THE LINKAGES BETWEEN MICRO FINANCE INSTITUTIONS (MFIS) AND COMMERCIAL BANKS IN KENYA

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DEDICATION

I want to dedicate this project to my Lord and Savior, Jesus Christ. In the potter's hand,

He makes something out of nothing.

To my awesome Husband, Sammy, for his unlimited support, thanks.

To my parents for their parental care, and their restless effort to educate me and for their belief in the power of education.

Edith, Doreen, Janet, Charles and Lewis thanks for all your support, love, and laughter. May the love we have for each other prosper forever.

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May the Lord bless you all!

TABLE OF CONTENTS

ABBREVIATIONS

AMFI	Association of Micro finance Institutions
CAMEL	Capital Adequacy Asset Quality Management Earnings and Liquidity
CBK	Central Bank of Kenya
CBS	Central Bureau of Statistics
CGAP	Consultative Group to Assist the Poor
FADES	Fundacion para Alternativas de Desarrollo
GOK	Government of Kenya
HFIs	Housing Finance Institutions
K-REP	Kenya Rural Enterprise Programmes
KWFT	Kenya Women Finance Trust
LDCs	Less Developed Countries
MEs	Micro Enterprises
MFIs	Microfinance Institutions
MSEs/SMEs -	Small and Micro enterprises
NCCK	National Council Church of Kenya
NGOs	Non-Govemmental Institutions
SACCOs	Savings or Credit Cooperatives
SHGs	Self Help Groups
SMEP	Small and Micro enterprises Program
USAID	U.S. Agency for International Development

LIST OF TABLES

ABSTRACT

Over many years commercial banks have not been involved in provision of micro credit to the small and micro enterprises. The sector has remained the preserve of micro finance institutions (MFIs). Liberalization of the financial sector has increased level of competition; hence banks are looking for avenues to expand their revenue base. The presence of a large underserved as well as unserved market in the small and micro credit sector has provided the opportunity to the commercial banks to enlarge their revenue.

This paper highlights ways in which the commercial banks have tried to link with the micro finance institutions so as to reach the small and micro enterprises in provision of funds. The paper observes that commercial banks lend directly to the micro finance institutions and indirectly to the small and micro enterprise through the MFIs.

The study finds that the commercial banks also receive services from the micro finance institutions which include savings and deposit mobilization among others. The study finds that in establishing the linkage, commercial banks are faced by challenges like loan repayment and low interest rate unlike the micro finance institutions whose greatest challenge is geographical location of the small and micro enterprises.

The study concludes that both categories of institutions are optimistic that there is high potential in lending to the small and micro credit sector therefore Association of Microfinance Institutions and commercial banks should establish a structure that will accommodate both financial and facilitating linkages.

CHAPTER ONE
INTRODUCTION

1.1. Background

1.1.1. Financial institutions

Financial institutions are defined as organizations that provide services that facilitate financial activities in an economy (Kapoor, 1994). The association of Microfinance institutions (AMFI) defines Microfinance to include services like savings, deposits, and insurance services aiming at the low-income earners. Microfinance institutions (MFIs) provide financial services to people and small and micro enterprises (SMEs) that do not have access to Commercial Bank loans. MFI can either be a credit union, savings or credit co-operatives (SACCOs), non-governmental organizations (NGOs), self-help organization or specialized banks. The global experience has shown that, MFIs change and develop as the scale and scope of their operations grow beyond delivery of credit services to include savings, deposit and insurance services.

1.1.2. Micro finance

Microfinance means building financial systems that serve the poor. In most developing countries like Kenya, poor people are the majority of the population, yet they are the least likely to be served by Banks. Microfinance is often seen as a marginal sector-a "development" activity that donors, governments, or social investors might care about, but not as part of the country's mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector (CGAP, 2003)

The Government of Kenya has, since the early 1990s, shown an interest in the development of small-scale and micro-enterprises. It has been aided in this effort by assistance from donors such as the World Bank, The U.S. Agency for International Development (USAID), the European Union, United Nation Development Programme (UNDP) and Ford Foundation among others. Further, Kenya's own Commercial Banking sector has started focusing on micro-enterprises and two of the major banks, the Kenya Commercial Bank and Barclays Bank have developed credit schemes in this regard (World Bank, 1997).

The key bottleneck is the shortage of strong institutions and managers. Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money. However, Microfinance works best when it measures-and discloses-its performance. Accurate, standardized performance information is imperative, both financial information (e.g., interest rates, loan repayment, and cost recovery) and social information (e.g., number of clients reached and their poverty level). The MFIs, Donors, investors, banking supervisors, and customers need this information to judge their cost, risk, and return (CGAP, 2003)

Micro finance involves the provision of thrift credit and other financial services to the poor and other small enterprises. More than 100 micro finance organizations and few Commercial Banks provide financial services to the poor in Kenya (Dondo, 2000). About 20 NGOs are financially sustainable institutions and can continue and expand its services over the long run. Achieving sustainability means lowering transaction cost offering services that are more useful to the clients, and finding new ways to reach more of the unbanked.

Estimate indicates that, about 47% of the rural population and 29% of the urban population live under conditions of absolute poverty. On the other hand, the unemployed rate current estimation is between 25% and 35%, threatens to get out of hand as roughly 0.5 million school drop outs continue to join the rank of the unemployed every year (World Bank, 2003).

High level of poverty combine with slow economic growth and therefore micro finance will reach the maximum number of poor clients only when it is integrated into the financial sector. Funding of the micro enterprises has been of great concern to various agencies in Kenya like the government, NGOs and Multilateral organizations (GOK, 2000).

The local micro finance organizations have attempted to fill the gap by using new technology to deliver services to the poor while borrowing from experience of Grameen Bank of Bangladesh, Bank Rakyat of Indonesia and Bancosol Bank of Bolivia. The MFIs have however operated without proper policy or legal framework (CBK Report, 2000).

1.1.3. The Commercial Banks

Commercial Banks on the other hand may be unwilling to provide credits to SMEs because they are poor lacking normal securities that can be used as collateral in conventional lending. Banks for along time have perceived such businesses as a highly risky and undeserving of any credit even though the business people save with the Banks. The cost associated with administering and monitoring credit services are quite high. The loan value required by people in this sector is low hence proportionally low revenue is generated from the loans (Mudiri, 2003).

The banks avoided and were unable to learn and understand the operations of the market preferring to deal with conventional lending activities that they know best. Growth in micro credit sector has been mainly driven by NGOs that are donor supported. A large number of NGOs has collapsed and are unable to operate sustainably and continue to rely heavily on donors (Baydas et al, 1997).Over the past few years banks have also made a significant push into the provision of Micro credit in order to take advantage of the prevailing high levels of profitability. The major issue that is encouraging entry into the micro credit sector is the growing level of competition within the banking industry (Baydas et al, 1997).

Celent report (2005) states that, better know-how, technology, greater access to funds, and enhanced capacity make commercial banks the most qualified to meet the untapped demand of micro entrepreneurs. More and more commercial banks are interested in entering the microfinance market which has proven to be profitable. For instance, the Grameen Bank, which only offers microfinance products and services, achieved a loan recovery rate of 98.95% and made a net profit of $6.53 million in 2005. Thus, commercial banks can see microfinance as a business opportunity and a way to attract new customers.

