IMPROVING FINANCIAL ACCESSIBILITY TO MICRO AND SMALL SCALE ENTERPRISES IN KENYA: A CASE STUDY OF GIKOMBA AND KIBERA, NAIROBI

BY

GACHOCHO, MARY NYAMBURA (B.A. HONS)

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DECLARATION

This thesis is my original work and has not been submitted in any university for the award of a degree.

Candidate: ______________________

(GACHOCHO MARY)

This thesis has been submitted with my approval as a university supervisor

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DR. P`. O. ONDIEGE

(Supervisor)

DEDICATION

To my parents, Mr. and Mrs. Joseph G. Mangutha, my brother and sisters. To them all, thank you so much and may God bless you, for your constant encouragement which inspired me in accomplishing this work.

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ABSTRACT

Lack of access to finance has been identified as a major constraint on the ability of MSEs in Kenya to fulfil their potential for dynamic growth. This study investigates the high propensity of MSEs to identify lack of access to finance as their primary constraint and the view of banks that MSEs have low demand for loans, in an attempt to come up with recommendations to enhance credit accessibility to MSEs.

Since 1991, financial liberalisation has been pursued initially as part of the structural adjustment reforms and subsequently under the financial sector adjustment program. These included issues such as policies of direct controls over interest rates and the allocation of credit, the historical orientation of banks towards import-export trade and large firms, and the lack of competition among banks. Although financial liberalisation has created some necessary conditions for increased MSEs lending, the effect so far has been limited.

Oketch et. al. (1995), notes that there are 105 formal institutions with MSEs support packages in the country. These assistance programs are diverse in terms of their orientation (finance, training, marketing, e.t.c.), geographical coverage (rural vs urban, national vs regional), intensity (amount of support) and targeted population groups (women, men, youth, sectors, e.t.c.). As MSEs continue to increase, it is important

for policy makers and planners to have an understanding of what percentage of MSEs are being reached by any form of assistance. To help shed light on these issues, the survey collected information on access to financial assistance.

The study revealed that despite the loans applications put forward, only a small minority of MSEs have benefitted from any form of credit, and most entrepreneurs rely primarily or exclusively on own savings to finance the enterprise. This has been due to high interest rates charged on loans, lack of adequate information about loan facilities and lack of collaterals required to back the loans. Banks are usually not willing to lend out money to MSEs because of a (supposed) lack of collateral, small loans are relatively expensive to administer and therefore can only be extended in return for higher rates of interest.

The study suggests measures that banks and financial institutions could adopt to overcome the problems of high transaction costs and risks in MSEs lending, for example by setting up credit reference bureau to provide information on clientele creditworthiness and facilitate easier processing of loan application.

The study found out that the financial assistance agencies are concerned about security of tenure in advancing loans. To gauge the extent of tenure security the study found out that only about 37 percent of the entrepreneurs had some form of tenure security, while the rest face the risk of displacement. The study recommends the need to plan MSEs sites to improve their tenure security and access to loans.

Nevertheless, the evidence suggests that exploitation of highly profitable opportunities by MSEs could be accelerated if MSEs entrepreneurs had greater access to external financing.

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ABBREVIATIONS

BASE - British Aid to Small Scale Enterprises
B.B.K. - Barclays Bank of Kenya
E.E.C. - European Economic Community
G.D.P. - Gross Domestic Product
GEMINI - Growth and Equity through Microenterprise Investments and Institutions
I.C.D.C - Industrial Commercial Development Corporation
I.L.O - International Labour Organisation
K.C.B. - Kenya Commercial Bank
K.I.E. - Kenya Industrial Estates
K-MAP - Kenya Management Assistance Programme
K-REP - Kenya Rural Enterprise Programme
KWFT - Kenya Women Finance Trust
KYTEC - Kenya Youth Training and Employment Creation
NGOs - Non Governmental Organisation
MSEs - Micro and Small Scale Enterprises
MRTT&T - Ministry of Research, Technical Training and Technology
N.C.C.K. - National Council of Churches of Kenya
O.D.A. - Overseas Development Agency
P.F.P./K - Partnership for Productivity - Kenya
SEFCO - Small Enterprise Finance Company
U.N.D.P. - United Nations Development Programme
USAID - United States Agency for International Development

CHAPTER ONE: INTRODUCTION

1.1 Overview

Kenya, like many other African countries, has faced a major economic crisis due to its narrow production base, environmental degradation and excessive dependence on external factors either in form of finance or technology. Increased unemployment, rising prices, falling wages and until recently high inflation are some of the negative effects of economic crisis.

For over a decade, it has been clear that Kenya is facing a worsening employment crisis. Estimates show that Kenya is currently generating nearly 500,000 entrants to the labour force annually which the modern sector will be unable to absorb fully, while the number of the unemployed persons is currently estimated to be 27 percent (Kenya,1996c).

In the face of a growing labour force, public sector hiring has slowed and formal private growth has stagnated, leading to an exponentially rising gap between the formal employment creation and the high rate of urban population increase. Increasingly attention has turned to the Micro and Small Scale Enterprise sector, as a way out of the unemployment crisis in Kenya, (Sinclair 1978, Mochache 1985, Macharia 1989, Ondiege, 1991). For instance, the MSEs sector was in 1994 estimated to have 910,455 establishments employing a total of about 2.2 Million persons (Kenya, 1996e).

In recent years, with the growing recognition of the strategic role that MSEs play in the economy of every nation in production, distribution, finance and employment creation, more emphasis is being placed on the necessity of credit in MSEs survival and growth. This sector forms an important part of the small business component in Kenya, and is one of the targeted sector that the government is using to achieve economic development. Government statements on economic issues have put more emphasis on the MSEs sector. Despite, the role played by MSEs sector, both internal and external constraints faced by the sector limit the realisation of the objectives set for the sector.

Efforts by the urban unemployed to develop these enterprises have been hindered by various problems, which include inadequate access to credit facilities, lack of capital, planning regulations, obstacles to market opportunities, poor management practises, poor infrastructure, inadequate access to professional services such as banking, insurance and legal services, licensing regulations and poor infrastructure among others (World Bank, 1988, Ondiege and Aleke-Dondo, 1991). This has led to low standards of living of the majority of the people involved either directly or indirectly in this sector, the worst affected being the urban poor.

Many of the MSEs have been established with meagre family savings. Reinvestment is therefore impeded since profits gained in the enterprise are normally used for the family upkeep. Greater investment in small scale enterprises would result in a more efficient use of available resources (both human and physical) and would promote economic growth. Small-scale activities can also contribute positively to other socio-economic objectives of development, such as educating dependants e.t.c. Thus, investment opportunities in small scale enterprises may provide an outlet for personal savings at relatively low income levels which would otherwise go unrealised, (World Bank, 1988).

World Bank (1989) report, "Sub-Saharan Africa - From Crisis to Sustainable Growth", views the MSEs sector as a "seed bed of African entrepreneurship" offering a competitive business environment free from regulatory constraint and well adapted to local resource endowments and demand. To develop this sector, the World Bank proposes an expansion of access to credit and promotion of self sustaining services to the sector. This is due to the recognition of the fact that programmes directed at MSEs development have only tended to benefit those with assets close to the upper end of the definitions accepted for small enterprise programmes. A combination of economic and political interests operates in favour of larger enterprises.

What must be recognised, and accepted both in policy and practice is that small enterprises exist, have problems and opportunities, and are affected by every significant change in the economy, social organisation, technology, physical environment, and the role of the state. Even if small enterprises are not supported, they should be planned for. In other words, they should be taken into account in all decision - making relating to production, consumption, work, and the economic, social and physical environments.

1.2 PROBLEM STATEMENT

In recent years, with the growing recognition of the strategic role that MSEs play in the economy of every nation and the necessity of credit in MSEs survival and growth, much more attention has been placed on how credit programs can be sustained without subsidies. However, there has been an apparent contradiction between the high propensity of MSEs to identify finance as their primary constraint and the view of financial institutions that MSEs lending remains low in part due to lack of demand by the MSEs. The basic research problem concerns itself with the limited financial accessibility to the MSEs. The study seeks to address the question of, how can financial accessibility to MSEs be enhanced?.

Loans are a major source of external financing to the MSEs. However, not all enterprises benefit from this source. The attitudes and conditions given by the banking institutions, contribute to only a proportion of enterprises benefitting from their financial assistance. Despite liberalisation of interest rates in July 1991, the response of the banks towards the MSEs has not been very encouraging. According to a GEMINI survey (1995), out of 708,000 MSEs only 29.1 per cent accessed credit from the formal sector.

The Government spells out actions to be taken in addressing the financial problem of the MSEs sector with an aim of providing an enabling environment for sustainable growth and development within the sector, in Sessional Papers No. 1(1991), No. 2 (1992), No. 2 (1996) and National Development Plans (1989/1993, 1994/1996). This is due to the recognition that most financial institutions have failed to reach small-scale businesses, and hence the need for encouraging alternative channels for delivering financial assistance by the Private Sector and Non-Governmental Organizations (NGOs). The Sessional paper No. 2 of 1992 on Small Scale Enterprise and Jua Kali Development in Kenya, which established an "Agenda for Action", and "formally" provided for a comprehensive framework for the promotion of MSEs and Jua Kali development in Kenya was expected to result in specific policy accomplishments within a period of 2 years.

The current Development Plan which covers the first phase of Sessional Paper No. 2 of 1996 on Industrial Transformation to the year 2020 calls for more collaboration of Ministry of Commerce (MCI), Ministry of Finance (MOF), Local Authorities (LAs), Office of the Vice President and Ministry of Planning and National Development (OVP and MPND), relevant ministries, private sectors, Non Governmental Organisations (NGOs) and Community Based Organisations (CBOs) in an attempt to improve access to credit.

The Sessional Paper No. 2 of 1996 on Industrial Transformation to the year 2020 notes, "despite government efforts to promote the MSEs sector, aided by a large number of donor agencies and NGOs, there remains four major constraints to the expansion of the MSEs sector namely; credit, access to land and infrastructure, access to training and technical support and access to technology and information".

The government policies address the supply side of external financing that calls for collaborative efforts between the government, financial institutions and the enterprises. Despite these efforts to promote the MSEs sector aided by a large number of donor agencies and NGOs, in form of targeted credit programmes, training and technical assistance. Lack of funds, both at the initial stage and other development stages, has ranked highest among other problems, hampering the development of Micro and Small Scale Enterprises (Meyer, 1989, Levitsky, 1989).

However financial policies have not been clearly targeted in particular to the Micro and Small Scale enterprises. This is demonstrated by the fact that:

.....though there has been previous attempts to develop the small-scale and Jua Kali enterprises, resulting in the identification of the needs of the sector and the problems encountered in solving them, firm measures have not been taken towards directly assisting this sector as a matter of strategy in the past, (Kenya Government,1989:163).

A survey of policy documents by Ondiege and Aleke- Dondo (1991), revealed that the Government has initiated policies touching on a wide area of the MSEs sector development. Though the policies have been continuously innovative, which is encouraging, the level of implementation of suggested strategies has been poor.

The Kenya government intention to expand access to credit and provide physical infrastructure to the MSEs sector has not gone unchallenged. Financial constraints in this sector is still a reality. The sheds from where the artisans operate are "a tell it all" sign, as some of them are rotting and almost collapsing while some of the artisans operate out under the hot sun and other vagaries of nature. Operation sites/sheds to a large extent influence access to credit facilities, and are important in enhancing the productivity of the sector especially if they are accompanied by provision of infrastructure/utilities such as electricity, water and roads.

ODA (1994), notes that "shortage of land creates substantial barriers to market entry for new and particularly manufacturing firms; firms requiring land to expand are prevented from doing so; lack of secure tenure disqualifies small entrepreneurs from a commercial bank loan; the threat of harassment discourage reinvestment of profits .....". Permanent sheds may also help when the enterprises applies for credit as financiers would like to have permanent address and location of the establishment before loans are advanced. It is therefore essential for the authorities to provide these enterprises with the titles or certificates of occupancy of the sites. If these enterprises can be provided with tenure security through issuance of certificates of ownership/occupancy, they could use them as collaterals thereby enabling them to have access to credit facilities.

Many are times when the government implementation process is slow or proposed policies forgotten. It is now five years since the Small Scale and Jua Kali development action plan was released, yet nothing much has been achieved as far as financing of the MSEs is concerned. What has happened?, What have we achieved?, Where are the loopholes?, Are there any lessons to be learnt so far?, What is the way forward as far as the MSEs sector financing is concerned?.

From the above, one conclusion seems inevitable, that if the sector is to grow and fulfil its expected role in economic development, then financial and non-financial problems currently facing the sector need to be addressed. This study addresses the above issues, focusing on the collaboration of various institutions in an attempt to come up with recommendations of closing the gap between the demand and supply of finance to MSEs. The study will also aim at identifying and prioritizing policy research needs, in accessing credit to MSEs for enhanced economic development.

1.3 STUDY OBJECTIVES

The main objective of the study is to review the existing financial policy framework for small scale enterprises, identify gaps and weaknesses in these policies and their implementation and make specific financial policy recommendations. The specific objectives of the study will be to:

1. Assess the existing financial policies and programs towards enhancing financial assistance to Micro and Small Scale enterprises;
2. Examine the existing sources of funds to Micro and Small Scale Entrepreneurs;
3. Examine the nature of demand and supply for MSEs finance;
4. Suggest policy recommendations that will enhance financial assistance to the MSEs.

1.4 STUDY HYPOTHESIS

1. Government policies have greatly neglected the small scale entrepreneurs in financial support.
2. Demand for MSEs finance exceeds the supply by the financial institutions.
3. Tight monetary controls by the financial institutions limit MSEs accessibility to finance.

1.5 STUDY JUSTIFICATION

Since Independence in 1963, a lot of funds have been spent to implement Government policies and programmes, and to build institutions specifically aimed at promoting the MSEs. To date, not much has been achieved due to poor coordination among implementing agencies. Many programmes have not been based on adequate needs assessment.

Despite Government recognition of the sector which led to the launching of the National Jua Kali Programme and the Micro and Small Scale Enterprises Training and Technology project with the assistance of the World Bank, lack of access to finance is consistently cited in surveys as a principal constraint on the development of MSEs. Financial liberalization has so far had little effect on the access of MSEs to financial credit. Tight money controls, bank's efforts to improve portfolio performance, centralization of decision-making and lack of competition explain why banks have shown little interest in developing MSEs as a market niche.

Much of the growth of MSEs has been spontaneous, which cannot adequately develop the sector, because only a few of the MSEs graduate into the formal sector. Further growth of the sector is not possible, without strong and effective support from the Government, the aid agencies, and the business community, all acting in coordination.

For purposes of development planning it is essential for policy makers and planners to promote the sector activities, by identifying the constraints that limit their ability to meet development goals. Policy makers need to incorporate the financing aspect of this sector, in order to direct these enterprises towards sustainable development. There is need to recognise that certain favourable conditions are necessary not only to generate self-employment in the informal sector, but also to improve and strengthen technology capabilities. Some of these conditions include creation of specific legislation or simplified controls, lower taxes or none, creation of special credit lines to overcome financial difficulties in various stages of evolution. The planner needs to realise that the sector has the potential to contribute to reduction of imports and thus help to improve the balance of payment deficit and he should ensure that the sector is really provided requisite attention at national level. It is only through the commitment of policy makers and planners that such national action will take place.

The study therefore seeks to contribute towards a financial policy of the small scale enterprises that integrates the private sector, the government, Non-governmental organisations, policy makers, planners, administrators and the MSEs entrepreneurs. It will also suggest techniques that financial institutions could adopt to overcome the problems of high transaction costs and risks in MSEs lending, in an effort to promote their development potential.

1.6 Scope of the Study

This study recognises that MSEs activities are on the increase and their contribution to the economy is important, hence the need to plan for them. The study covered MSEs in two areas, namely Gikomba and Kibera. The two sites were chosen on the rationale of the spontaneous growth of MSEs in these areas. Both sites have a wide variety of MSEs which would ensure a wide coverage. The study focused on identifying the constraints limiting MSEs accessibility to finance.

1.7 Research Methodology

1.7.1 Data Types and Collection Procedures

The study utilised both primary and secondary data. Primary data was obtained through interviews, formal questionnaires and direct observation. Secondary data used in the study was collected through reviewing of existing literature on the subject, both published and unpublished records. Government policy documents on the development of the MSEs sector were also reviewed.

1.7.2 Sampling Framework

Case Study Approach

In order to identify the study areas for the research, a reconnaissance survey of the MSEs activities in Nairobi was done. Gikomba and Kibera were selected by taking various points into consideration. These included the degree of activity mix, observed rate of increase of activities in the area, existence of MSEs lending institutions operating in these areas, and the expansiveness of the area in as far as it would affect data collection taking into account limited resources in terms of time, money and personnel. These two sites were therefore considered appropriate for the study.

