

REGULATION AND SUPERVISION OF MICROFINANCE INSTITUTIONS IN THE  
DEVELOPMENT OF FINANCIAL INCLUSION IN KENYA: BLESSING OR CURSE?

ODHIAMBO HANNINGTON OUKO

G62/8197/2006

A Thesis Submitted in Partial Fulfillment of the Requirement for the award of  
the degree of Master of Laws of the University of Nairobi

UNIVERSITY OF NAIROBI  
SOL LIBRARY

**Supervisor: NJARAMBA GICHUKI**

University of NAIROBI Library

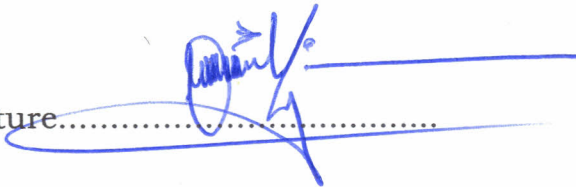


0413793 1

**DECLARATION**

This proposal is my original work and has not been presented for a degree in any other university.

**ODHIAMBO HANNINGTON OUKO**

Signature.....

Date.....25/7/2014

**REG. NO. G62/8197/2006**

This proposal has been submitted for examination with my approval as university supervisor.

**Njaramba Gichuki**

Signature.....

Date.....25/07/2014

**University of Nairobi, School of Law Parklands Campus, Nairobi**

## DEDICATIONS

In memory of my late mother **Nora Abonyo Odhiambo**, my late brother **Edwin Odhiambo Ouko**, my late sister **Rukia Achieng**. Although physically you flew away to be with the Almighty God, spiritually you will remain in my heart for ever.....in nature, nothing dies!. “From each sad moment of decay, some form of life arises” – **Charles Mackay**.

To my best friends, my beloved son **Shawn Eddy Ouko** and my daughters **Gillian Maya Adhiambo, Chantal Chantie Apiyo Ouko and Fiona-May Abonyo Ouko**. It's my hope that this work will one day inspire you to work harder in life and strive for excellence never to quit, knowing to well that struggle and resilience is the true essence of life. Even when you are down, you can still rise up and re build from ashes to accomplish what appears impossible – the word impossible should never appear in your vocabulary!.

## ACKNOWLEDGEMENT

First, to my God, my creator and my comfort. The fountain and the pillar of my life - This is truly a miracle.

This paper would not have been possible without the very able supervision of **Mr. Njaramba Gichuki**. His insight into angles of the problem that I had not seen before, more than anything else, gave this work a touch of class, completeness and reality.

To my father and mentor **Ishmael Odhiambo Ouko**, Thank you for always being the teacher that you are.

To my dear wife **Carolyn Nasimiyu Ouko**, thanks so much for the extraordinary sacrifices you made for me during the course of my studies. Without your constant prodding and encouragement, this work could not have been completed.

My gratitude also is to my classmates and my colleagues in the Banking Industry whose pulling of resources and constant criticism egged me to the finish line.

Lastly, I respectfully acknowledge the contributions of **Geoffrey Sore** and many other people whose names I have not mentioned for the assistance extended to me towards the completion of this thesis. I am truly indebted to you all, you are simply amazing. However, I hasten to add that the responsibility for all errors of commission or omission that may be exhibited in this work are to be borne by me solely.

## TABLE OF CONTENTS

DECLARATION .....	II
DEDICATIONS.....	III
ACKNOWLEDGEMENT .....	IV
GLOSSARY OF TERMS .....	2
ABSTRACT .....	3
CHAPTER ONE: INTRODUCTION.....	5
1.1 Background of the Study.....	5
1.2 Statement of the Problem .....	7
1.3 Justification of the Study.....	8
1.4 Research Objectives .....	9
1.5 Research Questions .....	9
1.6 Hypothesis.....	10
1.7 Methodology .....	10
1.8 Theoretical Framework .....	10
1.9.1 Effects of Regulation of Microfinance on Financial Inclusion.....	18
1.9.2 Challenges of Regulating Microfinance.....	21
1.9.3 Models of Regulation of Microfinance .....	23
1.10 Chapter Breakdown.....	25
CHAPTER TWO: THE LEGAL AND REGULATORY FRAMEWORK FOR MICROFINANCE IN KENYA.....	27
2.0 Introduction .....	27
2.1 Operation of Informal MFIs in Kenya .....	30

2.2 The Microfinance Act 2006 .....	32
2.2.1 Deposit Taking Microfinance restricted to Companies .....	32
2.2.2 Minimum Capital Requirements .....	35
2.2.3 Inspection and approval of DTMs by the Central Bank of Kenya.....	36
2.2.4 Minimum Liquid Asset Ratio Requirement .....	37
2.2.5 Intervention of the CBK in Management of DTMs .....	38
2.2.6 Contributions to the Deposit Protection Fund.....	39
2.2.7 Insolvency of Deposit Taking Microfinance.....	40
2.3 Non-Deposit Taking Microfinance in Kenya.....	41
2.4 The Microfinance (Amendment) Act, 2013.....	42
2.5 The Role of the Association of Microfinance Institutions in Kenya .....	44
2.6 Conclusion.....	44
<b>CHAPTER 3: COMPARATIVE STUDY OF REGULATION OF MICROFINANCE:</b>	
<b>PERU AND GHANA .....</b>	<b>46</b>
3.0 Introduction .....	46
3.1 Microfinance Regulatory Framework in Peru.....	47
3.1.1 Microfinance Services distinct from Microfinance Institutions.....	48
3.1.2 Role of Association of Microfinance Institutions of Peru .....	48
Unregulated MFI in Peru .....	48
3.1.3 Licensing of MFIs as a Regulatory Measure .....	49
3.1.4 Risk Regulations .....	50
3.1.5 Intervention by the Regulator into the Institution .....	51
3.1.6 Notable Features the Peruvian Microfinance Regulation .....	51

3.2 Regulatory Framework of Microfinance in Ghana .....	52
3.2.1 Licensing of Tier 1 and 2 MFIs in Regulations .....	53
3.2.2 Capital Requirements .....	53
3.2.3 Mandatory Liquidity Reserves for MFI in Ghana.....	54
3.3 Conclusion.....	55
<b>CHAPTER 4: PROPOSED REFORM MEASURES FOR REGULATION OF MFIS IN</b>	
<b>KENYA .....</b>	<b>56</b>
4.0 Introduction .....	56
4.1 Minimum Capital Requirements for Microfinance Institutions to be fixed by type of MFI	
.....	57
4.2 Regulation to allow NGOs do deposit taking Microfinance .....	58
4.3 CBK to Delegate Supervision of DTMs and to monitor closely the delegatee .....	59
4.4 Shift of DTMs from microfinance to Commercial Banking .....	60
4.5 Regulation of Non-Deposit Taking Microfinance .....	60
4.6 Preferential Treatment for Microfinance Institutions .....	61
4.7 Categorization of MFIs .....	63
4.7.1 Lending-only MFIs .....	64
4.7.2 Deposit Taking Microfinance .....	64
4.7.3 Money Transfer and Forex Exchange MFIs .....	65
4.7.4 The Integrated MFI .....	65
4.9 Conclusion and Research Recommendations .....	66
<b>BIBLIOGRAPHY .....</b>	<b>68</b>

## **ABBREVIATIONS**

MFI.....	Microfinance Institution
DTM.....	Deposit Taking Microfinance
CBK.....	Central Bank of Kenya
ROSCA.....	Rotating Savings and Credit Associations
ASCAS.....	Accumulating Savings and Credit Associations
M-PESA.....	A money transfer facility by Safaricom mobile service provider
SACCO.....	Savings and credit cooperative



## **GLOSSARY OF TERMS**

**Delegated regulation/supervision:** - Regulation or supervision that is outsourced by a primary prudential regulatory and supervisory body to another body, such as a federation

of retail institutions. Typically, the delegating body retains responsibility for the performance of the body to which regulation or supervision is delegated.

**Financial intermediation:** - The process of accepting repayable funds (such as funds from deposits or other borrowing) and using these to make loans or similar investments.

**Microcredit:** - Small-scale credit typically provided to self-employed or informally employed poor and low-income individuals and microenterprises.

**Microfinance:** - The provision of formal financial services to poor and low-income people and those systemically excluded from the formal financial system.

**Microfinance institution (MFI):**- A formal (i.e., legally registered) entity whose primary activity is microfinance.

**Nongovernmental organization (NGO):**- An institution that does not have “owners” (in the sense of parties with an economic stake in the outcome of the entity’s operations) and has one or more enumerated public benefit purposes, as stated in its constituent documents and often as required by law

**Prudential (regulation or supervision):**- Regulation or supervision that governs the financial soundness of licensed intermediaries’ businesses, to prevent financial-system instability and losses to small, unsophisticated depositors.

**Regulation:** - Binding rules governing the conduct of legal entities and individuals, whether they are adopted by a legislative body (laws) or an executive body (regulations).

**Supervision:**-External oversight and engagement aimed at determining and enforcing compliance with regulation.

## **ABSTRACT**

Appropriate regulation and supervision in the microfinance is imperative in bringing the poor and the low income communities the financial services that they need at their level. This is the essence of financial inclusion and it is important in the wholesome development of all sections of the population.

The aim of this research is to contribute to the understanding of microfinance regulatory and supervisory issues. The principal objective is to inform the design of regulatory policy in Kenya. This thesis provides a critical evaluation of the potential impact of regulation on microfinance institutions in achieving financial inclusion.

The analysis involves a review of existing research work on regulation of microfinance, analysis of the current microfinance regulatory framework in Kenya and a study of other jurisdictions, namely Peru and Ghana. This study finds that regulation of microfinance has an impact on the effectiveness of the institutions in increasing or encouraging financial inclusion.

Moreover, the findings in the study suggest that high minimum capital requirements for Deposit Taking Microfinance close out potential MFIs which can operate on small scale thus hampering financial inclusion. It also finds that the regulatory system of microfinance in Kenya tends to diminish the charity aspect in microfinance. In addition, the findings of the study suggest that the costs of compliance with the regulatory requirement are considerably high and outweigh the potential benefits that would be gained by the institutions. As a result, microfinance services are generally expensive and the poor shy from them.

The study thus concludes with the recommendation that a number of aspects of the microfinance regulatory system in Kenya be reviewed. It recommends

practical measures that can go a long way in addressing the problems in the current regulatory framework.

## CHAPTER ONE: INTRODUCTION

### 1.1 Background of the Study

Many studies have found close linkage between economic development and financial access<sup>1</sup>. One of the reasons given for the poor not being able to uplift their livelihoods easily in Kenya and the developing countries in general is limited access to financial services<sup>2</sup>. Microfinance has been widely accepted as a viable approach and a means to reaching the poor with financial services. Kenya, like many other countries in the world, recognized this fact and promoted the development of Microfinance Institutions (MFIs) to enable low income households to access financial services<sup>3</sup>. The rationale is that financial services offered by commercial banks were out of reach of the majority poor since they were considered 'expensive' and that in some cases, banks were too far geographically<sup>4</sup>.

The *Investopedia* defines microfinance as a type of banking service that is provided to the unemployed or low-income individuals or groups who would otherwise have no other means of gaining financial services<sup>5</sup>. The World Bank's New Microfinance Handbook emphasizes the role of microfinance in financial inclusion<sup>6</sup>. Microfinance institutions (MFI) refer to formal organizations whose

---

<sup>1</sup> World Bank, Policy Research Report (PRR) on Access to Finance: Measurement, Impact and Policy, Concept Note December, 2006, p 2. Available at [http://siteresources.worldbank.org/INTFR/Resources/PRR\\_on\\_Access\\_to\\_Finance.pdf](http://siteresources.worldbank.org/INTFR/Resources/PRR_on_Access_to_Finance.pdf) [Accessed on 16th July 2013].

<sup>2</sup> Asad Kamran Ghalib & Degol Hailu, *Banking the Un-Banked: Improving Access to Financial Services*, Policy Research Brief No. 9 2008, International Poverty Center, UNDP, NY 2008.

<sup>3</sup> Susan Johnson, "The Impact of Microfinance Institutions In Local Financial Markets: A Case Study From Kenya", *J. Int. Dev.* 16, 501-517 (2004), pp 502-503.

<sup>4</sup> *Ibid*, p 154, 158. Commercial banks raised the minimum deposits that a majority of the poor could not meet. Moreover, bank loans require security in the form of salary or other collateral security, things that the Kenyan poor could not relate with.

<sup>5</sup> <http://www.investopedia.com/terms/m/microfinance.asp> (Visited on 17th July 2013).

<sup>6</sup> Ledgerwood, Joanna, with Julie Earne and Candace Nelson, eds. 2013. *The New Microfinance Handbook: A Financial Market System Perspective*. Washington, DC: World Bank. doi: 10.1596/978-0-8213-8927-0. License: Creative Commons Attribution CC BY 3.0,

principal objectives to provide microfinance services to the economically marginalized people<sup>7</sup>. MFIs range in form and operations<sup>8</sup>.

The Concept of Micro-finance is not novel in the world. It has existed for a very long time in different parts of the world. Jonathan Swift established one of what is considered as the earliest and longest serving microfinance institution in the 1700s<sup>9</sup>. It was a micro-credit organization that provided short term small loans for poor farmers in Ireland on trust. His idea began gradually but grew into almost 300 branches in Ireland in less than ten years<sup>10</sup>.

The 1800s saw the emergence of formal savings and credit institutions in Europe organized principally among the rural and urban folks<sup>11</sup>. The institutions were motivated by concern to assist the rural population to break out of dependency on money lenders and to improve their livelihoods.

In the early 1900's Microfinance institutions had spread to North America and parts rural Latin America<sup>12</sup>. They were supported by the cooperative movement and donors. The main aims of the institutions were to increase the commercialization of the rural sector and to increase investments through credit.

The microfinance industry in Kenya has grown rapidly over the years in an attempt to meet the demand from the estimated 38 percent of Kenyans lacking access to financial services<sup>13</sup>. The microfinance industry can only meet about 20 percent of this demand<sup>14</sup>.

---

<sup>7</sup> UNCTAD, "Financial Inclusion and Development: the Role of Microfinance", UNCTAD 2008, p 3.

<sup>8</sup> The various forms and types of MFIs will be put in perspective in chapter 2 of this discourse.

<sup>9</sup> Aidan Hollis & Arthur Sweetman, "Higher Tier Agency Problems in Financial Intermediation: Theory and Evidence from the Irish Loan Funds", University of Calgary, September 1999, p 2.

<sup>10</sup> *Ibid*, p 5.

<sup>11</sup> Ananya Roy, *Poverty Capital: Microfinance and the Making of Development*, Routledge, New York, 2010, p 14.

<sup>12</sup> *Ibid*, p17.

<sup>13</sup> [www.kenyabureauofstatistics.com](http://www.kenyabureauofstatistics.com)

<sup>14</sup> FSD, *FinAccess Surveys 2009, Financial Sector Deepening Kenya, FSD 2011*, p 13.

By 2005, there were over 100 institutions involved in microfinance business in Kenya<sup>15</sup>. This number has risen steadily and financial inclusion has also improved to some extent. Between 2005 and 2009, financial access rose in most sections of the population<sup>16</sup>. Moreover, the number of people using informal services has also increased from 37.5% in 2006 to 38.7% in 2009 showing an increase in the demand for financial services that MFIs should meet<sup>17</sup>. Legal framework for regulation thus came in to ensure that MFIs achieve the desired objectives effectively. The Microfinance Act 2006 and the Microfinance Regulations are the main legal, supervisory and regulatory frameworks for Microfinance institutions in the country<sup>18</sup>.