1.1.4. Financial linkages

Harper and Kirsten (2006) explain that, the Linkages between established or formalized financial institutions and less formal or informal financial systems create new possibilities for delivering microfinance to the poor. The literature on financial linkages is based on how the information and enforcement problems in credit markets result in a mismatch of resources and abilities between formal and informal lenders. While formal financial institutions have extensive infrastructures, systems and access to funds, they are usually further removed from poor clients, making it very difficult to obtain adequate information and reducing risks. In contrast, informal financial institutions operate close to rural clients, possess quite good information and enforcement mechanisms and are typically more flexible and innovative. However, they are constrained in the services they can offer since informal institutions lack resources and infrastructure to serve clients beyond a small geographic area, resulting in highly concentrated loan portfolios.

1.2. Statement of the Problem

The MFI sector in Kenya is expanding at a very high rate (Mullei and Bokea, 1999). Various providers of finances are coming into the sector while others are on their way out. The level of donor funding has significantly reduced, as more MFIs become self- sustaining (CBK, 2000).

Blueorchard (2004) states that, what it takes to attain MFI viability comprises positive real interest rates on loans; positive real interest rates on savings deposits; high timely repayment rates; a high degree of self-financing from internal resources; appropriate microfinance products and services; and vigorous striving for a profit-margin. Microfinance Institutions are specialized providers of financial services to the micro-enterprises. Contrary to the traditional moneylenders, the microfinance institutions tend to offer to a large number of clients the opportunity to enter a virtuous cycle of growth and capital accumulation thanks to their scale of operations and cost efficiency.

Provision of adequate credit to the informal sector has been identified as a critical vehicle for poverty eradication (G.O.K, 2000). This credit is expected to lead to the enterprises growth, increase in income, job creation, legalization and access to credit from formal institutions since informal micro enterprises become formal businesses with a view to obtaining bank credit. Achievement of these expectations would be in line with MFIs goals, which have recently been financing the SMEs. However, according to The Weekly Review (1998), MFIs have little to show on what they have achieved in financing the SMEs.

A number of researches have been done in this area but they have not dealt with the issue of the linkage between MFIs and Commercial Banks in Kenya but rather, on how MFIs reach out to SMEs. Hussain (2000) explains that, to a large extent, the efficiency of SME linkages is directly related to developments in the financial sector. Unfortunately, the fragmentation of most financial systems in Africa has resulted in a significant disintermediation that has stifled investment flows. Over time, a wide chasm has emerged between the providers of financial services and the private sector. This gap is being bridged, to some extent, by the emergence of micro-finance institutions (MFI), which are providing the much-needed linkage between formal financial institutions (the commercial banks) and less formal business entities.

The relationship between the MFIs, banks and SMEs may be described as a form of vertical enterprise networking. Furthermore, the benefits of this relationship generate clustering among informal finance operators, as they discover the importance of scale economies in their financial transactions with the MFIs. The modalities of MFI operations facilitate risk pooling, information sharing and collective responsibility; this makes their portfolios more stable and deposits more secure. Quite apart from functioning as intermediaries between the SMEs and formal banking institutions, MFIs also play a catalytic role for individuals, communities and institutions involved in the provision of informal finance (Africa Development Bank 2000).

By pooling risk and credit demand, the MFIs are in a position to channel credit from formal institutions to SMEs at reasonable cost, while mobilizing deposits from the informal sector at minimal unit cost. The opportunities for pooling create a more conducive environment for enterprise networking among SMEs. The question which has been lingering is what is the nature of the linkage between microfinance institutions and commercial banks in Kenya?

This study entails finding out whether linkages exist between Commercial Banks and MFIs in Kenya and further establish the nature of this linkage and the challenges faced by both commercial banks and MFIs in establishing the linkages.

1.3. Objectives of the Study

To establish whether there exist linkage between Commercial Banks and MFIs in Kenya.

To establish the nature of linkages between MFIs and Commercial Banks as sources of funds to SMEs

To identify the challenges faced by Commercial Banks and MFIs in establishing linkages

1.4. Importance of the Study

Funding agencies

The study will facilitate re-evaluate of programs by the funding agencies on amount lent and methodology used.

Academia

The study will contribute to the general body of knowledge and form a basis for further research.

Microfinance institutions

The study will enable the MFIs in Kenya to know to what extend they can benefit from having a linkage with Commercial Bank.

Government

The study will help the government in formulating policy that relate to the regulatory environment of the country as far as linkage of commercial banks and MFIs is concerned. It will also come up with policies that address the various challenges with the sector to reduce any resultant chaos, and facilitate faster growth with minimum drawbacks.

Banks

The study will assist the banks in their endeavors to cultivate better methods in linking with the MFIs to offer funds to the low income earners. The banks will understand the benefits and challenges they face to establishing the linkage.

AMFI

The study will enable the AMFI to understand their responsibilities in facilitating a relationship between the MFIs and the commercial banks in relation to formulation of reliable policies.

CHAPTER TWO
LITERATURE REVIEW

2.1. Financial Needs of SMEs

The importance of small and micro enterprises, also referred to as the informal sectors or the Jua kali sector in the alleviation of poverty in Kenya has been recognized in the Ministry of Finance budget speeches (1999/2000,2000/2001,2001.2003,2003/2004,)

The businesses are largely undertaken by self-employed persons; own account workers or working employers of a small number of workers (Economic Survey, 2003).The SMEs employ nearly 2.3 million people or 29% of the country's total employment (CBS 1999). The SMEs have faced persisted pressure when seeking funds for investment. The SMEs cannot easily access funding because they have underdeveloped businesses that have a very short history making the Banks unwilling to lend using conventional methods. Furthermore, the promoters have neither the education nor the ability to convince the investors or the financial intermediaries.

Owners may also not have a saving history with a financial intermediary that can form the basis for savings-led credit. This possibly explains why banks in the past few years have relocated from rural to suburban areas rendering potential customers in these areas to have no access to credits (Coetzee et al, 2002). SMEs need credits for new investment in business. Rukwaro (2000) observes that most SMEs obtain funds from own sources, including savings and from friends, citing the fact that very few creditors are willing to lend for start up businesses. SMEs also need credits for operational activities and growth of the business. Studies have also found that the most funds received from credit institutions are used as working capital (Gatune, 2002).

2.2. Access to Credit by Small and Micro Enterprises

In the recent past, the presence of micro enterprises in all the major and secondary cities in the less developed countries (LDCs) is no longer an issue of dispute among stakeholders. In a World Bank study of lending of the SME project, three objectives were more frequently cited (Webster, Riopelle and Child Zero, 1996).The objectives are to create employment and income opportunities through the creation and expansion of SMEs to increase the activity and income of vulnerable group especially women and the poor so as to decrease rural family dependency on drought through diversification of their income generating activities.

On micro lending agencies, ACCION international observes that when they started making micro loans over 25years ago they demonstrated to a disbelieving world that the working poor make excellent borrowers. As of now, micro entrepreneurs previously shut out of the financial mainstream and are viewed as desirable new markets. They further realized that these businesses not only require capital but also basic business training as lack of this can hinder their efforts to advance (ACCION International Annual Report, 2000).

World Bank Report (2001) states that, 80% of the worlds 4.5 billion people living in low and lower middle income economies do not have access to formal sector financial services. About 360 million account for the unmet demand for the commercial savings and credit service from financial institutions.

2.3. The History of MFIs in Kenya

Dondo (2000) traced the history of the MFIs in Kenya to the mid 1950s when the joint Loan Board Scheme was established to provide credit to indigenous Kenyans with the small trading business loans.