At the pre-survey stage it was realised that very closely similar responses were obtained from businesses of the same type: e.g A, B, C,....... who were all in the manufacturing sector depicted very closely related similarities, while D, E, F, ... who were in the trade sector also depicted great similarities. To achieve a representative study, the researcher categorised various activities into three major types which are widely accepted namely; trade, service and manufacturing and a sample size of 10 interviews was conducted for each sector, covering a total of 60 entrepreneurs. From the selected sample sizes, a systematic random sampling method was used in identifying the cases to be interviewed. The first respondent was chosen at random, and the next respondent was selected after an interval of five entrepreneurs, to achieve a representative coverage of both sites.

1.7.3 Data Analysis and Presentation

Both qualitative and quantitative analysis were utilised to analyse primary and secondary data, along the stated objectives while tables and maps were used where they serve to illustrate the presented data.

1.8 Study Limitations

There was a general unwillingness among the interviewees to offer information. This was caused by suspicion and fear. They felt that the researcher was out to investigate them as an agent of the Government. Prior to this, there had been a rumour circulating that the Government was intending to evict some of the artisans in the area. This made it very difficult for the researcher to obtain some of the information which was necessary for the study especially questions related to income. However, the researcher had to convince them that the research had nothing to do with the government and it was purely an academic exercise.

Most of the respondents wanted to be assured about the positive benefits of the research before the interview was conducted, for instance if loans were to be guaranteed. Some respondents totally refused to be interviewed arguing that they had been interviewed many times but nothing has been done. This put the researcher in a difficult position. However, the researcher tried to solve this problem by taking time to explain to those who were willing, the purpose of the study and its implications.

MSEs had scanty records or statistics about their operations since most of the operators do not keep records. Thus, they had to rely on memory to remember their income per month. Most of the time they relied on estimates.

The original questions were drafted in English but had to be translated into Kiswahili during the interview. There were cases where the respondents could neither understand English nor Kiswahili. In the process of translation some questions lost their original meaning and therefore wrong answers were given in a few instances. This forced the interviewers to explain further which wasted a lot of time allocated for the research.

1.9 Organisation of the Study

The study is divided into six chapters. Chapter one provides an introductory background to the study. Chapter two reviews the Government financial policies for the sector as well as the sector's contribution to development. Chapter three discusses the study area and the historical perspectives of the sector. Chapter four analyses business socio-economic profiles while chapter five analyses the credit accessibility to the entrepreneurs. Chapter six concludes by summarising the study and giving policy recommendations.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter is concerned with providing the framework in which the study has been undertaken. The definition, role, problems and existing financial policies on small scale MSEs are examined.

2.2 Definitions of the Micro and Small Scale Enterprises

Much work has accumulated during the last 2 decades of extensive research on Micro and Small Scale enterprises particularly on the 'informal sector'. The most important aspect of the literature is the gradual transformation which has taken place - from an intellectual debate on the term, its definition and role, which dominated the studies of the 1970's to issues of policy and public action for improvement of the situation centering on and concerning, the sector - in the studies of the 1980's. The latter trend seems to have continued into the 1990's.

The subject of informal and MSEs has attracted a lot of interest from national and international development finance and technical agencies as well as from aid programmes. Consequently, a variety of interests explain the diversity in definitions.

The term informal sector, ever since it was first coined by

Keith Hart (1971), and then popularized by ILO report on Kenya (1972), has been the subject of a great deal of debate and disagreement, as to its meaning. While there is a variety of views regarding the term to be used to refer to these activities (informal,MSEs or Small Scale Entrepreneurs -SSEs), most scholars and researchers tend to agree on the major characteristics distinguishing this sector from the formal sector. These include: use of relatively simple technology, family ownership of the enterprises, low levels of capital outlay, wide diversity of incomes, ease of entry, reliance on indigenous resources, small scale of operation, labour intensive and adaptive technology.

For purposes of this study, the strategy report's (Republic of Kenya, 1989), definition is adopted on MSEs. "Micro enterprises" refers to those firms with 10 workers or fewer while "Small enterprises" have from 11 to 50 workers.

The Development Plan (1989) refers to a small enterprise as: "A small, profit oriented firm having between 1 and 50 employees and whose total assets do not exceed Kshs. 5 million in value". It categorises small enterprises into two broad groups, those employing between 1 and 9 workers, which are the "informal" sector or what is commonly known as "Jua Kali" business or micro enterprise, and those employing 10 to 50 employees as the "formal sector". The small scale enterprise sector comprises of a range of enterprises including self employed artisans, Jua kali enterprises, cottage industries, sole proprietors and small enterprises in the formal business sector having some 10 or 50 employees. These may be engaged in trade, commerce, distribution, transport, construction, agro-business, manufacturing and maintenance or repair.

Rempel (1996), concludes that the term informal sector, is a fuzzy concept. The most common approach is to define informal activities by use of constructs of industrial organization where the unit of analysis is a micro enterprise. For example, the ILO path - breaking study on Kenya defines formal activities on the basis of barriers to entry, type of ownership, scale of operation, source of technology, capital - output ratios, source of skills, and degree of competition and regulation in the market for goods and services. The enterprises that do not fit these constructs are then designated as informal (ILO, 1972:P.6).

Kavuluvulu (1990:4), defines informal activities as:

> .....small - scale income generating activities that are not bound by, or do not live up to formal contractual rules or regulations that are legally recognised in a given society ....

He notes that the informality of the activities extends to the 'way of doing things', characterized by ease of entry and exit, minimal start - up costs, reliance on make - shift facilities, indigenous resources and adopted technology, reliance on family labour and acquisition of skills outside the formal education system.

2.2.1 Role of Small Scale Enterprises in Economic Development

This section is an attempt to review some of the strong points of small enterprises from the point of view of development as well as some of the ways these could be made to contribute more effectively to the overall development process. This does not mean neglecting the problems which entrepreneurs face when dealing with the powerful forces of the free market economy.

Small and especially micro enterprises have now become the umpteenth in the long series of development fads, mainly for the following reasons:

(a) Large enterprise, whether plantation, manufacturing plant, or large business, has failed to stimulate a wide range development process to the extent fondly imagined possible at one time by development theorists and planners;

(b) the untapped pools of unemployed labour formed due to the disequilibrating forces of the development process have no security system to fall back on, and hence must attempt to survive by searching for alternative sources of income. For all practical purposes, this primarily means self - employment; and

(c) the labour - intensive nature of most small - scale enterprises implies that good use will be made of available factors of production (much labour in combination with little capital).

Informal activities are no longer viewed as an undesirable consequence of development process but an integral part of the urban economy. Given the lower capital - output ratios characteristic of informal activities, their existence serves as a check on the use of capital - intensive technology throughout the range of formal activity. The most significant aspect of the informal sector paradigm is its role in the analysis of cities in developing countries which reflect polarization in nearly every aspect of urban agglomerations - from socioeconomic to environmental, manifested in terms of employment, housing, transportation, and the way in which other urban services needs are met by low income city dwellers.

World Bank (1996), notes that Kenya has the potential to be among the first countries in Sub Saharan Africa (SSA) to attain the status of a "newly industrialised country". O'Brien S. (1996), notes that the secret behind East Asia countries miraculous success (these include Japan, Hong Kong, Republic of Korea, Singapore, Taiwan, Indonesia, Malaysia and Thailand), is that these countries have well conceived policies aimed at long-term and equitable economic growth.

The performance of the Kenyan economy, measured by average annual growth rates of real GDP, has generally been declining over the years. The growth rate declined from an average of 6.6 per cent in the period 1964-1973 to 5.2 per cent, 4.1 per cent and 2.5 per cent in 1974-1979, 1980-1989 and 1990-1995 respectively. The economy has experienced a slow down to record a 4.6 percent GDP growth rate in 1996, down from the revised growth of 4.8 per cent recorded in 1995. Declining National Output has been manifested in the rising unemployment and widespread poverty. With a nationwide labour force of 4.1 per cent per annum, approximately half a million people are expected to enter the labour force annually over the next decade (Republic of Kenya, 1996a).

For near full employment to be achieved during the period 1997-2020, employment growth must average 4.3 per cent annually. Modern wage employment accounts for 15% of the labour force where 50% of these are in the service industry including Government and only 15% in manufacturing. Informal sector accounts for 40% of the urban employment, a far higher percentage than is captured by official estimates, (Ondiege and Aleke-Dondo, 1991). A Gemini Survey (1993), indicated that these enterprises generated 75 per cent of private enterprise employment by creating 270,000 new jobs annually, compared to only 24,000 jobs created by larger firms.

Small scale enterprises, which include informal sector enterprises, have contributed significantly to employment and income generation in the Kenya's economy production, distribution, and service sectors. Data on employment (Table 2.2.1) reveals that a large proportion of the surplus labour in the economy is continuously joining the expanding informal sector.

Table 2.2.1 Informal Sector, 1993-1996

Number of Persons Engaged by Activity

Activity	1993	1994	1995	1996*
Manufacturing	418,252	492,439	616,854	710,859
Construction	20,591	26,015	31,554	36,049
Wholesale, Retail Trade,Hotels$Rest	909,879	1,126,217	1,405,450	1,675,482
Transport & Communication**	23,642	28,861	35,070	41,460
Community,social & personal services	94,148	118,841	151,538	179,901
Total	1,466,512	1,792,373	2,240,466	2,643,750

* Provisional
** Includes mainly support services to transport activity.

Source: Kenya (1997), Economic Survey

Distribution of informal sector employment by industry shows that in trades, hotels and restaurants industry employment grew by 19.3 per cent to 1,675,482 persons in 1996, which was 63.4% of total employment in the sector. This expansion in this industry may be attributed to the continued liberalisation of the economy. Manufacturing industry was the second leading employer with 710,859 persons, and a share of 26.9 per cent of total employment in the informal sector in 1996. Total persons in informal sector employment within the community and personal services rose by 18.7 per cent to 179,901 persons. On the other hand, construction industry had the smallest share of persons engaged in the informal sector.

The high employment generation potential principally results from the multiplicity of the informal sector activities; the use of simple and inexpensive technologies, which do not require specialised skills, its high labour intensity and ease of entry for it requires little capital investment and virtually no registration formalities.

An ILO survey of 17 African countries found out that the MSEs sector contributes, on average, 20 per cent of G.D.P. to the economies studied (World Bank, 1989). This sector, which has majority of the poor participating as entrepreneurs, employees and customers play an important role in production, distribution, finance and employment creation in the African economies and needs, therefore, it should be given serious consideration to help reform African's economic structure (Ondiege, 1992).

The small scale sector if improved can reduce the gap regarding employment opportunities in urban areas as well as correct discrepancies in income distribution. The 1995 ILO report on world employment, illustrates the informal sector role in reducing underemployment and poverty. Of greater significance is the World Development Report (1995), in which the World Bank shifts its focus from the formal sector to informal sector employment and notes the labour market adjustments that are now having a global impact.

Consequently, this sector may help in lowering the cost of living for the majority of the urban population living in poverty. The spread of the market economy, in developing countries has led to a greater reliance on the informal sector as a key source of job creation.

Vandermoortele (1991:10), estimates that 15 million new employment opportunities were created in Africa urban centres, during the 1980's. An ILO survey of 17 sub-saharan African countries, showed that informal activities accounted for 59% of the urban labour force and 20% of the Gross Domestic Product (World Bank, 1989:138).

Hernando de Soto (1989:12), estimates that in Peru, the informal activities account for 48% of the economically active population and 39% of the country's Gross Domestic Product (G.D.P.). He notes that this sector stimulates the growth of a market economy and strengthens market dynamisms. He showed how the "informals" in Lima, Peru either made use of the market or created their own. A Dhaka study (1992), on the informal sector labour and enterprises engaged in urban waste recycling described how these labour and enterprise groups created a market based on waste recycling which has rapidly expanded as a response to jobs and resource scarcity. Dhaka's thrilling rickshaw industry is another example of market expansion through the expansion of the informal sector occupations.

Nurul Amin (1994/1995:40), reports that 50% to 65% of the urban labour force in Asian metropolises are workers engaged in informal activities. He summarises informal sector as a mode of urban analysis, as follows:

(i) It has provided a framework of analysis to explain the large proportions (often from 40% to 65%) of urban workers who are engaged in economic activities outside the formal sector;

(ii) It has facilitated a logical extension of the Todaro model (1984), i.e., individual migration decision making and the probabilistic nature of job-seeking implies an excess of urban unemployment in the sense that the informal sector becomes a means of survival for urban immigrants who do not immediately find formal sector employment;

(iii) It has sharpened the understanding of rural-urban migration flows beyond the prediction of Arthur Lewis model, in the sense that labour transfers from the "rural subsistence sector" exceed by far the job creation ability of the "modern capitalist sector", and

(iv) It has facilitated the formulation of urban policy, planning, and management goals and actions to reduce segmentation of the urban economy, in pursuit of equity and the harmonious growth of cities.

2.2.1 Constraints to Micro and Small Scale Enterprises Sector Development

Despite the contribution of the informal sector to economic development, various factors have been identified as barriers for rapid expansion of small enterprises. Their development is constrained by factors such as inappropriate environment, particularly inadequate infrastructure, inappropriate technology, inadequate capital, limited market and credit inaccessibility. Lack of adequate capital may for instance, affect those in manufacturing and vehicle repair service subsectors who require relatively higher seed capital and have no access to formal sources of credit, (Ondiege, 1991).

Schaffer and Wen-Hsien (1985), notes that most operators of small enterprises are all too familiar with the problems of access to public services - the difficulties of obtaining licenses, low-interest credit, adequate premises, electricity and water supplies, technical training and assistance, supplies from government monopolies and sales outlets through government agencies. Little or no support reaches the smallest, poorest and most remote enterprises. In the great majority of cases, the distribution mechanisms for government services fail to function in accordance with the often repeated objective of "reaching the poorest of the poor". Schaffer (1985), identifies an aspect of the problem of access as the difficulties of making organisational connections, the ways in which resources are distributed and the kind of links between clients and institutions.

Ondiege and Aleke-Dondo (1991), observed that despite the fact that Kenya has over 50 institutions with credit schemes or assistance programs for MSEs and informal sector development, less than 10 per cent of these entrepreneurs knew of the existence of such NGOs assistance programs. This suggests lack of adequate information on these programmes and also the selective nature of those involved in assisting the sector's enterprises.

Government of Kenya report (1989), summarises constraints facing small enterprises in acquiring credit as: inadequate funds, stringent collateral requirements, and neglect of the small enterprise by the financial institutions. The report in an attempt to find solutions for these problems calls for a special fund for small enterprise reduction of deficit financing, reviewing interest rates and taxes on savings and developing money and capital market. This also includes providing appropriate incentives for banks to lend to small enterprises by increasing subsidized sources of financing these enterprises, allowing levy for business advisory services to clients and also sensitise financial decision makers to small enterprise promotion through training loan officers and also providing special awareness raising campaigns for Central Banks, treasury officials and directors of financial institutions.

Aryeety (1994), explains that despite, the liberalisation of the economy there are yet no indications that access to finance has improved. He argues that the situation may even deteriorate with tightening monetary controls, introduction of high yielding securities to absorb liquidity and efforts to raise the performance of loan portfolios. He concludes that banks have done very little in improving their information base and appraising capacity of small clients.

McCormick (1996), discusses the constraining factors towards a quality or quantity of innovative ideas. Among them include small weak markets, lack of information and financial resources. Finance was revealed as a major constraint on the scale of entrepreneurial activity.

Farbman (1981), notes that in Philliphines 83 per cent of the MSEs interviewed, felt that credit was their most important need, and the most important service that could be rendered by direct assistance programmes.

Rempel (1996), notes that the major proportion of people involved in the informal sector receive no protection, compared to protection for employees in formal activities provided by closed - shop labour unions, legislated minimum wages, various labour laws, government as wage leaders, a hierarchy of defined forms of advancement within large firms and wage efficiency relationships. Government at all levels generally do not recognise informal activities, the self - employed and the employed are not subject to government labour legislation, they do not receive government services nor are they protected by labour safety, health or minimum wage legislation.

Structural Adjustment Programmes were mounted in the 1980's by the World Bank and International Monetary Fund (I.M.F.). It was hoped that the policies inherent in the program would allow for creation of an environment conducive for the operations of small enterprises. For example with the financial sector liberalisation aimed at flexible interest rates, non-rationing of credit allocations and competitiveness in the sector, it was hoped that the institutions would change their lending practices allowing small enterprises access to their credit facilities.

Again, with fiscal discipline calling for reduced government borrowing from the banking institution, there would be more available finances to loan the private sector.

Barwa S.D. (1995), studies the impact of policies associated with structural adjustment programmes, such as currency devaluation, tight fiscal policy and monetary policy and promotion of exports. He attempts to investigate whether the liberalisation has moved the financial institution closer to making it easier for the small enterprises to get access to their credit. He identifies major constraints facing the enterprise in the sector, which include rising costs, increasing competition, reduced availability of raw materials and backwardness in technology.

