or diversify their activities.
- To encourage the development of new businesses.

---

[1] Study on legal and other constraints on access to financial services draft report by Deregulation Section Ministry of Planning and National Development Government of Kenya

[2] Michael Romer et al 1983 pg556-562

A World Bank study of lending for small and micro enterprise projects in Kenya cited three objectives as being important:

- To create employment and income opportunities through creation and expansion of micro-enterprise.
- To increase productivity and incomes of vulnerable groups especially women and the poor.
- To reduce rural familiar dependence on drought prone crops through diversification of their income generating activities.

Micro-finance institutions have been shown by studies to be growing tremendously especially in the last 15-20 years. They can therefore be described as being ubiquitous as they are found in every corner of the country. This is attributed to the fact that they promise to reach the poor but productive people to generate income through easy savings and loan schemes and few requirements such as collaterals, which are replaced by self co-guaranteeing groups using character-based approaches repayment discipline, and higher repeat and few defaults among the receipts. In Kenya for instance loan repayment rank above 90%; a remarkable feat for entrepreneurs with many needs but few sources. This has encouraged the growth of micro-financing institutions.[3]

However despite this rampant spread and growth of MFIs the industry remains unregulated. It is nevertheless lumped together with all the other non-governmental organisations and loosely co-ordinated by the Non-governmental Organisations Co-ordination Act (1990). NGOs are defined as a private grouping of individuals or associations, not operated for profit or for other commercial purposes but which have organised themselves nationally or internationally for the promotion of social welfare, development, charity or research through the mobilisation of resources. Most MFIs fall into this category for example Jitegemee and Kenya Women Finance Trust.

[3] Sunday Nation/April 17, 2005-Micro-finance Institutions under Renewed Spotlight.

Some MFIs are incorporated under the Companies Act while others operate under the auspices of umbrella organisations such as churches and other voluntary agencies, for example, Kenya Women Finance Trust was formed under the umbrella of its mother organisation World Women Banking before converting into an independent NGO.

Recently there has been a move by MFIs of converting into fully fledged banks, which are governed by the Banking Act and Central Bank Act. K-REP for instance applied for a banking license in 1997 while the latest conversion is that of Equity Building Society which applied for a license in 2004.

The legal and regulatory framework has not been conducive to the development of the MFI sector. The laws either have provisions which show outright hostility to the activities of MFIs or are not sensitive to the needs and situations of these enterprises. This hostility is reflected in the abundance of penal provisions in the legislation such as operating without a business license yet the license is too expensive and most institutions cannot afford to obtain one. An example of laws that are impeding is where a business licensed under the Trade Licensing Act is deemed to be an obstruction under the Local Government Act hence has to be deregistered.[4]

MFIs have sought to address these problems by establishing an Association of Micro Finance Institutions AMFI which among other things seeks to introduce self-regulatory factors in the MFI industry its members are drawn from committed to developing a micro-finance industry to serve the poor and low income people.

[4] *Laws and Regulations Affecting Development and Growth of Micro-finance Enterprises in Kenya*, African Economic and Financial Consultants.

STATEMENT OF THE PROBLEM

There is a lack of specific legislation of the microfinance industry and this has resulted in problems in the industry. The major problem identified is the ambiguity of the industry. Most people do not actually know what comprises an MFI. People seem to have misunderstood the concept of the nature of an MFI. There is therefore a need to formulate regulations that will give a definite structure of the characteristics of MFIs and their nature. In addition to this the MFIs themselves don't have defined structures a good example is the K-Rep Bank that converted from a fully-fledged MFI to a bank.

The question that arises is whether it should still be classified as an MFI since it carries out its lending operations as a normal bank but charges lower rates for banking compared to the other commercial banks, to cater for the poor. However the interest rates on loans remain high which is a typical characteristic of MFIs. The functions of MFIs should also be enumerated and the regulation should aim at streamlining the operations of MFIs.

MFIs have remained unregulated without appropriate policy and legal framework. There is therefore a need to focus more on these institutions to enhance their effectiveness in the provision of savings, credit and other financial services to the poor and MSEs. The challenge facing regulation in this industry is that MFIs range significantly in institutional type, scale of operations and level of professionalism. For example ROSCAs, NGOs and banks all these have varied operation. The MFIs have remained amorphous institutions hence there is need to have a defined mechanism for regulation addressing the microfinance industry bearing in mind the alarming rate at which this industry is growing in a developing country like Kenya.

In my study I will therefore look into the probable effects that will be brought about by the passing of the proposed Deposit Taking Micro-finance Bill (2004) to the industry hence aside from looking at the general effects of regulating the industry I will try to analyse what contribution the proposed bill will bring into the industry.

JUSTIFICATION OF THE STUDY

MFIs play a big role in the country's economic growth as a large number of the population lies within or below the poverty line hence cannot afford the high cost of credit charged by commercial banks. MFIs have therefore usurped the role of these commercial banks. According to the Poverty Reduction Strategy Paper (PRSP) of 1999, a large number of Kenyans derive their livelihood from MSEs. Therefore a development of this sector represents an important means of creating employment, promoting growth and reducing poverty in the long term.

The potential of using institutional credit and other financial services for poverty alleviation in Kenya is quite significant. About 18 million people which is about 60% of the population are poor and mostly out of the scope of formal banking services. According to National and Small Enterprises Baseline Study Survey of 1999 there are close to 1.3 million MSEs that employ nearly 2.3 million people which is about 20% of the total employment and contributes to 18% of the GDP and 25% of the non-agricultural GDP. Despite this important contribution only 10.4% of the MSEs receive credit and other financial services as they are regarded as being risky.[5]

OBJECTIVES OF THE STUDY

1. In a developing country like Kenya, micro financing contributes to 64% of all non-agricultural jobs in Kenya.[6] I will point out the central role played by MFIs in the development of the economy while at the same time looking at their structures and functions in terms of services provided.

2. To look at the incidental laws regulating the microfinance industry, that is, what are the existing laws that currently regulate MFIs considering they are formed as different institutions; some are cooperatives others NGOs and other variant organisations.

[5] Omino George, 'Regulation and Supervision of Micro Finance Institutions in Kenya.', *Essays on Regulation and Supervision*, March 2005, IRIS Center, University of Maryland.
[6] See, 'K-Rep's Appetite Increases', Sunday Standard, April 10th 2005

3. To look into the need for a more specific regulation of the industry.

4. To gain an insight on the international outlook and structuring of micro financing in other parts of the world.

5. To look at the probable consequences of regulation on the growth and development of the industry such as the effect on the number of MFIs and also the sizes of the MFIs in terms of their branches countrywide.

HYPOTHESES

1. The micro-financing industry contributes a great amount to the economy of Kenya by provision of services to the low-income earners. I am seeking to prove that micro financing contributes to the economy through the interest earned from loans, provision of employment opportunities and enhancement of investment by the unemployed population.

2. The existing provisions do not adequately regulate the industry they are incidental to it in that they are not sensitive to the special needs of micro financing.

3. A regulation of the industry will bring about a positive effect to the industry both nationally and internationally. MFIs will now have clearly defined structures with definite and specified activities to carry out.

RESEARCH QUESTIONS

1. I will seek to answer the following questions in pursuit of realising the objectives of my study:
2. What role is currently played by micro financing in Kenya?

3. What is the effectiveness of the current mode of regulation and does it promotes the growth and continuity of the industry?

4. What likely effects will come about from the proposed regulation by the Deposit Taking Micro-financing Bill to the growth of the industry?

5. Is the move towards a regulated industry a move in the right direction in terms of the future of the industry?

THEORETICAL FRAMEWORK[7]

The problem I am seeking to address is the lack of specific regulation of MFIs and the inadequacies of the existing collateral regulations. Currently MFIs are operating under different regulations and the implication of this is that the industry is not properly regulated. This is because the statutes they are operating under are not formulated to specifically address the functions of MFIs as shown below.

NGOs ACT

The MFIs registered under the NGOs Act are not catered for because NGOs are not bound to the same standards of economic performance or financial prudence that may be reasonably expected in the business sector. The NGO parent must set standards appropriate the financial sector for the MFIs to work well in the industry.

COMPANIES ACT

Other MFIs are registered under the companies Act such as Jitegemee Limited these MFIs the problems associated with registering MFIs as companies are the lengthy procedures which must be fulfilled for a company to be registered such as the formulation of the memorandum and articles of association. The registration process is also expensive.

[7] The information on the incidental laws applicable to MFIs in Kenya was obtained by a perusal of the various statutes to determine the extent of their application to the industry.

After registration a company becomes exposed to unnecessary publicity and it has to meet standards set out by the Act such as filing returns and reports this is unnecessarily cumbersome bearing in mind the fact that MFIs are not aimed at profit making.

BANKING ACT

Financing of credit activities by MFIs is not acceptable under the law as MFIs Cannot take deposits from the public unless they are licensed as a commercial bank under the Banking Act.