Before the Microfinance Act 2006, the Microfinance industry was not formally regulated except for the registration requirements. There was no regulatory framework and MFIs were registered as NGOs or Savings and Credit Cooperative Societies. The CBK did not set capital or licensing requirements for MFIs and they freely operated on their own. This was one of the motivations for the enactment of the Microfinance Act 2006<sup>19</sup>.

## **1.2 Statement of the Problem**

The requirements set by law for an institution to operate as a deposit taking microfinance have been termed as very stringent such that only established companies and institutions can comply and hence qualify.<sup>20</sup> These are mainly capital requirements and the pre-requisite of being a registered company. As a

---

<sup>15</sup> George Omini, "Regulation and Supervision of Microfinance Institutions in Kenya," *Essays On Regulation and Supervision*, Central Bank of Kenya 2005, (Nairobi 2005), p 4.

<sup>16</sup> KPMG, "Financial Deepening and M4P: Lessons from Kenya and Rwanda", Development In Practice, International Development Assistance Services (IDAS) Impact Paper 9: October 2012, p 3. Available at [http://www.kpmg.com/eastafrica/en/services/Advisory/Development-Advisory-Services/Thought\\_Leadership\\_at\\_DAS/Documents/Financial%20Deepening%20and%20M4P%20%E2%80%93%20Lessons%20from%20Kenya%20and%20Rwanda.pdf](http://www.kpmg.com/eastafrica/en/services/Advisory/Development-Advisory-Services/Thought_Leadership_at_DAS/Documents/Financial%20Deepening%20and%20M4P%20%E2%80%93%20Lessons%20from%20Kenya%20and%20Rwanda.pdf) (Accessed on 25<sup>th</sup> September 2013).

<sup>17</sup> FSD, *FinAccess Surveys 2009, Financial Sector Deepening Kenya*, FSD 2009, p 13.

<sup>18</sup> Preamble of the Microfinance Act.

<sup>19</sup> Omino (2005) *Supra*, p 5.

<sup>20</sup> FSD, *FinAccess Surveys 2009, Financial Sector Deepening Kenya*, FSD 2009, p 13.

result, many willing persons who can offer microfinance services are closed out of the business thus reducing sustainable access to financial services by the poor.

The regulations also hamper financial inclusion by forcing microfinance institutions to charge expensively for their services in order to survive the competitive financial services market. With the high capital requirements and monitoring under the CBK prudential guidelines, MFIs are forced to offer their services expensively in order to comply. The poor, to whom microfinance services are intended, are thus closed out by the very institutions that should be serving them.

The regulatory framework of DTMs encourages them to transform into commercial banks such that microfinance is just a path towards being a bank. This is because the regulatory requirements of running DTMs are more or less like those of running a bank and banks are generally more profitable. Many Micro-finance institutions in Kenya have transformed into banks. K-Rep Bank, Equity Bank and Jamii Bora bank, among others, are examples. This creates a trend where entry into DTM microfinance is restrictive while exit into commercial banks is encouraged. This reduces financial inclusion.

The restrictive regulatory framework has instead encouraged the proliferation of informal microfinance institutions such as merry-go-rounds, Rotating Savings and Credit Associations (ROSCAs), Accumulating Savings and Credit Associations (ASCAs) and local money lenders<sup>21</sup>.

### **1.3 Justification of the Study**

This study will play a crucial role in informing reform measures in the regulation of microfinance and financial inclusion in Kenya. This is because it

---

<sup>21</sup> AlekeDondo, "An Overview of the Microfinance Industry in Kenya", Presentation to the UNEP Finance Initiative East African Roundtable on Sustainable Finance Opportunities and Challenges, 1<sup>st</sup> October, 2007, Nairobi, pp 3-6.

critically and objectively analyzes the impact of various models of regulation of microfinance in enhancing financial inclusion. By putting the current regulatory framework in perspective and comparing it with other practices worldwide, the study will come up with the best practices that fit the Kenyan context.

This study intends to give impetus to the vibrant growth of the formal microfinance industry which, as the study opines, is under threat. It will come up with measures that ought to be employed to ensure that accessibility of microfinance business and services is enhanced. The study also aims at coming up with measures that will ensure more institutions are comfortably operating as microfinance and that they do not use microfinance only as a path and avenue to attain commercial banking status.

Lastly, this study will add to the literature on regulation, microfinance and financial inclusion in Kenya.

#### **1.4 Research Objectives**

This paper aims to achieve the following objectives;

- i. To understand the legal and regulatory framework of MFIs in Kenya.
- ii. To establish the relationship between formal regulation of MFIs and Financial inclusion in Kenya.
- iii. To identify the best legal and regulatory frameworks, if any, that will increase accessibility of financial services the poor significantly.

#### **1.5 Research Questions**

To achieve the above objectives, this research is guided by the following questions;

- i. What is the legal regime for microfinance institutions in Kenya?



- ii. How effective are the legal and regulatory framework in promoting financial inclusion in Kenya?
- iii. What is the way forward?

### **1.6 Hypothesis**

This research works with the following hypotheses;

- i. The legal regulatory framework of MFIs in Kenya does not encourage financial services inclusion as intended.
- ii. The limited access to financial services by the poor is largely to blame on the regulatory framework.
- iii. Sound law reforms in the MFI regulatory framework can significantly increase access to financial services by the poor hence improve many livelihoods.

### **1.7 Methodology**

This discourse involves a scrutiny of both primary and secondary sources for research purposes.

The secondary sources include statutes, books, journals, government reports, newspapers, international conventions, policy and concept papers and internet sources. The study

The primary sources include statutes, international instruments with limited interview where necessary.

### **1.8 Theoretical Framework**

A number of theories on the legal regulation of MFIs in enhancing financial inclusion have emerged over time. The theories seek to explain the case for regulation and the place for the same in the microfinance industry.

The normative theory views the regulator as a third party in the microfinance market<sup>22</sup>. The normative theory holds that the regulator represents best the interest of the consumers in offering microfinance products and services. The regulator comes in to protect the consumer<sup>23</sup>. The regulator in this case is the government through agencies such as the Central Bank of Kenya.

In contrast to the normative theory is the positive regulation theory. This theory posits that regulation is an inherent aspect of the microfinance<sup>24</sup>. Stakeholders in the industry should be the regulators so that they protect their interests<sup>25</sup>. Accordingly, government does not know the needs of the players in the industry as it is a third party. Positive regulation theory is of the view that one's best interests can only be protected by the persons themselves and not a third party.

Positive approach, this study observes, is a call for self-regulation or non-regulation since a situation where market players regulate themselves is impractical given the large number of MFIs.

The other theory is the private interest theory of regulation which considers regulation as a product of the interaction between the demand and supply<sup>26</sup>. It is this interaction that determines the role of regulation. The Microfinance industry itself is vital since it helps in giving highlights of points for and against certain forms of regulation<sup>27</sup>. The essential theme of the theory is that the government has power which can be utilized in form of regulation to benefit

---

<sup>22</sup>Warren J. Samuels, "Normative Premises in Regulatory Theory", *Journal of Post Keynesian Economics*, Vol. 1, No. 1 (Autumn, 1978), pp. 100-111, p 104. Available at <http://www.jstor.org/stable/4537462>(Accessed on 30th August 2013).

<sup>23</sup>Johan den Hertog, "Review of Economic Theories Of Regulation", *Discussion Paper Series 10-18*, p 33.

<sup>24</sup> M-CRIL "Existing Legal and Regulatory Framework for the Microfinance Institutions in India: Challenges and Implications" Sa-Dhan, p 66.

<sup>25</sup>P. Fenn and C. G. Veljanovsk, "A Positive Economic Theory of Regulatory Enforcement", *The Economic Journal*, Vol. 98, No. 393 (Dec., 1988), pp. 1055-107, p 1072.

<sup>26</sup>Stigler, G. "The Theory of Economic Regulation", *Bell Journal of Economics and Management Science*, 1971, pp3-21.

<sup>27</sup>*Ibid.*

certain persons and the exercises of that power can be seen as a product whose allocation is governed by demand and supply<sup>28</sup>.

Thus, the regulation of microfinance by government should be based on the demand for financial services by the unbanked poor and the supply of microfinance services by MFIs.

Closely related to the private interest theory is the market drive theory. The theory states that the outcome of any regulation should be to leave the MFIs to be driven by the market forces of demand and supply and discourage monopolies in that area<sup>29</sup>. Others with this approach include Monique Cohen who proposes that a regulatory framework should see to it that microfinance is client centered and driven<sup>30</sup>. Others are Rutherford Stuart<sup>31</sup> and Staschen Stefan<sup>32</sup>.

Non-deposit taking microfinance institutions in Kenya are not state regulated. This does not however mean that they can operate as they want. The demand and supply forces regulate the market. This does not mean that the government has no effect on them. They must comply with the laws of the land but the regulation is not direct.

The distinguishing line between the positive interest and market driven approach theories is thin. While positive interest theory posits that market forces should determine the form of regulation, market driven approach says that market forces themselves should regulate the industry. Both the theories

---

<sup>28</sup>Posner, R. A. "Theories of Economic Regulation." *Bell Journal of Economics and Management Science* Vol 2, 1974, pp 335-58, p 342.

<sup>29</sup>*Ibid.*

<sup>30</sup> Monique Cohen, "Making Microfinance More Client-Led," *J. Int. Dev.*, 14: 335-350. doi: 10.1002/jid.881. This article was originally presented at the Marriott School Microfinance Research Symposium 'The Second Microfinance Revolution: Creating Customer-Centered Microfinance Institutions,' Provo, Utah, USA, 5 April, 2001, p 4.

<sup>31</sup>Rutherford, Stuart, "Raising the curtain on the 'micro-financial services era'," Washington D.C 2000, *CGAP Focus Note*, No. 15, p 1.

<sup>32</sup>Staschen, Stefan. "Regulation and Supervision of Microfinance Institutions: State of the Knowledge", *GTZ:Eschborn*, August 1999.

fail to appreciate that market forces work well where the market is free. This is not the case in most microfinance industries in many countries<sup>33</sup>. Thus viewing regulation from a purely market forces perspective, this study observes, may not be effective.

The economic theory of regulation is in sharp contrast to the market approach and positive interest theory. The economic theory of regulation is premised on the fact that there are market failures and that is the reason or justification for regulation<sup>34</sup>. Top on the market failures that necessitate government intervention is information asymmetries in the market and other external factors<sup>35</sup>. Regulation is therefore for the cure or removal of the market failures<sup>36</sup>.

Public interest theory of regulation is perhaps the most popular among scholars. The theory states that the rationale for regulation of microfinance is that it is for the good and interest of the public<sup>37</sup>. The theory cites the inadequacies in the financial market and the 'disadvantaged position' at which the consumers of microfinance products and services are at. They thus view regulation as a 'helping hand'<sup>38</sup>. The public interest theory posits that the government should come in with regulation in order to safeguard interests of the consumers of microfinance who are generally poor.

---

<sup>33</sup> In a free market, both the buyers and sellers should have complete knowledge of the industry. There should be free entry and exit into either the demand and supply side of the industries. Financial constraints may hamper entry into the supply side of the microfinance industry.

<sup>34</sup> Stigler, G. (1971). "The Theory of Economic Regulation." *Bell Journal of Economics and Management Science*, 1971 2: 3-21, p 16.

<sup>35</sup> Ledgerwood, Joanna, with Julie Earne and Candace Nelson, eds. 2013. *The New Microfinance Handbook: A Financial Market System Perspective*. Washington, DC: World Bank. doi: 10.1596/978-0-8213-8927, p 442.

<sup>36</sup> Staschen, S "Regulatory Impact Assessment in Microfinance: A Theoretical Framework and Its Application to Uganda." Berlin: Wissenschaftlicher Verlag Berlin 2010.

<sup>37</sup> Barth, J. R., G. Caprio and R. Levine, *Rethinking Bank Regulation: Till Angels Govern*, New York 2006, Cambridge University Press, p 316.

<sup>38</sup> Chiara Chiumya, "The Regulation Of Microfinance Institutions: A Zambian Case Study, University of Manchester," 2006, p 58.

ValentinaHartarska and Denis Nadolnyak argue that regulation is good since it controls entry and exit of MFIs from the industry<sup>39</sup>.They argue that any industry in a country must be regulated in one way or another as a matter of public policy and consumer protection<sup>40</sup>. Others in this theory are Freixas X. and Rochet Jwho put forward the information asymmetry intrinsic to the microfinance transactions as the justification for regulation<sup>41</sup>.

Llewellyn states,

*“Public interestassumes that the state, acting in the public interest, establishes a legal framework to realize aspecific set of regulatory objectives”<sup>42</sup>.*

The other theory is of specialized regulation for MFIs. Proponents hold that microfinance is a specialized industry distinct from the general banking industry and should therefore have a specialized regulation<sup>43</sup>. To them, microfinance must be viewed, not as an extension of banking, but an independent industry with unique objectives and challenges<sup>44</sup>. Thus regulation should not lump MFIs and banks together.<sup>45</sup>

A contrary approach is of course the expansion of banking regulations to inculcate MFIs. This basically states that the banking regulations in place

---

<sup>39</sup>ValentinaHartarska& Denis Nadolnyak (2007) “Do regulated microfinance institutions achieve better sustainability and outreach? Cross-country evidence,” *Applied Economics*, 39:10, 1207-1222, pp 4-5. Available at <http://dx.doi.org/10.1080/00036840500461840> (Visited on 17<sup>th</sup> July 2013).

<sup>40</sup>*Ibid.*

<sup>41</sup>Freixas, X. and Rochet, J. (1997) *Microeconomics of Banking*, MIT Press, Cambridge, Massachusetts, p 6.

<sup>42</sup>Nzaro et al, “The Impact of Regulation Policy on Product and Service Delivery of Micro-Financial Institutions: A Case of Zimbabwe”, *Global Advanced Research Journal of Management and Business Studies (ISSN: 2315-5086) Vol. 2(9)* pp. 429-438, September, 2013, p 432.

<sup>43</sup>RezartHoxhaj, Regulation and supervision of microfinance in Albania, *BEH - Business and Economic Horizons Volume 2, Issue 2, July 2010*, pp. 75-81.

<sup>44</sup>*Ibid.*

<sup>45</sup> Mike Dennis, Some Legal and Regulatory Issues Relating to Microfinance, UNCITRAL Colloquium, Vienna, January 12-13, 2011, p 15. Available at <http://www.uncitral.org/pdf/english/colloquia/microfinance/DENNIS.pdf> (Accessed on 30th August 2013).

should be expanded and modified to inculcate MFIs<sup>46</sup>. Surprisingly, The Micro Finance (Amendment) Bill 2013 seems to take this approach.

Then there is the tiered approach to regulation which considers the specific features of particular MFIs, the services that they offer and the market that they serve<sup>47</sup>. By so doing, you avoid having a blanket regulation framework for all MFIs. Van Greuning and company have come up with a model that puts all MFIs into 3 broad categories; donor or public funding dependent MFIs, member dependent MFIs and those that leverage the general public's money to fund microfinance loans<sup>48</sup>. For each of these categories, the model applies different sets of values and selected indicators of financial risks. The Alliance for Financial Inclusion also proposes the tiered approach theory to regulation of microfinance<sup>49</sup>. Joselito Gallardo also takes the path of tiered approach to regulation of MFIs<sup>50</sup>.

This study adopts the blend of public interest theory and the tiered approach.

There are also a number of theories on financial inclusion and the role of financial intermediaries. Theories of the role of financial intermediaries build on the economics of imperfect information that began to emerge during the 1970s with the seminal contributions of Akerlof, Spence and Rothschild and Stiglitz<sup>51</sup>. Financial intermediaries such as MFIs exist because they can reduce information and transaction costs that arise from an information asymmetry

---

<sup>46</sup> Reinhard H. Schmidt, "Banking Regulation Contra Microfinance / Régulation Bancaire Et Microfinance", *Savings and Development*, Vol. 24, No. 1 (2000), pp. 111-121

<sup>47</sup> Van Greuning, Hennie, Gallardo, Joselito and Randhawa, Bikki, A "Framework for Regulating Microfinance Institutions" (November 30, 1998), *World Bank Policy Research Working Paper No. 2061*, p 7-8. Available at SSRN: <http://ssrn.com/abstract=620624> (Accessed on 14<sup>th</sup> October 2013).