Mugwanga (1999) states that microfinance activities in Kenya started in the early 1970s after the 1972 ILO Seminar Report on employment and it was initially supported by the church based institutions like National Council Church of Kenya (NCCK) and other smaller church based NGOs. The programme were ad-hoc and done as addition to other social outreach programmes

In 1980, other specialized organizations like the Kenya Rural Enterprise Fund (K-Rep) and the Kenya Women Finance Trust (KWFT) began operating and they were heavily subsidized and relied mainly on the donors for funds using integrated approach. In 1990 the minimalist approach was adopted by a number of MFIs and other activities like training were stopped or hived into separate programme. During this period there emerged the Pride Kenya and Faulu Kenya. NCCK then established the small micro enterprise program (SMEP) then in March 1999, K-Rep was the first MFI to convert to Commercial Bank (Dondo 2000).

2.4. The Characteristics of the MFIs

Microfinance is defined by the Associate of Microfinance Institutions (AMFI) as the provision of micro credit as well as other services like savings, deposits, insurance and other financial instruments which are the products given to the poor and low income earners.

The microfinance institutions have provided the largest volume of credit to the SMEs. The market for small loans in Kenya has remained unserved for a long time and therefore filled by the microfinance institutions (Coetzee et al, 2002).

Drake and Otero (1992) states that, the board of MFIs is composed of individuals with interest in the development sector. It sets a parameter for operations but spend little time reviewing the same. Governance issue for the board is not well stated. The clients are those individuals operating micro and small enterprises while capital is provided by the donors through loans, training and operational cost. The methods for financing services involves initial testing with small groups there after combine credit and training with the focus on project design, outreach and staffing.

Christen (1997) narrate that, a successful MFI should have a clear vision; access to finance, demonstrate viability and sustainability, quality performance, high quality products that can be sold to the banking community and the ability to apply CAMEL based tool that is, Capital Adequacy, Asset Quality, Management, Earnings and Liquidity. CAMEL allows comparison on performance among firms and encourage competition. MFIs have higher administration costs than formal commercial banks and hence charge higher interests on loan.

2.5. Classification of MFIs

Financial institutions offering micro credit are classified on the basis of emphasis on micro credit at the time of establishment of the institutions, a majority of the institutions being NGOs that have always offered and continued offering the micro credit. Other NGOs started out purely as microfinance institutions but have since evolved and operated as commercial banks offering both formal and micro credit services (Glosser,1994); as for those institutions that started as banks, and have since then diversified into offering either, microcredit alongside conventional banking products include, bank Raykat Indonesia (Boomgard et al,1994); and banks that were set up primarily as microfinance banks example is Centenary Bank in Uganda (Baydas et al,1997).

The SME sector is ripe for entry of more banks because banks have a network necessary to offer loans to the sector. The commercial banks are therefore stable and can lend, given appropriate lending methodologies to a large number of people hence realizing a bigger impact. More over, banks have the resources to expand farther and lend more money. They are unlike most of the NGOs that rely heavily on donors and government support, which is dying up. Governments are beginning to realize the impact o'f the SME sector on the economy and are therefore availing mechanisms that will facilitate its growth (Budget speech, 2003/2004).

Government has realized the need to de-link them from competing with the private sector and that subsiding the sector has worked to its disadvantage. There is effort towards regulation, as well as encouraging private banks to get more involved in the sector (Coetzee, 2002). The Kenyan Government is in the process of finalizing a session paper on the SME sector, which will encourage entry of more players (Budget speech, 2003/2004).

2.6. Emergence of Micro Credit Sector

Access to formal credit by small scale business persons has been quite poor particularly among the low income category. This is largely as a result of the credit policies associated with the loan provided by the formal sector. To bridge this gap, the micro credit sector, with specific principles that target and feed loans to the SMEs sector, has emerged (Wright, 2000).

It is widely known that banks have been more active in providing savings on behalf of the SMEs sector, collecting deposits yet lending the same to the formal sector (Otero, and Rhyne, 1994). Banks are still largely absent in the provision of the micro credit. The area has literally evolved on its own accord from an informal level to the current status whereby some banks actually provide micro credit facilities as a result of growing evidence of the viability of micro credit (Oketch, 2001).

2.7. Requirement for Successful Micro Credit Providers

Micro credit is defined as credit extended by formal institutions to individual or informal groups (Reinke, 2001). Successful micro credit activities for the bank must be driven by the following among others; Oketch (2001) highlight commitment and bank culture whereby the banks must treat the micro credit sector as part of the areas within the institution where profits will be made; staff must be appropriately rewarded and motivated towards improving business and limit delinquencies; administrative structure should be put in place to ensure that the bank are able to monitor their loans from analysis to replacement; development of appropriate lending methodologies that fit the particular clientele so that the borrower can benefit from the loan programs as well as repay the loan with interest to limit default rate. The necessary capacity in terms of human resource must be in place to ensure that staffs are able to appraise loanees, and follow up on loan made (Otero et al, 1994).

2.8. Micro-Finance and Poverty Alleviation

Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. They are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit (Kim, 1995).

The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self employed households is not stable, regardless of its size. A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for collateral with a clear title - which many low-income households do not have. In addition bankers tend to consider low income households a bad risk imposing exceedingly high information monitoring costs on operation (Hari, 2006).

Over the last ten years, however, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grassroots savings and credit groups around the world have shown that these micro enterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies (Barry, 1995).

To the extent that microfmance institutions become financially viable, self sustaining, and integral to the communities in which they operate, they have the potential to attract more resources and expand services to clients. Despite the success of microfmance institutions, only about 2% of world's roughly 500 million small entrepreneurs are estimated to have access to financial services (Barry et al. 1996). Although there is demand for credit by poor and women at market interest rates, the volume of financial transaction of microfmance institution must reach a certain level before their financial operation becomes self sustaining. In other words, although microfmance offers a promising institutional structure to provide access to credit to the poor, the scale problem needs to be resolved so that it can reach the vast majority of potential customers who demand access to credit at market rates.

The question then is how micro enterprise lending geared to providing short term capital to small businesses in the informal sector can be sustained as an integral part of the financial sector and how their financial services can be further expanded using the principles, standards and modalities that have proven to be effective (Hari, 2006).

To be successful, financial intermediaries that provide services and generate domestic resources must have the capacity to meet high performance standards. They must achieve excellent repayments and provide access to clients. And they must build toward operating and financial self-sufficiency and expanding client reach. In order to do so, MFIs need to find ways to cut down on their administrative costs and also to broaden their resource base. Cost reductions can be achieved through simplified and decentralized loan application, approval and collection processes, for instance, through group loans which give borrowers responsibilities for much of the loan application process, allow the loan officers to handle many more clients and hence reduce costs (Otero et al, 1994).

MFIs can broaden their resource base by mobilizing savings, accessing capital markets, loan funds and effective institutional development support. A logical way to tap capital market is securitization through a corporation that purchases loans made by micro enterprise institutions with the funds raised through the bonds issuance on the capital market. There is at least one pilot attempt to securitize microfmance portfolio along these lines in Ecuador. As an alternative, BancoSol of Bolivia issued a certificate of deposit which is traded in Bolivian stock exchange. In 1994, it also issued certificates of deposit in the U.S. (Churchill, 1996). The Foundation for Cooperation and Development of Paraguay issued bonds to raise capital for micro enterprise lending (Grameen Trust, 1995).

2.8.1. Savings Mobilization

Savings facilities make large scale lending operations possible. On the other hand, studies also show that the poor operating in the informal sector do save, although not in financial assets, and hence value access to client-friendly savings service at least as much access to credit. Savings mobilization also makes financial institutions accountable to local shareholders. Therefore, adequate savings facilities both serve the demand for financial services by the customers and fulfill an important requirement of financial sustainability to the lenders. MFIs can either provide savings services directly through deposit taking or make arrangements with other financial institutions to provide savings facilities to tap small savings in a flexible manner (Barry, 1995).