This means that the MFI has to meet the stringent requirements set out in the Banking Act such as generating a paid up core capital of Kshs. 150,000,000 and it shall increase as per the provisions laid out in the table in the schedule. This is very hard to comply with since most MFIs don't raise capital from the public instead they are donor funded.

CENTRAL BANKS ACT

This Act seeks to regulate the financial institutions that are registered under the Banking Act this will apply to the MFIs that are so registered. The main aim of this Act is to control the operations of these institutions especially pertaining to customer Protection so it has such provisions as the deposit funds trust which sets out the minimum amount that a financial institution should deposit with the central bank. This is curtailing on the operations of the MFIs as they do not hold large amounts of their funds because of the nature of their operations. They deal with small mounts of funds that they loan out to MSEs.

Other statutes that register MFIs are:

- Building Societies Act
- Trustees Act
- Co-operative Societies Act
- Kenya Post Office Savings Bank Act
- Societies Act

METHODOLOGY

In carrying out my study I will make reference to primary documents, these are the current statutes regulating the industry:

- The Non Governmental Organisations Act
- The Banking Act
- The Central Bank Act
- Registration of Business Names Act
- The Local Government Act
- An emphasis will be placed on the Deposit Taking Micro-Finance Bill (2004).

I will also refer to the following secondary sources:

- Articles published by individuals and bodies that carried out studies on the micro-finance industry.
- Textbooks on the microfinance industry- history, regulation and supervision and its operations.
- Journals, magazines and newspaper articles
- The Internet for information on the situation of the industry in other developing countries.

CHAPTER BREAKDOWN

PROPOSAL.

- An introduction to micro financing.
- A statement of the problem.
- Justification of the study.
- The objectives of the study.
- Hypothesis
- Research questions.
- Theoretical framework
- Methodology.

CHAPTER 1.

- A brief history of the development of micro-financing
- A brief description of K-Rep a leading Kenyan MFI and its history
- A breakdown of the operations of microfinance institution, their structure and the services they offer.

CHAPTER 2

- The need for regulating micro-financing
- The way to go about such regulation
- The proposed bill an analytical look.
- The likely effects of the bill.

CHAPTER 3

This will be comparative and I will deal with several case studies of other developing countries and the level of regulation of their micro-financing industries. The countries I will look at are:

- Bolivia as it contains specialised MFI laws case of Bancosol.
- Bangladesh –the case of the Grameen bank which is very similar to our own K-REP
- South Africa- a look at the South African Mutual Banks Act of 1993
- Uganda who's Central Bank recently took over regulation by enacting the microfinance deposit institution act (2003).

CHAPTER 4

- Recommendations of the best way to implement the proposed bill and comment on other regulations that may be required.
- Conclusion on the plausibility of regulating the industry.
- A look at emerging issues in the industry such as the recent issue of a corporate bond by Faulu Kenya and whether it requires specific legislation.

CHAPTER ONE.

1.1 HISTORICAL BACKGROUND

The development of micro-finance industry in Kenya can be traced back to late 1970s and early 1980s when organisations registered under the Non-Governmental Organisations Act were formed. Originally, providers of micro finance services focussed on very small businesses known as micro enterprises hence the term micro finance. The mission of these organisations was to provide financial services particularly credit services to micro and small enterprises whose development had hitherto been constrained by inaccessible credit from the formal banking sector.

The MSEs which comprised of about 1-20 people could not raise the collateral required by commercial banks hence only the large MSEs could access credit facilities from the banks.
There was a need to develop non-bank institutions as an economic development approach intended to benefit low-income people by offering saving schemes credit, some insurance and social intermediation services such as group formation and the capacity to save and repay the loans.

The term micro finance itself evolved form micro credit which changed to micro finance as the services provided by MFIs extended beyond provision of credit today they offer a wide range of services including credit, savings, money transfer, insurance and other banking and financial services. The eighties models of micro finance combined credit and technical assistance and were commonly referred to as integrated systems. In the late eighties the perfection of lending techniques, led to specialisation on credit delivery only. These were dubbed "minimalists" later; a new term financial systems approach was born to depict the emerging focus on building financially stable MFIs.

This model made a radical change from donor funding to self-sustainability and entry to the money market, which eventually led to the regulated financial institutions era that we are still in the process of adapting fully.

Currently there are about 1,000,000 NGOs [8]and other organisations involved in provision of micro-finance directly or indirectly through guarantees or loans for on lending by other MFIs. There are close to 10 serious MFIs, which support about 800,000 to 1,000,000 people. The total number of people supported by MFIs and other institutions offering micro finance services in Kenya is about 6 million with an estimated potential of 15-18 million people.[9] 80% of the population (about 20 million) require financial services and MFIs cover about 20% of this un-served market. MFIs are distributed in almost every corner of the country.[10]

1.2 A BRIEF LOOK AT K-REP, A LEADING MFI.

K-Rep is a private development commercial bank whose core business is micro-finance. It is distinguishable from other commercial banks by its pursuit for *triple bottom line results* – social impact, sustainable development and profits. The social objective is to help reduce poverty. This is addressed by providing banking and financial services to low income and poor people, with the aim of enabling them to better organise their lives, creating employment opportunities and increase their asset base. Sustainable development is an environmental, health and good living issue that the bank addresses by disseminating information to its client. The profit motive is a strategy for creating long-term sustainable development finance institutions that underpin the development of poor people and not an end in itself.

The history of the bank traces back to the evolution of its parent organisation-K-Rep group. Established in 1984 as a USAID project, its original purpose was to support Kenyan NGOs in promoting small businesses by providing grants and technical assistance.

---

[8] The Gemini survey of 1993

[9] Figures were obtained form a survey conducted by K-Rep on the number of people relying on MFIs services in Kenya.

[10] Evidenced by table one which outlines a geographical distribution of the major MFIs in Kenya.

It initially solely depended on USAID as its donor but this was curtailing to its growth hence they introduced a program to directly lend to micro enterprises and secured other donors. This saw the activities of the organisation expanding to include research and development and later a second significant change of creating a bank. The third development was the creation of the K-Rep Development Agency and K-Rep Advisory services in 2001. These two deal with matters of research& innovation, dissemination of information to the industry, and provision of fee based services such as capacity building and training, project management and strategic planning for businesses.[11]

1.3 SERVICES OFFERED BY MFIs

MFIs offer the following types of financial services.

Provision of credit

This involves provision of loan services to SMEs in definite pre-determined amounts with a set out repayment schedule. This is the leading service offered by MFIs, as they do not require collateral unlike commercial banks. Instead, the SMEs are required to open savings accounts with a requirement of a monthly deposit, which acts as security for the loan.

MFIs can also be used to access credit from commercial banks. The members of the group also co-guarantee each other. They offer credit facilities such as business loans, loans for purchase of shares in the stock market most of which are not offered by commercial banks. K-REP, one of the leading MFIs has sub-divided its credit provision population into groups:[12]

Juhudi Loan Product

'Juhudi' is a Kiswahili term meaning determination and it was the first loan product developed by K-Rep. It is fashioned after the group lending methodology of the Grameen Bank in Bangladesh but customized to fit the Kenyan society.

---

[11] The information about the k-Rep group was obtained through an interview with Mr. Kimanthi Mutua the Managing director K-Rep bank.

[12] <http//:www.K-Rep.com>

The purpose was to cover the loopholes of the then existing lending methodology by broadening outreach, ensuring self-sustainability and ensuring credibility and professionalism in the delivery of credit to the SMEs.

Kati Kati Loan Product

The third and largest loan product developed by K-Rep Bank in the year 2000. Kati-Kati is a Kiswahili term meaning moderate. Therefore it is meant to cater for financial needs of between Kshs. 100,000/= to Kshs. 250,000/= as a first loan with K-Rep Bank which is in essence moderate financial needs. It is neither meagre nor large. It is open to the public at large.

To qualify for the product, applicants must register a group of between 5 and 10 members with a common need from one locality. It involves members co-guaranteeing each other and contributing to a savings account. The members must be willing to attend weekly meetings then monthly meetings and they must raise cash collateral.

Chikola Loan Product

Chikola is the second loan product of the K-Rep Bank launched way back in1991. '*Chikola*' is a term from a local dialect of the Giriama people meaning 'merry-go-round'. It blends the concept of lending methodology of the indigenous rotating savings and credit clubs with that of the Grameen Bank. Chikola is popular in areas with groups whose objectives rotate around economic and business issues rather than welfare activities. The membership comprises of about 20 members and the group must be at least 1 year old.

They hold monthly meetings and are required to operate a joint savings account with a minimum amount equivalent to 10% of the loan. Money is lent to individuals with a one-year loan period repayable monthly.