<sup>48</sup> *Ibid.*

<sup>49</sup> AFI, "Formalizing microsavings: A tiered approach to regulating intermediation," Alliance for Financial Inclusion Policy note, Bangkok 2010, p 3.

<sup>50</sup> See generally Gallardo, Joselito, "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Philippines (January 18, 2002)". World Bank Policy Research Working Paper No. 2755. Available at SSRN: <http://ssrn.com/abstract=634468>

<sup>51</sup> Akerlof, G. "The market for lemons: quality uncertainty and the market mechanism", (1970), *Quarterly Journal of Economics* 48, Pp 488-500.

between borrowers and lenders<sup>52</sup>. When markets do not operate with minimal costs, firms arise if they can reduce market transaction costs by organizing resources more cheaply within the firm<sup>53</sup>. Financial intermediaries thus assist the efficient functioning of markets, and any factors that affect the amount of credit channeled through financial intermediaries can have significant macroeconomic effects.

There are two strands of postulations that formally explain the existence of financial intermediaries. The first strand emphasizes financial intermediaries' provision of liquidity. The second strand focuses on financial intermediaries' ability to transform the risk characteristics of assets. In both cases, financial intermediation can reduce the cost of channeling funds between borrowers and lenders, leading to a more efficient allocation of resources<sup>54</sup>.

Diamond and Dybvig analyze the provision of liquidity (the transformation of illiquid assets into liquid liabilities) by financial institutions<sup>55</sup>. In Diamond and Dybvig's model, ex ante identical investors (depositors) are risk averse and uncertain about the timing of their future consumption needs. Without an intermediary, all investors are locked into illiquid long-term investments that yield high payoffs only to those who consume late. Those who must consume early receive low payoffs because early consumption requires premature liquidation of long-term investments. Microfinance Institutions, just like banks, can improve on a competitive market by providing better risk sharing among agents who need to consume at different (random) times. An intermediary promising investors a higher payoff for early consumption and a lower payoff for late consumption relative to the non-intermediated case enhances risk sharing and welfare.

---

<sup>52</sup> Claus, Iris, & Arthur Grimes, "Asymmetric Information, Financial Intermediation and the Monetary Transmission Mechanism: A Critical Review", (2003), *New Zealand Treasury Working Paper* 03/19

<sup>53</sup>Coase, R. H. "The nature of the firm", *Economica* 1937 4, 386-405, p 392.

<sup>54</sup>Claus, *Supra*.

<sup>55</sup>Diamond, D. W. and Dybvig, P. H. "Bank runs, deposit insurance, and liquidity", (1983), *Journal of Political Economy*, June 1983, vol. 91, no. 3, pp. 401-19, p 415.

Financial intermediaries are able to transform the risk characteristics of assets because they can overcome a market failure and resolve an information asymmetry problem. Information asymmetry in credit markets arises because borrowers generally know more about their investment projects than lenders do. The information asymmetry can occur “*ex ante*” or “*ex post*”. An *ex ante* information asymmetry arises when lenders cannot differentiate between borrowers with different credit risks before providing loans and leads to an adverse selection problem. Adverse selection problems arise when an increase in interest rates leaves a more risky pool of borrowers in the market for funds. Financial intermediaries are then more likely to be lending to high-risk borrowers, because those who are willing to pay high interest rates will, on average, be worse risks<sup>56</sup>.

The information asymmetry problem occurs *ex post* when only borrowers, but not lenders, can observe actual returns after project completion. This leads to a moral hazard problem. Moral hazard arises when a borrower engages in activities that reduce the likelihood of a loan being repaid. An example of moral hazard is when firms’ owners “siphon off” funds (legally or illegally) to themselves or to associates, for example, through loss-making contracts signed with associated firms<sup>57</sup>.

The problem with imperfect information is that information is a “public good”. If costly privately-produced information can subsequently be used at less cost by other agents, there will be inadequate motivation to invest in the publicly optimal quantity of information<sup>58</sup>. The implication for financial intermediaries is as follows. Once financial institutions obtain information they must be able to signal their information advantage to lenders without giving away their

---

<sup>56</sup> Janet Mitchell “Financial intermediation theory and implications for the sources of value in structured finance markets”, (2005), *National Bank Of Belgium , Working paper document n° 71*, p 5.

<sup>57</sup>Williamson, S. D., “Costly monitoring, financial intermediation, and equilibrium credit rationing”, (1986), *Journal of Monetary Economics* 18, 159-179, p 162.

<sup>58</sup>Hirschleifer, J. and Riley, J. G., “The analytics of uncertainty and information: an expository survey”, (1979), *Journal of Economic Literature* 17, 1375- 1421, p 1391.



information advantage. One reason, financial intermediaries can obtain information at a lower cost than individual lenders is that financial intermediation avoids duplication of the production of information. Moreover, there are increasing returns to scale to financial intermediation. Financial intermediaries develop special skills in evaluating prospective borrowers and investment projects. They can also exploit cross-sectional (across customers) information and re-use information over time<sup>59</sup>.

Leland and Pyle formally show that financial institutions can communicate information to investors about potential borrowers at a lower cost than can individual borrowers<sup>60</sup>. They focus on an ex ante information asymmetry, where entrepreneurs selling shares to the market know the expected returns of their own investment, but other agents find this information costly to observe. This results in a moral hazard problem since firms with low expected returns have an incentive to claim a high expected return so as to increase their market valuation. In Leland and Pyle's model intermediaries can solve this moral hazard problem by monitoring the actions of firms.

## 1.9 Literature Review

A lot of work has been written in this area of regulation of MFIs and sustainable access to financial inclusion. Some of the literature gives models of regulation; others put forward the case for regulation whereas others tend to give the case for non-regulation.

### **1.9.1 Effects of Regulation of Microfinance on Financial Inclusion**

Chiara Chiumyain 'The Regulation of Microfinance Institutions: A Zambian Case Study' examines the effects of regulation of MFIs in the promotion of financial inclusion in Zambia. He observes that in developing countries, banks

---

<sup>59</sup>(Claus et al) *Supra*.

<sup>60</sup>Leland, H. E. and Pyle, D. H., "Informational asymmetries, financial structure, and financial intermediation", (1977) *The Journal of Finance* 32, 371-387, p 373.

serve less than 20 percent of the population leaving a staggering 80 percent unbanked<sup>61</sup>. Microfinance comes in to help the poor households to generate income. He says that regulation is needed to enhance financial stability and to bring sanity to the microfinance market<sup>62</sup>. He also says that regulation improves the credibility and integrity of MFIs thus increasing confidence in them.

Aleke Dondo and Henry O. Oketch trace the growth of K-Rep bank, a leading microfinance institution in Kenya, from a microenterprise Credit Program into a Commercial bank<sup>63</sup>. One of the questions tackled by the paper is whether CBK's commercial banking statutory requirements and prudential norms and regulations appropriate for microfinance banks. The authors propose that microfinance banks be subjected to the same conditions or more stringent measures than those of general commercial banks<sup>64</sup>. They propose that the capital adequacy, liquidity and asset quality requirements should be at the very least, similar to those of general commercial banks. The rationale is that microfinance banks have a relatively faster and larger impact of losses.

The paper proposes that CBK should continue to allow MFIs to set their interest rates according to their financial viability and long term sustainability. The authors recommend the classification of Microfinance banks based on the time overdue in keeping with repayment period for microloans. However, the authors suggest that CBK should keep off non-bank microfinance institutions<sup>65</sup>.

---

<sup>61</sup>Chiara Chiumya, "The Regulation Of Microfinance Institutions: A Zambian Case Study", University of Manchester, 2006, p 22.

<sup>62</sup>*Ibid*, p 205.

<sup>63</sup>Aleke Dondo & Henry Oketch, "Microfinance Development in Kenya: Transforming K-Rep's Microenterprise Credit Program into a Commercial Bank", African Economic Policy, Discussion Paper Number 70.

<sup>64</sup>*Ibid*, p 5.

<sup>65</sup>*Ibid*, p 6.

Some scholars hold that regulation has no direct effect on performance of MFIs. Valentina Hartarska & Denis Nadolnyak in 'Do regulated microfinance institutions achieve better sustainability and outreach? Cross-country evidence' assesses the impact that regulation has had in ensuring that MFIs are sustainable and that they increase their reach to the poor population<sup>66</sup>. The paper takes a critical eye to regulation. Specifically, the paper analyses the impact of regulation on the performance of MFIs using data for 114 MFIs from 62 countries<sup>67</sup>.

The authors acknowledge the fact that regulated MFIs that collect savings reach more borrowers meaning that there are indirect benefits of regulation. The paper draws its conclusions without examining whether the regulations in the countries of study were complied with or not. Having regulations is one thing and complying with them another.

Muli Musinga et al, in their article, argue that regulation has a direct impact on financial inclusion<sup>68</sup>. The authors cite countries like Ethiopia, Peru and Bolivia where changes in the national law resulted in increased opportunities for micro financial services providers. On the other hand, the paper observes that in countries where the laws do not allow NGOs in provision of micro financial services, financial inclusion is reduced since potential players are closed out. Bangladesh is such a country. As such, the regulatory system has an impact on financial inclusion.

---

<sup>66</sup>Valentina Hartarska & Denis Nadolnyak (2007) "Do regulated microfinance institutions achieve better sustainability and outreach? Cross-country evidence", *Applied Economics*, 39:10, 1207-1222, DOI: Available at <http://dx.doi.org/10.1080/00036840500461840>. (Accessed on 16th August 2013)

<sup>67</sup>*Ibid*, p 2.

<sup>68</sup> Muli Musinga et al, An Evaluation of Micro-Finance Programmes in Kenya as Supported through the Dutch Co-Financing Programme, With a focus on KWFT" Evaluation of the Netherlands Co-financing Programme

Stephen Gudz cites the legal constraints as one of the hindrances to the saving culture for micro-savers in Kenya.<sup>69</sup> He observes that institutions without a banking licence are not allowed to take deposits and since most microfinance institutions do not have such licences, they are by law not allowed.<sup>70</sup> Microfinance institutions without a banking licence are forced to partner with commercial banks and thus avoid the legal constraint to saving. Thus, the level of savings in a country is affected by the national laws. The more restrictive the laws are the lower the level of saving in the country. The other constraints are financial and technical in nature according to the author.

### **1.9.2 Challenges of Regulating Microfinance**

Maria A. Sucre Reyes in her article 'Access to finance, growth and poverty: How close are the links in the case' attempts to show that thorough and regular supervision is significant for MFIs<sup>71</sup>. She however notes that regulation of MFIs is costly because the institutions are pressed to offer better customer services and good customer experience and thus increase their interest rates so as to remain sustainable. Moreover, the article finds that supervision is associated with a higher concentration of MFI staff in the head office and as a result resting staff that would otherwise be working in other branches or in the field<sup>72</sup>.

The paper posits that MFIs, especially NGOs and other socially minded institutions, will find it hard to survive regulation if they do not redefine their

---

<sup>69</sup>Stephen F Gudz, *The Potential Role of Microfinance Institutions in Mobilizing Savings: Lessons from Kenya and Uganda*, Working Paper, Department of Agricultural Resource and Management Economics, Cornell University, New York, 1999.

<sup>70</sup>*Ibid.* p 33.

<sup>71</sup> Maria S Reyes, "Access to finance, growth and poverty: How close are the links in the case" Global Development Network, Oct 2010, p 6. Available at <http://www.techrepublic.com/resource-library/whitepapers/access-to-finance-growth-and-poverty-how-close-are-the-links-in-the-case-of-bolivia/> (Accessed on 16<sup>th</sup> August 2013).

<sup>72</sup>*Ibid.*, p 6.

relationship with the poor<sup>73</sup>. Thus, regulation means redefining the relationship between the MFIs and its clientele. The author uses the regulated and non-regulated financial systems in Bolivia to show the advantages or otherwise of regulation. It is worth noting at this point that non-regulation does not mean that they do not follow any rule but that they are out of the national regulatory framework<sup>74</sup>.

The paper presents the Bolivian experience which can be very informative in the analysis of the Kenyan experience with regulation and non-regulation of MFIs. However, the paper also majored on regulation as a whole and not on the specific regulatory measures or interventions.

Chiara Chiumya highlights the challenge of that monitoring and compliance. She states that monitoring and ensuring compliance with the regulations is a hard task<sup>75</sup>. There are also challenges of regulation costs, the novelty of regulation of microfinance as an idea and inadequacy of public awareness<sup>76</sup>.

The author does an in-depth exegesis of the role and place of regulation in the microfinance industry but does not indicate how the specific regulatory measures affect the market. It demonstrates clearly the need and indispensability of regulation of MFIs but fails to address the suitability of particular regulation rules or principles leaving a research niche that this study seeks to feel. Moreover, the paper centers on regulation of MFIs in Zambia as an individual country.

---

<sup>73</sup>*Ibid*, p 6. This brings into perspective the case that is currently in Court between Jamii Bora and some of its clients. Since the matter is currently sub-judice, this paper will not make a comment in that regard.

<sup>74</sup>*Ibid*, p 8.

<sup>75</sup> Chiarra (2006) *Supra*, p 206.

<sup>76</sup>*Ibid*.

### 1.9.3 Models of Regulation of Microfinance

Kate Lauer, in addressing regulation in *The New Microfinance Handbook* chapter 17, presents different models of regulation<sup>77</sup>. According to the article, regulation refers to different types of formal legal edicts and pronouncements by government, all of which are published or otherwise made public. Unlike the previous pieces of literature, the article highlights the specific areas that regulation should affect. These include registration, licensing, supervision and management.

The authors explain the two common approaches to addressing regulation<sup>78</sup>. First is the unified or integrated approach. Here there is one supervisor dealing with prudential regulation, supervision and the conduct of business regulation. The unified system has all knowledge and information under one roof but it lacks the rigor of prudential regulation.

George Omino in his article puts forward the rationale for regulation<sup>79</sup>. The paper posits that the main reason for regulation of deposit taking microfinance is the fact that deposit taking involves a possible risk of loss depending on how the deposits are used. Thus, MFIs intending to take deposits from the public must be regulated and supervised by the CBK. The other factor that necessitate regulation of deposit taking MFIs include ensuring convenience to depositors and ensuring adequate liquidity to enable depositors to withdraw without subjecting the MFIs to solvency risks. The other is attainment of acceptable rates of returns because depositors and shareholders of MFIs expect good returns.

---

<sup>77</sup>Ledgerwood, Joanna, with Julie Earne and Candace Nelson, eds. 2013. *The New Microfinance Handbook: A Financial Market System Perspective*. Washington, DC: World Bank. doi: 10.1596/978-0-8213-8927-0. License: Creative Commons Attribution CC BY 3.0. Cap 17, pp 413-462.

<sup>78</sup>*Ibid*, p 415.

<sup>79</sup>George Omino, Regulation and Supervision of Microfinance Institutions in Kenya. Central Bank of Kenya publication, March 2005.

He recommends a tiered approach to regulation of microfinance institutions in Kenya. The first tier has deposit taking MFIs which should be regulated strictly by the CBK according to the author. The second tier has Credit-Only MFIs which should be subjected to regulations by the Ministry of Finance. The third and last tier constitutes of informal MFIs which should be supported instead of being regulated.