Convenience of location, positive real rate of return, liquidity, and security of savings are essential ingredients of successful savings mobilization (Christen et a, 1994). Once microfinance institutions are engaged in deposit taking in order to mobilize household savings, they become financial intermediaries. Consequently, prudential financial regulations become necessary to ensure the solvency and financial soundness of the institution and to protect the depositors. However, excessive regulations that do not consider the nature of mfis and their operation can hamper their viability. In view of small loan size, mfis should be subjected to a minimum capital requirement which is lower than that applicable to commercial banks. On the other hand, a more stringent capital adequacy rate (the ratio between capital and risk assets) should be maintained because mfis provide uncollateralized loans (Christen et al, 1994).

2.8.2. The Legal and Regulatory Framework

Government should provide an enabling legal and regulatory framework which encourages the development of a range of institutions and allows them to operate as recognized financial intermediaries subject to simple supervisory and reporting requirements. MFIs should be given freedom of setting interest rates and fees in order to cover operating and finance costs from interest revenues within a reasonable amount of time. Government could also facilitate the process of transition to a sustainable level of operation by providing support to the lending institutions in their early stage of development through credit enhancement mechanisms or subsidies (Christen et al, 1994).

2.8.3. Microfinance Operations

One way of expanding the successful operation of mfis in the informal sector is through strengthened linkages with their formal sector counterparts. A mutually beneficial partnership should be based on comparative strengths of each sector. Informal sector mfis have comparative advantage in terms of small transaction costs achieved through adaptability and flexibility of operations (Ghate et al, 1992). They are better equipped to deal with credit assessment of the urban poor and hence to absorb the transaction costs associated with loan processing. On the other hand, formal sector institutions have access to broader resource-base and high leverage through deposit mobilization (Christen et al, 1994).

2.9. The Formal Sector Institutions

Hari (2006) states that, formal sector finance institutions could form a joint venture with informal sector institutions in which the former provide funds in the form of equity and the later extends savings and loan facilities to the urban poor. Another form of partnership can involve the formal sector institutions refinancing loans made by the informal sector lenders. Under these settings, the informal sector institutions are able to tap additional resources as well as having an incentive to exercise greater financial discipline in their management.

MFIs could also serve as intermediaries between borrowers and the formal financial sector and on-lend funds backed by a public sector guarantee (Phelps, 1995). Business-like NGOs can offer commercial banks ways of funding micro entrepreneurs at low cost and risk, for example, through leveraged bank-NGO-client credit lines. Under this arrangement, banks make one bulk loan to NGOs and the NGOs packages it into large number of small loans at market rates and recover them (Women's World Banking, 1994). There are many on-going researches on this line but context specific research is needed to identify the most appropriate model.

Traditionally, the formal sector Banking Institutions in Kenya have been serving only the needs of the commercial sector and providing loans for middle and upper income groups. Similarly, for housing the HFCK has generally not evolved a lending product to serve the needs of the poor primarily because of the perceived risks of lending to this sector. Following risks are generally perceived by the formal sector financial institutions include; Credit Risk , high transaction and service cost, absence of land tenure for financing housing , irregular flow of income due to seasonality, lack of tangible proof for assessment of income , and unacceptable collaterals such as crops, utensils and jewellery (Hari, 2006).

As far as the formal financial institutions are concerned, there are Commercial Banks, Housing Finance Institutions (HFIs), Rural Development Banks, and Co-operative Banks among others.

2.10. Banks and Micro Credit Sector

Mudiri (2003) states that, banks may be willing to provide credit to the small and micro credit sector because the clients of the sector are largely poor, lacking of normal securities that can be used as collateral in conventional lending. Banks have therefore for along time perceived such businesses as highly risky and undeserving any credit even though the business persons save with the banks. Moreover, the costs associated with the administering and monitoring credit services are quite high. The loan value required by the clients in this sector is low hence proportionately low revenues are generated from the loans. This is an issue that could explain why for a long time lending to the rural areas has been driven by governments or donors who subsidizes lending. Banks have also been unable to develop the necessary capacity to be sustainable in the market.

The banks avoid and were unable to learn and understand the operation of the market preferring to deal with the conventional lending activities that they know best. A better understanding of the market would lead to better credit risk management technologies that would enhance their revenue generating activities. It is also evident that government regulations have not encouraged commercial banks into the sector. Central banks demand cash ratios that limit the availability of funds to lend, while nature and cost of setting up and operating banking promises discourage banks from locating in areas where the poor would access loans (Baydas et al, 1997).

Growth in the micro sector has been mainly driven by NGOs that are donor supported. A large number of this donors have collapsed or are unable to operate sustain ably and continue to rely heavily on donors (Baydas et al, 1997).

Initial attempts into the micro lending were made by the governments through creation of development banks that were made to allocate credit to certain sector at subsidized rates. Studies have shown that direct credit has undermined development of sound financial systems in many third world countries mainly because the loans are limited to budgetary allocation and are priced below the market rates. The presence of moral hazards in many developing countries means that credit rarely reaches desired clients and, in many cases, there is no obligation to repay the loan. (Coetzee, 1997).

2.11. The Theory Behind Financial Linkages

Harper and Kirsten (2006) explain that, the Linkages between established or formalized financial institutions and less formal or informal financial systems create new possibilities for delivering microfinance to the poor. The literature on financial linkages is based on how the information and enforcement problems in credit markets result in a mismatch of resources and abilities between formal and informal lenders. While formal financial institutions have extensive infrastructures, systems and access to funds, they are usually further removed from poor clients, making it very difficult to obtain adequate information and reducing risks. In contrast, informal financial institutions operate close to rural clients, possess quite good information and enforcement mechanisms and are typically more flexible and innovative. However, they are constrained in the services they can offer since informal institutions lack resources and infrastructure to serve clients beyond a small geographic area, resulting in highly concentrated loan portfolios.

In Tanzania, CRDB Bank Limited, a private bank has aggressively entered the market by offering MFIs a range of financial services from long and short term loans and credit lines to various payment and transfer instruments (Piprek, 2005). To do this the bank has set up an entire microfinance unit dedicated to the development of this new market segment.

Linkages between formal and informal financial institutions appear to be able to reduce the high information and enforcement problems that increase transaction costs in rural credit markets. For purposes of this large research initiative, a financial linkage was defined as any mutually beneficial partnership between a formal and a less formal institution that results in the expansion of rural financial services. This "expansion" does not just refer to reaching more of the same clients; but strives to provide access to previously unserved (or new) segments of the rural population or to broaden the variety or improve the quality of financial products and services.

The cases investigated, in Africa, Asia and Latin America show a rich variety of such financial linkages. For purposes of the study the recipients of these financial services were defined as all rural smallholders, enterprises, households, small traders and local organizations and associations, and any previously unbanked rural people. Private microfinance banks and financial NGOs establish linkages with various actors in an effort to expand the scope and scale of their businesses, enabling them to survive in competitive, maturing microfinance markets. Fundacion para Alternativas de Desarrollo (FADES), a non-regulated, non-government organization in Bolivia, strategically created a number of inter-institutional linkages allowing them to offer their clients an array of services, such as deposit and money transfer facilities, bill payment and salary and pension contribution collections (Gonzalez-Vega and Quiros, 2005). In Kenya, the recently privatized microfinance bank, K-Rep Bank, links with various MFIs and SACCOs as a way to minimize costs and further its business (Sabana, 2005).

2.12. Types of Financial Linkages

Direct financial linkages: refers to linkages between financial institutions in which the main purpose of the linkage is to help less formal institutions diversify their sources of funding, expand their loanable funds and/or balance liquidity shortages and excesses. A typical example of this type of linkage is a bank or apex organization offering bulk loans to MFIs for on-lending to clients.