Friederic (1995), notes that MSEs contribution to development is hampered by unconducive environments in which MSEs operate. This is due to a large number of interrelated factors which include:

(i) Inadequate access to market information, technological and managerial knowledge, skills and financial resources;

(ii) Limited access to markets;

(iii) Weak linkages with business partners and

(iv) Inadequate framework of regulations and incentives.

2.3 Government Financial Policies for the Micro and Small Scale Enterprises

In recognition of the MSEs sector role in generating employment and income, the Kenya Government has come up with several policy measures and programmes to boost its development. These include infrastructural development, construction of Nyayo sheds, training and credit schemes. This study confines itself to only those policies or programmes related to providing credit.

2.3.1 Evolution of Government Policy

Immediately after independence the Kenya Government strategy for industrialisation was geared towards expansion of overall output, with the assumption that only large enterprises in the formal sector contributed to economic growth. In 1967, MSEs were given recognition when the Act establishing the Industrial and Commercial Development Coorporation (I.C.D.C.) was amended. The I.C.D.C. had been established by the colonial Government in 1954 to facilitate economic development through the provision of financial and technical assistance to industrial and commercial enterprises. The amendment of the act created the Kenya Industrial estates (K.I.E.) to look into the matters relating to finance and technical assistance for the industrial ventures of Kenyan citizens.

(i) The ILO Report on Kenya (1972)

The 1972 ILO study on increasing productive employment in Kenya, recognised that the informal sector was not just an urban phenomenon, but was a very important part of rural life. More interestingly, they characterised the development of the sector and of the activities associated with it as illustrating self-reliance:

> In a striking way it is a parallel to the Harambee, or self-help, movement which has been such a fundamental part of Kenyan social and economic development in the period since the attainment of national independence: in both cases the recognition of unfilled needs generated by social change is followed by individual or action group action on a local basis. (ILO, 1972:225)

ILO urged the Kenya Government to promote the MSEs by abandoning shanty demolition and harassment policies and their substitution by site -and-service schemes, and greater security of tenure. They also recommended the simplification of trade licensing system, and suggested more closer ties between formal and informal sectors through subcontracting. The study also recommended that the informal sector be given priority emphasis in economic development plans.

(ii) Third National Development plan (1974-1978)

In this plan, the informal sector received considerable attention as a result of the ILO report, and ensuing sessional paper on employment. Government policy stressed the need to promote Small and medium informal sector enterprises through the establishment of industrial estates and rural industrial development centres for the informal sector entrepreneurs. Policy strategies were to address the issue of directing assistance to the informal sector throughout the country. It was proposed that the Kenya Industrial Estates (K.I.E.), started in 1967, be made an autonomous organisation to make it more effective in providing working sites for small enterprises and informal sector investors.

(iii) Fourth Development Plan (1979 - 1983)

The plan identified accurately some of the major handicaps facing small-scale manufacturers. Section 7.3 stated that, "the Government will adopt new initiatives concerning the promotion of MSEs and the alleviation of some of their handicaps". Some measures stipulated were:

(i) A massive expansion of K.I.E. services to at least one facility in each of Kenya's 33 districts by the end of the plan period;

(ii) A fund of Kshs. 50 million to help informal sector enterprises take advantage of K.I.E. and other industrial development facilities, and

(iii) The Government was to promote establishment of credit guarantee schemes for loans given by commercial banks to MSEs.

Despite some of these measures, the level of implementation was hampered by institutional and administrative constraints, and nothing much has been achieved to date.

(iv) Fifth Development Plan (1984 - 1988)

This plan period reiterated the strategies in the Fourth Development Plan. The plan envisaged the establishment of a full-fledged small industries division in the Ministry of Commerce and Industry, to monitor the small industry development program and provide assistance to the industrial extension service. The plan also stated that there would be a shift of emphasis from capital - intensive modern industries to small and cottage industry to increase employment levels.

(v) Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth

The paper stresses that the informal sector has "a vital role to play in the renewed growth of the country". Informal sector entrepreneurs generally lack the collateral to obtain credit. Past programmes designed to address this problem such as the Ministry of Commerce and Industry's Joint Loan Board Scheme, have had inadequate resources to meet demand, often suffered from high default rates among borrowers, and are inherently limited in the number of firms they can reach. In an attempt to overcome these constraints and make credit accessible to MSEs the Government stipulated some policy measures:

(i) Amending collateral requirements, for example through recognising letters of allotment on land and expediting land registration process in urban areas;

(ii) Encouraging aid donors to promote commercial banks and other lending institutions with low interest loans, allowing them a wide interest margin to cover greater risks and higher costs of lending to informal sector firms;

(iii) Cooperatives, NGOs and other strong local voluntary associations representing informal sector entrepreneurs would be encouraged to devise their own credit programmes. Such organizations are viewed as better placed than centralised agencies to evaluate the personal capabilities of the borrower and enforce repayment;

(iv) The Government would promote schemes to provide graduates of Youth Polytechnics and other secondary schools with the tools of their trade and with small infusions of working capital to start up their own business; and

(v) Macro - economic policies together with direct assistance to individuals in small - scale business will be utilised in an effort to assist, in particular, the informal sector entrepreneurs in manufacturing, transport construction and housing and those small firms with the potential to make a successful transition to large enterprises.

(vi) Sessional Paper No. 2 of 1992 on Small Scale Enterprise and Jua Kali Development in Kenya.

The Sessional Paper provided an "Agenda for Action", that was expected to result in specific policy actions. The Government was to intensify its efforts to acquire supplementary soft foreign loans for on-lending to public and private financial institutions for lending to the MSEs sector. The Government would revise the application of the Industrial Training Act so as to accommodate the use of the fund by banks and DFIs for training their MSEs clients.

Ministry of Research Technical Training and Technology (MRTT&T) in conjunction with the treasury and the Directorate of Personnel Management, was to establish a special training fund for MSEs entrepreneurs. Contribution to this fund was to include the Government, private sector and the donor community. The Central Bank, through the same forum, was to initiate studies on comparative risks and costs associated with lending to the MSEs sector in Kenya in order to lay the groundwork for future policies in the banking sector.

The Paper envisaged the collaboration of the Office of the Vice President and Ministry of Finance, Central Bank, College of Banking and Finance, MRTT&T and NGOs in developing innovative and diversified lending programmes and schemes as a means of attracting funding.

(vii) Sixth Development Plan (1989 - 1993)

During the plan period, the Government recognises that the MSEs activities are easily born but have high mortality rate. The root cause lies in the hostility of the environment in which they are persecuted, starved of capital, overlooked by

Commercial financing system and until recently, ignored by most external aid agencies.

The Government was determined to redress the problem or limiting factor of availability or inaccessibility to capital, through institutional restructuring. The Government was to support programmes to reduce the cost of giving small loans while ensuring that banks have adequate liquidity and that they become more actively involved in this sector both in the provision of start-up finance and short-term working capital. Cooperative bank was encouraged to play a more dynamic role in recycling funds through its branches. The Capital Markets Development Authority was to design ways and means through which successful small-scale and Jua Kali enterprises can expand their capital base.

(viii) Sessional Paper No. 1 of 1994 on Recovery and Sustainable Development to the Year 2010.

This paper intended to complement and build on Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth. It provides a reaffirmation of medium to long term strategy to maintain measures for socio-economic stability which will lead to sustainable development. This paper identifies a number of constraints on the rapid expansion of the sector including; the inhibiting general policy environment, cumbersome laws and regulations, inadequate training for artisans, poor information dissemination and a lack of credit provision.

This paper recognises that Kenya has an extensive network of institutions promoting MSEs activities. However, these have often been ineffective for a number of reasons: high costs to targeted clients; poor dissemination of information of the services that they have to offer; little coordination between the institutions involved, leading to duplication and unnecessary competition; lack of clear policy guidelines; lack of integration of training in the assistance programme; and lack of capacity and experience on the part of the institutions in needs assessment of target MSEs beneficiaries.

Despite the existence of many financial institutions in Kenya, MSEs continue to experience limited access to credit. Credit programmes in the MSEs sector will target emerging entrepreneurs, including the small and medium scale enterprises, which are referred to as the "missing middle" level entrepreneurs. Women, who form a significant proportion of MSEs entrepreneurs, are specific target beneficiaries. Special groups, including the physically handicapped, with a disproportionately high percentage of unemployed, will also be targeted. To ensure increased flows of loan funds, Government has pledged to intensify its efforts to acquire supplementary soft loans for on-lending to financial institutions for lending to the Small Scale and Jua Kali sectors.

(ix) Seventh Development Plan (1994-1996)

During this plan period, the Government is aiming at divesting itself of direct control of MSEs sector activities and will concentrate on providing an enabling environment. More private sector involvement will be encouraged through the provision of necessary institutional and economic infrastructure at the local level.

(x) Sessional Paper No. 2 of 1996 on Industrial Transformation to the Year 2020.

This paper recognises that limited access to credit has continued to be a major constraint for the private industrial sector. The financial sector in Kenya has undergone reform following the inception of Structural Adjustment Programme. Foreign exchange transaction have been liberalised, credit allocation and interest rate determination process have ben deregulated and the range and quality of financial services and their delivery improved. Alternate financing sources include Development Finance Institutions (DFIs) and the stock exchange, among others.

Inspite of the continuing restructuring of Kenya's financial sector, there remain problems facing many entrepreneurs, in particular the MSEs. These include the absence of an efficient financial intermediation mechanism which can effectively channel resources towards private productive investment. Attitudinal problems arising from the persistent distrust between lenders and borrowers, poor marketing strategies of the banks and the continuing competition for limited funds between Government papers and the banks. The crowding-out of the private sector from accessing credit is clearly demonstrated by the fact that the stock of domestic Government debt of KSHs. 5,751 Million at the end of 1994 represented about 29.5 per cent of G.D.P. Further, there does not exist, in Kenya, adequate incentives and guarantees for banks to encourage financing of small and medium scale enterprises.

The Sessional Paper proposes that the Government is to continue supporting NGOs and other agencies that provide credit to MSEs. The Government is to ensure that MSEs have access to training and technical support and technology and information, amend and/or remove licensing and other regulations that have been identified as impeding the development of MSEs.

(xi) Eighth Development Plan (1997-2001)

This plan period covers the first phase of Sessional Paper on Industrial Transformation to the Year 2020. In order to enhance the rapid growth of the MSEs sector the plan period envisages the collaboration of the Ministry of Commerce and Industry, Ministry of Finance, Local Authorities, OVP and MPND and other relevant ministries with the private sector, NGOs and community based organisations. This will focus on: formulating and developing programmes to improve access to credit and finance; and to support women and youth involvement in MSEs sector through special programmes.

(xii) Budget Speech for the Fiscal Year 1996/97

During the current financial year (1996/97), the Government pledges to make a substantial increase in the funding of public institutions which have been established specifically to provide credit to small scale MSEs.

CONCLUSION:

The foregoing survey reveals that the government has initiated policies on a wide range of small and micro enterprise development activities. However, expected benefits have not been satisfactorily met as noted in the Sessional Paper No. 2 of 1992. What is less so, is the implementation of suggested strategies because only a few have actually been carried out, and some to only insignificant levels. This shows that the government has recognised the role this sector can play in the economy, if past impediments to the sector's productivity can be removed.

2.4 MICRO AND SMALL SCALE ENTERPRISES FINANCIAL INFRASTRUCTURE IN KENYA

This section discusses some of the existing sources of assistance for the development of MSEs sector in Kenya. In general there is considerable support for the informal sector through a variety of government, bilateral, multilateral and NGOs sources:

i) Ministerial agencies providing assistance programmes for the informal sector include - Kenya Institute of Business Training, Joint Loan Board Scheme, Kenya Industrial Training Institute, District Industrial Committees and the women's Bureau;

ii) Government parastatals promoting MSEs - Kenya Industrial Estate (KIE), the Small Enterprise Finance Company Ltd (SEFCO), the ICDC, and the KCB;

iii) There are also about 100 NGOs involved in the Promotion of informal Sector enterprises which include the Kenya Rural Enterprise Programme (K-Rep), National Council of Churches of Kenya (NCCK), Undugu Society, Partnership for productivity - Kenya (PFP/K), Tototo Home Industries, Daraja Trust, Kenya Women Trust Fund (KWFT), Technoserve (programmes for cooperatives), Small and Micro Enterprise Development (SAMED) supported by the British Aid to Small Enterprise (BASE) programmes;

iv) Private Sector initiatives that promote the informal sector - Kenya Institute of Management Assistance program (K-MAP), Asian Foundation, British American Tobacco (B.A.T.), Coca-Cola e.t.c;

v) Donor agencies - US Agency for International Development (USAID), The Ford Foundation, Canadian International Development Agency (CIDA), Norwegian Agency for International Development (NORAD), African Development Foundation (ADF), Friederich Ebert foundation etc;

vi) Many informal sector cooperatives and organizations have sprang up as lobby groups or trade Associations. These include Kenya Small Traders Society (KSTS), Kenya Hawkers Association and Kenya National Federation of Jua Kali Associations (KNFJKA) and

vii) Multilateral organizations such as ILO, UNDP and UNESCO also contribute to the promotion of this sector.

Despite these efforts by these bodies, small-business owners continue to experience difficulties accessing credit. Various surveys reveal that, there is little interaction between programmes offered by most of these support agencies.

2.4.1 GOVERNMENT

The Government has been a key actor in MSEs development. The first real effort at promoting MSEs was in 1967, when the K.I.E.was established, to provide credit, management assistance and industrial estates so as to encourage the formation of enterprises in urban and rural areas by Kenyan citizens. Today, there are 75 credit programs for MSEs in Kenya, implemented by the Government, DFI's, Commercial banks and NGOs. The increase in number of institutions supporting this sector has not been matched by significant changes in policy, although many policy pronouncements have been made.

The Joint Loan Board Scheme (JLBS)

JLBS started during the colonial period in 1955, with the main objective of assisting indigenous African entrepreneurs to start and run small businesses. Tangible securities are replaced with guarantors and in some cases chattels. Loan terms are 2 to 5 years and the interest rate since its inception has been 6.5 %. There is a board in every District and major municipalities.

In 1986 a task force was established in the Ministry of Commerce, to look into how the board could be reformed. It identified a number of weaknesses. Among them, was that income from interest was only covering 65% of the direct operating expenses, the appraisal methodology was inefficient, loan arrears were jeopardizing the credibility of the scheme, and the administration of the programme was complicated by the fact that it was jointly managed by the Ministry of Commerce and Local Authorities while the appraisal committee is chaired by the District Commissioners. Development plan (1989), notes that Kenya's 45 JLBS had lent a total of Kshs 87.5 Million to more than 30,000 loanees. Of these 11,000 borrowers were in default to the tune of a staggering Kshs. 45m.

The Development plan (1989, section 7.62) notes that the Government will

(i) Set a supervisory unit at headquarters level to provide for continuous inspection and internal audit throughout the country;

(ii) Provide training programme for trade development officers and board clerks at all districts to improve loan processing and recovery;

(iii) Engage qualified extension officers to monitor proper use of funds;

(iv) Seek additional funds from both public and private sectors to improve the capital base for loanees. Interest rates will be reviewed from time to time to reflect the real value of the funds and

(v) Resolve conflicts in the management of the scheme.

2.4.2 The Non Governmental Organisations (NGOs)

These are the newest group of lenders who have shown potential likely to bring about further growth and sustainability of institutionalized credit for MSEs. Although there was some lending by NGOs in the late 1970,s and early 1980's , it was not until 1984, with the advent of K-REP, financed by the USAID, that a comprehensive approach to MSEs credit emerged. A number of NGOs have sprung up exclusively to provide assistance to informal sector entrepreneurs such as K-REP, KWFT AND PFP-Kenya.

All major NGOs operating credit schemes in Kenya have adopted the minimalist model (Ondiege and Aleke-Dondo, 1991). The main features of this model are: the use of groups of 5 borrowers to secure the loans, the disbursement of small loan amounts, high recovery rates, relatively low operational costs, and the mobilisation of savings. Although this approach is relatively new in Kenya, it does offer hope for lending small amounts in a cost effective manner to large numbers of MSEs operators. This method has improved the cost-effectiveness of these programs to the extent that the ratio of credit administration costs to credit disbursed is 1:4.

Despite the fact that some of the NGOs are doing well, the long-term commitment of most of them to MSEs lending is questionable. This is because most are donor funded and could easily collapse if such funds were withdrawn. Below is a discussion of one of the key lending NGOs and the methods that it has developed or applied in lending to MSEs.

The Kenya Rural Enterprise Programme (K-REP)

This section relates the experiences of K-Rep in developing effective microenterprise credit programmes. It also reviews some of the factors limiting the ability of NGOs to function as financial intermediaries.

Established in 1984 with funding from USAID, with the primary objective of channelling financial support, together with training and technical assistance, to local NGOs involved in informal sector programs throughout the country. Three categories of projects currently supported by K-Rep:

(i) Support for NGOs and Business Associations:

K-Rep extends grants and/or loans to other NGOs and Business Associations which in turn assist clients in their areas of operation;

(ii) Community Based Enterprise Support:

K-Rep provides loans and small grants to community-based enterprises (i.e. group-owned and operated enterprises) mainly in rural areas. Loans are made at market interest rates, with repayment periods between 1-6 years depending on the nature of enterprise activity; and

(ii) Grants, loans or contracts to non-profit and profit organizations and individuals are provided to pursue innovative work in enterprise development.