Stefan Staschen presents what he calls 'the twin peaks'<sup>80</sup>. This one has one government agency responsible for prudential guidelines and another responsible the conduct of business regulation. The authors observe that the twin peak approach make prudential regulation more intensive and focused. It can however suffer from miss-communication or inadequate communication between the two regulators hence hamper efficiency. The paper also explains the role of self-regulation and delegated regulation where a nongovernmental agency is mandated to carry out regulation in the industry.

Monique Cohen presents a market driven approach where the customer is at the center<sup>81</sup>. To her, a good regulatory model should put the customer at the center<sup>82</sup>. The customers of MFIs are the unbanked poor who cannot afford financial services by commercial banks<sup>83</sup>. Thus, regulation should be guided by rules and laws that enhance financial inclusion.

Kuria Wanjau et al seek to come up with a model that uses poverty incidence and population density to map the frontiers of microfinance in Kenya<sup>84</sup>. By so doing, the paper argues, a regulation system will not be uniform across the country but will be based on the poverty index and the population density of the region.

---

<sup>80</sup> Ledgerwood (2013) *Supra*, p 421.

<sup>81</sup> Monique Cohen, "Making Microfinance more Client-led", USAID.

<sup>82</sup> *Ibid*, p 10.

<sup>83</sup> Rutherford, Stuart, *The Poor and Their Money*, Oxford University, New Delhi 2000, P. 7.

<sup>84</sup> Kuria Wanjau et al, "Tackling the 'frontiers' of microfinance in Kenya: the role for decentralized services" Final Draft, DFS, March 2005.

## **1.10 Chapter Breakdown**

The study consists of five chapters.

### **i. Introduction**

Chapter one which is the introduction to the study, includes background to the study, problem statement, research objectives and questions, hypothesis, theoretical framework of the study, literature review, methodology and the structure of the study.

### **ii. The Legal and Regulatory Framework of Microfinance in Kenya**

Chapter two looks at the legal and regulatory environment of Microfinance in Kenya. It looks at the legal provisions on both the regulated (Deposit Taking MFIs) and unregulated microfinance.

### **iii. Comparative Study of Regulation of Microfinance and Financial Inclusion**

Chapter three contains a comparative study. The study puts in perspective critical legal issues in regulation of microfinance and analyzes them in view of Peru and Ghana. Peru has one of the best microfinance environments in the world according to the Global Microscope on the Microfinance Business Environment 2012 index<sup>85</sup>. In the same report, Ghana emerged best in Africa and Kenya was 10<sup>th</sup> overall. These are therefore good jurisdictions from which Kenya can draw vital lessons and best practices in the regulation of microfinance.

---

<sup>85</sup> EIU, Global Microscope on the Microfinance Business Environment 2012 (Report) Oct 2012, Economist Intelligence Unit.



#### **iv. Reform Proposals and Recommendations in the Regulation of Microfinance in Kenya**

The fourth and last chapter looks at the way forward in the legal regulatory framework of microfinance in Kenya. It will largely be informed by the findings of chapter two and three. Possible law reform will be gone into in this chapter. It will also contain the recommendations and the conclusion of the study.

## CHAPTER TWO: THE LEGAL AND REGULATORY FRAMEWORK FOR MICROFINANCE IN KENYA

### 2.0 Introduction

The concept of microfinance in the world has existed for a very long time but earliest formalized MFIs were in the early 1700s. One of the earliest formal MFI was the Irish Loan Fund system which provided loans to the rural poor<sup>86</sup>. The idea was prompted by one Jonathan Swift to assist what he termed as the 'industrious poor'. This idea spread and around the 1840s, the idea had taken root. The institutions provided small, short term loans at a small interest<sup>87</sup>. Larger MFIs emerged in the form of People's Banks, Credit Unions, and Savings and Credit Co-operatives. Credit unions, for instance, emerged to protect the poor from the money lenders of the time and to better their welfare<sup>88</sup>. Formal microfinance then spread to the other parts of the world including Africa.

There informal savings and credit institutions had existed earlier. In Africa, such institutions include "*susus*" of Ghana and "*tontines*"<sup>89</sup>. Kenya has both formal and informal MFIs. The informal MFIs are in the of grassroot organizations such as '*chamas*', merry-go-rounds, Rotating Savings and Credit Associations (ROSCAs), Accumulating Savings and Credit Associations (ASCAs) and local money lenders<sup>90</sup>. Two basic features of informal

---

<sup>86</sup> Aidan Hollis & Arthur Sweetman, "Higher Tier Agency Problems in Financial Intermediation: Theory and Evidence from the Irish Loan Funds", University of Calgary, September 1999, p 2.

<sup>87</sup> *Ibid.*

<sup>88</sup> The idea of credit union was developed by Friedrich Wilhelm Raiffeisen to make the poor independent, Michael Klein, the Cooperative Work of Friedrich Wilhelm Raiffeisen and its Christian Roots, April 2009 - IRU-Courier - Number 1, Raiffeisen, Germany 2009.

<sup>89</sup> E.H. Gueye, "Tontines And The Banking System -Is There A Case For Building Linkages, Poverty-Oriented Banking (INT/92/M01/FRG)", Working Paper No 2, Enterprise and Cooperative Development Department International Labour Office, Geneva 1992, p 6.

<sup>90</sup> Aleke Dondo, "An Overview of the Microfinance Industry in Kenya", Presentation to the UNEP Finance Initiative East African Roundtable on Sustainable Finance Opportunities and Challenges, 1<sup>st</sup> October, 2007, Nairobi, pp 3-6.

MFIs are the involvement of saving transactions and the fact that they are member-based<sup>91</sup>.

It is imperative to note at this point that this study uses 'Informal microfinance' to refer to small schemes designed to improve the well-being of the poor through easier access to saving and loaning services without reference or recourse to the legal aspects.

There are today several formal MFIs in Kenya. *Mix Market*, the global microfinance data analysis body, records that there were 233 formal MFIs in Kenya in 2013<sup>92</sup>. They evolved mainly as poverty eradication initiatives. They provide services such as loaning, saving, investment schemes, and money transfer and investment advice. MFIs in Kenya are registered under 9 different statutes depending on their nature as we shall see later in this chapter.

The microfinance industry in Kenya has done relatively well and it is ranked second best in Africa after Ghana according to Economist Intelligence Unit report 2010<sup>93</sup>. Together with Ghana, Kenya was also among the top ten in the world.<sup>94</sup> This success has been linked to a strong regulatory framework although many MFIs are still working to conform to ownership and capital requirements set up by the 2008 Microfinance Regulations<sup>95</sup>.

The regulatory system of microfinance in Kenya is largely normative with the government as the regulator through the CBK. The normative regulatory theorists, as we saw earlier, hold that a third party which is the government is the one that is best suited to represent the interests of the parties in the

---

<sup>91</sup>*Ibid.*

<sup>92</sup> Available at [http://www.mixmarket.org/profiles-reports/crossmarket-analysis-report?page=2&report\\_display\\_type=show\\_data\\_tables&fields=balance\\_sheet.gross\\_loan\\_portfolio%2Cproducts\\_and\\_clients.total\\_borrowers%2Cbalance\\_sheet.deposits%2Cproducts\\_and\\_clients.number\\_of\\_depositors&filter\\_country=Kenya&form\\_id=crossmarket\\_analysis\\_report\\_top\\_for\\_m&date\\_select=all&quarterly=ANN](http://www.mixmarket.org/profiles-reports/crossmarket-analysis-report?page=2&report_display_type=show_data_tables&fields=balance_sheet.gross_loan_portfolio%2Cproducts_and_clients.total_borrowers%2Cbalance_sheet.deposits%2Cproducts_and_clients.number_of_depositors&filter_country=Kenya&form_id=crossmarket_analysis_report_top_for_m&date_select=all&quarterly=ANN)

<sup>93</sup> EIU, "Global microscope on the microfinance business environment 2010: An index and study by the Economist Intelligence Unit", Economist Intelligence Unit Limited 2010, p 7.

<sup>94</sup>*Ibid.*

<sup>95</sup>*Ibid* p 56.

microfinance industry<sup>96</sup>. However, the normative regulatory framework for microfinance in Kenya is only as concerns Deposit Taking Microfinance. The CBK is mandated to license, regulate and supervise deposit-taking businesses under the Microfinance Act and Regulations. MFIs in Kenya are either deposit taking or non-deposit taking. Only the deposit taking MFIs are regulated under specific microfinance laws. Currently, there are 83 deposit taking microfinance institutions licensed by the Central Bank of Kenya<sup>97</sup>.

The non-deposit taking MFIs are not under direct government regulation. The parties regulate themselves by protecting their interests. There is an aspect of positive regulation where there is no involvement of a third party as a regulator<sup>98</sup>. Parties regulate themselves by the agreements that they enter into<sup>99</sup>.

This study observes that this self-regulation in non-deposit taking microfinance is not effective since the parties, i.e. the institution and the customer are not at the same bargaining power. The customers, who are generally poor, are likely to be given a raw deal due to the desperateness of having money. For instance, they are likely to accept loans with unreasonably high interest rates or other terms of repayment.

The Association of Microfinance Institutions of Kenya, an umbrella association bringing together major Microfinance Institutions in the country, enhances the capacity the industry<sup>100</sup>. It must also be noted that some Commercial banks are also venturing into microfinance business. The big banks in the

---

<sup>96</sup> Warren, *Suprap* 104.

<sup>97</sup> Central Bank of Kenya, <http://www.centralbank.go.ke/index.php/microfinance-institutions/14-bank-supervision/83-list-of-licensed-deposit-taking>. [Visited on 26<sup>th</sup> July 2010.]

<sup>98</sup> Fenn, *Supra* p 1072.

<sup>99</sup> Ministry of Finance, Medium Term Plan (2008 – 2012), for The Financial Services Sector, October 2008, p 8.

<sup>100</sup><http://www.amfikenya.com/>. (Visited on 26<sup>th</sup> July 2010).

microfinance industry are in Kenya<sup>101</sup>. This has been seen as strength to the industry by development partners such as USAID<sup>102</sup>.

## 2.1 Operation of Informal MFIs in Kenya

Informal MFIs in Kenya operate in different ways. The informal microfinance sector is dominated by Accumulating Savings & Credit Associations (ASCAS) and Rotating Savings and Credit Associations (ROSCAs)<sup>103</sup>. It must be noted that the degree of formality of informality depends on the level of regulation of the operations of the institutions.

ROSCAS can be defined as groups of persons who agree to meet for a well-defined period of time in order to save and borrow among themselves<sup>104</sup>. They are referred to as 'merry-go-rounds' in common parlance. They are very common with rural women<sup>105</sup>.

ROSCAs operate in the form off periodic contributions of specified sum in a 'pot' and the 'pot' is poured to one member each time<sup>106</sup>. The modes of selecting the member on whom the 'pot will be poured' vary from casting lots to consensus<sup>107</sup>. It may also be in the form of bidding where the person who commits to make the largest future contributions is likely to be selected. However, it must be noted that bidding only gives priority but the pot must be poured to all members. Moreover, in most cases, the entire pot is not poured. Some of the cash remains in the kitty.

---

<sup>101</sup> USAID, "Kenya Microfinance Capacity Building Program", Final Report CONTRACT: GEG-I-00-02-00011-00, TASK ORDER: 804, Development Alternatives, January 2008, p 8.

<sup>102</sup> *Ibid.*

<sup>103</sup> Ministry of Finance, Medium Term Plan (2008 – 2012), for The Financial Services Sector, October 2008, p 6.

<sup>104</sup> F.J.A. Bouman, "Indigenous savings & credit societies in the developing world" in Von Pischke, Adams & Donald (eds.) *Rural Financial Markets in the Developing World*, World Bank, Washington, 1983, p 1.

<sup>105</sup> *Ibid.*

<sup>106</sup> Timothy B & Stephen Coate, "Rotating Savings and Credit Associations, Credit Markets and Efficiency", *The Review of Economic Studies*, Vol. 61, No. 4 (Oct., 1994), pp 701-719, p 704. Available at <http://www.jstor.org/stable/229791> (Accessed on 5th August 2013).

<sup>107</sup> *Ibid.*

ASCAs are distinct from ROSCAs in that in ASCAS funds are not immediately withdrawn but are left to develop for loan making<sup>108</sup>. In ASCAS, members aim at building a pool of funds from which members can borrow from. Both ROSCAs and ASCAS are autonomous and membership is voluntary. Most of the informal microfinance institutions in Kenya are a blend of both ASCA and ROSCA.

Informal microfinance includes financial services such as loan sharks or informal shylocks and community members and saving groups. These were once the sole source of banking services to the poor but the range has greatly increased to date<sup>109</sup>. The institutions, where registered, are in most cases in the form of Self Help Groups registered with the Ministry of Sports Culture and Arts formerly Ministry of Gender, Children and Social Development. However, there are those which are registered as investment companies or societies<sup>110</sup>.

The informal microfinance plays an important role among low income members of the society. There is however need to improve their capacity in terms of technical know-how especially with ROSCAs and ASCAS. The government has established financial support through the youth enterprise fund, the women's fund and the Uwezo fund to empower such groups. However, most of them are unable to access the funds due to lack of awareness of the existence of such support initiatives or how to qualify for the same. Literacy levels are still very low and even preparing organization's constitution and applying for certificate of registration are big obstacles.

There is therefore need for awareness programmes and capacity building for informal microfinance institutions.

---

<sup>108</sup>Bouman (1983) *Supra*, p 371.

<sup>109</sup>The Central Bank of Kenya. "Annual Report 2008." Nairobi: Central Bank of Kenya, 2008. Accessed July 15, 2011. <http://www.centralbank.go.ke/publications/default.aspx>

<sup>110</sup> Societies in Kenya are registered under the Societies Act, Cap 108 of the Laws of Kenya. C

## **2.2 The Microfinance Act 2006**

Before the Microfinance Act 2006, the Microfinance industry was not formally regulated except for the registration requirements. There was no regulatory framework and MFIs were registered as NGOs or Savings and Credit Cooperative Societies. The CBK did not set capital or licensing requirements for MFIs and they freely operated on their own. This was one of the motivations for the enactment of the Microfinance Act 2006<sup>111</sup>.

The Microfinance Act is the statute that provides for the licensing, regulation and supervision of microfinance business in Kenya<sup>112</sup>. All MFIs in Kenya are registered and monitored under the Act. The Act classifies MFIs into three different levels: deposit-taking institutions, credit only non-deposit taking institutions and informal organizations as we saw in 2.2 above.

The Microfinance Act applies only to Deposit taking MFIs and specified non-deposit taking MFIs<sup>113</sup>. Thus, only Deposit Taking Microfinance have a normative regulatory framework with the CBK as the regulator.

### **2.2.1 Deposit Taking Microfinance restricted to Companies**

Deposit taking MFI must be registered as a company under the Companies Act or be subsidiaries of a duly registered bank under the Banking Act in addition to being licensed under the Microfinance Act by the Central Bank of Kenya<sup>114</sup>. Microfinance business can also be carried out through agency where the principal is qualified.

---

<sup>111</sup>Omino (2005) *Supra*, p 5.

<sup>112</sup> Preamble of the Microfinance Act.

<sup>113</sup> Section 3 of the Microfinance Act.

<sup>114</sup> Section 4(1) of the Microfinance Act.

In order to be licensed, the applicants must produce copies of documents of the registration and incorporation of the company<sup>115</sup>. The applicant must also indicate the prospective place of the microfinance operation, specifying the head office and branches if any.

The restriction of DTM business to companies may close out Non-governmental organizations and other charitable organizations which are willing to offer such services. Such institutions are forced to register companies in order to qualify. Registration of companies is complex especially in rural areas where microfinance services are in high demand<sup>116</sup>. Without a company, such institutions are forced to operate informally. Registration of a company is complex and the company registry is only in Nairobi. This is a disadvantage to MFIs which wish to operate in areas that are very far from Nairobi. Given the fact that some of the institutions only wish to operate in certain regions of the country, it is unreasonable to insist that they register as a company first in Nairobi before they can carry out deposit taking microfinance business in those areas.