Facilitating linkages: refers to linkages between institutions in which the formal institution "hires" the less formal institutions to act on its behalf. This type of linkage facilitates the transactions, such as remittances, the payment of utilities, and the mobilization of savings or even facilitates loan payout. Typically the one partners or financial institution will pay the other partner a fee to "facilitate" the transaction.

Research findings have identified that, over the last 4-5 years many private banks and insurers have entered the microfinance market by establishing direct financial and facilitating linkages with less formal actors. ICICI Bank, India's second largest commercial bank partners with microfinance institutions (MFIs) in unique ways to extend credit directly to India's numerous self help groups (SHGs) in rural areas (Harper and Kirsten, 2006). ICICI uses the MFIs as facilitation agents to help screen and monitor the members of self help groups.

2.13. Forging Links in Credit Allocation

One way to link up banks and informal lenders for purposes of credit allocation is to develop an agency relationship in which loanable funds are channeled through MFIs for on-lending to SMEs. The informal operators in various parts of the continent provide valuable insights into the means by which such arrangements might be pursued effectively, cost-efficiently and sustainably. The importance of vertical linkages and horizontal clustering cannot be overemphasized. While the principle of channeling credit through informal sources is accepted, caution must be exercised in the choice of informal agents that might act as conduits for such lending. It is important to rely on well-established agents that operate from within recognizable bodies-such as associations, cooperatives, and unions which have greater credibility than individuals. The policy of channeling formal credit to informal lenders may be defended on the grounds of efficiency and increased financial integration, especially among small farmers. Informal lenders can build a personal relationship with borrowers that can ensure an extremely low loan default rate (Hussain, 2000).

2.14. Linkages in the Banking Industry

To a large extent, the efficiency of SME linkages is directly related to developments in the financial sector. Unfortunately, the fragmentation of most financial systems in Africa has resulted in a significant disintermediation that has stifled investment flows. Over time, a wide chasm has emerged between the providers of financial services and the private sector. This gap is being bridged, to some extent, by the emergence of micro-finance institutions (MFI), which are providing the much-needed linkage between formal financial institutions (the commercial banks) and less formal business entities (MEs and SMEs) (Hussain, 2000).

The relationship between the MFIs, banks and SMEs may be described as a form of vertical enterprise networking. Furthermore, the benefits of this relationship generate clustering among informal finance operators, as they discover the importance of scale economies in their financial transactions with the MFIs. The modalities of MFI operations facilitate risk pooling, information sharing and collective responsibility; this makes their portfolios more stable and deposits more secure. Quite apart from functioning as intermediaries between the SMEs and formal banking institutions, MFIs also play a catalytic role for individuals, communities and institutions involved in the provision of informal finance (Africa Development Bank, 2000)

2.15. Related Studies

Mbuvi (1983) studied causes of failures in small businesses in Machakos aiming to establish where they obtain finances and found out that the causes where both internal and external. Wakah (1999) studied the perceived relevance of non financial business development offered to SMEs in Nairobi and found out that business development services requirements far exceed the supply of the services and most of the SMEs are lacking the relevant business development services.

Mudiri (2003) research on the credit management techniques applied by financial institutions offering micro credit in Kenya, highlights the issue that affect performance of the Banks and the MFIs in the provision of micro credit; their credit management-models and the impact of the model and related issues on the default rate. The study further observed that banks lend to the sector using the individual lending model, while majority of the MFIs use group based model of the Grameen Bank of Bangladesh experience.

Mokogi (2003) studied on the economic implication of lending of MFIs on SMEs. He established whether the credit scheme administered by MFIs have an impact on SMEs performance in terms of parameters like sales, net income, fixed assets, number of employees and the space occupied by businesses. The study sought out whether SMEs that participate in the MFI credit scheme graduate to borrow from Commercial Banks upon attaining higher loan requirements than those offered by the MFIs. The two studies carried out in 2003 drives to this research on whether the MFIs are linked to the Commercial banks as providers of funds to the SMEs having been in operation and performing some related functions.

2.16. Challenges of Linkage in Financial Sector and Commercial Banks

The connection between microfinance and poverty alleviation is indeed considered straightforward within the microfinance industry. Of the eight Millennium Development Goals, microfinance is mainly assumed to be directly related to goal number one, which aims at eradicating extreme poverty and hunger. Although success stories such as the Grameen Bank in Bangladesh, and the Indonesia's Bank Rakyat have been widely used as evidence of the impact of microfinance on poverty reduction, the link between the two may not be that direct. The current debate is that microfinance benefits the less poor, and that the poorest that are implied in the MDGs rarely benefit from microfinance. Apart from the fact that microfinance programs are only able to reach less than five percent of the world's one billion poor people, there is no guarantee that microfinance is really serving the poorest that is the main focus in the MDGs, (UNCDF, 2004).

The growth of microfinance institutions will not be significant as long as a coherent policy to link small and medium enterprises and large companies is not in place. Such policies encourage large companies to subcontract SMEs which in turn improve product quality, increase employment opportunities and ultimately reduce poverty (Lutombi, 2004).Besides this, we can see and evaluate real development in the rural areas where the microfinance sector is working. There are some challenges facing the industry such as barriers to reaching targeted people. It is uncertain whether the target percentage of the Millennium Development Goals will be achieved or not (UNCDF, 2004).

Formal financial institutions are not interested in small loans because they do not bring significant business or are considered too risky. The microfinance sector provides the opportunity to less favored people to develop small economic activities to eradicate poverty. Other challenges include restoring peace in conflict areas and strengthening corporate governance especially for the MFIs. Moreover, for many of the programs aimed at supporting the micro finance industry to be effective, there is need for continued economic stability, government commitment to develop the industry, improvements in mechanisms to monitor the implementation of the programs (UNCDF, 2004).

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Research Design

The survey design was used in this study

3.2. Population

The target population of this study was the microfinance institutions (MFIs) and the commercial banks offering micro credit in Kenya. According to the K-Rep register of MFIs, the Association of microfinance institutions of Kenya and the Central Bank of Kenya, there are 64 registered MFIs which offer services to SMEs in Kenya and include organizations within churches, cooperative societies, NGOs, self-help and welfare associations, 2 building societies, 2 specialized microfinance bank and 3 commercial banks.

3.3. Sampling

The sample frame constituted the commercial banks and the microfinance institutions. Stratified sampling was used to select 20 registered MFIs, 20 commercial banks that offer micro-credit and 2 building societies within Nairobi.

3.4. Data Collection Methods

The names and addresses of the Microfinance Institutions in Kenya were obtained from the Association of the Microfinance institutions, the Central Bank of Kenya and K-Rep register.
Descriptive data was collected from primary sources through semi-structured questionnaires distributed to the managers of the Commercial banks and the microfinance institutions.

3.5. Data Analysis

Data was analyzed using descriptive statistics and was tabulated with the help of SPSS package. The analysis was carried out on the nature of linkages between Commercial banks and the MFIs as providers of funds to the SMEs.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATIONS

This chapter covers data analysis and interpretation on the linkage between commercial banks and microfinance institutions in Kenya.

Data from the MFIs and commercial banks was collected, separated into distinct components and analyzed.

The data was collected in order to respond to the 2 key objectives which were; to establish the nature of linkages between MFIs and Commercial Banks as sources of funds to SMEs and; to identify the challenges faced by Commercial Banks and MFIs in establishing linkages.