Although the Kenyan NGOs that have adopted the minimalist credit approach have made significant improvements, these NGOs are faced with the problem of balancing the objectives of welfare and the focus on sustainable credit programs. This conflict threatens the success of their schemes, as the attention of their management is split between credit and welfare objectives.

2.4.3 ROSCAS (Rotating Savings and Credit Associations)

Like many countries, Kenya has thousands of ROSCAS which are a source of credit for MSEs entrepreneurs.

In Kenya, ROSCAs are found in rural and urban areas, either as registered social welfare groups (mostly women's groups) or as unregistered groups of friends and family members. ROSCAs operate on simple principles. At regular meetings, each member contributes a fixed sum of money, which is given to one member, and each member gets a turn as a recipient.

The ROSCAs provide credit to those who would be ineligible to borrow from other sources. They also mobilise savings, serve a social function, and provide a form of insurance (from the group's savings). The ROSCA's offer a number of advantages to members. Their operations are simple and easily understood by even illiterate or semi-illiterate people, who form the bulk of their membership. Springing from local initiative, ROSCAs generate a sense of ownership and loyalty and embody truly participatory development. The ROSCAs are a promising approach to developing sustainable credit schemes for MSEs in Kenya.

2.4.4 COMMERCIAL BANKS

Despite the fact that Kenya has a relatively sophisticated banking sector with 30 commercial banks with more than 400 branches, subbranches, agencies and mobile units, most banks are passive observers as far as lending to MSEs is concerned. Until 1980's, none of the commercial banks had a credit program specifically for the MSEs.

Although commercial banks have historically been the main deposit mobiliser and source of credit in the economy, their share of the economy has been declining as a result of the proliferation of financial institutions of other types. The system of commercial banks in Kenya is dominated by four major banks- Kenya Commercial Bank (KCB), Barclays Bank of Kenya (BBK), Standard Chartered Bank (SCB), and the National Bank of Kenya (NBK), which together account for more than 80% of the deposits and credit volume of commercial banks.

Barclays Bank of Kenya

Barclays Bank of Kenya has been operating in Kenya for over 77 years. It has more than 90 branches and sub-branches throughout the country. It has established various credit schemes managed under their Small Business Unit through the collaboration with UNDP, ILO, USAID, ODA, EEC and the Government of Kenya, among others. The credit schemes are targeted at specific groups such as women's groups, off-farm manufacturing, service enterprises, graduates of youth polytechnics, book publishers e.t.c.

In collaboration with USAID, Barclays manages a loan guarantee scheme for projects worth as much as kshs. 6,750,000. Under this scheme the borrower is responsible for providing 50% of the securities , and the rest is covered by USAID. Barclays assists the entrepreneur with a business plan, and the branch office monitors the loan to the MSEs. The USAID-Funded Rural Private Enterprise (RPE) program was started by USAID in 1985 for the dual-purpose of providing long-term credit to commercial banks to lend to MSEs and changing the attitude of commercial bankers towards small borrowers, de-emphasizing securities and placing no more stress on the character of the borrowers and the potential of their projects. Barclays and the British -ODA developed a scheme similar to the one Barclays has with USAID but with targeted loan size ranging between KSHs. 40,000 to KSHs. 300,000.

In collaboration with Kenya Management Assistance Programme (K-MAP), Barclays runs a credit scheme, with an aim of improving survival rate in small businesses. It benefits borrowers who have received business and/or technical training or counselling services through K-Map for a period of 18 months. The credit limit is between KSHs. 100,000 and KSHs. 3.6 M. The required security is 100 percent if possible or a minimum of 50 percent of required facility. The credit period is upto 5 years.

In collaboration with ODA, Barclays runs a Small Business Credit and Training Scheme with an aim of improving access to bank credit for MSEs. It is worth as much as KSHs. 1 Million repayable over a maximum period of 5 years. The scheme is designed for small and micro off-farm industrial and commercial enterprises with a successful business record of at least 3 years. The scheme is operating in Kisumu, Eldoret, Webuye, Thika, Meru, Nyeri, Karatina, Mombasa, Nakuru, Naivasha, Nairobi and Kericho.

In collaboration with Kenya Women Finance Trust (KWFT), Barclays runs a programme for small scale business women entrepreneurs. Credit limits are Kshs. 50,000 (level 1), Kshs.50,000 - Kshs.100,000 (level 2) and Kshs. 100,001 - Kshs.4 Million (level 3). Required security is 100 percent if possible, or 30 percent level 2 and 50 percent level 3. The loans are fully secured by a guarantee fund and in addition, the NGOs provides monitoring and management support to the borrowers. Barclays also operates a scheme for youth Polytechnic Graduates which is guaranteed by ILO and is for loans of between KSHs. 10,000 and Kshs. 60,000.

Kenya Commercial Bank

Unlike Barclays which is privately owned, KCB is predominantly owned by the Government, with only 30% of its shares owned by the public. It is another bank engaged in lending to the MSEs. KCB has the largest network of offices, with 69 full branches, 59 subbranches and 117 mobile centres.

In addition to participating in the USAID-Funded RPE program, KCB has a few other schemes. Among them is the "Jua Kali" credit scheme which started in 1987, also funded by USAID. This scheme operated only in Nairobi and reached 200 borrowers with Kshs. 2.5 Million. More recently, KCB has started a graduate loan scheme, aimed at providing credit of upto KSHs. 300,000 to graduates to start new businesses. The total funds available under this scheme are KSHs. 30 Million plus an additional KSHs. 10 Million only for women graduates.

2.4.5 Development Finance Institutions

These have always been seen in Kenya as the main enterprise promotion organisations. Two such institutions are the KIE and the Small Enterprises Finance Company Limited (SEFCO).

Kenya Industrial Estate (KIE)

K.I.E. is a wholly Government owned financial institution established in 1967 as a subsidiary of ICDC. Its main objectives at its inception, was to

(i) promote the "Africanisation" of industry in Kenya

ii) Assist in entrepreneurial development.

As a lending institution, KIE also provides Long-term finance for acquisition of machinery and permanent working capital for small scale enterprises. By the end of 1987, KIE had disbursed about Kshs. 400 Millions in loans to approximately 700 industrial sheds in 30 estates and several Rural industrial Development centres and industrial promotion areas.

KIE informal sector programme

In 1980, with the Government's recognition of the crucial role played by the informal sector in the country's economic development, KIE begun the craft industry programme, on an experimental basis to provide financial and technical assistance to informal sector entrepreneurs. The program covered all the districts of Nyanza Province and provided small loans of Kshs. 5,000. The experiment proved a solid success, with over a loan-repayment over 90%. In 1982, the program was expanded to include all the district of the Western Province plus Kericho & Muranga district. The craft industry program provides credit only to manufacturing and service enterprises of the informal sector.

To date, K.I.E. has to date given financial and technical assistance to over six thousand enterprises throughout the country. Loans are repayable over a period of 6 months to 3 years at a current interest rate of 2.7 percent per month. The loan programme lends small loans of between Kshs. 10,000 and Kshs. 250,000. The programme considers businesses which meet the following criteria:

(i) Loanees must undergo training and orientation before they receive money;

(ii) Business must be viable and have been in existence for at least 6 months;

(iii) Business must be managed by owner;

(iv) Entrepreneurs must have a good reputation and of good character as satisfied by two guarantors and by an eminent area person; and

(v) Loans must be used to finance procurement of machinery and equipment or working capital.

Lack of data makes it impossible to assess the programmes impact on employment and income generation.

Small Enterprise Finance Company (SEFCO)

Started in 1983 as a subsidiary of the Development finance Company of Kenya. Its main objectives were to:

i) Assist in the promotion of African entrepreneurs by providing finance & advisory services for setting up expanding, modernizing or rehabilitating small enterprises wholly owned & managed by indigenous African entrepreneurs in rural areas. SEFCO operates 3 loans programmes, 2 of which are specifically for informal sector entrepreneurs.

(i) The Craftsmen Credit Guarantee Program:

This is a joint program between SEFCO and Friedrich Ebert Foundation (FEF), which targets rural men and women engaged in various crafts such as tailoring, carpentry, metal work, knitting e.t.c. The craftsmen are encouraged and assisted in forming a credit Guarantee Association of 10-25 members, after which a credit guarantee fund is set up. This fund consists of a 50% contribution from members in the form of an interest free loan to the association and an interest -free loan from FEF repayable in 4 years.

Funds are deposited in a savings account with a local bank and interest earned is used to defray the associations administrative expenses. SEFCO provides a counter - productive fund which is 10 times the members contributions, which is deposited in a fixed - deposit account with a bank. The bank then offers overdraft facilities to association members (upto Kshs. 20,000 each) using the fixed deposit as security.

The scheme has operated since 1984 covering 5 districts -5 associations in Kiambu, 5 in Machakos, 2 in Kisumu, 1 in Bungoma and one each in Kakamega, Kitale and Eldoret. Through these associations, the scheme caters to about 200 craftsmen with SEFCO having approved commitment amounting to Kshs. 400 Millions. Program reported to be doing well, with a loan repayment rate of 80%. Data on incomes is not available, while employment indicates that, on average each assisted enterprise employs more than 2 people.

(ii) Individual Credit Guarantee Program.

This is jointly by FEF and SEFCO. Target group is young people graduating from vocational training institutions and members of credit associations or other ventures geared towards employment creation and entrepreneurial development. The maximum under the scheme is KSHs. 250,000 with a maximum repayment period of 5 years and one year grace security is in form of chattel mortgages (business or personal assets) valued at least 50% of the loan amount. Entrepreneurs should have the capacity to raise a minimum equity contribution of 20% of the total project cost. In addition to these programmes, SEFCO offers management advisory services to its clients at all stages including project formulation, operation and evaluation.

2.5 Shortcomings of MSEs Financial Development Policies

Despite the established good financial network, there exists a serious gap between the demand for credit from the MSEs sector and what can feasibly be supplied by the established institutions. Thus there is need to increase the capacity of these institutions or maximise the impact of lending by making credit available to the MSEs with the greatest potential for growth.

Constraints in lending to MSEs occur primarily at three different levels:

(i) At the level of the small borrower who lacks experience with credit institutions;

(ii) With the financial organizations which are not predisposed to lending to small enterprises; and

(iii) At the level of existing regulations which limit the total funds available for on-lending.

Although Kenya has 30 commercial banks the vast majority have so far shown little interest in the MSEs sector. Even the few banks, like Barclays and KCB that have established special credit programmes, they have been mainly involved in the on-lending of donor funds with guarantee schemes financed by donors to cover the extra risks associated with lending to small businesses.

Bromley (1996), notes that those who work in small enterprise support programmes may wish to achieve total coverage of enterprises, or to favour the smallest and most remote enterprises, but they are hampered by the lack of adequate information, staff, funds and transport, and by a variety of legalistic concerns.

Frederic (1995), notes that institutions providing services to MSEs frequently suffered from

(i) limited outreach to MSEs,

(ii) Over-centralisation,

(iii) Severely restricted operating funds, staff mobility and incentives, and

(iv) Inadequate technical capacities.

CHAPTER THREE: BACKGROUND TO THE STUDY AREA

3.1 Background to Nairobi City

Nairobi has experienced a rapid growth both in population and physical extension. The physical area of Nairobi expanded from 3.84 square Kms in 1910 to 25 Kms in 1919. By, 1948, the city boundary covered an area of 83 square Kms. In 1963, the boundary was extended to 680 sq. Kms which is currently still the official extension of the city, (Ondiege,1990). The rapid boundary expansion can be explained by the high rate of urbanisation that has attributed to increased immigration and high natural population increase.

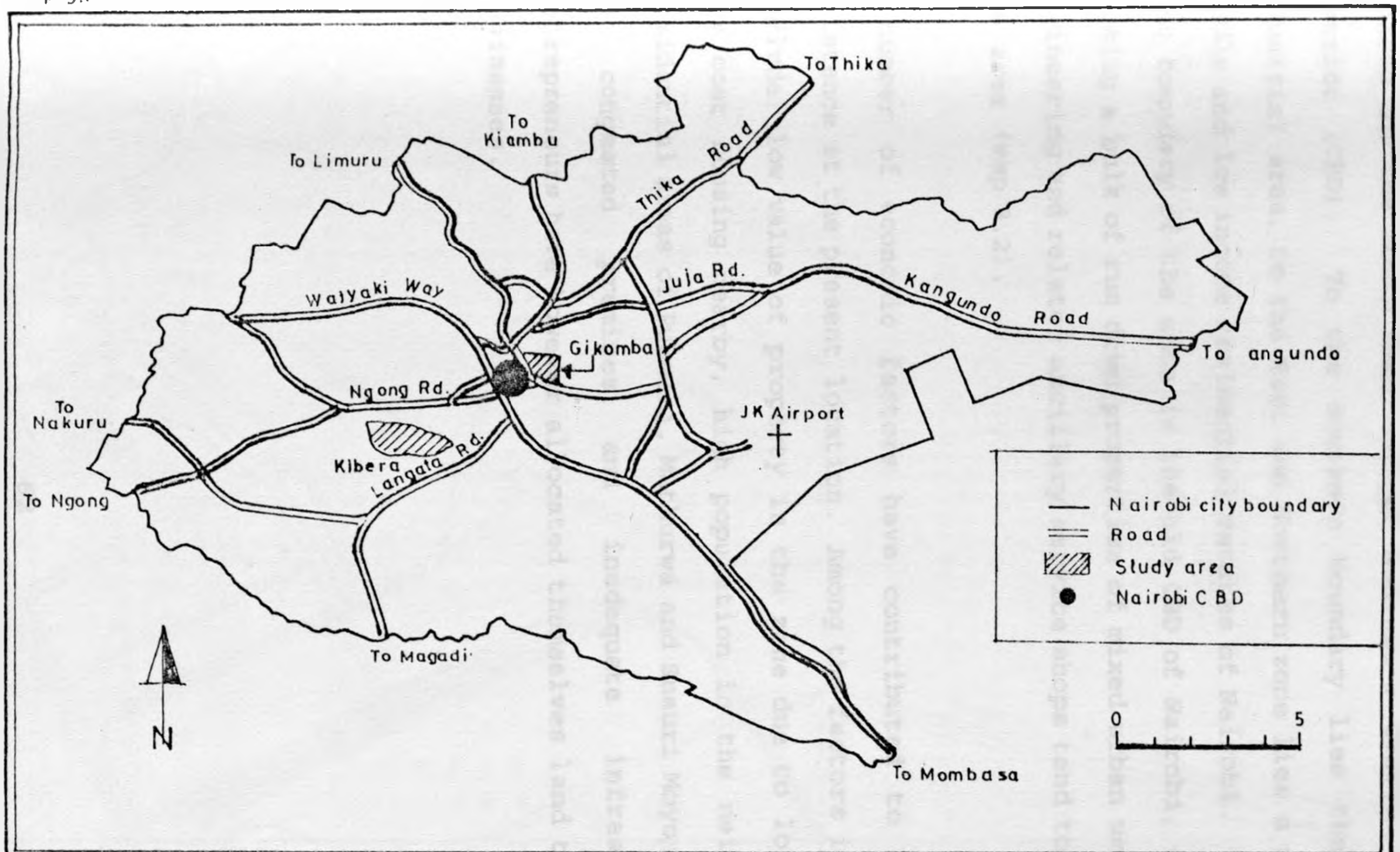
A notable observation however is the growth of the city itself, has by passed the growth of the necessary infrastructure. Immigrations in the city, and lack of sufficient employment opportunities for the majority has resulted in spontaneous development of informal and small scale activities. This has largely been as a result of the decline in wage employment opportunities in Nairobi, especially in the public sector. The public sector's share in total employment declined from 47.4% in 1992 to 46.5% in 1993 and to 45.7% in 1994.

3.2 Study Area

The two study sites were chosen in Nairobi. Kibera is to the western suburb of Nairobi, while Gikomba is to the Eastern side (Map 3.1).