Moreover, there is a tendency of microfinance losing the charitable aspect when they are registered as companies as opposed to NGOs<sup>117</sup>. Some institutions offer microfinance services as charity or giving back to the society and not from a profit motivation. Companies tend to be more profit driven and once an NGO registers a company through which to offer microfinance services, the charity aspect starts fading and being replaced by profit motivation hence making microfinance services expensive and thus reducing financial inclusion.

---

<sup>115</sup> Section 5 of the Microfinance Act. The documents include of the memorandum, articles of association, other instrument under which the company is incorporated and a verified official notification of the company's registered place of business.

<sup>116</sup> William Maema, "Legal Considerations for doing Business in Kenya" The Competitive Enhancement Programme Conference in Nairobi organized by Centre for Development of Enterprise (CDE) on 2nd February, 2007, p 8. Available at [http://www.tresgarras.com/ikm/sites/default/files/downloads/legal\\_Considerations\\_for\\_Doin\\_g\\_Business.pdf](http://www.tresgarras.com/ikm/sites/default/files/downloads/legal_Considerations_for_Doin_g_Business.pdf) (Accessed on 3rd September 2013)

<sup>117</sup>Maema, *Supra* p 13.



## **The Case of Jamii Bora Limited<sup>118</sup>**

Jamii Bora, Swahili for Good Family, began in 1998 under the headship of Mrs Ingrid Munro. Munro was motivated by the poor housing conditions in the slums of Nairobi to provide better housing through a microfinance scheme for the poor slum dwellers. She managed to convince the slum dwellers to contribute money to Jamii Bora Trust which she had started to enable them purchase land and build decent houses.

The slum dwellers heeded her call and proceeded to form self-help groups to boost them to the admirable status of home owners. They collected funds eagerly and donors came in and contributed millions of shillings to the project. The organization was able to purchase 300 acres of land and construction of low cost houses was done.

Trouble started when the founder of Jamii Bora was alleged to have sold the organization to a private company. Ingrid Munro responded by claiming that she did not sell the project but only transferred it to another investor who was willing to proceed with the objective of Jamii Bora Trust.

After the change of ownership, some of the house occupants of the houses under the project were issued with auction notices by Jamii Bora Bank for not servicing their prior loans and time had run out. The occupants demonstrated in the street in protest terming the entire project as scheme to steal from the poor. They claimed that the houses were substandard and there was need to improve them.

---

<sup>118</sup> The story made headlines across the major media houses in Kenya. The story in this study is as reported by the The People Newspaper of 18<sup>th</sup> July 2013. Christine Musa, "Jamii Bora: Nothing to write home about?", *The People Newspaper*, 18<sup>th</sup> July 2013. <http://www.thepeople.co.ke/10579/jamii-bora-nothing-to-write-home-about/> (Accessed on 20<sup>th</sup> October 2013)

According to the clients, when Jamii Bora transformed from Trust into company, the charitable aspect was lost and the motivation thereafter was purely profit. For them, it was a project to help the poor.

This study opines that Jamii Bora Trust had a more charitable than profit approach in the project but when the ownership and management shifted to a company, the project started being more profit than charity oriented.

As a trust, Jamii Bora could not carry out deposit taking microfinance. To start doing so, it had to be registered as a company and hence the change of management and the conflicts that followed. Maybe it would have been better if it was allowed to do DTM business, the charity aspect could have been retained.

### **2.2.2 Minimum Capital Requirements**

Deposit-taking MFI must demonstrate that the company meets the minimum capital requirements as prescribed in the Schedule<sup>119</sup>. An important document for prospective deposit taking MFIs is the feasibility study report which covers issues such as objectives of the business, the domestic economic situation, the financial sector environment, the legal framework of the MFI, the organizational structure and the risk analysis of the operations. The license, once issued, is renewable at the end of every 31<sup>st</sup> day of December<sup>120</sup>.

Deposit taking MFIs must keep a core capital of not less than ten percent of total risk-adjusted assets plus risk adjusted off balance sheet items<sup>121</sup>.

They must also, at all times, keep a core capital of not less than eight percent of its total deposit liabilities<sup>122</sup>. It must also keep a total capital of not less than

---

<sup>119</sup> Section 11 of the Microfinance Act.

<sup>120</sup> Section 6(3) of the Microfinance Act.

<sup>121</sup> The off balance sheet items of a deposit taking microfinance are to be determined by the Central Bank of Kenya.

<sup>122</sup> Part (b) of the schedule to the Microfinance Act on Minimum Capital Requirements.

twelve percent of its total risk-adjusted assets plus risk-adjusted off balance sheet<sup>123</sup>.

The minimum capital of a deposit taking MFIs is 60 million shillings<sup>124</sup>. The schedule provides for a 20 million minimum capital for a category of deposit taking MFIs under section 7 and yet none of the categories is specified.

These capital requirements under the Microfinance Act can only be met by well established businesses. This study opines that the capital requirements for deposit taking microfinance are restrictive especially to institutions which seek to operate on micro deposits or microloans.

### **2.2.3 Inspection and approval of DTMs by the Central Bank of Kenya**

The Central Bank of Kenya is the core regulator in deposit taking microfinance. CBK's functions range from supervisory, disciplinary, general monitoring and setting standards. The law has given the CBK a number of tools to enhance this regulation. The CBK reserves the power to issue, renew, revoke or restrict a license<sup>125</sup>.

Section 8 of the Act provides for the tool of inspection. It provides that the Central Bank may, under a warrant issued by the High Court, enter any premises and examine the books, accounts or records of any person whom it reasonably believes to be carrying out deposit-taking business contrary to the provisions of this Act.

Similarly, section 35 empowers the Central Bank to carry out an inspection or to cause an inspection to be done to any MFI suspected of contravening the Act. This is to ensure that only licensed persons carry out deposit taking microfinance business and that they do so according to the provisions of the Act.

---

<sup>123</sup> Part (c) of the schedule to the Microfinance Act on Minimum Capital Requirements.

<sup>124</sup> Part (d) of the schedule to the Microfinance Act on Minimum Capital Requirements.

<sup>125</sup> Sections 6,9 and 10 of the Microfinance Act.

The question that section 35 raises is how the suspicion of non-compliance will happen without inspection. This study opines that inspection should be available to the CBK even when a DTM is running 'smoothly'. It should not just be available when there is a problem because part of the role of the regulator should be to prevent problems as far as it can and not just try to solve problems that have arisen.

The Central Bank of Kenya also approves all places of doing deposit taking microfinance business. Under section 13, no person shall open or close a branch or place of business in Kenya without the prior approval of the Central Bank. This is perhaps for the CBK to be aware of the location of all MFIs for easy supervision. Moreover, the Central Bank has power to prescribe any activities that MFIs should not involve in.

Approval of place of business by the CBK, this study observes, is commendable. It ensures that microfinance business is carried out in known places to ease supervision and reduce possibilities of fraud.

#### **2.2.4 Minimum Liquid Asset Ratio Requirement**

The central bank also sets the Minimum Liquid Assets for deposit taking MFIs<sup>126</sup>. A liquid asset requirement, or ratio as may be, is an obligation of deposit taking microfinance to maintain a predetermined percentage of total deposits and certain other liabilities in the form of liquid assets. The minimum Liquid Assets refers to assets that are in the form of cash<sup>127</sup>. Some scholars argue that minimum liquid asset as a tool of regulation in banking is outdated and it impedes the efficiency of the financial sector<sup>128</sup>.

---

<sup>126</sup> Section 12 of the Microfinance Act.

<sup>127</sup> Barclay O'Brien, Valuing Microfinance Institutions, Giordano Dell-Amore Foundation, Savings and Development, Vol. 30, No. 3 (2006), pp. 275-296, p 281.

<sup>128</sup> Gulde, Anne-Marie, et al, "Liquid Asset Ratios and Financial Sector Reform" (October 1997). IMF Working Paper, Vol. 3, pp. 1-62, p 34. Available at SSRN: <http://ssrn.com/abstract=882711> {Accessed on 5th August 2013}.

They argue that this requirement thrives well in a macro-finance environment. Complicated banking systems with high dependence on overseas and domestic interbank markets require more detailed liquidity standards and not static ratios.<sup>129</sup>

However, to ensure security of deposits and at the same time lowering the capital requirements for DTMS, the minimum liquid asset ratio comes in handy.

### **2.2.5 Intervention of the CBK in Management of DTMs**

The Microfinance Act empowers the CBK to intervene in the management of a deposit taking MFI in certain circumstances. This may occur where the MFI has contravened the provisions of Act or the conditions upon which its licence was granted<sup>130</sup>. It may also happen where the business of the institution is being conducted in a manner detrimental to the interests of its depositors or creditors<sup>131</sup>. The intervention is after a notice by the CBK to the institution specifying the defaults noted in the conduct of the business and require the institution to take remedial action within such reasonable period as may be specified in the notice<sup>132</sup>.

Failure to comply with the notice may result in prohibition of fresh deposits, removal or suspension of the responsible officer, revocation of licence or even closure of the business among other consequences<sup>133</sup>.

The intervention of the CBK may be through appointment of a person to manage the affairs of the MFI and exercise all the powers of the institution<sup>134</sup>. The CBK may also appoint a competent person in matters microfinance into the board of the MFI. The most grievous form of intervention by the Central

---

<sup>129</sup>Ibid. p 4.

<sup>130</sup> Section 37 of the Microfinance Act.

<sup>131</sup>Ibid.

<sup>132</sup> Section 37(2) of the Microfinance Act.

<sup>133</sup>Section 37(3) of the Microfinance Act.

<sup>134</sup> Section 37(4) of the Microfinance Act.

Bank is through cancelation of any existing power of attorney, mandate, appointment or other authority by the institution in favour of any officer or any other person<sup>135</sup>.

The Central Bank may require an institution to furnish it with periodic reports of its business operations<sup>136</sup>. The reports shall have relevant information including whether or not the institution is complying with the set requirement, capital ratio requirements, adequacy of performance by management etcetera<sup>137</sup>.

### **2.2.6 Contributions to the Deposit Protection Fund**

The Microfinance Act has put in place several measures to ensure that deposits by the public to MFIs are safe. Deposit protection is part of consumer protection<sup>138</sup>.

Section 39 requires deposit taking MFIs to make contributions to the deposit protection fund established under the Banking Act<sup>139</sup>. The amount contributed by specific deposit taking MFI is prescribed by the Deposit Protection Fund Board established under section 36 of the Banking Act.

If it appears to the Board that the affairs of an institution are being conducted in a manner detrimental to the interests of the deposit-taking business or of the depositors of the institution, it may increase the contributions of that institution beyond the prescribed maximum of Ksh.s 100,000<sup>140</sup>.

---

<sup>135</sup> Section 37(4) c of the Microfinance Act.

<sup>136</sup> Section 36 of the Microfinance Act.

<sup>137</sup> Section 35(4) of the Microfinance Act.

<sup>138</sup> IDLO, "Consumer Protection and Microfinance", Country Reports, Legal Empowerment, Working Paper Series, International Development Law Organization 2011, p 65.

<sup>139</sup> Sections 17 and 37 of the Banking Act.

<sup>140</sup> Section 39(3) of the Microfinance Act and rule 2 of the Microfinance (Deposit Taking Microfinance Deposit Protection Fund) Regulations, 2009.

It is from this fund that a customer of protected deposits can claim payment in the event of insolvency of the MFI. The conditions and modes of payment are outlined in section 40 of the Microfinance Act.

This study commends the idea of deposit protection fund for financial institutions in Kenya. It's a reservoir from which depositors can be paid in case of insolvency of the institution. Care must however be taken, so that institutions do not just run themselves into insolvency since the depositors will be compensated. It is possible for some unscrupulous managers to swindle the money of the institution and customer's deposits and then apply for liquidation. This is why periodic intervention into the management of MFIs by the CBK is necessary. This will ensure that such moves by unscrupulous managers are detected early and addressed at that stage.

### **2.2.7 Insolvency of Deposit Taking Microfinance**

The Central Bank of Kenya may appoint the board as the liquidator of an MFI where it becomes insolvent<sup>141</sup>. An MFI is deemed insolvent where it is unable to pay its debts<sup>142</sup>. It is also insolvent where a winding-up order is made against it or a resolution of creditors to voluntarily wind up the business is passed. Another indicator of insolvency is when the institution is unable to pay sums due and payable to its Depositors or when the Central Bank determines that the value of the assets of an institution is less than the amount of its liabilities.

Where the deposit protection fund board is appointed as the liquidator, it will exercise all the powers of a liquidator subject to the Central Bank's or High Court's authorization<sup>143</sup>.

The principal objective of the deposit protection fund is to protect depositors in case of insolvency of the deposit taking microfinance.

---

<sup>141</sup> Section 38 of the Microfinance Act.

<sup>142</sup> This is within the meaning of section 281 the Companies Act (Cap. 486).

<sup>143</sup> Sections 38(7), 41 and 42 of the Microfinance Act.

This study is of the opinion that the role, if any, of the managers or directors in the institution becoming insolvent should be investigated and punishments administered where culpability is proved. This is to reduce cases of sheer negligence and fraud on the part of the managers and directors of such institutions. The insolvency process should be able to unearth the causes of the insolvency where possible so that those responsible can carry the responsibility to avoid the *Salomon vs. Salomon*<sup>144</sup> situation. In the case, creditors of the insolvent company could not sue the shareholders, who were the directors of the company, for outstanding debts and yet the insolvency was clearly caused by Salomon, who abused the privileges of incorporation and limited liability as rightly cited by the Court of Appeal<sup>145</sup>. This is a landmark case and demonstrates the separate legal personality of a company from the owners but also points out to the possibility of abusing the position of a company by owners.

This study proposes that when it comes to insolvency of DTMs, the Court of Appeal decision in *Salomon v A Salomon & Co LTD (1897) AC 22* should be followed.

### **2.3 Non-Deposit Taking Microfinance in Kenya**

Non-Deposit taking Microfinance institutions in Kenya are not yet regulated. There are no regulations in place so far<sup>146</sup>. However, section 3(2) of the Microfinance Act empowers the cabinet secretary in charge of finance to develop regulations concerning non-deposit taking microfinance institutions in Kenya.

---

<sup>144</sup>Salomon v A Salomon & Co LTD (1897) AC 22.

<sup>145</sup>The House of Lords, however, unanimously overturned the Court of Appeal decision.

<sup>146</sup>As at 5<sup>th</sup> August 2013. <http://www.centralbank.go.ke/index.php/microfinance-institutions/14-bank-supervision/84-non-deposit-taking> {Visited on 5th August 2013}.



The lack of regulation in non-deposit taking microfinance exposes the industry to numerous risks such as unhealthy competition, operational challenges and sustainability difficulties<sup>147</sup>.

## **2.4 The Microfinance (Amendment) Act, 2013**

The Act was assented to on 27<sup>th</sup> November 2013. The Act amends sections of the Microfinance Act, 2006, the Central Bank of Kenya Act, the National Payment System Act and the Kenya Deposit Insurance Act. The aim is to include MFIs in provisions in which MFIs had been excluded.

The Act adopts a risk-based approach to licensing to reduce transformation costs. It reduces entry requirements for deposit taking microfinance. For instance, the argument is that the licensing conditions close out many potential MFIs that would increase financial inclusion.

A risk based approach will allow MFIs with different levels of capital to operate DTM. With growing capital and increasing deposits, the risk grows higher and hence the higher capital requirement.<sup>148</sup> Where the institution is a loan only MFI, there is no risk of loss of deposits and the capital requirement doesn't need to be higher.