4.1. Data Collection and Response Rate

Data was collected from 15 commercial banks, 13 microfinance Institutions and 2 building societies located within Nairobi out of all the targeted institutions through a questionnaire. The questionnaire was administered using drop and pick later method. The data was collected from the heads of the selected MFIs and Commercial banks.

Follow up questions were directed to the respondents as well as staff within the institutions to validate information that did not come out very clearly in the questionnaires.

Brochures were also obtained from the specific institutions to further information on the services offered/ obtained by the institutions to each other and to the SMEs.

Table 1: Analysis of the Response Rate

Types of institutions	Questionnaires	Numbers who responded	Building societies	Percentage
Banks	20	15	2	75
Microfinance institutions	20	13	2	65
Totals	40	28	4	70

Source: Research Data

Of the 40 questionnaires distributed, 28 representing 70% were returned. The response rate among commercial banks was however better (75%) while that of MFIs was lower at 65%. The 2 questionnaires distributed to Building Societies were received.

The institutions that did not respond positively to the research gave reasons. Some argued that their policy does not allow them to release information due to sensitivity nature of financial information.

The finding and conclusions drawn are based on the 75% commercial banks and 65% microfinance institutions.

4.2. Background Of The Studied Financial Institutions

The information on the background includes services provided to MFIs by the commercial banks, period over which commercial banks have dealt with MFIs and their frequency of borrowing, forward linkage from commercial banks to MFIs to SMEs, availability of facilitating services and challenges encountered in establishing the linkages.

4.2.1. The Commercial Bank Provision Of Services To Mfis

The products offered to the microfinance institutions by the commercial banks include loans, savings, advisory, bank checks and money transfers. The study showed that all the microfinance institutions received services from commercial banks.

Table 2: Services to MFIs

Provision of Services to MFIs	Banks	Valid Percentage	Cumulative percentage
Totals	**15**	**100%**	**100%**

Source: Research Data

The study showed that among the 5 products offered to MFIs which were; loan services, money transfers, saving services, bank checks and advisory services, 67% of the commercial banks provide all products and 33% provide at least 3 out of the 5 provided services to the MFIs.

Table 3: Products to MFIs

Products Offered to MFIs	Banks	Percent	Valid Percent	Cumulative Percent
	2	33.3	33.3	33.3
5	13	66.7	66.7	100.0
Total	15	100.0	100.0	

Source: Research Data

4.2.2. Period of support to micro finance institutions

The study indicates that 100% of the MFIs obtained support from the commercial banks for a period of over 5 years.

Table 4: Period of support

Period	Banks	Percent	Valid Percent	Cumulative Percent
Over 5 Years	15	100.0	100.0	100.0

Source: Research Data

Table 5: Frequency of borrowing

Borrowing period (Years)	Banks	Percent	Valid Percent	Cumulative Percent
1-5	14	66.7	66.7	66.7
5-10	1	33.3	33.3	100.0
Total	15	100.0	100.0	

Source: Research Data

The study further indicates that 67% of the MFIs borrowing period is between 1-5 years and 33% borrowing period of between 5-10 years.

4.2.3. Forward Linkage From Commercial Banks To Mfis To Smes

All the 13 micro finance (100%) surveyed had developed a forward linkage of providing the SMEs with the funds received from the commercial banks and mostly for rural financial services.

Table 6: Funds from commercial banks to SMEs

Receipt of services from commercial banks	MFIs	Percent	Valid Percent	Cumulative Percent
Total	13	100.0	100.0	100.0

Source: Research Data

4.2.4. Availability of facilitating services

Out of 13 microfmance institutions surveyed, 69% indicated that commercial banks hired their organisation to act on their behalf to mobilizing saving. Only 30% of the respondents indicated they were not hired. The hired MFIs indicated that the reason as to why they undertake the facilitating services is to help screen the members of the Self Help Group form Rural Smallholders, small Enterprises and small traders. The facilitating services undertaken by the MFIs include mobilizing savings.

Table 7: Whether commercial banks hire MFIs to act on their behalf

Hired/ Not hired	MFIs	Percent	Valid Percent	Cumulative Percent
Hired	9	69.2	69.2	69.2
Not hired	4	30.8	30.8	100.0
Total	13	100.0	100.0	

Source: Research Data

4.3. Challenges Encountered in Establishing the Linkages

The banks surveyed listed the following challenges that they encounter in establishing the linkage to the MFIs. They indicated that they encounter much problem in loan repayment, they also indicated that most the SMEs lack collaterals that is why they are unwilling to offer direct services to them but pass through the MFIs. Due to reaching SMEs via MFIs they experience low interest rates.

Table 8: Challenges encountered by the commercial banks

Challenges	Banks	Percent	Valid Percent	Cumulative Percent
Low interest rates	7	46.7	46.7	46.7
Low interest rate and Loan repayment	8	53.3	53.3	100.0
Total	15	100.0	100.0	

Source: Research Data

Microfinance listed the geographical location of the SMEs to be their greatest challenge in establishing linkages. Other challenges included the loan repayment and risk since most of the SMEs lack collateral.

Table 9: Challenges MFIs encounter to establish linkage

Challlenges	MFIs	Percent	Valid Percent	Cumulative Percent
Collateral	1	7.7	7.7	7.7
Geographical location	12	92.3	92.3	100.0
Total	13	100.0	100.0	

Source: Research Data

CHAPTER FIVE

SUMMARY OF RESEARCH FINDINGS AND CONCLUSIONS, LIMITATIONS OF THE STUDY, RECOMMENDATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

5.1. Summary of Research Findings and Conclusions

5.1.1. Summary of Research Findings

The study aimed at establishing whether there exists any linkage between commercial banks and microfinance institutions as providers of funds to the small and micro enterprises in Kenya.

The study established that there exists two linkages which include the financial linkage and facilitating linkage The findings reveal that both linkages exist between commercial banks and MFIs.

The study indicated that, (95%) of the commercial banks offer funds to the MFIs as well as providing other services like saving services, loan services, money transfers, bank checks and advisory services. The study established that, commercial banks also provide services directly and indirectly to the SMEs, however the frequency of most MFI borrowing period range between 1 -5 years. It was noted that the most important issues that the bank consider when offering services to the MFIs include group members, loan repayment and loan duration.

A number of factors were found to contribute to commercial banks offering of funds to the MFIs and which included ability of the MFIs to pay, risk, collaterals, repayment period and use of the funds.

Additional findings reveal that there exist facilitating linkages whereby the commercial banks hire MFIs to act on their behalf. This is done through mobilization of savings as well as exploiting collaboration and partnership opportunities. MFIs also provide a forward link to the SMEs. They offer funds received from the commercial banks to the SMEs. They monitor the members of the Selfhelp Group as well as offering financial services to them. The study established that the MFIs also consider loan repayment and loan duration when providing funds to SMEs.

The study shows that (40%) of the financial services are provided to the rural smallholders, (30%) to the small enterprises, none to the households and (30%) to the small traders. The study further found that the funds offered to the SMEs are to help expand rural financial services through reaching the same clients and the unserved segment.

The main challenge found to face the MFIs in offering services to the SMEs is Geographical location. This is because most of the SMEs are rural based. Loan repayment also posses a challenge to the institutions since most of the SMEs lack security leading to inability to repay their loans. Another challenge has been the lack of training of the clientele in channeling the loans as scheduled.

A number of reasons were identified as affecting the involvement of the commercial banks on establishing linkages. Critical among them is the loan repayment which does not favor the involvement in the sector. Other challenges include low interest rate, risk, credit approvals, determining credit rating and how funds are utilized by the SMEs.