Map 3.1

LOCATION OF THE STUDY AREAS



Gachocho M,1997

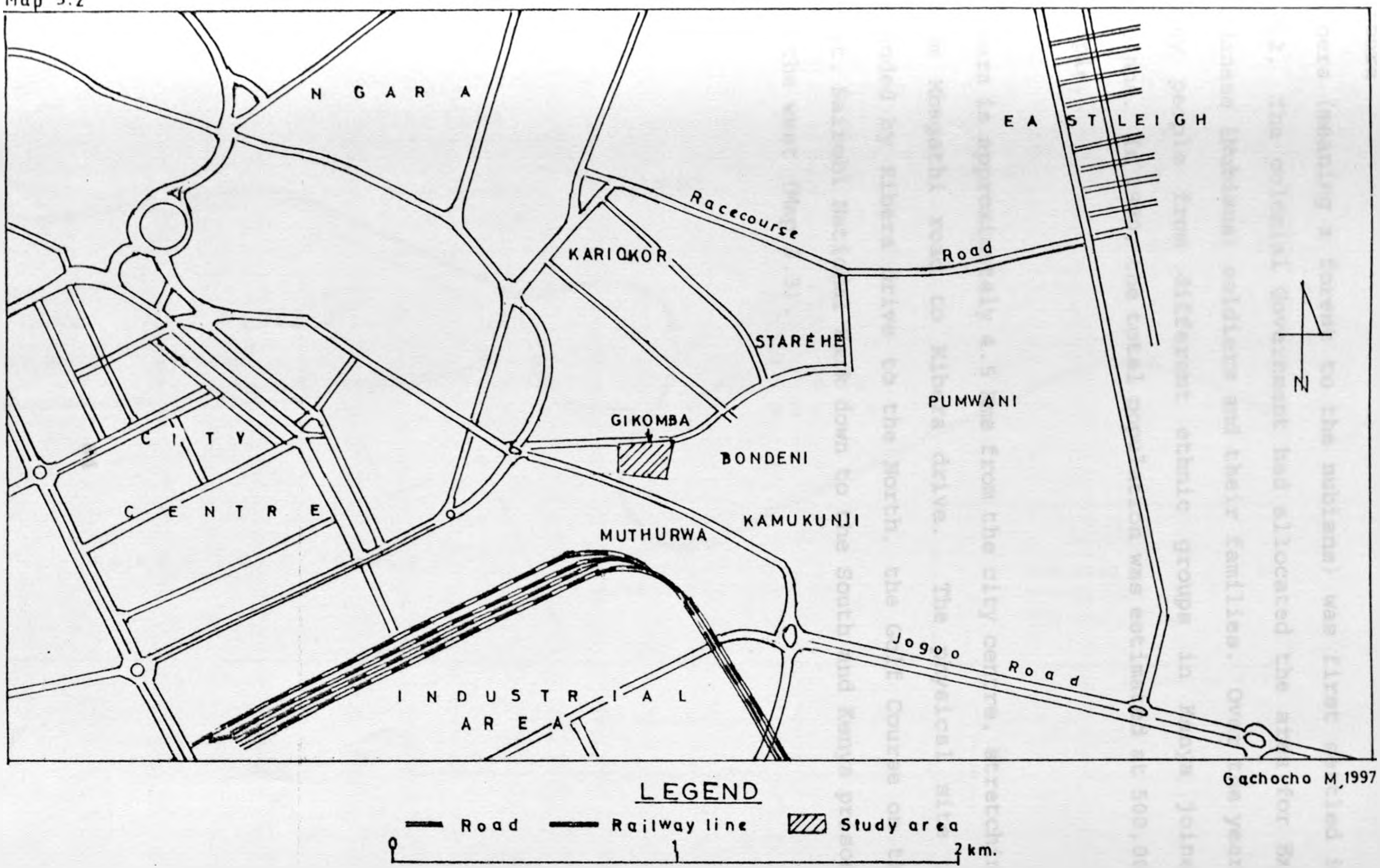
Gikomba

Gikomba belt neighbourhood is an area of about 75 hectares, located in the South East end of Nairobi's Central Business District (CBD). To the Southern boundary lies the Nairobi industrial area, to the East and Northern zone lies a number of middle and low income residential estates of Nairobi. The North West boundary of the zone is the old CBD of Nairobi, currently forming a bulk of run down properties of mixed urban use. Light engineering and related ancillary service shops tend to dominate the area (map 3.2).

A number of economic factors have contributed to Gikomba's existence at the present location. Among the factors identified include: low value of property in the zone due to location of low cost housing nearby, high population in the neighbouring residential areas of Pumwani, Muthurwa and Shauri Moyo resulting in congested premises and inadequate infrastructure. Entrepreneurs have however allocated themselves land to conduct businesses.

Map 3.2

GIKOMBA STUDY AREA



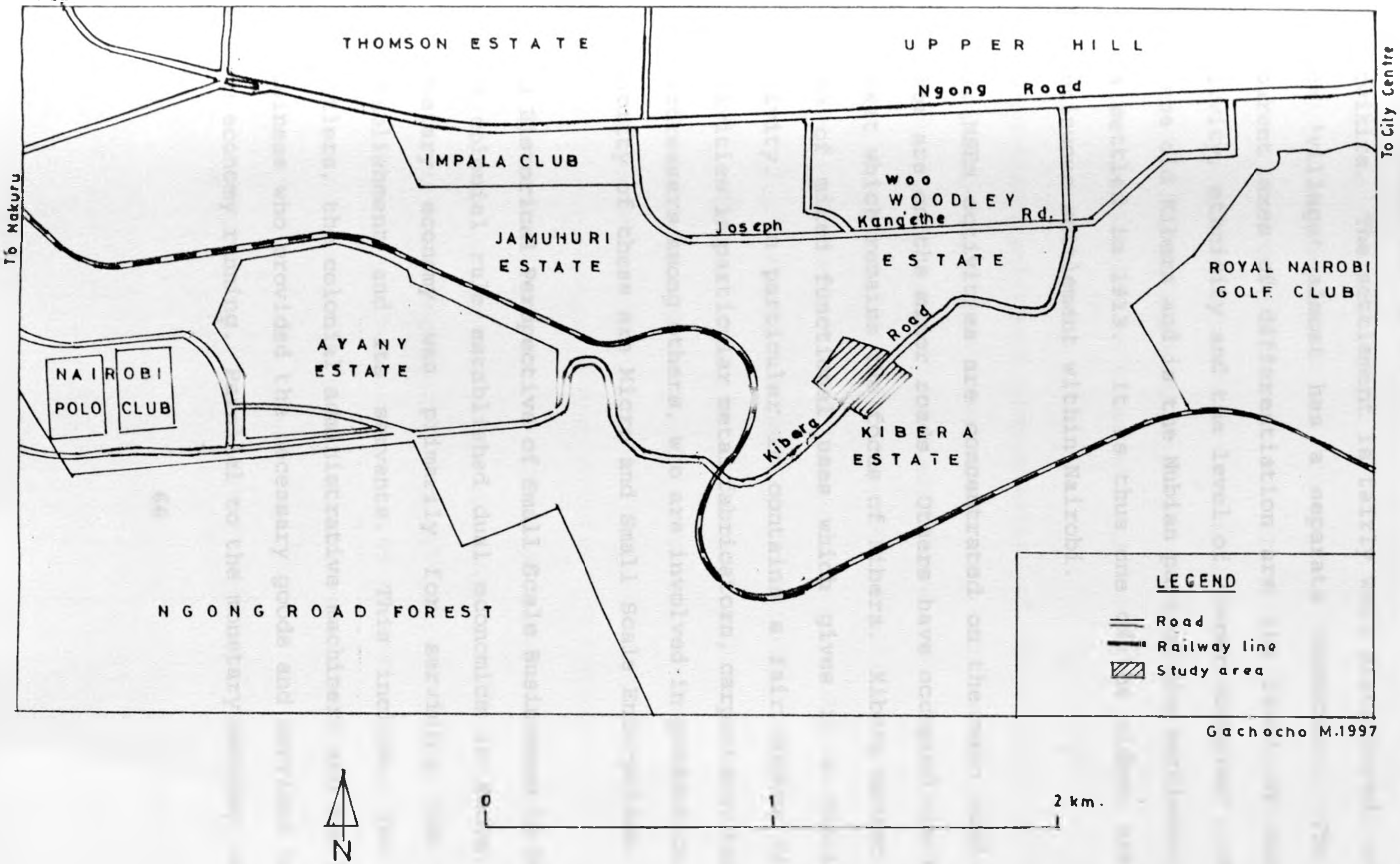
Kibera

Kibera (meaning a forest to the nubians) was first settled in 1912. The colonial Government had allocated the area for Ex-Sudanese (Nubians) soldiers and their families. Over the years many people from different ethnic groups in Kenya joined Nubians. In 1990, the total population was estimated at 500,000 people.

Kibera is approximately 4.5 Kms from the city centre, stretching from Mbagathi road to Kibera drive. The physical site is bounded by Kibera drive to the North, the Golf Course on the East, Nairobi National Park down to the South and Kenya prisons to the west (Map 3.3).

Map 3.3

KIBERA STUDY AREA



It is composed of a series of villages; Makina, Kambi Muru, Kisumu Ndogo, Silanga, Kianda, Mashimoni, Lindi, Laini Saba and Gatwikira. The settlement is fairly well distributed, so that each 'village' almost has a separate character. The main apparent axes of differentiation are the level of economic activity, ethnicity and the level of 'owner occupier'. Makina is the old Kibera and is the Nubian part of the settlement that was settled in 1913. It is thus one of the oldest areas of continuous settlement within Nairobi.

Most MSEs activities are concentrated on the main road while other are on the minor roads. Others have occupied the Kibera market which remains the focus of Kibera. Kibera market is an area of mixed functional uses which gives it a feeling of activity. In particular it contains a fair number of MSEs activities in particular metal fabricators, carpenters, tailors, hairdressers among others, who are involved in production. The majority of these are Micro and Small Scale Enterprises.

3.3 Historical Perspective of Small Scale Businesses in Nairobi

The colonial rule established dual economics in Kenya. The monetary economy was primarily for servicing the crown establishment and its servants. This include, the white settlers, the colonial administrative machinery and the Indian business who provided the necessary goods and services to keep the economy running. Parallel to the monetary economy, was the natives economy which was initially a barter economy but later adapted money as a medium of exchange (Mochache , 1985).

With the establishment of the formal business sector which supplied the needs of the establishment and its settlers, there were established MSEs which manufactured and supplied goods and services to simple unsophisticated but growing demand from the African population in urban and rural areas.

The economic policy of Kenyanization of the economy led to the influx of people from rural areas into urban areas with a hope of getting employment. However, there was a disparity between demand for jobs and the ability of the public sector to absorb that demand. Their enterprising nature identified discrepancies in demand and supply for goods and services which they ventured to meet. This realisation can be said to have set in motion the start of Micro and Small Scale activities in Nairobi African neighbourhoods.

The colonial era set up the base upon which small scale activities have developed in Kenya. The Africans were restricted from engaging in any sort of commercial activities. Forced labour was however not liked by Africans and was one of the major reasons for starting small scale activities.

Since Independence, rural urban migration has been on the increase and Nairobi has experienced the largest share of this increase. The reason has been that for a long time Nairobi has remained a primate city in Kenya. Most of the economic activities are concentrated in Nairobi and this has been the main pull to the immigrants. Low income neighbourhoods like Gikomba and Kibera have been the major recipients of the immigrants. These population then resort to small scale activities as an entry point to the urban economy. The high employment generation potential principally results from the multiplicity of the informal sector activities, the use of simple and inexpensive technologies, which do not require specialised skills, its high labour intensity and ease of entry as it requires little capital investment and virtually no registration formalities. Between 1993-1996 the number of people employed in the sector in Nairobi were as indicated in Table 3.3.1.

Table 3.3.1 Employment in the Informal Sector in Nairobi

Year	1993	1994	1995	1996*
Nairobi	366,332	433,014	538,432	623,924

* Provisional

Source: Economic Survey, 1997

CHAPTER FOUR: BUSINESS SOCIO-ECONOMIC PROFILE

This Chapter is divided into three sections. The first section discusses the social background of entrepreneurs, the second presents the business characteristics and the third analyses the problems encountered by the Jua Kali entrepreneurs.

4.1 DATA

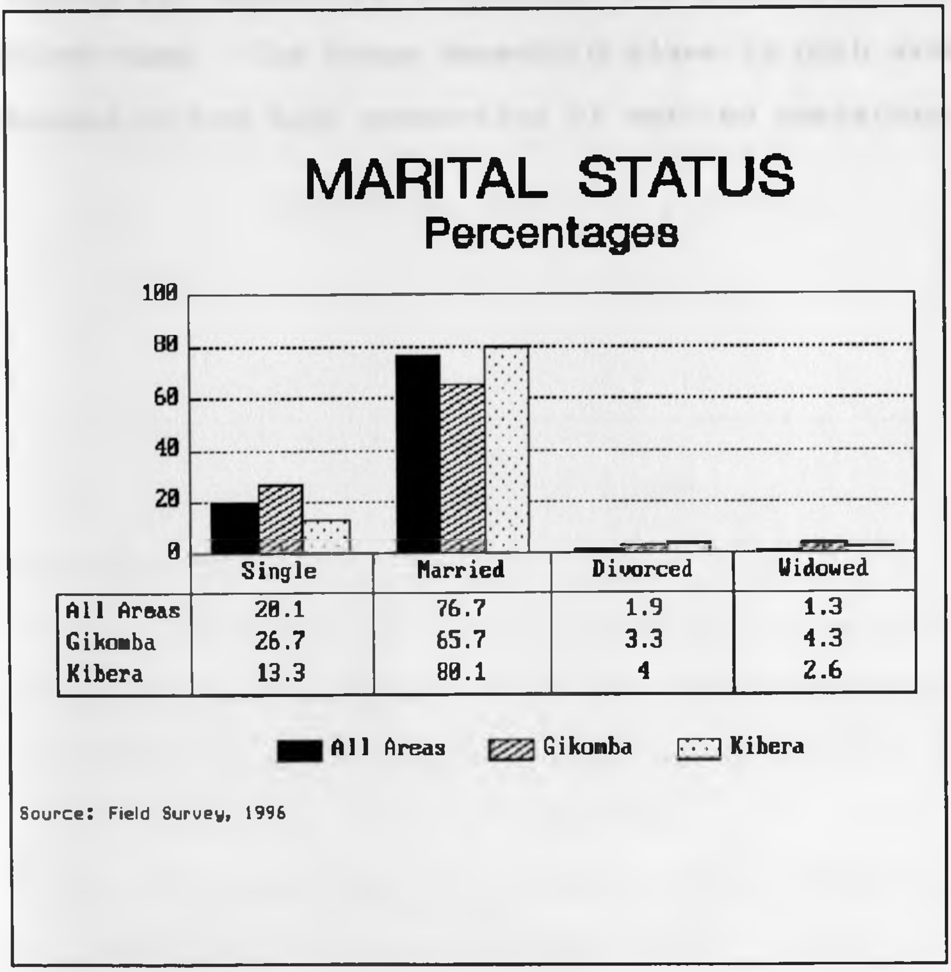
For reasons of time and analytical manageability it proved virtually impossible to analyse the data on the basis of the various disaggregrated "business types". Therefore the activities surveyed were grouped into 3 major categories. These included enterprises engaged in manufacturing which constituted 35 percent of all the studied enterprises, trade accounted for 35 percent and the service sector for 30 percent of the studied sample. Enterprises categorised under manufacturing sector included metal production, fabrication and tinsmithing, furniture making, tailoring and shoemaking. The trade sector comprised of food and drink retail, textile/shoe retail and restaurants, and the service sector enterprise include shoe repair, electrical repairs and motor vehicle repairs.

4.2 ENTREPRENEUR CHARACTERISTICS

Marital Status

In the two areas of the study, majority of the entrepreneurs were married. The married entrepreneurs accounted for 76.7 percent, single accounted for 20.1 percent, divorced 1.9 percent and widowed 1.3 percent. This could have repercussions in mobilisation of investment capital on the way in which enterprise revenues are allocated and utilised by owners.