Other products offered by K-REP include:

- Personal loans for graduating members of existing K-Rep Bank groups and open to the public who require amount of loan up to Kshs. 500,000/=. There is no group guarantee backing, hence sufficient collateral is prerequisite.
- Business loans designed for small-scale businesses that require credit up to Kshs. 5,000,000/=. Sufficient collateral is prerequisite.[13]
- Simu ya jamii a new product which is a loan service aimed at enabling microentreprenuers to purchase the community based GSM phone.
- Matatu operators' facility a loan facility that enables matatu asoociations and owners to purchase new vehicles or carry out joint projects such as petrol stations.
- Consumer credit a credit facility with contractual savings for salaried employees.
- Equipment financing involved in provision of small loans to small businesses operating photo studios.

This illustrates a diversity of activities that can be provided by a single MFI.

PRIDE, another nation-wide MFI, focuses on individual rather than group based lending. Its clients are established urban entrepreneurs and two thirds are women. Due to its individual and urban focus, it tends to attract higher income entrepreneurs and distributes slightly larger loans. PRIDE supplies the loan sums, but requires clients to establish a savings account with a commercial bank, forcing a link between formal financial institutions and micro-entrepreneurs. PRIDE is investigating a new software system that will link groups of micro-finance clients to formal financial institutions, reducing the banks costs of lending to the clients and encouraging further linkages[14]

In addition to provision of loans /credit, voluntary savings and mandatory savings, MFIs also offer training services to their members in various fields the Jitegemee trust is aimed at

[13] <http://www.K-Rep.com>

[14] <htpp://www.prideafrica.com>

enabling the "mwananchi" to be self sufficient hence it engages in training them in technical areas as carpentry and other small but self sustaining activities.[15]

Kenya Women Finance Trust reaches out to women but also allows men to participate as long as they don't compose more than 20 percent of a group nor assume any leadership positions. Originally concentrating its efforts on professional women, it has reached out to low-income women entrepreneurs. It operates through a myriad of branches (table 1) throughout the country and provides savings and credit services through group and individual relationships. Its financial services include: group savings, loans and loan guarantees while the non-credit facilities include: client counselling and client training.[16]

Equity Bank offers services as: capitalisation, loan guarantees.

Other services offered by the various MFIs are provision of informal education by availing facilities and giving out training on issues such as the rampant HIV and AIDS, provision of agricultural implements and technology to farmers and other small-scale activities.As mentioned earlier some MFIs also operate as SACCOs and others as ROSCAs (Rotating Savings and Credit Associations) in many countries, ROSCAs are mainly utilised by women. They are also more common in urban than in rural areas, and usually formed for specific purposes, and comprise people from a similar status and background with assured and regular incomes

A component of this sector that is not widely known is that which offers a service called factoring or bridging. It is crucial in that it helps small businesses to meet their trading obligations with other, usually bigger businesses while they await payments, which takes some time. What they do is pay up the obligations of these small businesses and then the small businesses repay them later on after making their sales. It is unique to only traders. One such bridging organisation is the Kenya Gatsby trust

---

[15] the information was obtained from a brochure belonging to Jitegemee Trust which elaborates its activities.

[16] Washington K. Kiiru, Glenn D. Pederson-Kenya women finance trust, case study of a micro-finance scheme.

TABLE 1

TABLE SHOWING SOME LEADING MFIs AND THEIR GEOGRAPHICAL COVERAGE.[17]

MFI	GEOGRAPHICAL COVERAGE
KENYA WOMEN FINANCE TRUST (KWFT)	Countrywide including: Karatina, Kilifi, Nairobi,Kwale.
FAULU KENYA	Nairobi, Nyeri, Eldoret, Kitale, Bungoma, Meru Mombasa.
K-REP GROUP	Nairobi(3), Nakuru, Eldoret, Nyeri, Mombasa, Embu. Field marketing offices spread countrywide.
PRIDE LTD	Spread all over the country in over 20 districts.
WEDCO LTD.	Only one branch in Kisumu.
SMEP	Nairobi –not very widespread.
EQUITY BANK LTD.	COUNTRYWIDE:
ECONOMICAL LOANS FUND (ECLOF)	Nairobi (2), Meru, Thika, Nyeri, Limuru, Nakuru, Eldoret, Bungoma, Kisumu.

[17] There are about 20 leading MFIs in Kenya, which are also registered members of the Association Of Micro-finance Institutions. This information was obtained from a field study carried put in the head offices of these MFIs.

CHAPTER TWO.

2.1 THE MEANING OF REGULATION AND SUPERVISION

One of the most important issues in microfinance today is the regulation and supervision of the industry. As aforementioned, most informal organizations providing financial services to micro-enterprises do not fall under the Government Regulations that are applied to banks and other formal financial institutions. Many non-bank MFIs especially NGOs, operate on the fringes of existing regulations, especially with regard to deposit mobilization.

Financial regulation refers to the body of principles, rules, standards, and compliance procedures that apply to financial institutions.

Final supervision involves the examination and monitoring of organizations for compliance with regulation.

Prudential regulation and supervision are designed to

- Avoid a banking crisis and maintain the integrity of the payments system.
- Protect depositors.
- Encourage financial sector competition and efficiency.[18]

2.2 WHEN SHOULD MFIs BE SUBJECT TO REGULATION?[19]

MFIs should be regulated if and when they mobilize deposits from the public. This is because individual depositors cannot be expected to monitor the stability of MFIs and hence it is the responsibility of the state to do this.

[18] Micro Finance Handbook: An Institutional and Financial Perspective, Joanna Ledger Ward at page 20.

[19] <http://www.microfinance gateway.com> 'Key Issues On an International Perspective'.

The business of borrowing and lending to the public is very risky especially for MFIs as they lend money to the poor who have a higher default risk this therefore calls for a system of regulating this institutions to avoid a crisis and also to protect the providers of the funds.

As mentioned earlier most MFIs operate, as NGOs hence are donor funded, this creates a risk since it is likely that the donors will push programs that target credit rather than focus on meeting existing demand for financial services. It is therefore imperative to put in place a system of regulation that will ensure the MFIs meet their objectives of providing financial services to the poor efficiently.

When an MFI reaches a size big enough to result in dire consequences to both its owners and creditors upon its failure, there is a need to regulate such an institution to protect the interested parties. MFIs are growing in size and spreading at a fast rate as is the case with K-Rep bank which has a 5-year growth plan intended to cover most parts of the country this s evidence of the increase in size of the MFIs. Equity Bank has branches in virtually all the parts of the country.

The vast majorities of MFIs are small and informal and operate as voluntary association at the local level. It is not feasible to regulate them. Regulators should concentrate their attention on institutions that would like to offer deposit-taking services to the general public. The primary motivation for MFIs to shift their micro-financial services to a regulated financial institution is to ensure a long-term financial and institutional viability through increased access to borrowed funds by accepting deposits entering the inter-bank market or operating access to credit lines.Very few MFIs have the combination of ownership structures management, financial discipline, information systems and profitability necessary to be safe deposit takers.[20]

Kenya has taken the specific regulation approach and come up with a deposit taking micro finance bill-2004, which is the first specific proposed regulation in the industry.

---

[20] Joanna Ledger Ward, supra, at page 21

2.3 A LOOK AT THE PROVISIONS OF THE DEPOSIT TAKING MICRO-FINANCE BILL 2004

As the name suggests it is aimed at regulating deposit taking microfinance institutions and not all micro financing institutions. The reason as mentioned earlier is that MFIs are mostly small and informal institutions hence it will be very difficult to bring them under the ambit of the law as they do have significant individual contribution to the industry. In addition they have very varied operations, which make it difficult to come up with one system of Law to regulate all the institutions.

In looking at the regulations proposed by this Bill I will take into account the very important factor that MFIs have features that are different from the other financial institutions in that they have a different risk profile.

The five key features that make MFIs unique are:

- Client base- borrowers are low-income entrepreneurs working in the informal sector, rather than traditional, registered, formal businesses.
- Lending methodology- loan decisions are character based and backed by little if any conventional collateral, rather than the result of sophisticated analysis of financial statements supported by pledges of formal security.
- Costs of lending- transaction costs of lending are relatively high, somewhere between traditional bank lending and informal credit markets.
- Loan portfolio composition- credit is comprised of a high volume of small, short-term loans with strong geographical concentrations, in contrast to a standard retail banking loan portfolio profile.
- Funding base- deposits are largely from community-based savers, rather than from highly mobile and somewhat speculative short-term investors.
- Structure and governance- bringing financial services to a widely dispersed, relatively remote clientele usually results in a decentralised structure and weak institutional

infrastructure, rather than the centralized structure and bureaucratic governance of most financial institutions.

An appropriate regulatory approach should be based on a clear understanding of this risk profile and also the legal institution of the country.