The Act also allows deposit taking microfinance to take part in the national payment system so as to increase their scope of financial services.<sup>149</sup> They can

---

<sup>147</sup> Denis L. Muganga, "The Role of Regulation and Supervision of Microfinance Institutions: evidence From South Africa and its Implications for the Development of Non-Deposit Taking Microfinance Regulation, in Kenya," The State University of Bergamo – Italy, Masters in Microfinance, 2009 – 2010, [http://www.universitymeetsmicrofinance.eu/uploads/2/5/8/2/25821214/denis\\_muganga.pdf](http://www.universitymeetsmicrofinance.eu/uploads/2/5/8/2/25821214/denis_muganga.pdf). Accessed on 21st May 2014.

<sup>148</sup> Shim J, "Regulatory Capital Requirement, Portfolio Risk, and Capital Determinants: Empirical Evidence from U.S Property-Liability Insurers" 2009, Illinois Wesleyan University, [http://www.fma.org/Reno/Papers/RegulatoryCapitalRequirement\\_JeungboShim.pdf](http://www.fma.org/Reno/Papers/RegulatoryCapitalRequirement_JeungboShim.pdf). Accessed on 21st May 2014.

<sup>149</sup> The Act amends section 2 of the National Payment System Act by including MFIs in the definition of national payment system. See section 3 of the Microfinance (Amendment) Act.

now carry on business activities like issuance of third party cheques, operating current accounts, foreign trade operations and agency banking.

In the Act, the risk classification of assets and provisioning policy for deposit taking microfinance has been made more reflective of the MFI lending models. This is informed by the fact that microfinance loans are short term in nature and the conditions should therefore be less burdensome for the MFIs to comply.

The Act has also introduced stress testing, outsourcing, mergers and amalgamations, permissible activities and *shariah* compliant financial services<sup>150</sup>.

The Micro-finance (Amendment) Act 2013 empowers the Central Bank to promptly give emergency loans to a micro-finance institution in a crisis to avert making the crisis worse.<sup>151</sup> The Act provides that the CBK will lend emergency loans to microfinance firms. In essence, microfinance lenders qualify to be in the class of sensitive institutions.<sup>152</sup> Microfinance lenders now qualify to be admitted to the clearing house just like commercial banks.

This study opines that the enactment and implementation of the Microfinance (Amendment) Act will resolve the minimum capital requirement challenge in the microfinance industry. However, there are still challenges in the Microfinance industry that remain in need of address. For instance, inspection of an institution by the regulator must still be with a High Court Order. Moreover, the amendment Act does not provide any form of formalized regulation for non-deposit taking microfinance. Issues of capacity building and empowerment of informal microfinance institutions are not addressed.

---

<sup>150</sup> The Microfinance (Amendment) Act.

<sup>151</sup> Section 36 of the Microfinance (Amendment) Act.

<sup>152</sup> Sensitive institutions refers to institutions whose liquidity is closely monitored by the regulator.

## **2.5 The Role of the Association of Microfinance Institutions in Kenya<sup>153</sup>**

The Association of Microfinance Institutions (AMFI) serves an important role in the microfinance industry. It is a member-based institution which was registered under the Societies Act by the leading MFIs in Kenya in 1999. The main objective is to build the capacity of the microfinance industry. Its establishment was as a result of the need for MFIs to have an avenue where they could have a common voice, lobby governments for microfinance friendly policies and to share information and experiences in the industry. It is also an avenue for networking amongst member and microfinance stakeholders.

AMFI also serves as a self regulatory mechanism in the form of Performance Monitoring System for MFIs. It sets standards and benchmarks for professionalism in the industry<sup>154</sup>.

## **2.6 Conclusion**

Before the advent of MFI regulation in the year 2006, several institutions offered microfinance financial services to the rural, peri-urban and low income sections of the populace. Those that were registered did so under the Non Governmental Organizations Co-ordination Act, the Building Societies Act, the Trustee Act, the Societies Act, the Co-operative Societies Act, the Companies Act and the Banking Act.

The continued growth of MFIs invited attention from the Government and other players. The microfinance subsector was seen as holding great potential in serving the majority unbanked Kenyan populace. Thus, to support the microfinance industry grow, it was felt that there was need to develop an enabling legal and regulatory framework to enhance standards, discipline and

---

153 <http://www.amfikenya.com> (Visited on 11th September 2013)

154 <http://www.amfikenya.com/Programs/Performance-Monitoring> (Visited on 11th September 2013).

efficiency in the microfinance subsector. These considerations together with others culminated into the enactment of the Microfinance Act, 2006.

Only the Deposit Taking Microfinance institutions are regulated directly with the CBK as the main regulator. These regulations have had direct effect on financial inclusion in Kenya. This chapter analyzed the regulatory framework of MFIs in Kenya in the face of financial inclusion.

Chapter 3 of this discourse looks at selected issues in the legal regime and does a comparative study with Peru and Ghana. The comparative study is limited to the selected issues.

## **CHAPTER 3: COMPARATIVE STUDY OF REGULATION OF MICROFINANCE: PERU AND GHANA**

### **3.0 Introduction**

The effectiveness of a microfinance regulatory system has a direct impact on the conduciveness of microfinance business environment in a country<sup>155</sup>. Different jurisdictions have approached the regulation of microfinance from different angles and the result is varying degrees of the conduciveness of the microfinance environment<sup>156</sup>. The main parameter for gauging success of microfinance industry is the contribution it makes towards enhancing financial inclusion in a country. Having looked at the microfinance regulatory framework in Kenya, this chapter conducts a comparative study the legal and regulatory regime of microfinance in Peru and Ghana.

Peru has consistently emerged top in the conduciveness of the microfinance industry according to the Global Index rankings<sup>157</sup>. Among the factors cited as the parameters of the ranking are regulatory and supervisory capacity, institutional framework, credit bureaus, pricing, dispute resolution, and government policies in microfinance. Being the best country in microfinance and a developing country like Kenya, vital lessons can be drawn from the regulatory framework of microfinance in Peru.

In the same rankings, Ghana has the best microfinance environment in Africa followed by Kenya<sup>158</sup>. It is also a developing country that is emerging and by it being in Africa, it is important to put its achievements in perspective and getting vital lessons and best practices that can be contextualized and applied in the Kenyan microfinance environment.

---

<sup>155</sup>Kenneth Kaoma Mwenda, Gerry Nkombo Muuka, (2004) "Towards best practices for micro finance institutional engagement in African rural areas: Selected cases and agenda for action", *International Journal of Social Economics*, Vol. 31 Iss: 1/2, pp.143 – 158, p 145.

<sup>156</sup>*Ibid.*

<sup>157</sup> Economist Intelligence Unit, *Global Microscope on the Microfinance Business Environment 2012*, *ECONOMIST* 6-9 (2012).

<sup>158</sup>*Ibid.*In the survey, Kenya was second to Ghana in Africa.

### 3.1 Microfinance Regulatory Framework in Peru

Microfinance in Peru emerged during the economic turmoil of the 1980s<sup>159</sup>. There were civil wars that greatly interrupted agricultural industry causing a major rural urban migration and a shift to microenterprises thus an increased demand for microfinance<sup>160</sup>. In Peru, microfinance employs almost three quarters of the active section of the population<sup>161</sup>. The regulatory system is composed of multiple supervisory and regulatory bodies<sup>162</sup>.

There are 3 categories of Microfinance institutions in Peru<sup>163</sup>. The first category is the Municipal Savings and Loan Institutions (MSLIs) which are owned by the local governments. The second is the Rural Savings and Loan Institutions (RSLI). The last category has Entities for the Development of the Small and Microenterprise (EDPYMES) which were created for regulation of the rapidly growing number of institutions in the area.

This study proposes categorization of MFIs is an appreciation of the fact that different MFIs are at different levels and applying uniform requirements across the board may be suppressive to some. For instance, the MFIs operating in rural areas are not under similar circumstances. Access to financial institutions in the towns and cities is easier and the issue of geographical limitation to access may not be a serious obstacle to financial inclusion. In the rural areas, geographical access is a real challenge. Thus, there is need to treat MFIs which operate in rural areas more favourably. Peru accords Rural Savings and Loans Institution with favourable formation and operation requirements<sup>164</sup>.

---

<sup>159</sup> Sara Pait, *The Microfinance Sector in Peru: Opportunities, Challenges and Empowerment with Gender Mainstreaming 2* (WEMAN Programme March 2009), p 3.

<sup>160</sup> *Ibid.*

<sup>161</sup> *Ibid.*, p 3.

<sup>162</sup> MixMarket, *Country Annual Briefing*, September 2011. Accessed at <http://mixmarket.org/mfi/country/Peru/report> (Visited on 14th October 2013).

<sup>163</sup> Pait, *Supra.*

<sup>164</sup> *Ibid.*

### **3.1.1 Microfinance Services distinct from Microfinance Institutions**

In Peru, microfinance is defined by considering the activity or service itself and not the institution<sup>165</sup>. As such, microfinance regulation is not limited to MFIs only. Even banks can practice microfinance lending. For instance the definition of a microloan is given by giving setting a limit. Loans that are below the limit do not require any collateral security<sup>166</sup>. Currently the limit is set at US \$ 7,000 approximately Ksh. 60,000<sup>167</sup>. Thus, whether the loan is offered by a big bank or a small microfinance institution, the rules apply.

This study suggests that regulating the service as opposed to the institution, it is possible to increase the number of sources of microfinance services. Banks and other microfinance service will also be motivated to offer microfinance services due to the preferential treatment for microfinance services. For instance, if microfinance services are zero-rated, it will serve as an incentive. Moreover, MFIs which do not offer microfinance services in the true sense of it will not enjoy undue preferential treatment accorded to microfinance services. This regulation of services as opposed to institutions is possible if microfinance is clearly and legally defined.

### **3.1.2 Role of Association of Microfinance Institutions of Peru**

#### **Unregulated MFI in Peru**

There are several microfinance institutions in Peru that are not regulated formally<sup>168</sup>. They are comprised of institutions which have expansive experience in matters microfinance. The unregulated microfinance institutions federate the Consortium of Private Organizations for Development of Small

---

<sup>165</sup>Robert Vogel, Microfinance Regulation: Lessons from Bolivia, Peru and the Philippines, Report prepared for the International Seminar on Microfinance in China and Latin America Nov. 1-2, 2012, The People's Bank of China and The Inter-American Development Bank/Multilateral Investment Fund, p 10

<sup>166</sup>*Ibid.*

<sup>167</sup>*Ibid.*

<sup>168</sup>Christian Etzensperger, Research Insight Peru - Model Market for Microfinance, responsAbility research, March 2012.

businesses and Microenterprise (COPEME)<sup>169</sup>. They mostly employ Village Bank technology in their operations. COPEME provides initial access to financial services for startups before they are incorporated into the banking system.

### **3.1.3 Licensing of MFIs as a Regulatory Measure**

Resolution number 600-98 of Peru sets out the basic entry requirements for microfinance institutions. Institutions which seek to offer microfinance services must meet the norm under the Resolution.

Firstly, the owners of the prospective MFI must submit a 'Certificate of no-Criminal Record' or in Kenyan case, certificate of good conduct. They must also produce statement of rents and properties for the institution. They must also demonstrate knowledge and experience in financial management. Thus, the experience of senior executives in financial operations is put into consideration in awarding license.

The prospective MFI is further required to submit a feasibility study of the business climate and the market in which they wish to operate in.

Once the above requirements are met, the licensing institution will visit the institution's proposed place of business and carry out an inspection of the various systems and the general condition of the office. The prospective MFI must meet the minimum capital equity for the type of microfinance they are applying.

Once this is established, the Central Bank will issue approval and the institution can commence business.

---

<sup>169</sup> Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa (COPEME).



### 3.1.4 Risk Regulations

There are different kinds of risks in the microfinance industry. There are risks of the institutions running insolvent and the depositors losing their money. The other notable risks include the security of loans by MFIs.

Solvency risks in Peru, like in Kenya, are regulated by setting a minimum capital for MFIs. However, the minimum capital requirements in Peru are set according to the different types of MFIs. Moreover, the minimum capital requirements are every trimester based on the wholesale inflation in that period.

There is also the Capital Adequacy Ratio (CAR) of at least 9.1 percent. Essentially, this means that, the risk-weighted assets of all MFIs should be up to eleven times the regulatory capital<sup>170</sup>. The regulatory capital comprises of paid capital, reserves, and losses from previous years, loan-loss provisions of loans with risk category Normal and up to 50% of paid capital in subordinated debt<sup>171</sup>.

Concerning credit risk, there are four types of loans with varying risk categories by type of the client. The first type of loans falls under commercial and microenterprise loans which are given to firms and individuals to finance their economic activities. The second type is the microenterprise loans which have a limit of US\$30,000. The other category is consumer loans which are advanced to individuals for their consumption. These are not for investment and are basically for consumption. The fourth and last category is mortgage loans which are granted for development of real property.

---

<sup>170</sup> Alfredo Ebentreich, "Microfinance Regulation in Peru: Current State, Lessons Learned, and Prospects for the Future," *Essays On Regulation And Supervision*, Microfinance Regulation and Supervision Resource Center,

<sup>171</sup> Details on regulatory capital and the risk weighted assets are outlined in articles 184° to 196° of Law N° 26702.

For microenterprise, consumer and mortgage loans are solely based on their past due dates. For commercial loans, the Peruvian regulations require, in addition, an assessment of the fiscal situation of the client<sup>172</sup>. For microloans, the institutions are allowed to set their information requirement for each of their clients depending on their circumstances by the SBS. In commercial loans the SBS sets the minimum information that each credit file should have.

It is worth noting that the Peruvian Law of the Financial, Insurance and Private Pension System, Law N° 26702, sets up certain limits on financing to a single client, to related parties, board members and employees of the institution. This is to ensure that the owners and close parties to the institutions do not favour themselves in loaning to the detriment of others.

### **3.1.5 Intervention by the Regulator into the Institution**<sup>173</sup>

There are set out procedure on how the regulator can interfere in an institution for liquidation. The regulator carries out a survey of the institution for up to 3 months in which there are limitations imposed on the scope of business activities that they can engage in. The institution must submit a rehabilitation plan within seven days after being put under surveillance. If the plan does not satisfactorily outline the rehabilitative path, the institution is liquidated<sup>174</sup>.

### **3.1.6 Notable Features the Peruvian Microfinance Regulation**

The regulation of microfinance in Peru is anchored on a number of practices.

There is a modular diversity of regulatory types and upward mobility between them. The regulatory system is also characterized by extensive supervision and

---

<sup>173</sup>Articles 95° to 123° of Law N° 26702 has the details on liquidation of financial institution.

<sup>174</sup>*Ibid.*

nondiscrimination between domestic and foreign capital<sup>175</sup>. The state does not generally intervene although there are exceptions<sup>176</sup>.

It also allows for freedom of capital allocation and the freedom to determine interest rates and commissions. The regulation has also permitted many institutions to take deposits for several regulatory forms<sup>177</sup>.

### **3.2 Regulatory Framework of Microfinance in Ghana**

In Ghana there is a separate legal framework for Non-Bank Financial Institutions (NBFIs)<sup>178</sup>. The schedule to this law lists nine different institutional types covered under the law. Non-Banking Financial Institutions are subdivided into four groups, viz. deposit-taking (other than discount houses) and non deposit-taking Non-Banking Financial Institutions, discount houses and venture capital fund companies. Four different institutional types are subsumed under non deposit-taking institutions. The category of deposit-taking Non-Bank Financial Institutions is further sub divided into savings and loan companies, building societies and credit unions<sup>179</sup>. The Credit Unions are owned by cooperative associations of individual members are registered under the Law on Co-operatives and subject to regulation by the Credit Union Supervisory Board. They are also required, under the NBFi Law, to be registered and licensed by the Bank of Ghana<sup>180</sup>.