Fig. 4.2.1

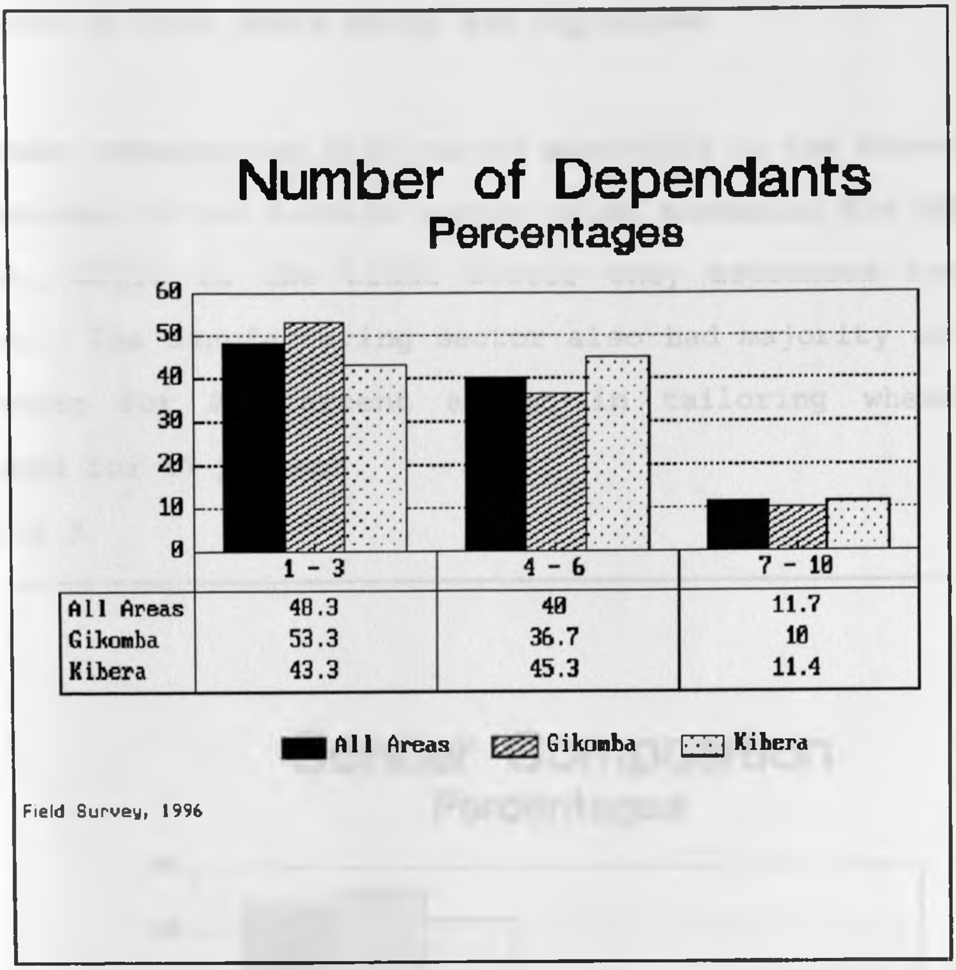


Source: Field Survey, 1996

Number of Dependants

In relation to marital status one has to keep in mind the dependency ratio. That is the number of children depending on their parents and by extension the MSEs for survival. The survey revealed that the number of dependants ranged from 1 to 10 in total. Majority of the entrepreneurs (48.3%) supported 1-4. The data reveals that majority of the entrepreneurs (51.7%) have a family size of more than 5 dependants. It is important to note that a large family size incurs more expenses than a small family per month, as the former has more responsibility than latter ones. The large household sizes in both areas can be explained by the high proportion of married operators.

Fig. 4.2.2



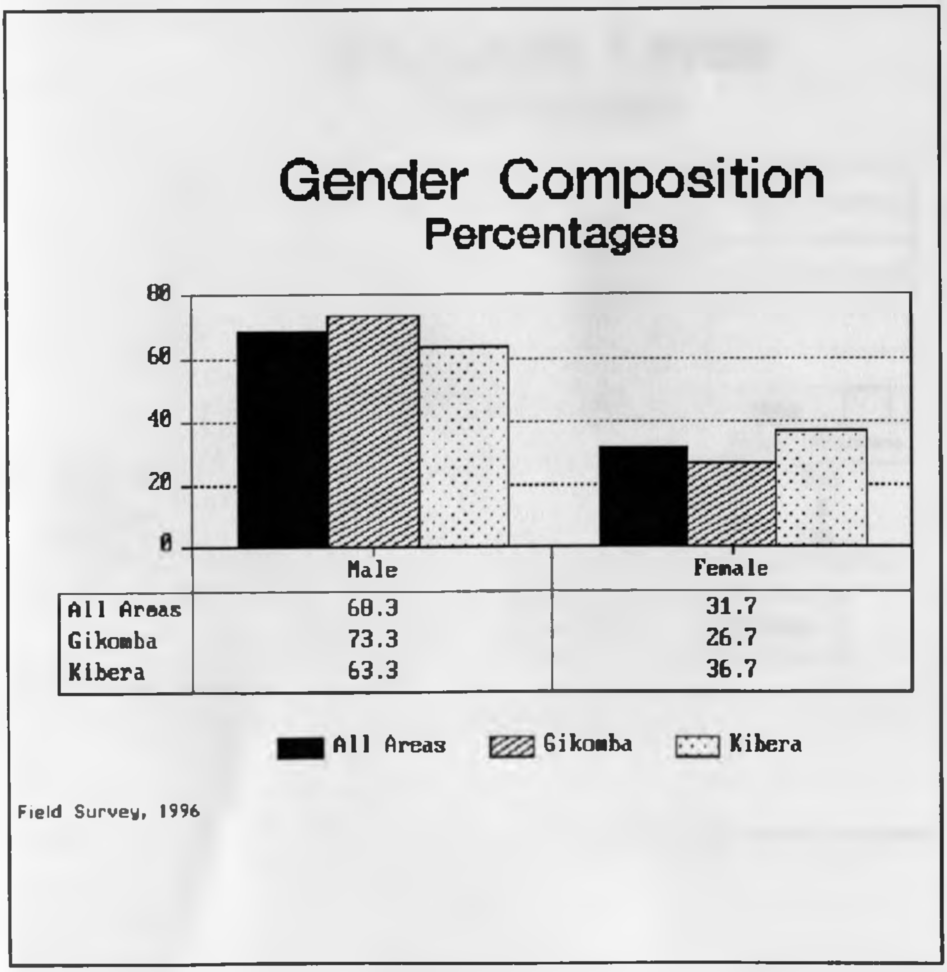
Gender Composition

From the survey majority of the entrepreneurs interviewed were males who accounted for 68.3%, while the females accounted for 31.7%. In Gikomba, male respondents accounted for 73.3 percent and females accounted for 26.7 percent. In Kibera, male respondents accounted for 63.3 percent while the rest were females. Women entreprenuers in Kibera exceed those in Gikomba area. This is because majority of the women have occupied the

Kibera market, while in Gikomba most MSEs activities are conducted on open areas which are unplanned.

The gender composition also varied according to the subsectors. For instance in the service sector males accounted for about 93 percent, while in the trade sector they accounted for 78.9 percent. The manufacturing sector also had majority as males accounting for 89 percent except in tailoring where they accounted for 47 percent.

Fig. 4.2.3

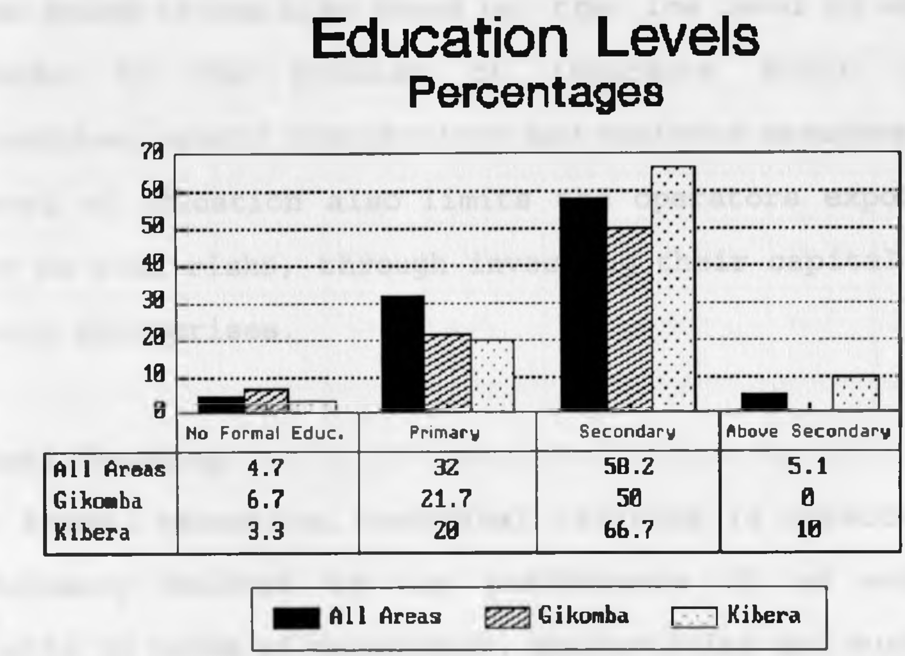


	Male	Female
All Areas	68.3	31.7
Gikomba	73.3	26.7
Kibera	63.3	36.7

Education levels

Overall results in the two study areas show that 4.7 percent of the entrepreneurs interviewed had no formal education training while 32 percent had primary level education. Another 58.2 percent had secondary school education while 5.1 of the entrepreneurs had higher and/or college education level.

Fig. 4.2.4



	No Formal Educ.	Primary	Secondary	Above Secondary
All Areas	4.7	32	58.2	5.1
Gikomba	6.7	21.7	50	0
Kibera	3.3	20	66.7	10

Source: Field Survey, 1996

Education levels of Kibera operators seem to be higher than their counterparts in similar activities in Gikomba. Primary, secondary and above secondary education levels accounted for 20.0%, 66.7% and 10.0% in Kibera, and 21.7%, 50.0% and 0.0% in Gikomba respectively. This implies that planned activities tend to attract majority of school leavers. The lower education levels in Gikomba coincides with higher age groups which owes to the fact that these people were among the first entrepreneurs to start businesses as early as the 1970's.

From the study it was also found out that low level of education translates to the problem of ignorance about business opportunities, credit institutions and business management. The low level of education also limits the operators exposure and ability to take risks, through investing their capital in more involving enterprises.

Technical Training

Unlike formal education, technical training is expected to be more closely related to the performance of an enterprise especially in terms of management, productivity and sustainable development of enterprises. This is because relatively lower incomes may not allow enterprises hire the services of good managers and technical staff. This observation would partly explain poor or low income levels earned in the sector.

Data collected in the study indicates that only about 55 percent of entrepreneurs have received any form of technical training. Apprenticeships account for the highest proportion (21.7%) of those who have obtained technical training, while village youth polytechnic, National Polytechnic and Technical Training Institutes account for 10.0%, 11.7% and 11.7% respectively. A gender disaggregation of technical training levels indicate that women proprietors are generally less educated than their male counterparts (Table 4.2.1).

Table 4.2.1 Technical Training

Technical Training	All Areas	Male	Female	Gikomba	Males	Females	Kibera	Males	Females
None	45.0%	28.3%	16.7%	60.0%	40.0%	20.0%	30.0%	16.7%	13.3%
Apprenticeship	21.6%	16.7%	5.0%	20.0%	16.7%	3.3%	23.3%	16.7%	6.6%
Village Youth Polytechnic	10.0%	6.7%	3.3%	10.0%	6.7%	3.3%	10.0%	6.7%	3.3%
Technical Training Institute	11.7%	8.3%	3.4%	6.7%	6.7%	0.0%	16.7%	10.0%	6.7%
National Polytechnic	11.7%	8.3%	3.4%	3.3%	3.3%	0.0%	20.0%	13.3%	6.7%

Source: Field Survey, 1996

The above shows that MSEs entrepreneurs have low levels of technical training. This concurs with McVay (1989), who noted that the Micro and Small Scale Entrepreneurs have a difficulty in identifying simple quality improvements and new products that they could make. This is due to their low literacy and minimal training in technical skills.

Men tend to have a higher level of technical training than women. This is mostly evident in the manufacturing sector which was dominated by men. Kibera entrepreneurs seem to have higher levels of training than their counterparts in Gikomba. This shows that planned activities attract majority of school leavers who are technically trained than the unplanned areas. Thus, the Government could encourage planning of MSEs areas as an inducement to self employment among school leavers.

4.3 Characteristics of Enterprises

Business Location

Majority of these entrepreneurs are essentially located in the low income areas, among them: Eastlands, Kamukunji, Gikomba, Kariobangi, Mathare, Kibera, Kawangware and Kangemi. Ondiege (1995), notes that majority of these enterprises tend to locate in residential areas due to lack of spaces in the commercial areas from which they can operate from, unlike in secondary towns where majority of these enterprises are located in the commercial areas.

MSEs entrepreneurs tend to locate where there is high demand for their products and services. These points tend to be near or on the main and minor roads especially those passing through residential areas. They also operate on the road reserves illegally as squatters, thus they always conflict with the Local Authorities Planning By-laws, (Ondiege, 1995).

Majority of the enterprises were located on main and minor roads which mainly pass through these areas. In Gikomba majority of the MSEs (79%) were located on the main road, 18 percent on the minor roads sides while 3 percent were far away. Mochache (1985), notes that among the factors contributing to the informal activities at Gikomba area is the abundance of public transportation lines. In Kibera about 96.7 percent were near main road while about 4 percent were on the minor roads.

Business Premise Type

Operation sites are important in enhancing the productivity of the sector especially if they are accompanied by the provision of infrastructure utilities such as electricity and water. Permanent sheds may also help when the enterprises applies for credit as financiers would like to have permanent particulars such as address and location of business before loans can be advanced.

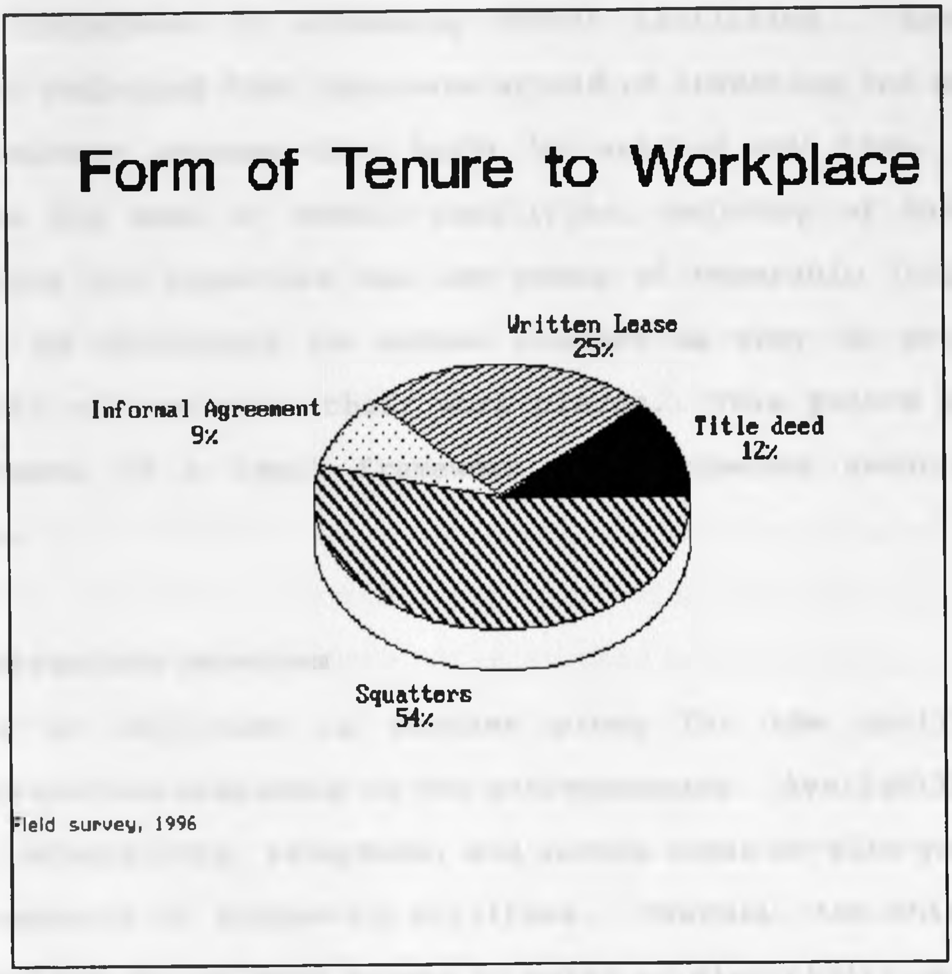
The survey categorised enterprises as operating from a permanent structure, a temporary structure or in the open air. On the overall 58 percent operated in the open spaces, 23 percent under temporary sheds while only about 19 percent operated in permanent sheds. Majority of the MSEs operators (60%) in Gikomba operate in the open spaces, 27 percent in temporary sheds and about 13 percent in permanent sheds. Majority of the entrepreneurs engaged in the metal furniture and fixture activities accounting for about 69.7 percent were carried out in the open spaces, workshops or temporary sheds, as they require large space. In Kibera only about 57 percent are operating in the open spaces, 20 percent in temporary sheds and about 23 percent in permanent sheds. The high percentages of operators in the permanent sheds has resulted due to the fact that quite a number of the MSEs operators have occupied the Kibera Market which is near the main road.

However, there were complaints of congestion within the stalls due to lack of space both for operation and storage. This has resulted in operators working from outside especially those engaged in metal and fixtures and in the furniture making. In the trade and restaurant sector, about 80 percent of the food and drink retailer businesses operated in the open spaces, while about 60 percent of the restaurants were being operated from temporary sheds. About 97 percent of the textile retail operated in the open spaces in Gikomba whereas this accounted for about 32 percent in Kibera.

Site Ownership

Both assistance agencies and entrepreneurs are concerned about the security of access to the workplace for the MSEs. To gauge the extent of tenure security and the extent to which entrepreneurs face the risk of displacement, the study collected data on the form of tenure entrepreneurs hold. Out of the studied sample, only 12 percent had title deeds of their operation sites, 25 percent had written leases, 9 percent were on informal agreement while about 54 percent of the entrepreneurs were squatters, (Fig. 4.2.5).

Fig. 4.2.5



This indicates that less than half of the entrepreneurs (37%) have some security of tenure (written lease or title deed) to their work place. Of the remaining 63 percent, 9 percent operate under an informal agreement, while 54 percent are squatters. These 63 percent of entrepreneurs are considered to have "insecure tenure", where they could be removed from their workplace by the city council at anytime.