5.1.2. Conclusions

The study found out that most of the banks offer services to the MFIs in provision of micro credit in Kenya. The commercial banks also provide services to SMEs both directly and indirectly. Majority of the MFIs receive at least 3 products from the commercial banks and they have received support services from the commercial banks for over 5years.

The study concludes that commercial banks provide financial services to both MFIs and SMEs. As a result, the MFIs receiving financial services from the commercial banks and further offer the funds to the SMEs.

Both categories of institutions are optimistic that there is high potential in lending to the small and micro credit sector therefore AMFI and commercial banks should establish a structure that will accommodate both financial and facilitating linkages.

5.2. Limitations of the Study

While conducting the above study, the researcher came across" various limitations. These include the following:

Some of the empowered people where out of their office attending to other important issues of the institutions hence unable to complete the questionnaire by themselves. However, the research was able to access this information through direct interview with the staff members in the relevant department of the surveyed institutions.

Many of the institutions targeted, though listed, were very relaxed to provide the required information. Some of the dropped questionnaires were not responded to.

Majority of the MFIs operate like individually owned sole proprietorships, therefore, they are very sensitive about financial information that comes to the public domain. The researcher had to rely on information as given by the MFIs introducing some bias.

The concentration of the study within Nairobi may have introduced an element of geographical bias. However due to the nature of information required and the issue of convenience, it was difficult to obtain data outside Nairobi.

5.3. Recommendations

The study recommends that banks should increase their presence in the microfinance institutions and the small and micro enterprise sector. While lending to the SMEs the banks should consider their level of income and lower their interest rates.

The study further recommends that the MFIs should put more emphasis on the facilitating linkages so as to reach majority of the unserved or new segment.

5.4. Suggestions for Further Research

There is need for a study to determine the sustainability of the existing linkages between the commercial banks and the microfinance institutions.

There is need to carry out research to determine if the existing linkages are for longer-term period or short-term basis.

A study on matching the micro credit history and the longer term needs of the borrowers, on how they can graduate from obtaining funds from microfinance institutions to commercial banks.

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APPENDIX A: LIST OF INSTITUTIONS OFFERING MICROCREDIT

1. Kenya Rural Enterprise Programmes Development Agency-(K-REP)
2. Kenya Women Finance Trust (KWFT)
3. Faulu Kenya
4. Pride Africa
5. Young Women Christian Association
6. Jitegemee Trust ltd
7. Cooperative Bank
8. Kenya Commercial Bank
9. Hope Africa
10. Sunlink Microfmance Partners
11. Family Building Society
12. Equity Building Society
13. Barclays Bank Of Kenya
14. Jaru Microcredit Africa Ltd
15. WEDCO Enterprises Ltd
16. Kenya Ecumenical Church Loan Fund (ECLOF)
17. Ghetto Child Programme
18. Vintage Management Ltd
19. Daraja Trust
20. World Vision Kenya
21. Small and Micro Enterprise Programmes (SMEP)
22. Jamii Bora
23. Kenya Small Traders and Enterprise Society (KSTES)
24. Business Initiatives and Management Assistance
25. Undugu Society
26. Small Enterprise Credit Association
27. ADRA Kenya
28. Action AID
29. Widows and Orphans Welfare
30. AREP
31. Plan International

APPENDIX B: LIST OF COMMERCIAL BANKS IN KENYA

1. African Banking Corporation Ltd.
2. Akiba Bank Ltd
3. Bank ofBaroda(K) Ltd
4. Bank of India
5. Barclays Bank Of Kenya Ltd
6. CFC Bank Ltd
7. Charterhouse Bank Ltd
8. Chase Bank (K) Ltd
9. Citibank N.A
10. City Finance Bank Ltd
11. Co-operative Bank Of Kenya Ltd
12. Commercial Bank Of Africa Ltd
13. Consolidated Bank of Kenya Ltd
14. Credit Agricole Indosuez
15. Credit Bank Ltd
16. Daima Bank Ltd
17. Delphis Bank Ltd
18. Development Bank of Kenya Ltd
19. Diamond Trust Bank (K) Ltd
20. Dubai Bank Kenya ltd
21. Equatorial Commercial Bank Ltd
22. Fidelity Commercial Bank Ltd
23. Fina Bank Ltd
24. First American Bank of kenya Ltd
25. Giro Commercial Bank Ltd
26. Guardian Bank Ltd
27. Habib Bank A.G Zurich
28. Habib Bank Ltd
29. Housing Finance Co. (K) Ltd
30. Imperial Bank

31. Industrial Development Bank
32. Investment & Mortgages Bank Ltd
33. K-Rep Bank Ltd
34. Kenya Commercial Bank Ltd
35. Middle East Bank (K) Ltd
36. National Bank of Kenya Ltd
37. National Industrial Credit Bank Ltd
38. Oriental Commercial Bank Ltd
39. Paramount Universal Bank Ltd
40. Prime Bank Ltd
41. Prime Capital and Credit Ltd
42. Southern Credit Banking Corp. Ltd
43. Stanbic Bank Kenya Ltd
44. Standard Chartered Bank (K) Ltd
45. Trans-National Bank Ltd
46. Victoria Commercial Bank Ltd

APPENDIX C: INTRODUCTORY LETTER

Irene Mutua

University of Nairobi
Faculty of Commerce
MBA Program
P.O. BOX 30197
Nairobi

September 2006

Dear Sir/Madam,

Re: Request For Research Data-Linkages between MFIs and Commercial banks as Providers of Funds to SMEs

I am a postgraduate student at the University of Nairobi undertaking research in the above area.

Your institution has been selected randomly for this study. I would therefore highly appreciate if you could provide me with information requested in the questionnaire at the earliest convenience.

I would wish to guarantee that the information provided would be treated confidentially, and used only for research purposes.

The report will be available to you if required.

I look forward to your favorable response.

Thank you.

Yours sincerely

Irene Mutua

APPENDIX D: QUESTIONNAIRE FOR THE COMMERCIAL BANK INSTITUTIONS

Institutional information

Part A

1. Indicate whether your organization provides services to MFIs.

Yes No

2. If Yes, What products does your organization offer to the Microfinance institutions (MFIs)? Tick as appropriate in the box below.

Loans services

Saving Services

Bank checks

Money transfers

Advisory services

Others (Specify)

3. Indicate the period over which you have dealt with/ supported services to the MFIs. Tick the most appropriate box.

Below 1 Year

3-5 Years

1 -2 Years

Over 5 Years

4. How are the services provided to the SMEs by your organizations offered? Please tick the most appropriate box.*

Direct

Indirect (Through MFIs)

5. If your organization offers both direct and indirect services, state the percentage in each category.

- Loan services

Direct

Indirect

- Banking services

Direct_

Indirect

- Saving services

Direct_

Indirect

- Advisory services

Direct

Indirect

- Bank checks

Direct_

Indirect

- Others (Specify)

Direct

Indirect

6. What is the frequency of most MFI borrowing period? Tick only one of the most appropriate boxes.

YEARS	
0-1	
1-5	
5-10	
10-20	
Above 20	

PART B

7. On the scale of 1-5, classify how your organization regards the following corporate objectives towards the MFIs. Please tick the most appropriate option.

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Diversify their sources of funding					
Expand their loanable funds					
Offering bulk loans to MFIs for on-lending to clients.					
Facilitates loan payout from SMEs					

8. On the scale of 1-5, state the importance of the following considerations to your organization as providers of fund to the MFIs. Please tick the most appropriate box.

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Frequency of loan					
Loan duration					
Group numbers					
Loan repayment					

9. On a scale of 1-5, indicate the importance of the following factors in contribution to offering funds to MFIs, please tick the most appropriate option.