---

<sup>175</sup> Christian, *Supra* p 5

<sup>176</sup> Law 26702, Article 7 states that "The state shall not participate in the financial system, except for its investments in COFIDE as a second-floor bank, in the Banco de la Nación and in the Banco Agropecuario."

<sup>177</sup> Christian, *Supra* p 4, 5. The institutions allowed include banks, financial services providers, Municipal Savings Banks (CMAC) and Rural Savings and Loans Banks (CRAC).

<sup>178</sup> The Financial Institutions (Non-Banking) Law, 1993

<sup>179</sup> Staschen, Stefan. "Regulation and Supervision of Microfinance Institutions: State of the Knowledge", *GTZ:Eschborn*, August 1999, p 6.

<sup>180</sup> Gallardo J, "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Philippines" The World Bank Financial Sector Development Department November 2001, p 9.

### **3.2.1 Licensing of Tier 1 and 2 MFIs in Regulations**

In Ghana, only tier 1 and Tier 2 MFIs are restricted to corporate entities. The Bank of Ghana is the one that licenses these institutions. The bank released a notice on licensing requirements for microfinance institutions<sup>181</sup>.

The shareholding of microfinance institutions such as Susu companies, Deposit taking financial NGOs and Money lending companies is restricted to citizens of Ghana. However, shareholding in non-deposit taking microfinance institutions may be exclusively Ghanaian, exclusively foreign or jointly Ghanaian and foreign.

Application for a licence must be accompanied by, among other documents a completed Personal Questionnaire on the particulars of the directors and senior persons to be in-charge of the management of the business, including their background in financial industry. There must also be a feasibility report on the business plan and financial projections for the first five years of operation. They must also give information on capital and sources of funds.

### **3.2.2 Capital Requirements**

Tier 2 and 3 entities require not less than GH¢100,000.00 and GH¢60,000.00 respectively as minimum paid-up capital. The Central Bank may issue the final approval and licence to the applicant after satisfying itself that the above and other pre-licensing conditions have been met.

The minimum capitalization requirements at entry for both Rural Banks (US\$20,000) and S&L companies (US\$50,000). These are notably below levels set for commercial and development banks. This means that the solvency standard is unimpaired capital is at least 6 percent and 10 percent for rural banks and S&L companies respectively.

---

<sup>181</sup>Licensing Requirements for Microfinance Institutions. Section A deals with tier 1 and 2 institutions.

Unlike in Kenya, Capital requirements for microfinance institutions in Ghana are not similar to those of commercial banks. This is an appreciation of the fact that capital resources of MFIs are generally less than those of commercial banks even though they are both in the finance industry. This has enabled many institutions to venture into microfinance thus improving financial inclusion in the country<sup>182</sup>.

### **3.2.3 Mandatory Liquidity Reserves for MFI in Ghana**

The Bank of Ghana is mandated to prescribe the primary and secondary reserves for deposit taking microfinance<sup>183</sup>. For rural banks, the mandatory ratio of primary reserves to total deposit liabilities is 10%<sup>184</sup>.

For portfolio risks of delinquent microfinance, there is the basket based provisioning where the aggregate outstanding balance of loans grouped in each average basket. There is no regard to security available for individual loans. Further, the Bank of Ghana requires licensed MFIs to preserve a general loss provision of 1% of the aggregate outstanding of all the current or standard class of loan assets. Financial institutions are also required to separately disclose, in their financial accounts and reports, the specific and general loss provisions made for non-performing delinquent loans and standard/current loan assets.

The mandatory liquidity reserve is set according to the type of MFI with rural MFIs having the lowest. The rationale, this study proposes, is that smaller MFIs have smaller risks. This provision has enabled MFIs in Ghana to operate

---

<sup>182</sup> (Gallard) *Supra*, p 11.

<sup>183</sup> Steel, William F. and Andah, David O., Rural and Micro Finance Regulation in Ghana: Implications for Development and Performance of the Industry (June 10, 2003). The Economy of Ghana: Analytical Perspectives on Stability, Growth and Poverty, Ernest Aryeetey and Ravi Kanbur, eds., Woeli Publishing Services and James Currey, 2008; World Bank Policy Research Working Paper No. Available at SSRN: <http://ssrn.com/abstract=1832551>

<sup>184</sup> Gallardo J, "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Philippines" The World Bank Financial Sector Development Department November 2001, p 3.

at different levels depending on their ability. It has also ensured that regulation of MFIs by the regulator is not just on DTMs alone.

### **3.3 Conclusion**

Peru and Ghana present one of the best microfinance environments in the world. The two countries, like Kenya, are third world economies and have made significant economic strides through microfinance. Although their regulatory frameworks differ in a number of ways, there are vital lessons that can be drawn depending on the uniqueness and similarity of the economic environments.

A number of lessons can be drawn from the two jurisdictions. Firstly, regulation of the services instead of the institution tends to increase the number of sources of microfinance services thus improving financial access. Targeting the microfinance services ensures that the benefits of preferential treatment go to the intended service. When the favourable treatment is accorded to institutions that are deemed to be microfinance, the institutions may not channel those benefits to favour microfinance services. Instead, they use the benefits to increase their profits in other financial services that are not micro.

Regulating MFIs at different levels or categories enables a smoother aspect specific regulation. For instance, if incentives are to be given by the regulator to start MFIs in the areas, such incentives will only be given to the rural MFIs. It is also possible to have MFIs which specialize in certain areas.

Chapter four of this study seeks to draw some of the lessons from the two countries and other areas and contextualize them in the Kenyan context. The aim is to have a regulatory framework that enhances maximum financial inclusion. The chapter also highlights the research gaps in this discourse and makes recommendations thereon.

## **CHAPTER 4: PROPOSED REFORM MEASURES FOR REGULATION OF MFIS IN KENYA**

### **4.0 Introduction**

This study confirms the first hypothesis that aspects of the regulatory regime of microfinance contribute to the financial exclusion in Kenya<sup>185</sup>. However, the financial exclusion that is in Kenya is not solely to blame on the regulatory framework of microfinance as suggested by hypothesis two. There are a couple of factors including low literacy levels. The analysis of the microfinance regulatory frameworks in Peru and Ghana reveals that sound law reforms in the MFI regulatory framework can significantly increase access to financial services by the poor. Hypothesis three is thus confirmed and it is the subject of this chapter.

This chapter proposes law reform measures in the regulation of the microfinance industry. The objective of any regulatory model for microfinance should always be financial inclusion. The challenge is how to balance financial access, financial stability, financial integrity, and consumer protection. It analyses reform measures and how they can enhance financial inclusion in Kenya.

The reform measures are informed by experiences of Kenya, Peru and Ghana. It looks at both institutional and legal reforms. The reform measures that can be considered are discussed in this chapter. The chapter also highlights aspects of microfinance that this study did not explore and the recommendations thereof.

The proposals in this study are largely based on the public interest theory. This theory of regulation provides that regulation which states that regulation

---

<sup>185</sup>Chapter 2 of this discourse.

should serve the interests of the public i.e. the low income customers of microfinance institutions<sup>186</sup>. This is because of the fact that the two parties in this case are not at the same bargaining power or levels of information and the government must step in to protect the public. This may be through deposit protection and increasing accessibility. The study also adopts a tiered approach to regulation where institutions are regulated at different level putting in mind their unique needs and types of microfinance services they offer<sup>187</sup>.

#### **4.1 Minimum Capital Requirements for Microfinance Institutions to be fixed by type of MFI**

The minimum capital requirements for financial institutions are generally meant to ensure security of deposits by the public and reduce the burden of the supervisor, in our case the Central Bank of Kenya<sup>188</sup>. The rationale for minimum capital requirements is that the lower the minimum capital, the greater the likelihood of more institutions that will require supervision<sup>189</sup>.

However, high minimum capital requirements may be a hindrance to financial inclusion if it closes out many would be DTMs from the industry.

The minimum capital requirement for Deposit Taking Microfinance in Kenya is 60 million Kenya shillings.<sup>190</sup> This has obviously closed out many potential microfinance institutions into deposit taking thus hindering financial inclusion as demonstrated in chapter 2 of this discourse. The minimum capital requirement should be connected to the commitment of the MFI in the

---

<sup>186</sup> Barth, J. R., G. Caprio and R. Levine, *Rethinking Bank Regulation: Till Angels Govern*, New York 2006, Cambridge University Press, p 316.

<sup>187</sup>Van Greuning, Hennie, Gallardo, Joselito and Randhawa, Bikki, A "Framework for Regulating Microfinance Institutions" (November 30, 1998), World Bank Policy Research Working Paper No. 2061, p 7-8. Available at SSRN: <http://ssrn.com/abstract=620624> (Accessed on 14th October 2013).

<sup>188</sup> CGAP, "A Guide to Regulation and Supervision of Microfinance," Consensus Guidelines, October 2012, p 21

<sup>189</sup>*Ibid*, p 19.

<sup>190</sup>Part (d) of the schedule to the Microfinance Act on Minimum Capital Requirements.



microfinance business and the levels of risks that they are exposed to. This should be revised to between twenty to sixty million depending on the levels of MFIs and the circumstances under which they operate. Part (d) of the schedule to the Microfinance Act on Minimum Capital Requirements should therefore be amended.

For instance, for institutions which create branches, the minimum capital requirement should be pegged on the number of branches. Institutions that have multiple branches incur more risks in terms of credit risks and operational risks hence the need for higher levels of capital to cushion depositors.

This will imply that an MFI which seeks to open one or more branches must first notify the regulator in order to review the minimum capital requirement based on the level of risks involved.

This approach will ensure that the minimum capital requirements reflect the levels of risk exposure by the institution. MFIs which want to operate at a small scale will have a chance to do so. Similarly, MFIs which want to operate on large scale will have to demonstrate capacity to secure deposits by the public through the higher capital requirements.

#### **4.2 Regulation to allow NGOs do deposit taking Microfinance**

It is appreciated that most MFIs start as non-governmental organizations which are later motivated to get into deposit taking for sustainability and often times, profitability. In Kenya and many areas in the world, NGOs are not allowed to do deposit taking microfinance business. As a result, NGOs which want to engage in DTM business have to 'transform' into a company<sup>191</sup>. This is

---

<sup>191</sup> B Randhawa & J Gallardo, Microfinance Regulation in Tanzania: Implications for Development and Performance of the Industry Africa Region Working Paper Series No. 51 June 2003, p 27.

not in actual sense transformation, but transfer of its assets to another institution. The NGO therefore simply forms a company in as an avenue to start DTM business.

This aspect presents certain challenges. With such impediments to becoming a legal entity, many MFIs do not think that formalization has anything good for them<sup>192</sup>. Moreover, the social mission of the NGO is likely to be lost when the business is under a company and that is the challenge that we see in Kenya. The social mission on most DTMs has been lost such that some commercial banks provide more micro financial services than MFIs. The ownership requirements of the company may also force the NGOs to look for other investors who may not share in the social aspect of the NGO.

Section 4(1) of the Microfinance Act should be amended to allow willing NGOs to run DTMs. This will ensure that the much needed social and charitable angle to microfinance and financial inclusion are in place.

However, care must be taken so that only established and proven NGOs should be allowed to carry out DTM business. The minimum capital requirement must be applied according to the risk levels of the MFI.

#### **4.3 CBK to Delegate Supervision of DTMs and to monitor closely the delegatee**

The regulator of commercial banks is accepted as the best placed to regulate microfinance institutions. With increased number and spread across of MFIs across the country, it is necessary to take advantage of the devolved governments and delegate some duties. The CBK can then monitor the County

---

<sup>192</sup>*Ibid.*

agencies to which the delegation has been done closely<sup>193</sup>. This will speed the process of forming and supervising MFIs across the country hence enhancing financial inclusion.

This study recommends an additional power to the CBK to allow devolution of some of its supervisory roles through delegation. This can be done by an amendment of the CBK Act or the Microfinance (Amendment) Act.

#### **4.4 Shift of DTMs from microfinance to Commercial Banking**

To address the issue of ‘successful’ DTMs leaving microfinance into banking, the study suggests that the law must be reformed such that DTMs that seek to move into banking should undertake to continue offering microfinance services even if they become banks. This is practiced by banks such as Equity bank and K –Rep Bank but it cannot just remain a matter of practice, this should be elevated and anchored in regulation. This provision can be introduced in the Deposit Taking Microfinance (Deposit Protection Fund) Regulations, 2009.

#### **4.5 Regulation of Non-Deposit Taking Microfinance**

In Kenya, non-deposit taking microfinance institutions are not formally regulated<sup>194</sup>. There are many institutions that operate informally and their financial operations are not monitored<sup>195</sup>. When left unregulated coupled with the low literacy levels of the target market for microfinance, the possibility of abuse is high. Cases have been reported of shylocks charging abnormally high

---

<sup>193</sup>CGAP, *Supra*, p 43.

<sup>194</sup> Hannah Frommell, “Does a Bigger Commercial Banking Sector Benefit The Poor? – A Minor Field Study in Kenya, Lund University” (Master’s Thesis, University of Lund 2012), p 15.

<sup>195</sup>*Ibid.*

interest rates for small amounts and failure to repay leading to demand for ‘a pound of flesh’ from the unbanked poor<sup>196</sup>.

Non-deposit taking microfinance can be monitored at the county level so that their operations are closely watched to ensure that they do not take advantage of the financial desperateness of the poor. For instance, there should be a cap on interest rates chargeable.

This study proposes that regulation must ensure that all persons involved in microfinance are registered and their activities monitored as a consumer protection tool and ensure compliance with the law.

Recommendation 4.3 above will be handy as it will help the CBK in supervising such MFIs at the county level.

#### **4.6 Preferential Treatment for Microfinance Institutions**

One of the challenges to microfinance which has been identified is that microfinance services are in some cases more expensive than commercial banking services. For instance, it was found that the interest rates on loans in microfinance are generally higher than those charged by commercial banks. The only advantage is that small loans of up to as low as Ksh. 20, 000 can be obtained from MFIs unlike most banks.

To ensure that loans from regulated MFIs are relatively lower for them to be more accessible, the CBK and development partners should offer loans to institutions that offer microfinance services at lower interest rates as an incentive. The Microfinance (Amendment) Act 2013 now qualifies MFIs to

---

<sup>196</sup>The Standard, Shylock who gets paid with a pound of flesh is exposed, Standard Newspaper, Monday, February 14<sup>th</sup> 2011,  
<http://www.standardmedia.co.ke/?id=2000028993&cid=349&articleID=2000028993>.  
(Visited on 6<sup>th</sup> September 2011).

emergency loans from the CBK. However, the issue of relatively lower rates than those of commercial banks is not addressed.<sup>197</sup>

The treatment should be on services and not institutions.

Kenya can borrow from Peru the practice of making provisions for microfinance services and not microfinance institutions. This is in recognition and acknowledgement of the fact that microfinance services are not only offered by MFIs but by banks also. Some commercial banks in Kenya offer cheaper financial services than most MFIs.

The definition of microfinance services will require the law clearly set the factors that make a service to qualify as microfinance. For instance, loans of up to Ksh. 50,000 can be set as microloans and the interest rates and repayment period favourably set. There are arguments against defining microcredits using a maximum because it closes out 'micro-lenders' from lending to borrowers who have advanced and want higher loans<sup>198</sup>. The answer to this critique would be that such borrowers should advance to macro-credit services which are readily available in commercial banks. Microfinance is meant for the low income earners and handlers of 'small' moneys.