Most entrepreneurs felt that this insecurity of tenure is a major hinderance in accessing credit facilities. About 43 percent indicated that they were afraid of investing too much in the business because they might be evicted any time. Thus despite the need of credit facilities, majority of the MSEs operators can therefore not use proof of ownership (title or lease) as collateral to access finance as they do not have security of tenure to their work places. This points to the importance of a legal framework that promotes security of tenure.

Infrastructure Services

Access to utilities is another proxy for the quality of infrastructure available to the entrepreneurs. Availability of water, electricity, telephone, and access roads on-site was used as a measure of access to utilities. Overall, two-thirds of enterprises do not have access to water or electricity on their premises, and only about 13 percent of those operating from permanent structures in both areas have both electricity and water. Although infrastructure is important in all business activities, it is particularly critical in the manufacturing and services sectors, where access to utilities may determine type of technical processes that can be used.

Electricity

Electricity is a major component of industrial development, as it was found out that it enhances improvement in working leading to a reduction in production costs. Out of the interviewed sample only 25 percent and 45 percent in Gikomba and Kibera respectively had electricity within their business premises. 65 percent of the respondents felt that lack of electricity was a major constraint to their business development. The study revealed that the underlying factors that hindered the provision of electricity to the MSEs premises included lack of proper entitlement to the land and lack of proper business operation structures as majority are operating in the open spaces. In promoting the MSEs it is essential to provide the operators with secure and serviced business sites as this has an implication of their accessing credit.

Telephone Services

Out of the interviewed sample, it was established that only a small percentage had telephone connections. The survey revealed that only 7 percent had telephone connections in Gikomba, while this accounted for 15 percent in Kibera. However, it was established that about 55 percent of the operators did not see telephone as a necessity of immediate need, and they would prefer provision of more common telephone booths in the area.

They indicated that the booths in the area are few and located far from their working premises and most of the times they are not operational. It was established that a large number (35 %) of those in the manufacturing sector had requested for telephone connections but they continued to remain in the waiting list with the Kenya Posts and Telecommunications (KP&T).

Water Supply

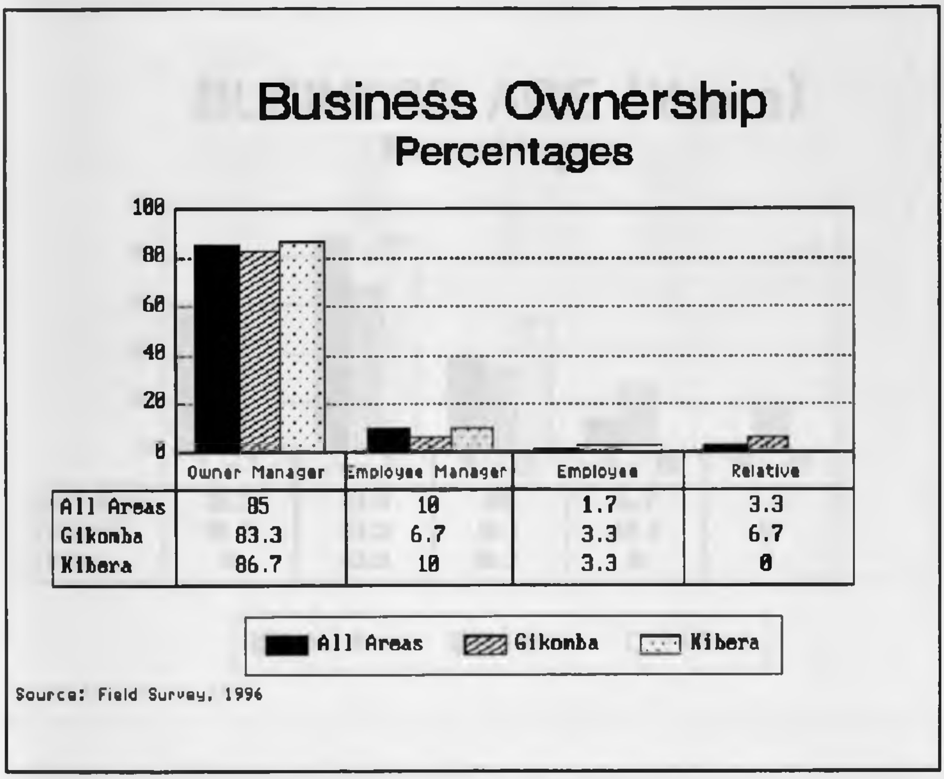
Gikomba area is poorly served by piped water, which is provided at communal main points. It was observed that MSEs activities have encroached into the residential areas and hence they share the water points provided for the area dwellers. This has greatly increased the number of persons using each of the water points, resulting to congestion and insanitary conditions.

Kibera is served by isolated water points owned by individuals. However, pipes that happen to burst take long before being repaired leading to irregular flows.

Business Ownership

Majority of the entrepreneurs own and run their businesses. Owner operated businesses account for 85 percent. Employer managers accounted for 10 %, relatives assistance 3.3% while 1.7% were just employees. Enterprises ownership varied with sub-sectors and gender. Group businesses were not evident which can be explained by the fact that group businesses involve a lot of formalities, trust and cooperation such that entrepreneurs prefer going into business and managing it themselves.

Fig. 4.2.6

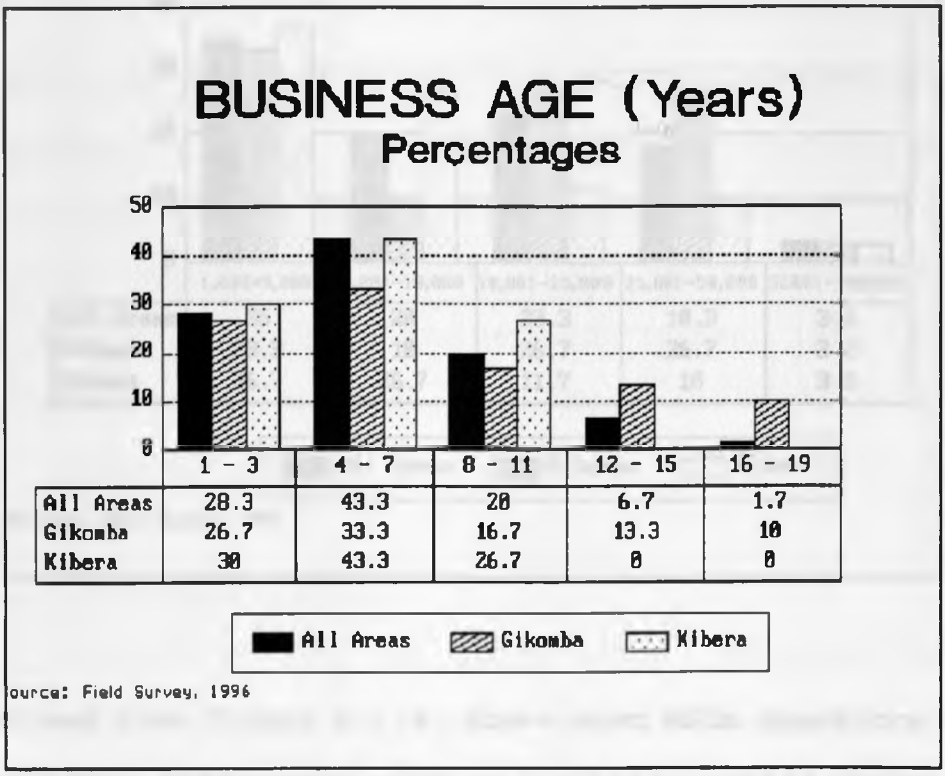


BUSINESSES AGE

As observed from the figure below (fig. 4.2.7), most of the businesses activities are young. Most have been in operation for less than 7 years, with 1 to 3 years accounting for 28.3 percent and 4 to 7 years accounting for 43.3 percent. This shows that businesses in both areas have been coming up very fast. Gikomba has some businesses which have been operational for 12 years accounting for 10 percent. This is because

Gikomba has a longer history as an area of MSEs activities as compared to Kibera.

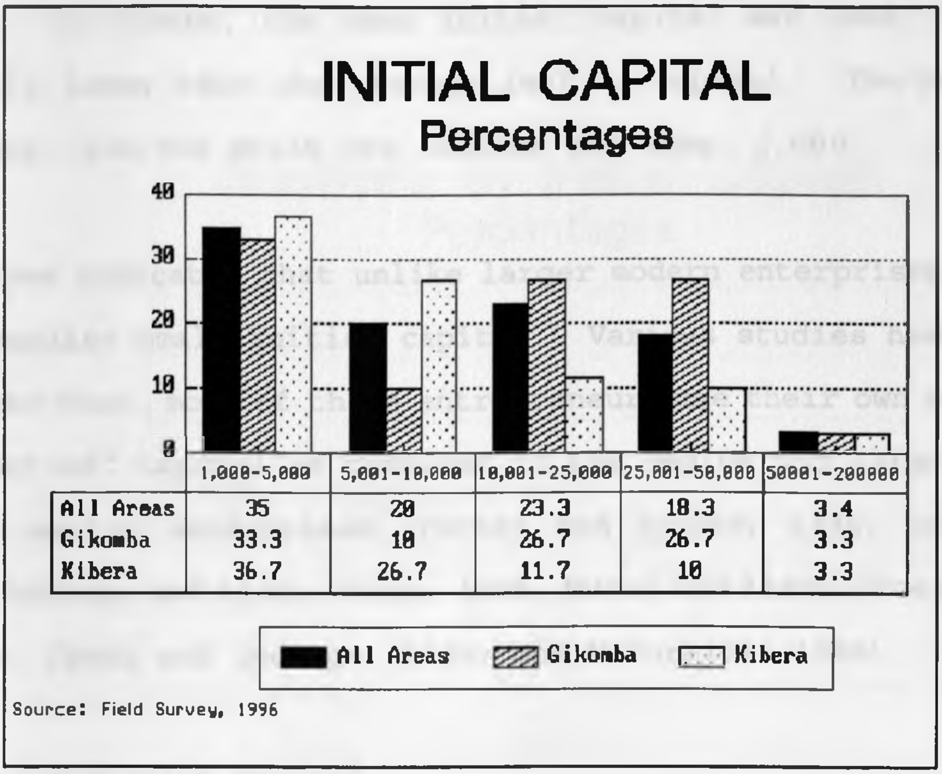
Fig. 4.2.7



Business Initial Capital

The observed mean initial capital for the businesses was Kshs. 19,667. The minimum was Kshs. 1,000 and the maximum was Kshs. 200,000. The difference was dependent on the study area.

Fig. 4.2.8



	1,000-5,000	5,001-10,000	10,001-25,000	25,001-50,000	50001-200000
All Areas	35	20	23.3	18.3	3.4
Gikomba	33.3	10	26.7	26.7	3.3
Kibera	36.7	26.7	11.7	10	3.3

As observed from figure 4.2.8. above most MSEs operators (55 %) started their businesses with an initial capital below Kshs. 10,000. This is lower than the observed mean of Kshs. 19,667. 23 percent had their initial capital within the mean range (Kshs. 10,001 - 25,000), 18 percent in the range of Kshs 25,001 and Kshs. 50,000 while only 3.4 percent had more capital that ranged between 50,001 and 200,000.

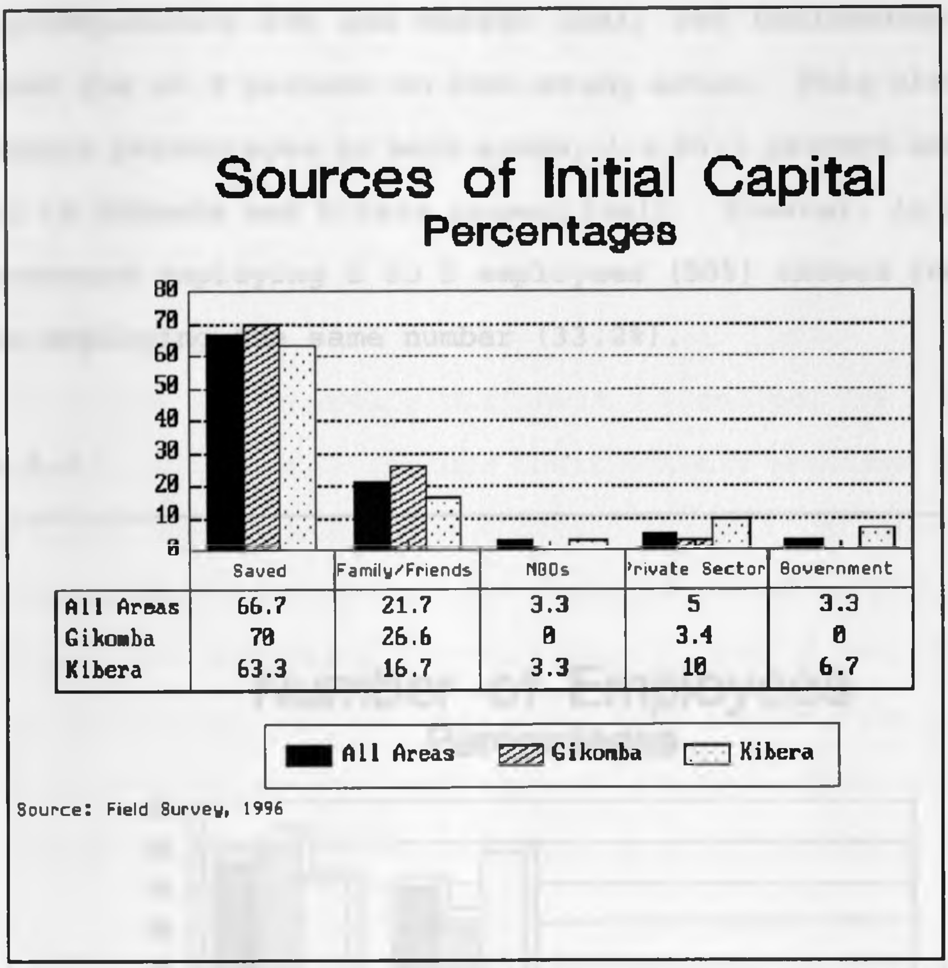
In Gikomba, the mean initial capital was Kshs. 24,367 which is higher than the observed mean initial capital for the two study areas. The maximum in Gikomba was Kshs. 200,000 which was evident in the manufacturing sector while the lowest was Kshs. 1,000. In Kibera, the mean initial capital was Kshs. 15,467 which is lower than the average initial capital. The maximum was Kshs. 100,000 while the minimum was Kshs. 2,000.

The above indicates that unlike larger modern enterprises, most MSEs require small initial capital. Various studies have also observed that, most of these entrepreneurs use their own savings as start-off capital as compared to the medium and large scale formal sector enterprises (Parker and Torres, 1994; Ondiege, 1992; Ondiege and Aleke-Dondo, 1995; Mutua and Aleke-Dondo 1990; Syagga, Kamau and Ondiege, 1989; and McCormick, 1988).

Source of Initial Capital

Overall results in the two study areas indicated that the biggest source of initial capital was personal savings which accounted for 66.7 percent. This has major implications on the operation or expansion of MSEs activities, because when the savings are low, entrepreneurs will, obviously have little to use as seed capital. Loans from family members and friends accounted for 21.7 percent while loans from NGOs, private sector and Government institutions accounted for 3.3 percent, 5.0 percent and 3.3 percent respectively, in both areas.

Fig. 4.2.9



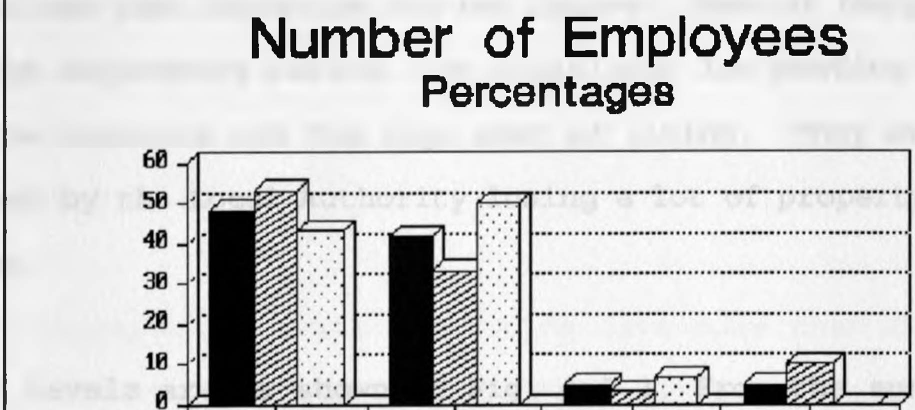
	Saved	Family/Friends	NGOs	Private Sector	Government
All Areas	66.7	21.7	3.3	5	3.3
Gikomba	70	26.6	0	3.4	0
Kibera	63.3	16.7	3.3	10	6.7

The above concurs with studies done by Liedholm and Mead (1987), Ondiege and Aleke Dondo (1995) which found out that a large number of MSEs entrepreneurs obtain their start up capital from their own savings and that of relatives, sometimes supplemented by short-term loans. Neither formal financial institutions nor informal sources play much role in start-ups, although some firms are able to tap into formal financial resources after they have established a successful track record.