<u>Part 2</u> deals with provisions relating to licensing:

<u>SECTION 4</u> contains provisions on the qualifications for carrying out deposit taking microfinance business. Though this will paint a definate picture on what constitutes deposit taking micro finance business, it will also have a curtailing effect by limiting the existing MFIs to more stringent operational and financial provisions. Their flexibility will be limited in terms of provisioning, write offs and operating policies which is the common practice with most MFIs as they are currently governed by the NGOs Act. By abiding to company regulations as provided for in this section they will to comply with strict reserve requirements under the Companies Act. The businesses will not be able to transfer their resources easily between the financial operations and any development activities they will be involved in since most of the MFIs will be converting from their current NGO status.

While an unregulated NGO may have more flexibility to operate a wider range of programs, a regulated micro-finance can fund its portfolio growth with more readily available capital than donor funding

Although the licensing of the deposit taking micro finance as company will have the advantage of enhancing its access to additional funding there is the other side of the coin which is that the business will no longer qualify for subsidised funding as is the case with the current MFIs which operate as NGOs instead the deposit taking business will be required to issue shares to the public to raise the required capital.

<u>SECTION 8</u> provides that the Minister may by notice to a licensee revoke a licence and gives certain conditions. However this section does not say anything to do with consultation with a committee, board or even the CBK before such revocation, which brings about the risk of political interference in the licensing process. The Minister may exercise this power

autonomously and maliciously for personal gain. In addition no remedy has been provided for this unforeseen risk.

Because the bill has given the minister the authority to approve some MFIs changes together with Central Bank, the MFIs are likely to be vulnerable to political influence.

Part 3 of the bill relating to the management of deposit taking micro finance business contains provisions for minimum capital and minimum capital ratio.

Section 9 provides that a deposit taking micro finance business shall maintain minimum capital requirements as set out in the first schedule to this Act. The main reason for maintaining capital is to absorb shocks. The higher the level of capital of capital a business has the safer the business is.

The effect of regulating the minimum amount of capital a micro finance business should have, will be to limit on the number of deposit taking MFIs in the industry. This will help in controlling the institutions closely as they will be at a manageable number. This will help in streamlining the MFIs by having the businesses meet certain specifications and thus reducing the currently prevailing ambiguity on what these MFIs are.

In addition this will have a positive effect on the interests of customers, as the funds they deposit with the MFIs will be ore secured due to the capital limitation.

Section 10 provides that the deposit taking micro finance business shall maintain minimum holding of assets as the CBK with the approval of the minister, may, by regulations, prescribe.

Bank regulators will therefore use the minimum asset requirement as a tool for controlling the number and type of market entrants if they want to increase the market entrants they will reduce the minimum asset level requirement and if their objective is to reduce the number of firms in the industry or improve the level of standards they will simply increase the level of minimum asset requirement to avoid more entrances and even exit some existing businesses that don't meet the requirements.

Section 11 deals with the branches of a deposit taking micro finance business and part (a) limits the DTMFB from opening a branch outside Kenya the problem that will arise here is in regards to the existing MFIs which are part of foreign mother MFIs that will want to be registered under the Act. Most MFIs operating in Kenya are of this nature and thus this will limit foreign investment in the industry.

Part (b) provides that a minister shall give his approval before the opening of a new branch or the closure of an old one. Though this is intended to prevent over-branching and is positive to that effect, it is likely to bring about negative effects of limiting the growth of MFIs. This is because MFIs are aimed at alleviating and assisting the poor and it is therefore necessary for them to establish branches in very remote areas in order to reach their clientele better. These areas are however crime- ridden and unsafe and might not win the favour of the minister. Artificial restrictions on the expansion of MFIs could result in delinquency.

Section 13 deals with application for loans and credit facility and it places the requirement that the applicant only needs to show their ability to repay the loan this is in tandem with the current operations of MFIS as they do not require collateral form their members and neither do they impose strict portfolio sampling methods when deciding on who to grant the loan. Instead they tend to look at the past trend of the client in repaying the loan and they base their decision on this. The loan volumes are so large such that standard guidelines are not appropriate.[21]

Section 14 provides a ceiling limit to be set by the Central Bank that shall not be exceeded by the MFI this is a protective measure against lending one person too much money as it wiil be dangerous in the event of default. The same is achieved by sub-section, which prohibits the use of the MFIs shares as collateral for loan.

Section 16 of this bill proposes to the limitation of shares to a maximum of 25% for an individual person. This will serve as an effect way of avoiding the problem of full control of a DTMFB that will have the effect of loss of business independence.

[21] The Micro Finance Network Occasional Paper 1 at page 41

The introduction of ownership is likely to promote self-regulation by owners who will be seeking to preserve their capital investment However the exceptions under subsection of this section pose a danger to the industry in that there is a risk of the operations of a DTMFB being wholly controlled by a foreign company which is against the intendment of the regulators.[22]

Section 18 and 19 set out the qualifications and disqualifications of the directors of DTMFB. The fact that this is encapsulated in the Act is advantageous in that it will ensure that only the persons with competent professional background in financial intermediation and who meet the required standards as set will qualify to act in such capacity.

However as earlier mentioned MFIs have unique features that need to be captured in their regulation and in this light therefore it is imperative that directors of the DTMFB should be tied with these unique features such as, needs of clients, reliance on character appraisal, decentralized operations and fast turn around decisions. Such persons should be equipped with years of experience serving small business enterprises. The provisions of the Bill are much generalized and may not meet the high demands of micro lending.

PART 4 deals with provisions relating to financial management of a deposit taking micro finance business.

SECTION 21 provides that all entries in any books of accounts and all accounts kept shall be recorded and kept in the English language and shall use the system of numerals employed in Government accounts. This brings about a complication due to the fact that most depositors of MFIs are not literate to very high levels and hence may not be able to interpret the books if accounts to understand the implications thereon. There should be a simplified system of reporting for this group of stakeholders, which is the major risk taker.

Under sections 20 -22, this entails the preparation of annual financial reports to give the status of the business. This is a welcome move in terms of enlightening the public on the performance of the business plus it will also make it easy for the owners and other stakeholders to monitor the activities of the business.

---

[22] Daily nation Sunday edition 8th may 2005

The requirement of Government reporting is likely to bring about benefits later on such as accountability to a third party for prudent supervision, objective oversight by someone less absorbed in the development mission and approval requirements before major strategy or management shifts are made thus moderating MFIs. However the other side of the coin unveils the substantial investment the business will have to make in order to incorporate an accounting and portfolio management system into the business. It also requires additional personnel and annual expenses.

Reporting formats were originally conceived for banks with few large transactions and although MFIs need the same type of financial management information, they are more concerned with aggregate indicators. Since their portfolio consists of thousands of little loans it is not realistic to monitor the performance of each loan and so reporting formats should be appropriate to the loan size and transaction volume.

SECTION 25 provides for the establishment of an internal audit function that shall report to the Board of Directors on the financial matters of the organisation. In addition to the required accounting qualifications such a person will be required to have experience in deposit taking micro finance business. This is a very good move as the audit of such an institution is unique in that it requires a clear understanding of the operations and functions of MFIs, which as earlier stated are unique and specific.

However a problem arises under SECTION 26, which provides for the appointment of external auditors in accordance with section 61 of the Companies Act. This Act does not provide for the special needs of an MFI and hence the auditors appointed will not possess the requisite knowledge on the specific characteristics of MFIs the probable result of this is that the auditors will overlook dangers that are likely to be specific to the MFI such as was the case in the case of Finanscol a leading Colombian MFI which almost collapsed due to

financial difficulties.In this case the external auditors had issued an unqualified report due to their lack of understanding of the manner of operation of the organisation.[23]

2.4 LIKELY OVERALL EFFECTS OF THE PROPOSED BILL. ON THE INDUSTRY.

The proposed bill will boost the sub-sector from many perspectives:

It will legitimise micro finance practise and bring it into the fold of the financial markets, as opposed to the peripheral it hitherto been perceived to be.

It will bring about appropriate regulations for micro finance operations in some cases banking regulations are not favourable such as those relating to branching while in other cases they are less stringent than the requirement by MFIs such as guidelines for non-performing loans which require strict measures in the case of MFIs.

It will level the playing field for MFIs operations under different statutes, protect legitimate MFIs from quack ones and most of all provide a framework for developing institutions that depend on the local financial markets for their growth and sustainability, as opposed to donor funds. For example as of now, K-Rep conforms to all regulations of the CBK but other MFIs don't, it pays taxes some MFIs don't.

The Bill is also likely to bring about a positive effect of uniformity in the micro financing operations, which is not the current case. For instance an MFI like K-Rep has an institutional policy to only lend money to existing borrowers while others agree to lend to starters.

[23] REGULATION AND SUPERVISION OF MICROFINANCE INSITUTIONS the Micro finance network Occasional Paper No.1 pg 43&44.

The regulation is also likely to bring about a tier system in the industry such that the MFIs will be comprised in three tiers as follows:

1st tier- **formally constituted deposit taking MFIs that will be regulated by the Central Bank and** the Deposit Taking micro-financing regulation when it comes into place. They will also be members of the Deposit Protection Fund Board.