Microfinance can also be defined in terms of the security on loans required by the financial institutions. To distinguish microfinance loans from orthodox retail banking loans, the CBK may require that microloans be uncollateralized as a rule. With such a regulation, micro-borrowers who have very little or no collateral can start with unsecured loans and invest. Once they grow their enterprises to a level where they acquire substantial assets, they can transfer to macro-credit for further growth. Micro-lenders can also be allowed to accept some collateral security which may not necessary satisfy the value of the loan fully in case of default.

---

<sup>197</sup>Section 36 of the Microfinance (Amendment) Act.

<sup>198</sup> Schicks, Jessica, and Richard Rosenberg. 2011. "Too Much Microcredit? A Survey of the Evidence on Over-Indebtedness." Occasional Paper 19. Washington, D.C.: CGAP. <http://www.cgap.org/gm/document-1.9.55377/OP19.pdf>

With defined microfinance activities, the CBK can accord such activities preferential treatment with the aim of enhancing financial inclusion in Kenya. For example, favourable tax treatment can be accorded to microfinance activities or transactions, regardless of the nature of the institution<sup>199</sup>. This study proposes that microfinance services be zero-rated as an incentive. Another preferential treatment for microfinance activities can be in the form of channelling government development loans such as the Uwezo Fund and the Women Enterprise Fund through microfinance. This is irrespective of whether the microfinance services are offered by commercial banks or MFIs<sup>200</sup>.

Defining microfinance services as opposed to microfinance institutions has the advantage of enlarging the sources of microfinance services hence increasing financial inclusion. The preferential treatment will motivate more institutions to venture into microfinance. To ensure ease of adjustment of the definition of microfinance activities due to the dynamic nature of the economy, the definition can be done in the Microfinance (Deposit Taking Microfinance Deposit Protection Fund) Regulations, 2009.

#### **4.7 Categorization of MFIs**

Another avenue that Kenya can explore to improve financial inclusion is through categorizing of microfinance institutions and according different requirements for them.

The Microfinance (Amendment) Act 2013 has adopted most of the recommendations under this heading.

---

<sup>199</sup> CGAP, "A Guide to Regulation and Supervision of Microfinance," Consensus Guidelines, October 2012, p 70.

<sup>200</sup>Uwezo fund is a development fund by the Government of Kenya to promote development programmes for women and the youth. The Women Enterprise Fund targets women groups.

### **4.7.1 Lending-only MFIs**

Some MFIs can be licensed for providing loans only. Such MFIs would in most cases be charitable organizations such as NGOs and opulent individuals who would want to give back to the society through micro-lending.

Capital requirement for such MFIs may not be necessary since there are no deposits at stake. As such, the regulator may not impose stringent capital requirements. Moreover, there can be preferential tax treatment for such micro-lenders since the motivation is not solely profit.

The regulator can thus impose non-prudential regulations only<sup>201</sup>. Non-prudential regulation is generally cheaper<sup>202</sup>.

### **4.7.2 Deposit Taking Microfinance**

These are licensed to receive deposits and give loans as well. DTMs must be subjected to prudential regulations to cushion deposits. In principle, the minimum capital should ensure that the institution can cover the infrastructure, management information system and start-up losses to reach a feasible scale<sup>203</sup>. The minimum capital should be anchored in regulation since it may become necessary to adjust. It is easier to adjust a regulation than a statutory provision<sup>204</sup>.

The Regulator can also license DTMs to take deposits up to certain level depending on their capital adequacy. If such institutions feel they are capable of taking more deposits, they must apply to the regulator who will assess the financial situation of the institution before giving the green light. This will serve

---

<sup>201</sup> Chen et al, "Growth and Vulnerabilities in Microfinance." Focus Note 61. Washington, D.C.: CGAP, February 2010.

<sup>202</sup> *Ibid.*

<sup>203</sup> Patricia J, Capital Requirements and Bank Behaviour: The Impact of The Basle Accord, Basle Committee On Banking Supervision Working Papers, No. 1 – April 1999, p 14.

<sup>204</sup> *Ibid.*

to increase the number of institutions offering microfinance services at different levels. This means that the minimum capital requirement should be in the form of a ratio.

The regulation should outline the types of permissible activities that a prudentially regulated DTM may engage in based on the capital adequacy.

In terms of management, boards of deposit-taking MFIs should include members with experience in finance and banking, as well as members who understand the clients well.

#### **4.7.3 Money Transfer and Forex Exchange MFIs**

Some institutions may be licensed for money transfer and forex exchange services only. They will also have specific prudential regulations including capital adequacy. They must demonstrate capacity to assess and manage currency risks. Although mobile telephony money transfer services has been a success story in Kenya, it is not clear why the regulator has allowed mobile telephony companies to operate without proper regulation. Money transfer services are a core element of the banking activity under the Banking Act and as such should be under the regulation of the CBK.

#### **4.7.4 The Integrated MFI**

Regulation should allow institutions which want to carry out multiple microfinance services to do so. It should not pin institutions to certain activities when they have the potential to offer multiple microfinance services. Integrated MFIs should however be subjected to all the requirements of the other categories especially in terms of capital adequacy.

They must demonstrate sufficient capacity in terms of capital, knowledge, experience, liquidity etc.

This study proposes that categorizing microfinance institutions will have a number of advantages.



Firstly, it will reduce the burden of the CBK as the regulator. MFI categories such as 'lender-only' can be regulated at the county level since there are no risks of deposit loss. CBK can remain with DTMs and the Integrated MFI.

#### **4.9 Conclusion and Research Recommendations**

There are a number of regulatory measures that Kenya can employ to increase financial inclusion in the country. Consumer protection, deposit security and financial stability are among the factors that a regulatory system should consider.

The reform measures proposed in this chapter will achieve the objective of enhancing financial inclusion in a number of ways. The first is to ensure that ensuring more microfinance providers are in the market. Moreover, by legally defining microfinance it is easier for the regulator to give specific preferential treatment to microfinance activities. The categorization of microfinance institutions based on the activities will also result in an increase of MFIs and specialization in particular kinds of microfinance services hence increased efficiency. The regulations will also allow emergence of microfinance institutions which offer specific micro-services depending on the license. This will not only see the source of microfinance widen, but also provide an extra formal avenue for charity and giving back to society through lending-only MFIs. Another vital proposal by this discourse is regulating activities as opposed to institutions. This also serves to increase the base of the sources of microfinance services since they are not restricted to formal MFIs.

This research looks at the regulatory framework of microfinance in Kenya and its impact on financial inclusion which is the core objective of microfinance. However, there are a number of aspects of regulation that this study does not delve into. Some of the aspects must be put in perspective in order to come

with specific regulatory provisions. Some of the crucial areas that are worth researching into are discussed below.

There is need for a study into the efficacy of the microfinance regulatory tools. This will go a great mile in informing the CBK and other sub-regulators as proposed herein in effective microfinance regulation. The study should be more regulator-focussed than regulated-focussed.

## **BIBLIOGRAPHY**

### **Books**

Christen, R.P., Lyman, T.R. & Rosenberg, R. 2003. Microfinance consensus guidelines and guiding principles on regulation and supervision of microfinance. CGAP publication, July.

Coetzee, G. 2005. Centre for micro-finance: providing finance for the poor. Management Today Yearbook.

Demirguc-Kunt, A. 2006. Finance and economic development: Policy choices for developing countries. World Bank Publication

Gichuki N. Law of Financial Institutions in Kenya (2nd edition). Nairobi: LawAfrica; 2013.

Hishigsuren, G. 2006. Transformation of microfinance operations from NGO to regulated MFI. IDEAS, USA.

Honohan, P. & Beck, T. 2007. Making finance work for Africa. World Bank, Washington DC 20433.

Omino, G. 2005. Regulation and Supervision of Microfinance Institutions in Kenya. Central Bank of Kenya publication, March

Rutherford, Stuart, The Poor and Their Money, Oxford University, New Delhi 200a.

Stuart Rutherford, The Poor and Their Money, OUP, New Delhi, 2000 (second impression).

Wendt, H. & Eichfeld, R. 2006: Building on success: the next challenges for microfinance. American Enterprise Institute for Public Policy Research, Development Policy Outlook series no. 4, September.

Yunus, M. 2007. What is microcredit? Grameen Bank, September.

Sengupta, R. & Aubuchon, C.P. 2008. The microfinance revolution: An overview. Federal Reserve Bank of St. Louis Review, January/February, 90(1), 9-30.

### **Journal Articles**

Akerlof, G. "The market for lemons: quality uncertainty and the market mechanism", (1970), Quarterly Journal of Economics 48, 488-500

Alfredo Ebentreich, "Microfinance Regulation in Peru: Current State, Lessons Learned, and Prospects for the Future," ESSAYS ON REGULATION AND SUPERVISION, Microfinance Regulation and Supervision Resource Center,

Avery, R B and A N Berger (1991): "An Analysis of Risk-Based Capital and Its Relation to Deposit Insurance Reform," Journal of Banking and Finance, 15 September, pp. 847-874.

Braverman, A. and J. L. Guasch (1986). "Rural Credit markets and institutions in developing countries: lessons for policy analysis from practice and modern theory." World Development 14(10/11): 1253-1267.

Christen, R.P., Lyman, T.R. & Rosenberg, R. 2003. Microfinance consensus guidelines and guiding principles on regulation and supervision of microfinance. CGAP publication, July

Diamond, D. W. and Dybvig, P. H. "Bank runs, deposit insurance, and liquidity", (1983), Journal of Political Economy 91, 40-49.

Gross, A. & Silvia, S. 2003. Microfinance and social funds: Guideline for Microfinance in poverty focused, multi-sectorial projects. Microfinance and Rural Finance, Operational Notes no. 1, World Bank/CGAP

Kenneth Kaoma Mwenda, Gerry Nkombo Muuka, (2004) "Towards best practices for micro finance institutional engagement in African rural areas: Selected cases and agenda for action", International Journal of Social Economics, Vol. 31 Iss: 1/2, pp.143 – 158.

Microfinance Gateway. 2009. What is microfinance?  
<http://www.microfinancegateway.org/p/site/m/home>.

Samolyk, K (1994): "Banking Conditions and Regional Economic Performance: Evidence of a Regional Credit Channel," Journal of Monetary Economics, 34, pp. 259-278.

Spence, M. (1973), "Job market signalling", Quarterly Journal of Economics 87, 355-374

### **Internet Articles and Working Papers**

Aleke Dondo & Henry Oketch, "Microfinance Development in Kenya: Transforming K-Rep's Microenterprise Credit Program into a Commercial Bank", African Economic Policy, Discussion Paper Number 70.

B Randhawa & J Gallardo, Microfinance Regulation in Tanzania: Implications for Development and Performance of the Industry Africa Region Working Paper Series No. 51 June 2003

Chen, Greg, Stephen Rasmussen, and Xavier Reille. 2010. "Growth and Vulnerabilities in Microfinance." Focus Note 61. Washington, D.C.: CGAP, February

CGAP. 2005. Protecting Microfinance Borrowers. CGAP Focus note no. 27, May.

CGAP, "A Guide to Regulation and Supervision of Microfinance," Consensus Guidelines, October 2012

Ernest Aryeetey and Ravi Kanbur, *THE ECONOMY OF GHANA: ANALYTICAL PERSPECTIVES ON STABILITY, GROWTH AND POVERTY*, Woeli Publishing Services and James Currey, 2008; World Bank Policy Research Working Paper No. 49. Available at SSRN: <http://ssrn.com/abstract=1832551>

Gallardo J, "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Philippines" The World Bank Financial Sector Development Department November 2001.

Gonzalez, A & Meyer, R. 2009. Microfinance and small deposit mobilization fact or fiction? MIX Data Brief No. 2, June;

Ledgerwood, Joanna, with Julie Earne and Candace Nelson, eds. 2013. *The New Microfinance Handbook: A Financial Market System Perspective*. Washington, DC: World Bank. doi: 10.1596/978-0-8213-8927-0. License: Creative Commons Attribution CC BY 3.0. Cap 17. Pp 413-462.

Littlefield, E., Morduch, J & Hashemi, S. 2003. *Is Microfinance an Effective Strategy to Reach the Millennium Development Goals?* CGAP publication, January.

Littlefield, E. & Rosenberg, R. 2004. *Microfinance and the poor: Breaking down the walls between microfinance and formal finance*. *Finance & Development*, 41(2), June

Patricia J, *Capital Requirements And Bank Behaviour: The Impact Of The Basle Accord*, Basle Committee On Banking Supervision Working Papers, No. 1 – April 1999

Rosengard, J.K., Rai, A., Dondo A. & Oketch, H.O. 2001; *Microfinance development in Kenya: transforming K-Rep's microenterprise credit program into a commercial bank*. *African Economic Policy*, Discussion paper number 70, June.

Staschen, Stefan. "Regulation and Supervision of Microfinance Institutions: State of the Knowledge", *GTZ:Eschborn*, August 1999.

Stephen F Gudz, "The Potential Role of Microfinance Institutions in Mobilizing Savings: Lessons from Kenya and Uganda," Working Paper, Department of Agricultural Resource and Management Economics, Cornell University, New York, 1999.

Wright, G.A.N. & Kaplan, M. 2001. *Savings in Africa: Remembering the Forgotten Half of Microfinance*. Nairobi Kenya: MicroSave-Africa.

### **Newspaper Articles**

Central Bank of Kenya (CBK). 2008. *Bank supervision annual report 2008*. Retrieved May 23, 2013, [www.centralbank.go.ke](http://www.centralbank.go.ke)

Republic of Kenya (GOK). 2008. The microfinance (categorization of deposit taking microfinance institutions) Regulations of 2008.

Republic of Kenya (GOK). 2006. Microfinance Act, Kenya Gazette supplement no 103 (Act no. 19) of 2006.

CGAP. 2003. *Regulation and supervision of microfinance*. Donor brief no. 12, May

## Reports

Central Bank of Kenya (CBK). 2009. Bank supervision annual report 2009. Retrieved May 23, 2013, [www.centralbank.go.ke](http://www.centralbank.go.ke);

CGAP. 2008, *Sub-Saharan Africa policy mapping*. August.

Coase, R. H. "The nature of the firm", (1937), *Economica* 4, 386-405.

Financial Sector Deepening (FSD). 2007. *Financial access in Kenya: results of the 2006 national survey*. FSD Kenya, October.

Lauer, K. 2008. *Transforming NGO MFIs: Critical Ownership Issues to Consider*. CGAP Occasional number 13, June.

Price Water House Coopers, Rural Finance Sector Restructuring and

Development, draft interim report, Rajasthan, component 1A, August 2004. Robert Vogel, Microfinance Regulation: Lessons from Bolivia, Peru and the Philippines, Report prepared for the International Seminar on Microfinance in China and Latin America Nov. 1-2, 2012, The People's Bank of China and The Inter-American Development Bank/Multilateral Investment Fund.

Janet Mitchell 'Financial intermediation theory and implications for the sources of value in structured finance markets', (2005), *National sssBank Of Belgium Working paper document n° 71*

Williamson, S. D., "Costly monitoring, financial intermediation, and equilibrium credit rationing", (1986), *Journal of Monetary Economics* 18, 159-179.

Economist Intelligence Unit, Global Microscope on the Microfinance Business Environment 2012, *ECONOMIST* 6-9 (2012).



Sara Pait, The Microfinance Sector in Peru: Opportunities, Challenges and Empowerment with Gender Mainstreaming 2 (WEMAN Programme March 2009).

Gallardo J, "A Framework for Regulating Microfinance Institutions: The Experience in Ghana and the Philippines" The World Bank Financial Sector Development Department November 2001

O. Hospes, M. Musinga, M. Ong'ayo, "An Evaluation of Micro-Finance Programmes in Kenya as Supported through the Dutch Co-Financing Programme, With a focus on KWFT" Evaluation of the Netherlands Co-financing Programme, <http://www.gdrc.org/icm/country/Kenya-finalreport.pdf>