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Partnership					
Ability to pay					
Risk					
Collateral					
Size of loans					
Repayment period					
Use of the funds					

10. Does your organization hire MFIs to act on your behalf?

Yes No

11. If the answer is Yes, then what facilitating services does your organization offer at a fee? Please tick the most appropriate box.

Mobilizing saving Remittances

Loan payout Payment of utilities

Others (Specify)

12. For what reasons does your organization use MFIs to facilitate? Please tick the most appropriate box.

To help screen the members of the Self Help Group

To monitor the members of the Self Help Group

Others (Specify)

13. Does your organization offer funds to help expand rural financial services? Tick the most appropriate box.

Yes No

14. If yes, how does your organization achieve this objective? Tick the most appropriate box.

Through reaching the same clients

Reaching new/ unserved segment

Others (Specify)

15. What problems/ challenges does your organization encounter in establishing the linkage to the MFIs? Please tick from the list below.

Loan repayment

Geographical location

Low interest rate

Others (specify)

16. Explain any other problems/ Challenges encountered, in the establishment of linkage between your organization and the MFIs in providing funds to the SMEs.

APPENDIX E: QUESTIONNAIRE FOR THE MICROFINANCE INSTITUTIONS

Institutional information

Part A

1. Indicate whether your organization receives services from the commercial banks.

Yes No

2. If Yes, What products does your organization receive from the commercial banks? Tick as appropriate in the box below.

Loans services Saving Services.

Bank checks

Money transfers

Advisory services

Others (Specify) _

3. Indicate the period over which you have dealt with/ have received support services from the commercial banks. Tick the most appropriate box.

Below 1 Year 3-5 Years

1-2 Years Over 5 Years

4. Do you offer funds received from the commercial banks to the SMEs? Tick the most appropriate box

Yes No

5. What is the frequency of your organization borrowing period? Tick only one of the most appropriate boxes.

YEARS	
0-1	
1-5	
5-10	
10-20	
Above 20	

PART B

6. On the scale of 1-5, classify how your organization regards the following corporate objectives towards the SMEs. Please tick the most appropriate option.

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Diversify their sources of funding					
Lending to SMEs.					
Facilitates loan payout from SMEs					

7. On the scale of 1-5, state the importance of the following considerations to your organization as providers of fund to the SMEs. Please tick the most appropriate box.

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Frequency of loan					
Loan duration					
Group numbers					
Loan repayment					

8. On a scale of 1-5, indicate the importance of the following factors in receiving funds and other services from the commercial banks

Key: (1) Very important (2) Important (3) Not important (4) clear (5) Not clear

	1	2	3	4	5
Partnership					
Ability to pay					
Collateral					
Size of loans					
Repayment period					
Use of the funds					

9. Do commercial banks hire your organization to act on its behalf?

Yes No

10. If the answer is Yes, then what facilitating services does your organization undertake at a fee? Please tick the most appropriate box.

Mobilizing saving

Remittances

Loan payout

Payment of utilities

Others (Specify)

11. For what reasons does your organization undertake the facilitating role? Please tick the most appropriate box.

To help screen the members of the Self Help Group

To monitor the members of the Self Help Group

Others (Specify)

12. If your organization offers financial services to the following list, please state the percentage in each category.

Rural smallholders

Small enterprises

Household

Small traders

Local organizations

Associations

Other (Specify)

13. Does your organization offer funds to help expand rural financial services? Tick the most appropriate box.

Yes

No

14. If yes, how does your organization achieve this objective? Tick the most appropriate box.

Through reaching the same clients

Reaching new/ unserved segment

Others (Specify)

15. What problems/ challenges does your organization encounter in establishing the linkage to the commercial banks? Please tick from the list below.

Loan repayment

Geographical location

16. Explain any other problems/ Challenges encountered, in the establishment of linkage between your organization and the commercial banks in providing funds to the SMEs.

APPENDIX F: Case Processing Summary

Case Summaries from commercial banks

		Services to MFIS?	products offered to MFIS	Period supporting MFIS	Provision of services to SMES	Frequency of MFI borrowing	Are funds to expand rural financial services?	How the objective is achieved	Challenges encountered
1		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
2		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
3		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00
4		1.00	3.00	4.00	1.00	3.00	2.00	.00	2.00
5		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
6		1.00	5.00	4.00	1.00	2.00	2.00	.00	2.00
7		1.00	5.00	4.00	1.00	2.00	2.00	.00	2.00
8		1.00	4.00	4.00	1.00	2.00	1.00	1.00	2.00
9		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
10		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
11		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00
12		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00
13		1.00	5.00	4.00	1.00	2.00	1.00	1.00	1.00
14		1.00	5.00	4.00	1.00	2.00	2.00	.00	2.00
15		1.00	5.00	4.00	1.00	2.00	2.00	.00	1.00
ota l	N	15	15	15	15	15	15	15	15
	Mean	1.0000	4.8000	4.0000	1.0000	2.0667	1.6667	.3333	1.5333
	Median	1.0000	5.0000	4.0000	1.0000	2.0000	2.0000	.0000	2.0000
	Grouped Median	1.0000	4.8571	4.0000	1.0000	2.0667	1.6667	.3333	1.5333
	Std. Deviation	.0000	.5606	.0000	.0000	.2582	.4880	.4880	.5164
	Variance	.000	.314	.000	.000	6.667E-02	.238	.238	.267
	% of Total Sum	INF	INF	INF	INF	INF	INF	INF	INF

a Limited to first 100 cases.

Case Summaries from microfinance institutions

		services from commercial bank	products from commercial banks	period of received support from commercial banks	Funds from CBto SMEs?	frequency of MFI borrowing period	CB hire MFIs to act on their behalf?	facilitating services MFIS undertake	reasons to facilitating role	challenges MFIS encounter to establish linkage
1		1.00	3.00	4.00	1.00	2.00	1.00	1.00	2.00	2.00
2		1.00	3.00	4.00	1.00	2.00	2.00	.00	.00	2.00
3		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00	1.00
4		1.00	5.00	4.00	1.00	2.00	1.00	1.00	1.00	2.00
5		1.00	5.00	4.00	1.00	2.00	2.00	.00	.00	2.00
6		1.00	5.00	4.00	1.00	2.00	2.00	.00	.00	2.00
7		1.00	4.00	4.00	1.00	2.00	1.00	1.00	1.00	2.00
8		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00	2.00
9		1.00	5.00	4.00	1.00	2.00	1.00	1.00	1.00	2.00
10		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00	2.00
11		1.00	5.00	4.00	1.00	2.00	2.00	.00	.00	2.00
12		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00	2.00
13		1.00	5.00	4.00	1.00	2.00	1.00	1.00	2.00	2.00
'Fotal	N	13	13	13	13	13	[illegible]	13	13	13
	Mean	1.0000	4.6154	4.0000	1.0000	2.0000	1.3077	.6923	1.1538	1.9231
	Median	1.0000	5.0000	4.0000	1.0000	2.0000	1.0000	1.0000	1.0000	2.0000
	Grouped Median	1.0000	4.7273	4.0000	1.0000	2.0000	1.3077	.6923	1.2222	1.9231
	Std. Error of Mean	.0000	.2130	.0000	.0000	.0000	.1332	.1332	.2493	7.692E-02
	Std. Deviation	.0000	.7679	.0000	.0000	.0000	.4804	.4804	.8987	.2774
	Variance	.000	.590	.000	.000	.000	.231	.231	.808	7.692E-02
	% of Total Sum	INF	INF	INF	INF	INF	INF	INF	INF	INF

a Limited to first 100 cases.