2nd tier- formally constituted credit only MFIs. These are those MFIs that don't take deposits from the public but take cash collateral on their loans. The micro-finance unit in the Ministry of Finance will regulate them.

3rd tier- informally constituted MFIs like ROSCAs and FSAs, which will be regulated by donors, commercial banks and Government agencies from whom they obtain funds.[24]

2.5 DONOR PERSPECTIVE:

From the donor perspective, some outside regulation or standard setting is important for three main reasons:

While donors have committed large amounts to many of these institutions, they have minimal leverage over management once funds are committed, and have typically not included performance clauses in their contracts. Regulation by the government will secure their funds.

Donors rely on financials provided by the MFI and upon reports from consultants to determine the financial conditions of MFIs. The information is inaccurate and poorly compiled and may even be untrue. They will now have access to reliable information.

Regulatory oversight will help in protecting and enhancing a donor's investment in an NGO through periodic monitoring and minimum performance standards.

[24] Omino George, supra, note 5.

CHAPTER 3.

A LOOK AT CASE STUDIES FROM VARIOUS COUNTRIES.

3.1. BOLIVIA:

The reason for my discussion of Bolivia as a case study is because it has specialised categories of laws designed specifically as will be evidenced.[25] The Bolivian superintendency has been particularly innovative in the regulation and supervision of micro-finance. The process began with the authorisation in February 1992 of Banco Solidario S.A (Bancosol), as the first private commercial bank in the world dedicated to the exclusive provision of financial services to the micro enterprise sector. A second significant step came in April 1995, when Bolivian Government enacted a decree that regulates the incorporation and operation of the private Financial Funds (PFFs). PFFs are non-bank financial intermediaries designed to serve the small business and micro enterprise sector.

Bolivia has a law on Banking and Financial institutions that was formulated in 1993 to govern financial services provision. However an assessment of the supply and demand for credit in the Bolivian financial system indicated the need for a new type of entity specialising in micro and small business finance. A considerable portion of the potential demand for financial services among low-income sectors was not being met by the current regulated institutions, nor by the NGOs specialised in providing credit to these sectors. This is because the coverage of Bancosol and other Bolivian micro credit NGOs fell short of the potential demand.

Those institutions currently participating in the micro-finance market, in the supervised and the non-profit sectors are insufficient to guarantee efficient financial intermediation for micro entrepreneurs and small businesses. Multiple-service banking is an excessively broad framework for lending operations to micro entrepreneurs and small businesses, requiring minimum capital that overprotects micro lending operations and acts as a barrier to entry.

[25] In my case study presentation I will refer to a publication by RACHEL Rock on micro financing in Bolivia.

In April 1995 the Bolivian Government enacted supreme Decree 24000 which regulates the incorporation and operation of the Private Financial Funds. Los Andes was the first Bolivian Private Financial Fund which grew out of the NGO Micro Lender Pro Credit.

PFFs have the following main characteristics. This special category of financial institutions was established to finance the activities of micro and small businesses, as well as to make loans to individuals for durable goods purchases. They may also be engaged in small-scale consumer credit operations. The PFFs are organised as corporations; this legal form allows for timely increases in equity when required by the superitendency of Banks and may also help attract financial institutions from abroad. They require US$ 1 million for establishment in capital and must maintain a net worth equivalent to at least 10% of their assets and contingencies weighted on the basis of risk.

PFFs are permitted to perform financial leasing and factoring to traditional lending. They may receive deposits and provide financial services such as making drafts and payment orders and also buying and selling foreign currency. They are subject to the credit limits laid down by the law on banks and financial institutions. Before receiving an operating license, PFFs must have managers with extensive experience serving the small business and micro enterprise sectors.

PFFS are restricted from several types of banking operations such as capturing demand deposits, foreign trade practises, trust operations and other charges of fiduciary duty, investment in enterprise capital, participation in the underwriting and placement of securities, and mutual fund management.

Other limits on PFFs are:

The loan made to a borrower may not exceed 3% of the net worth of the PFF.

Credits with personal guarantees may not exceed 1% of the PFFs net worth.

A PFF may not maintain a credit relationship with an institution of the national financial system for more than 20% of the PFFs net worth.

To avoid conflicts of interest, shareholders, statutory auditors, directors and managers, and individuals or entities associated with a PFF may not obtain loans, directly or indirectly form the institution.

PFFS are also subject to any operative restriction that the superitendency of banks deems prudent.

The Bolivian superitendency recognised the need to make provisions in the 1993 law to allow for the large volume of small loans characteristics of microfinance institutions. Because the small size of micro loans allows them to be considered minor risks, when classifying and evaluating assets and their accruals in the calculation of equity position, which includes the limit on the total amount of loans made with a personal guarantee to twice the institutions financials net worth, the following exceptions were made:

Banking institutions should exclude from this limit all loans that are equivalent to US$ 2,000 or less or 1/1000 of the institutions net worth.

Non-bank institutions, including PFFs, should exclude from this limit loans equivalent to US$ 500 or 1/20 of 1% of the institution's net worth whichever is greater.

3.1.1COMPARISON OF BOLIVIA AND KENYA:

Form the above description of the operations of Bolivia's regulatory system of institutions which provide services to small and micro credits, we can derive a few similarities and at the same point out differences between the workings of Bolivia's regulation of micro finance and the proposed regulation of Kenya's microfinance industry as follows:

The institutions in Bolivia that are regulated are those that provide finance to the small and micro businesses and are organised as corporations. In Kenya there is a similar move aimed at regulating only the deposit taking micro finance institutions and there is a requirement in the proposed bill to register all the institutions as companies under the Companies Act cap. 486 of the Laws of Kenya.

In both countries provisions have been made for maintenance of minimum levels of capital but whereas Bolivia also has a provision for maintenance of a net worth equivalent to 10% of assets and contingencies weighted on the basis of risk, the proposed Kenyan bill provides for the maintenance of minimum liquid assets to be prescribed by the Central Bank with the minister's approval.

Bolivian regulation prescribes the permissible financial operations by these institutions as well as providing for limits on their operations. In the case of Kenya, the bill has no mention of the financial operations to be carried out but under section 12 it gives a list of prohibited activities of the institutions.

Some prohibited activities are similar to those prohibited in Bolivia such as; foreign trade operations, trust operations, investing in enterprise capital and participating in the underwriting and placing of securities.

In Bolivia the limit on loan to a borrower may not exceed 3% of the net worthwhile the bill provides for a limit to be set by CBK. Further more the bill contrary to provisions existing in Bolivia limiting credits with personal guarantees to 1% of the PFFs net worth and also limits on the PFFs maintaining any relationship with an institution of the national financial system no such provision can be found in the bill.

The proposed bill provides that insider lending in by MFIs should be approved by CBK with the approval of the minister while the Bolivian regulation totally prohibits any form of insider lending.

3.1.2 MAJOR REGULATORY ISSUES FACING BANCONSOL:

The challenge of creating a microfinance bank within the commercial bank regulatory regime has highlighted several incongruities:

Portfolio restrictions:

There is a restriction by the law on Banking that the portion of a financial entity's portfolio backed by personal guarantees may not exceed twice the equity of the institution. Despite the superitendency giving an exemption for this, problems are still encountered since Bancosol as it uses the solidarity group lending methodology where one loan is shared among about five people but this ends up being counted as one large loan hence it ends up exceeding the set limit of US$2000.

Though intending to reduce exposure to credit risk, this restriction does not take into account the viability and proven track record of the solidarity group lending mechanism. Demanding tangible guarantees undermines a basic characteristic of the micro lending model. This regulation results in unreasonable capital adequacy standards and restricts its financial leverage, directly limiting its portfolio growth, outreach and profitability. Bancosol has recommended that that the superitendency adapt the resolution to apply to those institutions serving the micro enterprise sector by raising the threshold loan level and increasing the percentage of equity.

Documentation:

The Bolivian regulatory framework calls for detailed loan application requirements. Most of the required documentation is superfluous to a character based lending methodology that relies on the personal relationship between loan officer and borrower, and a qualitative loan assessment. It is especially onerous where each loan officer is managing hundreds of loans; it ties loan officers to their desks when they need to devote maximum attention to client follow-up in the field. Ease and flexibility of obtaining credit, are fundamental elements in attracting

micro entrepreneurs to pay the necessary high interest rates, are also undermined. Banconsol has proposed a guideline for documentation as follows;

Evaluating the financial and economic statues of its clients at least once a year rather than with each disbursement, verifying use of loans greater than US$3,000 only rather than all the loans made, continually evaluating the risk assessment of a family unit but without the regulatory requirement of a signed affidavit by the spouse verifying the assets/liabilities, income/expenses.

Branch openings:

The superitendency allows for the opening of agencies operating on a full time schedule that are expected to become full-scale branches. This poses a problem as it takes about 2 years to generate enough business to be able to run a full scale branch office.

Bancosol therefore proposes that there be authorisation to open mini-offices that operate a part time schedule with a few limitations such as operating accounts and accepting loan payments.

3.2 BANGLADESH:

Bangladesh as a case study is of great importance as it has one of the oldest and most diverse microfinance sectors in the world including some of the largest and most sophisticated microfinance institutions; the Grameen bank, BRAC and ASA.[26] In Bangladesh, the unique circumstances of no regulatory oversight and a large, well funded NGO community have resulted in the ad hoc evolution of sophisticated and innovative MFIs. Most MFIs in Bangladesh combine micro credit with a strong education and social change agenda to address the structural poverty of rural areas.

Most MFIs in Bangladesh are NGOs, which are registered under the societies Act of 1860 and are exempt from oversight by the Central Bank despite their participation in lending and collection of deposits activities. Most have a donor-funded pool and hold member

[26] Some of the information on Bangladesh as a case study is obtained from an article written by janney carpenter on micro financing in Bangladesh.

deposits in low-risk investment portfolio. However the larger MFIs use member savings to fund their lending activities due to the high loan demand. There are about four major market players providing credit facilities.[27]

The permissiveness of the current regulatory environment allows NGOs to undertake nearly all the activities they need to meet their development objectives such as accepting deposits, extending credit, raising capital from donors and other sources. Those NGOs large enough to receive foreign funding are overseen by the NGO bureau, which must approve all foreign aid flows. To receive foreign funds, the NGO must submit a work plan and a budget for the proposed project. However, the bureau does not conduct any assessment, examination or evaluations of the financial condition of the Ngo or even the financial viability of the project funders are responsible for completing their own risk assessment. This means that members and funders can only rely upon management to avert fraud, mismanagement and any other unforeseen circumstances. This is very risky as they have no definite cause of action in case either of these occurs.

Few MFIs have adopted a legal form with some regulation hence they face minimal oversight and monitoring. Financial co-operatives are chartered under the co-operative societies Act which enables them mobilize deposits from the general public in addition to their members. The government registrar regulates these institutions though he has little preventive or protective regulation and conducts very little supervision.

Most of these institutions have minimal outside financial review and audit hence as they assume more financial risks they face two challenges:

1. The need to strengthen their self regulation and internal controls
2. The possibility of government regulation through the Central bank or other supervisory body.

[27] Regulation and supervision of micro financing case study approach by various micro finance experts from the countries featured.

There is minimal pressure on the MFIs to change their current structuring as international donors are more than willing to finance their activities with minimal internal or external oversight requirements. The result of this is that of only one MFI regulated by the Central bank the Grameen Bank; the country's biggest micro lender.

3.2.1 EXISTING REGULATION- THE GRAMEEN BANK CHARTER.

Grameen's formal and legal bank status allows it to raise capital and collect deposits to finance its banking finances, which are aimed at the poor people. It therefore functions as a banking institution. It became a specially chartered organisation in 1983 with the passage of the Grameen bank ordinance.[28]

The Grameen Bank ordinance is a special charter adopted in 1983 that describes the formation of the institution its management and governance structures, supervision by the ministry of Finance, ownership structure and functions. It serves as the articles of incorporation and major policies.

This charter addresses licensing requirements to ensure a prudent structure for the bank and on-going supervision and monitoring requirements. The major features of the Grameen ordinance were adopted to fit a microfinance institution as follows:

Capital requirement the capital for the bank was US$ 4.25 million, which exceeded the standard requirement for a commercial bank in Bangladesh that is US$3.25 million. There are no capital adequacy or liquidity ratios requirements for Grameen bank.

Ownership by Bangladesh bank ownership is shared between Bangladesh bank and members. The central bank owns 25% of the stake.

[28] The Grameen bank project was sponsored by the rural economics programme of the department of economics, university of Chittagong in 1976. The Bangladesh bank subsequently adopted it to deliver credit to the rural areas.

Compliance with standard portfolio risk classification (delinquency, loan-loss provisions and write-offs) Grameen reports delinquency to the Bangladesh bank using the same features as formal banks.

Branch restrictions Grameen must request Bangladesh bank for approval to open a new branch. The central bank prepares a brief feasibility study of the area and population plus demographics. It also obtains the opinion of local politicians and commercial banks officers.

Access to Bangladesh bank funds the bank can issue bonds, debentures that are guaranteed by the government.

Limitations on scope of activities all activities are permitted as long as they are conducive to the objectives of the Grameen bank.

Board structure governance of the bank is by a twelve-member board of directors of which three are government appointed and members elect nine.

Approval on senior management the board appoints the managing director with the prior approval of the central bank.

Taxable status no tax is due for the first ten years.

3.2.2 COMPARISSON WITH KENYA

The case of Bangladesh is somewhat similar to our situation in the sense that currently in Kenya there are two major MFIs that are regulated by the central bank; K-REP Bank and Equity Bank, which recently converted into a bank.

K-Rep Bank borrowed a lot on its structure formulation form the Grameen bank and so most of its operations are very similar to those of the Grameen bank an example of these is the Juhudi product, which was borrowed from the Grameen bank.

However Bangladesh opted to have a specific regulation for this bank while Kenya wants to implement a blanket regulation system for all deposit taking institutions. A look at the

regulation also reveals that there are a few differences in the regulation by the Grameen charter and the proposed deposit-taking bill (2004) of Kenya. Issues such as non-taxation of MFIs for the first ten years, lack of restriction on activities, the feasibility study carried out on a proposed area before opening a branch and the ownership structure with a focus of the holding of 25% of its shares by the central bank are very foreign concepts and do not feature in Kenya's proposed bill. This shows that not much was borrowed from the Grameen charter.

3.3 CASE OF SOUTH AFRICA

As a case study South Africa is of significance due to its notoriety in self-regulation by MFIs. The major challenge faced by South Africa's financial sector is to meet the needs of the previously unbanked population. There is a chasm between the financing needs of micro entrepreneurs and the requirements of commercial banks. Very few financial institutions are designed to meet the needs of the informal sector. Banks view loans to small and MSEs as extremely risky when there is no collateral, credit history, business plan or history. Because of the usury Act and high transaction costs banks don't find it cost effective the banking infrastructure is also segregated geographically so that many township residents do not have convenient access to financial services. MSEs are also not innocent victims in this situation as they are often reluctant to borrow from banks due to the arduous application process and the requirement for a minimum loan size, which is usually above their needs and ability.

3.3.1 EXISTING REGULATION.

The current regulatory framework provides for two primary categories of financial institutions. The first tier consists of commercial banks and mutual banks. The differences between the two are in the minimum capital requirement with that of mutual banks being lower and in the nature of investment with mutual banks considered as having a development focus. The second tier includes unregulated institutions and associations that fall under the common bond exclusion.

Based on these categories it therefore follows that different regulation will exist for different institutions as follows:

Mutual Banks Act

The Mutual Banks Act of 1993 was an attempt to add depth to south Africa's financial system by creating a banking category that had less stringent capital adequacy prerequisites but similar risk management requirements. It attempted to involve communities in banking by having a provision for local boards of branches of mutual banks. Members of the community were expected to acquire shares in the mutual bank. A mutual bank can accept deposits and grant loans, advances and other credit.

Usury Act

This Act regulates consumer transaction including money lending, commercial credit and leasing. It states that no moneylender may receive finance charges at an annual rate greater than the maximum rate as determined by the registrar. This affects lending by banks to MSEs, as they are not allowed to charge high interest rates despite there being a greater risk in such lending. The rationale is in the interests of consumer protection against exploitation but it makes it impossible for MFIs to achieve full cost recovery, therefore limiting access to financial services to low-income earners.

In 1999 the usury Act exempted micro lending institutions from this limit for transactions worth SA R 10,000,00 provided the institution was registered under the MFRC and it complies with the gazette notice (June 1 1999) provisions.[29]

Self Regulation

As South Africa made the transition to majority rule in the early to mid-1990s, it had to face up to the need for a parallel transition in its economic institutions. Since then, South Africa has made significant strides toward improving the national policy and legal environment for more equitable economic growth including small-scale finance.

As part of the process of deepening the financial sector, the Micro Finance Regulatory Council (MFRC) came into being in 1999, under an exemption to the Usury Act. The MFRC's purpose

---

[29] < http://www.cliffdekker.co.za >South African banking regulations.

is to supervise the operations of those institutions lending under its unrestricted interest rate window, and to provide for effective consumer protection and regularization of micro-lender operations in a growing market. Having served this role for over five years, the MFRC is soon to be absorbed into a larger regulatory structure, as part of a new generation of financial reforms.[30]

An excerpt from the regulatory and supervisory for banks in South Africa shows the duties of the MFCRC as follows:[31]

1 The Micro Finance Regulatory Council (hereinafter referred to as the "MFRC" established in terms of the notice as the regulatory institution tasked with supervisii regulating this lucrative but previously unregulated sector of the financial se industry. The MFRC is a legal entity incorporated under section 21 of the Compani as an association not for gain whose representatives are drawn equally from consume the money lending industry. Its duties are, *inter alia*, to:

Register lenders in accordance with accreditation criteria approved by the Minister of Trade and Industry;

Ensure that complaints from the general public are responded to objectively;

Educate and inform the general public and lenders in relation to their rights and obligations under the notice;

Annually publish information regarding the money lending industry, the services provided, security and/or guarantees required, types of charges and the average : charges levied by each lender in a comparable format;

---

30 <http://www.microfinancegetway.com> Meagher P. Microfinance Regulation and Supervision in South Africa.
31 <http://www.cliffedekker.co.za> South African banking regulation.

Annually furnish the Minister of Trade and Industry with a detailed report on lenders its activities and functions and any other information that the Minister may require.

The MFRC works in conjunction with NLR and Since 1 July 2002 it has been compulsory for registered micro lenders (of whom there are 1300 nationwide) to operate according to the rules of the National Loans Register (NLR), which require lenders to:

- Submit details of all loans to the NLR databases
- Make enquiries on the database before approving any loans
- Inform borrowers about their current NLR records
- Follow prescribed processes for verifying data to be stored on the NLR and for resolving any disputes with borrowers
- Discourage reckless borrowing and over-indebtedness

The NLR currently contains records of over 5-million loans, averaging R1'250 in size, made by 396 lenders. The total loan book of the registered micro lending industry stands at over R15-billion.

The MFRC will certainly bring much-needed norms and standards to the industry. However, its primary focus remains on lending for consumer spending. Micro-enterprises continue to be neglected.[32]

3.3.2 Comparison with Kenya

The case of South Africa is very different with our own situation as the main focus is on the MICR, which is highly empowered by the provisions of the Usury Act under which it is formed. It is charged with the mammoth responsibility of handling most if not all-regulatory issues of MFIs in South Africa. In Kenya our own institution AMFI's mission is to develop a micro finance industry and an institutional framework that serves poor and low-income people

[32] The Newsletter of the Swiss-South African Co-operation Initiative Issue no 10. December 2003.

in Kenya. Its long-term objectives are to: ensure that the micro finance legislation is passed by parliament; and to increase membership in the network among MFIs. It regularly collaborates with government and donors' organizations in Kenya some of the activities it has been involved in are:

It participated in the development of the poverty reduction strategy paper, which is a national initiative. It also hosted the meeting of the Regional Program to Build Micro Finance Networks in Africa held in April 1999.

Kenya has clearly no intentions of taking up the South African system and has instead opted to come up with a regulatory framework in the form of a statute. The only leaf we can therefore borrow from South Africa is that of empowering AMFI to be able to regulate the MFI industry more efficiently and ensure compliance with the new regulation once it comes into place.

3.4 CASE OF UGANDA.

Uganda now prides itself with a statute to regulate micro financing (deposit taking institutions). Good donor practice played a major role in Uganda's micro finance legislation, passed in 2002. The timing was right for regulation because the Ugandan micro finance sector was well developed, with three to five MFIs nearly ready to become licensed deposit -taking institutions. GTZ worked closely with the Ugandan Central Bank (BOU) to develop a framework for licensing, regulating, and supervising deposit-taking MFIs. In consultation with the BOU, USAID's SPEED project is helping to build the capacity of these institutions to intermediate client deposits. Stakeholder consultation and the technical strength of donor teams are key success factors.[33]

A brief historical background reveals that the micro finance sector in Uganda has seen tremendous growth since 1994. Currently there are over 500 MFIs operating in 52 of the 56 districts. Of the estimated 600,000 clients of the MFIs, 70% are women and 20% are in the rural areas.

[33] <http://www.cgap.org>

Financial institutions in Uganda have been regulated by two major laws: the Financial Institution Statute (FIS) of 1993 and Bank of Uganda (BoU) Statute of 1993. Both these acts were designed to regulate commercial banks, insurance companies and credit institutions. MFIs were not recognized by these acts. MFIs were registered and regulated as companies limited by guarantees and NGOs.

The void in legal clarity over MFIs left the funds deposited by public to various MFIs unsupervised by any government agency and vulnerable to the whims of those with ill-intent. The government stated this as a threat to the wellbeing of the "financial industry" of the country.

The government of Uganda took pro-active steps to create a legal framework for MFIs and enacted the micro finance deposit taking Institution (MDI) Act in 2003. The law defined roles for MFIs and MDIs and created a legal mechanism for them to accept deposits. It categorized organizations engaged in monetary transactions involving deposits, savings and lending of public funds in four tiers: Tier 1 institutions are commercial banks; Tier 2 institutions are licensed credit institutions; Tier 3 Micro finance Deposit-Taking Institutions (MDIs) may take deposits from the public and on-lend them to the public; Tier 4 institutions may only accept compulsory savings from clients, and Tier 4 cooperatives may take voluntary savings from members and on-lend them only to members.

The law also introduced licensing requirements and regulatory oversight procedures for MDIs. The MDIs will have to acquire a license to operate and transact in and will be governed and supervised by the BoU. Obtaining a license will enable the MDI to accept deposits from public, lend credit and short-term loans to micro-enterprises and low-income households, transmit local currencies, perform payroll services, and deal with utilities and school fees payments. Under the new law, only Tier-4 MFIs can accept compulsory savings from its clients, while only user-owned Tier-4 MFIs are allowed to take voluntary savings from clients for on-lending purposes.

Under the new act an MDI must be incorporated as a limited company with issued shares, have a minimum capital of US$ 285,000 and a capital adequacy ratio at least 15% of weighted assets

at any time. MDIs cannot grant credit facility of more than 1% of share capital to individuals and no more than 5% of core capital to a group. No group or individual can own more than 30% of the MDI in the initial stage. In five years, groups or individuals will be limited to only 20% ownership of an MDI. Wholly owned microfinance subsidiaries of licensed commercial banks and MFIs that are owned by BoU, approved publicly held companies that also have similar businesses in other countries, are exempted from this ownership restriction. Operations and management of MDIs must be run by a staff with considerable experience in the banking sector.

As part of the MDI Act, an MDI Deposit Protection Fund will be established by the Bank of Uganda to protect depositors.

While clearing up some legal ambiguity, these frameworks have created new challenges for existing MFIs. Organizations who wish to obtain a MDI license must now satisfy several new requirements. Only about five to nine current MFIs can meet the Tier 3 requirements of MDI Act 2003. To become an MDI, an MFI will have to change its name, mission statement, human resource capacities, organizational structure and culture, to reflect its new status. Transformation from MFIs to MDIs will require MFIs to become sort of mini banks, threatening the peculiar social aspect of MFIs. Of the approximately 500 MFIs currently in operation in Uganda, it is expected that only a very few (3 to 5) qualify for MDI status upon passage of the MDI Act. This means that the vast majority of MFIs in Uganda will not be subject to Bank of Uganda regulation and supervision. As these Tier 4 institutions grow, they may qualify for a Tier 3 MDI license and be subject to the provisions of the MDI Act. There is currently a variety of Tier 4 organizations, including: approximately 10 to 15 medium sized MFIs (with 5,000 to 25,000 clients); approximately 40 smaller MFIs (with 500 to 5,000 clients); and a large number of MFIs with fewer than 500 clients.

To assist with the expansion of these Tier 4 institutions, the Ugandan Microfinance Network (AMFIU), with support from the Bank of Uganda and the Ministry of Finance have begun to

develop a set of performance indicators that can be used as benchmarks for the various categories of Tier 4 MFIs.[34]

It is very important to safeguard public funds. As with all legislative acts and their enforcement in practice, a balance must be struck to encourage the MFIs, as MDIs stay focused on the peculiar needs of the less privileged and reach out to the poorest. There also should be extensive exchange of information and experience between countries with similar laws in the books or in the pipeline so that everyone can benefit from the growing process and avoid reinventing the wheel. [35]

The Micro-Deposit Taking Institutions Act of 2003 (MDI Act) provides an example of regulation and supervision that allows those institutions that are ready, willing and able to mobilize deposits in a prudent manner to do so. By adopting a tiered structure to the regulation of microfinance activities, the MDI Act creates an enabling environment for the continued development of MFIs in the country. It acknowledges that microfinance NGOs are a legitimate and important part of Uganda's financial system, acknowledges their unique needs, and furthers the capacity building of these organizations.

3.4.1 Comparison with Kenya

The case of Uganda as expected is very similar to our own as we are also experiencing a tremendous growth since the early 1990's. Due to the great increase in numbers of MSEs and MFIs the government also saw it fit to come up with a Micro-Financing Bill to define these institutions clearly and to reduce the risk they were facing of mismanagement and fund embezzlement.

The provisions of this Bill are somewhat similar to those of the MDI bill of 2001 of Uganda. Some of the common aspects include: the licensing requirements and regulatory oversight by

---

[34] Policies, Regulations and Systems that Promote Sustainable Financial Services to the Poor and Poorest by Women's World Banking

[35] Presented by Olivia Kayongo, Program Coordinator, Micro Credit Development Trust (MCDT), Uganda, at the Grameen Trust Associated Session for Grameen Global Network at MEARMS. MCDT has been a Grameen Trust partner since 2000.

The provisions of this Bill are somewhat similar to those of the MDI bill of 2001 of Uganda. Some of the common aspects include: the licensing requirements and regulatory oversight by the central bank, the formulation of the deposit taking institution into a limited company with a limitation on its ownership by a particular person and the minimum capital requirement, the limit on the maximum credit that it can issue, the requirement of banking experts as the management staff and also the establishment of the tier system for institutions at the various levels. The particulars may be different but the whole concept of capturing the unique characteristics of MFIs is depicted in both these bills.

CHAPTER FOUR

4.1 RECOMMENDATIONS

Micro finance institutions have demonstrated considerable resilience, flourishing outside a regulated environment. As the number of institutions increases, and as MFIs have grown in scale and complexity, the Government as the regulator has sought the means to support their growth, while safeguarding the financial system and protecting the interests of MFI clients, the most vulnerable economic sectors of the population. I will now point out field lessons that illuminate appropriate regulation of the MFIs industry. I will consider the risk profile of MFIs as highlighted in chapter two, and look at possible prudential guidelines where MFIs are vulnerable.

The government in conjunction with other regulators as the Central Bank of Kenya should be cautious in implementing the proposed deposit taking bill in that the process should not be too hasty to ambush the existing institutions nor should it be based on only one institutional model like concentrating only on the deposit taking institutions without giving room for other lower institutions to rise to the level of these deposit taking institutions. Considering that MFIs have been free to innovate financial services methodologies that are appropriate to their characteristics, there is a danger that regulations designed for the risk profile of commercial banks may box MFIs into practices that require replicating traditional banking practices and thereby losing their target market. Also once regulated depositors may lose their ability to evaluate their risk.

However there is also a danger that the proliferation of MFIs in response to a seemingly limitless market for Micro finance services may exceed the regulators capacity of supervision.

It is therefore very important to strike a balance; regulators should consider a line below which the financial market are better of unregulated and focus their attention on those institutions with the potential to obtain a significant scale. This has somewhat been exhibited in the proposed deposit taking bill (2004)

SPECIFIC RECOMMENDATIONS

4.1.1 OWNERSHIP AND GOVERNACE RISK

The proposed bill has a provision for issue of shares to the public under section 12; in as much as will encourage investment by private investors and contribute to the increased stability of these institutions, the bill should also have taken into consideration the likelihood of encouraging investment by other public and development-oriented institutions with micro finance or related development finance experience. This would have the effect of ousting inexperienced stakeholders and replacing them with more experienced ones to ensure that the unique characteristics of MFIs are not overlooked.

In addition to providing that the board should be composed of directors as under sections 17,18 and 19 it should also state that these directors should be professionally equipped to define sound policies for MFIs the bill should also go ahead and define exactly what constitutes gross negligence by the institutions such as operating without an internal auditor.

In addressing the measures to compensate the owners in the event of a loss, the bill has put in measures such as a minimum capital requirement and the establishment of a deposit fund with the Central Bank however other provisions it should have made are like limiting the distribution of dividends to the members until benchmarks are reached and requiring standby financing commitments by MFI owners.

4.1.2 MANAGEMENT RISK

In addition to having a provision for internal and external auditors, the bill should have stated strong internal auditing capabilities and aggressive internal auditing procedures including spot checks on borrowers. There should be specified guidelines establishing the performance requirements of external auditors as they provide a decentralized service. The bill should have put I more stringent reporting and management requirements in that supervisors should have the power to require MFIs to document their operating methods and to hold the organization accountable to their operating methods and procedures.

This will ensure streamlining and uniformity of the MFIs operations. This can be achieved for instance by; the senior management being required to train and supervise mid-level management, introduce appropriate reporting systems, and maintain adequate communication systems so that uniform policies and procedures are adopted.

4.1.3 NEW INDUSTRY

The bill should have a provision that supports close monitoring of MFIs that dramatically surpass the growth projections presented in the license application. The experiences of Finansocol and other institutions have indicated that rapid growth can lead to deterioration in loan portfolio quality and hence should be closely monitored.

The challenge facing most MFIs is to conduct a large volume of very small transactions and to do so profitably. Given this challenge, it is appropriate to limit the number of products. There should also be a move to limit the products and services offered to a reasonable minimum such that the variance should not be alarming. MFIs at least should have common products that they offer especially in terms of credit facilities. The regulation should therefore ensure that any new products should be well tested before being implemented on a broad scale. Each innovation in a methodology must be carefully evaluated to determine how the new methods will influence the original service delivery.

Furthermore an institutions capacity to implement many new products and services, while continuing to grow their existing ones must also be considered.

It therefore seems imperative that any regulation enacted to regulate MFIs should consider this aspect of new industry broadly and put in place measures to regulate it. Our bill has no mention whatsoever of this aspect all-together which in my opinion is a big risk.

4.2 CONCLUSION

Hundreds of micro finance institutions have emerged throughout the country and have developed innovative and unconventional lending methodologies designed to meet the specific characteristics of micro enterprises and low-income communities. This demonstrates the importance of micro financing and through provision of these services; MFIs deepen the financial system and expand the economic contribution of the small communities.

In my study I have highlighted the concept of micro financing as being a global concept and went ahead to illustrate this by looking at the various jurisdictions that have an elaborate MFI industry. Micro financing is a worldwide concept that has been embraced by the developing countries in the west and the east. This is because it seeks to enhance the lives of low-income earners.

From this case study analysis it has come out clear that most of these industries have very many features in common this being attributed to the uniqueness of the industry and also in some cases from borrowing from each other like for instance the case of K-Rep borrowing the products and peer group collateral concept form the Grameen bank. The industry therefore can be said to work as a global network with cross-country influences, which have speeded up the process of regulation.

The fact also that most MFIs are still donor funded and receive help from international have taken to only organizations has also contributed to countries embracing the influence of these countries.

This may be a possible explanation of the grave similarities in the regulation of the MFI industry most of them regulating those institutions that borrow funds from the public. Another similarity is that most regulating statutes do not contain strict regulatory requirements for collateral for lending money to clients. In my study I comparatively looked at the case of the Uganda regulation with the proposed bill for Kenya.

As MFIs mature, they realize the need to enter the formal financial system to fund their growth and to diversify their services to meet the demand of their target market. This makes traditional lending techniques inappropriate and since traditional banking regulation and supervisory practices are also ill suited to the unique characteristics of MFIs there arises a need to formulate legislation that well suits these institutions. MFIs need well-designed regulation that is appropriate to their market niche and their financial risks. This will instil a drive to establish more permanent institutions that will meet the requirements and standards of the existing large organizations.

However it is prudent to conclude that in the first instance the regulation once implemented will at the first instance attract the traditional institutions that currently are operating as either banks or NGOs that obtain funds from the public. However with time this is likely to change and the market will start attracting new entrants, which might also not have the affinity for development finance. This is because initially the thresholds set by the regulation will be quite low to attract people to the market. This is the reason why the bill has given Central Bank the mandate to prescribe that ratio that shall be maintained by a person carrying out the deposit taking micro finance business.[36]

[36] Section 9(3) the proposed deposit taking micro finance bill 2004.

Two scenarios are likely to arise from this:

1) The MFIs might lose their focus on the poor and lo-income earners in society in a bid to maximize on their profits or

2) There might be very many entrants who will create stiff competition and as a result MFIs will try to differentiate themselves by deepening their outreach to these communities.

In summary of this I will make a case for regulation and note two arguments:

1) The first is that sustainable MFIs having the and respect of the communities in which they operate, will be able to provide the target population with a broader range of financial services as long as they are permitted to mobilize deposits.

2) Secondly, these programs will strengthen the institutions and create stable financial Intermediaries that will more effectively reach low-income communities as compared to commercial banks.

So what can be said to be the probable future of the micro financing industry after regulation? Regulation of this industry is also likely to attract the already existing commercial banks to provide micro finance services. This may have the effect of buyouts by the big banks of the small micro finance institutions. The danger of this is the likelihood of convergence of sorts between the commercial banking sector and the micro finance industry. This may then render useless all the efforts of creating a unique regulatory mechanism for micro finance institutions. The regulation of the micro finance industry is likely to have an impact on the banking industry as well.

In conclusion the regulation of the micro finance industry is a good move and will bring about changes in the landscape of the MFI industry that will mark the beginning of a new regulatory regime, which will see the creation of new institutions, the exit of some and also the change and alteration of the structures of the existing ones. It is therefore a move in the right direction and the only hope we should possess is that it will achieve the expected results and attain the goals aimed at, such as creation of a streamlined industry with definite structures and defined functions that seeks to adequately to respond to the needs of a growing and upcoming economy such as the Kenyan economy.