Number of Employees

Most entrepreneurs run and manage their own businesses which accounted for 48.3 percent in both study areas. This also took the highest percentages in both areas, i.e 53.3 percent and 43.3 percent in Gikomba and Kibera respectively. However, in Kibera entrepreneurs employing 2 to 5 employees (50%) exceed those in Gikomba employing the same number (33.2%).

Fig. 4.3.0



	1	2 - 5	6 - 10	11 - 15
All Areas	48.3	41.7	5	5
Gikomba	53.3	33.2	3.3	10
Kibera	43.3	50	6.7	0

Source: Field Survey, 1996

This depends on the income earned and hence entrepreneurs earning a lot of income manage to employ more than one person. In Gikomba, the metal fabrication subsector is very active employing upto over 10 employees compared to none in Kibera that has reached this level.

Business Income

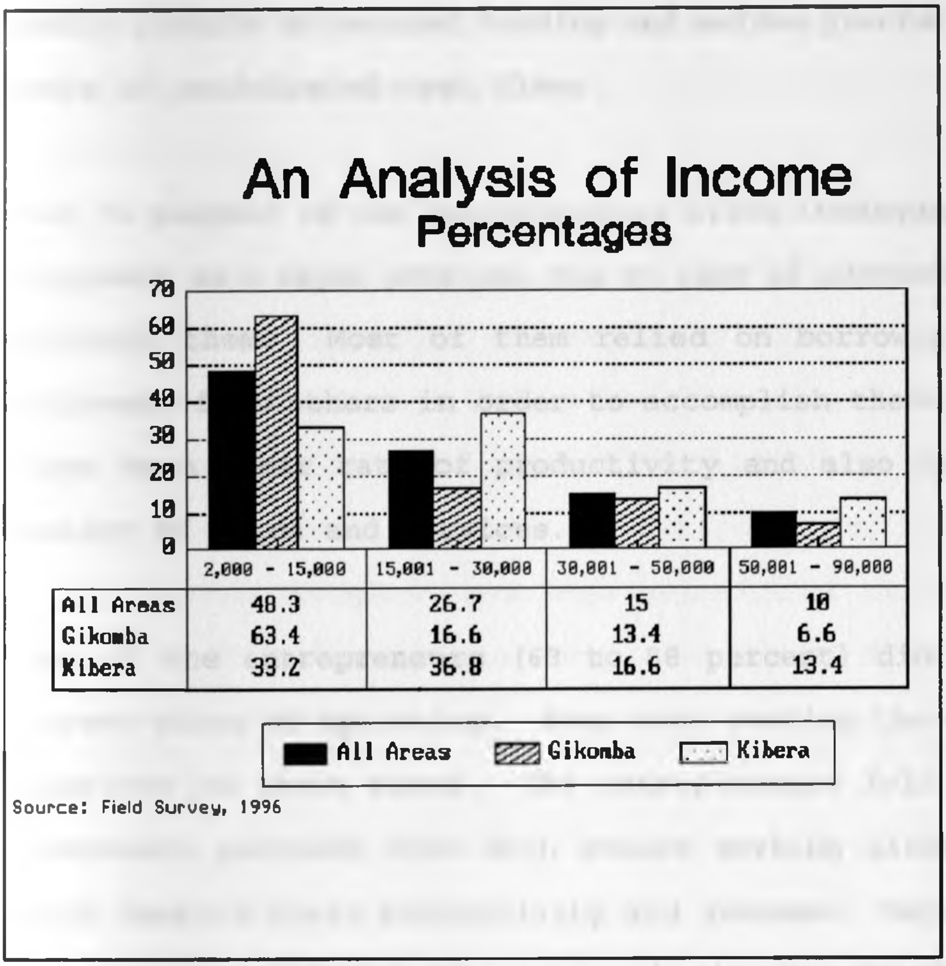
Data on income is generally difficult to collect as business operators are not free to discuss their monthly earnings and are always suspicious on questions concerning their incomes. Most of the respondents indicated that they are faced with a number of problems that determine the net income. Some of the problems are high dependency ratios, the occasional low profits accrued from the business and the high cost of living. They are often harassed by the Local Authority losing a lot of property in the process.

Income levels are as shown in Fig. 4.3.1. From the survey the mean earnings was estimated at Kshs. 24,858 with a standard deviation of Kshs. 19,956. The high variance can be explained by the seasonal variation in demand for products in the local market. The minimum and maximum incomes were Kshs. 2000 and Kshs. 90,000 per month respectively. The observed minimum income is slightly below the Government stipulated minimum wage in urban centres that currently stands at approximately Kshs. 2,500. The observed maximum income also shows that MSEs can earn as much or more than those in formal jobs. This further shows that small scale activities do have great potential in providing more incomes to the urban population. There is need to enhance finance accessibility to MSEs to enable them improve their incomes.

The Gikomba entrepreneurs had a mean earnings of Kshs.28,900 per month, minimum and maximum earnings were Kshs. 2,000 and Kshs 80,000 per month respectively. Kibera entrepreneurs had a higher mean income earning of Kshs. 30,850. The maximum earnings were Kshs. 90,000 while the minimum were Kshs.2,000. This shows that Kibera entrepreneurs earn more than their counterparts in Gikomba. Therefore planning of MSEs areas can to a very great extent also improve the income received by the entrepreneurs.

Manufacturing and service activities earn more than the trade sector. The study found out that the 10 percent that was in the higher income bracket (Kshs. 50,000 - 90,000) were comprised of those engaged in the manufacturing and trade sector. This indicates that more credit accessibility can earn higher income and this implies that entrepreneurs can improve their status by purchasing new machines and consequently developing the sector.

Fig. 4.3.1



4.4 Problems Encountered by the MSEs Entrepreneurs

Major problem cited by the entrepreneurs was inadequate funds which accounted for 91.7 per cent. Most of the financial requirements of the informal sector are met from personal savings, which are inadequate hence constraining the operation or expansion of business. The entrepreneurs do not have access to commercial sources of credit, because they lack the necessary collateral requirements. Kenya's conservative commercial banking sector insists on secured lending and seldom grants loans on the basis of anticipated cash flows.

Over 75 percent of the entrepreneurs cited inadequate tools and equipment as a major problem, due to lack of adequate capital to purchase them. Most of them relied on borrowing tools and equipment from others in order to accomplish their work. This slows down their rate of productivity and also levels of the quality of goods and services.

Most of the entrepreneurs (63 to 88 percent) did not own the current sites of operation. Some were renting the site or were squatters on these sites. The entrepreneurs felt that if the Government provided them with secure working sites/sheds they would improve their productivity and incomes. Majority of the entrepreneurs (82 %) felt that poorly developed infrastructural facilities was a major constraint to their business development. Most of the roads are impassable during the rainy season, and the MSEs operators lose most of their customers during this time. Lack of electricity and water was also a major handicap in the area.

In addition, Jua Kali entrepreneurs often lack accounting and management skills and are therefore, unable to present convincing investment proposals to banks. Although management was not cited and perceived as a major problem by most of these entrepreneurs, the study observes that less than 45 percent of the entrepreneurs kept written records while over 75 percent had no bank accounts for the business. Lack of business records and bank accounts makes it difficult to determine business performance and plan for future business operations, as most of the entrepreneurs rely on estimates of the income their enterprises generate. The banks also view lending to this sector as unattractive because of the high costs of information gathering and administration and the perceived higher risk of default (even though it has been argued that default rates in the informal sector are no worse than those for large scale, formal enterprises).

Other problems which accounted for 35 percent included lack of business skills, restrictions, regulations, harassment by Local Authorities, lack of reliable sources of raw materials and supplies and lack of adequate markets.

The study found out that only about 5 percent of the entrepreneurs had an insurance policy safeguarding their property against risks such as fire, loss of property, theft and burglary. The only form of security that majority of the entrepreneurs (76%) had enforced was employing a night watchman to guard over properties. Despite the fact that about 85 percent of the entrepreneurs were aware of the existence of insurance covers, majority of them (47%) had no intentions of insuring their properties and they viewed the insurance companies as robbers due to their high premiums.

This poses a great danger because time and again entrepreneurs continue losing properties worth thousand of shillings in fires. However, about 30 percent indicated interest in insuring their property if the insurance companies could inform them more about their policies and how they would benefit. MSEs operators indicated that they would appreciate if the insurance companies could start a scheme of advancing loans to the MSEs entrepreneurs against their policies.

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CHAPTER FIVE: NATURE OF DEMAND AND SUPPLY FOR FINANCE AMONG MSEs

5.1 DEMAND AND SUPPLY FOR FINANCE

Borrowers and lenders effective demand for and supply of finance is determined by many factors among them incentives, costs, risks and information, (Table 5.1.1).

Table 5.1.1 Determinants of Demand and Supply for Finance

Factor	Lender (Supply)	Borrower (Demand)
1. Incentives	Interest on loan; building client base	Opportunity to expand sales and capacity which is determined by market demand and competition
2. Costs	Time spent screening, monitoring and ensuring repayment of loans	Interest rate; time spent in applying for credit
3. Risks	Arrears or default if borrower is unable or unwilling to repay	Inability to repay loan may lead to bankruptcy
4.Information	Inadequate knowledge of customers reputation and business prospects; difficulty of appraising small loans accurately	Inadequate knowledge about dealing with banks or availability of credit; lack of adequate financial accounts on the firm; uncertainty about ability to increase sales enough to repay loan.

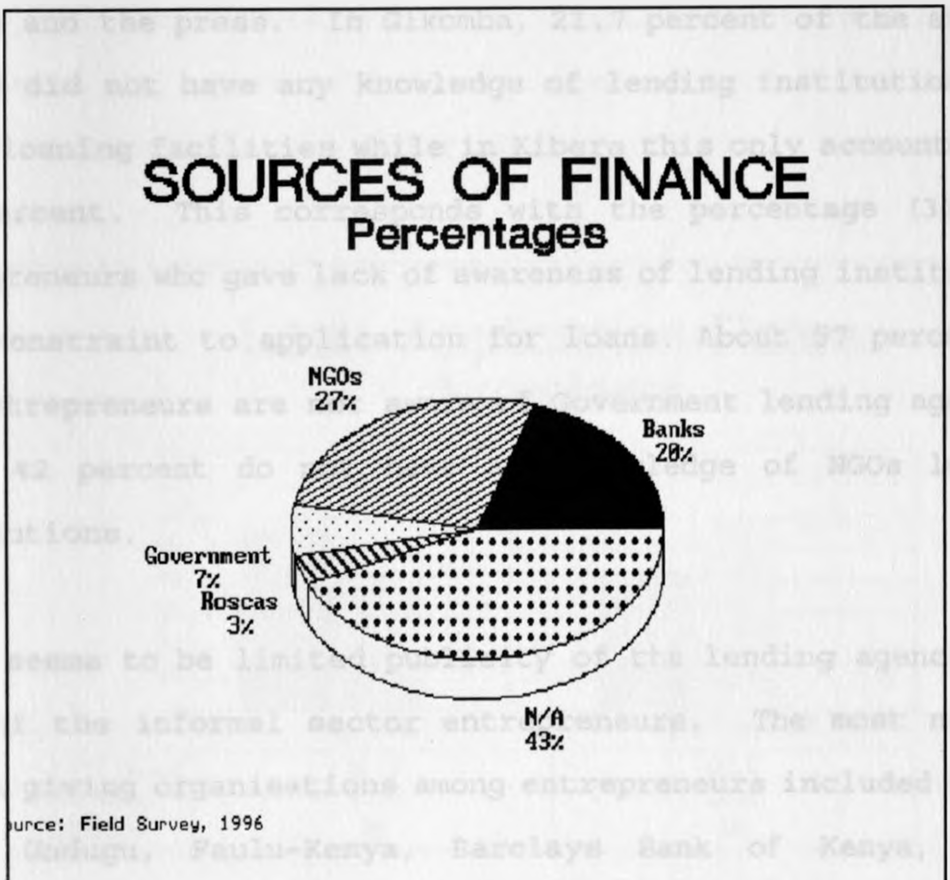
Adapted and Modified from Aryteety, 1994

5.2 Demand of External Finance by MSEs

Demand for finance may be perceived or potential demand. Perceived demand may be when entrepreneurs cite finance as a constraint when in need of cash, while potential demand, constitutes the desire for credit which is not acted upon, in the face of market imperfections and institutional barriers. Patrick (1966), notes that potential demand includes discouraged would-be applicants who would come forward if they thought their chances were better or if banks were not so hard to deal with. Tomecko and Aleke-Dondo (1992), estimated that the total effective demand for credit for MSEs in 1992 was Kshs. 2.8 Billion, not taking account of the influence of securities and interest rates. They noted that for the existing non-commercial banks to meet this demand, they would have to double their portfolio, necessitating an increase in their present institutional capacity.

To test whether entrepreneurs desire for external financing had been translated into effective demand, the study investigated if entrepreneurs had actively sought credit. 20 percent of all entrepreneurs sought loans from the banks, 26.7 percent from NGOs, 6.7 percent from Government institutions, 3.3 percent from the ROSCAs, while 43.3 percent had never sought a loan from any organisation (Fig.5.2.1). The results, however, indicate that despite the relatively large number of rejected bank loans applications, there is little spill over into informal segments of the financial markets except in the starting up of businesses where majority of the entrepreneurs have sought loans from families and friends, reflecting the highly segmented nature of the financial market.

Fig. 5.2.1



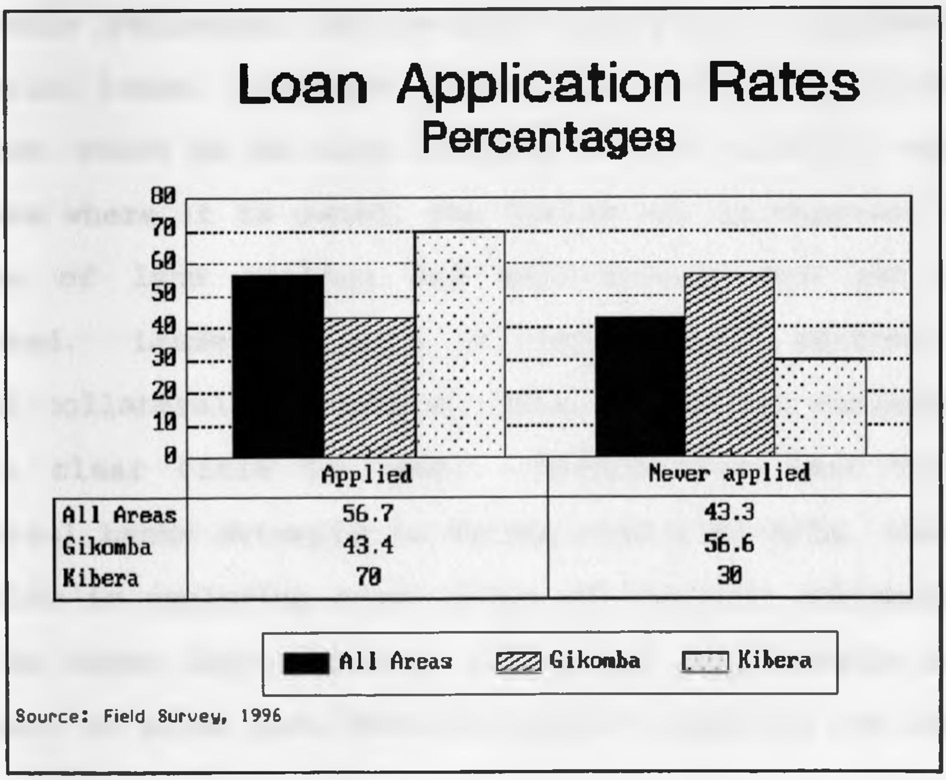
5.2.1 Loan Requests by Entrepreneurs

The survey data indicates that awareness of lending institutions varied between the two study areas, and thus affected the application rates. Majority of the respondents (66.7%) were aware of the lending institutions through the friends, private agents and the press. In Gikomba, 21.7 percent of the studied sample did not have any knowledge of lending institutions and their loaning facilities while in Kibera this only accounted for 8.3 percent. This corresponds with the percentage (30%) of entrepreneurs who gave lack of awareness of lending institutions as a constraint to application for loans. About 57 percent of the entrepreneurs are not aware of Government lending agencies while 42 percent do not have any knowledge of NGOs lending institutions.

There seems to be limited publicity of the lending agencies to most of the informal sector entrepreneurs. The most notable credit giving organisations among entrepreneurs included K-REP, NCCK, Undugu, Faulu-Kenya, Barclays Bank of Kenya, Kenya Commercial Bank, and Kenya Industrial Estates (K.I.E). This shows that despite the numerous lending institutions targeting the financing of the informal sector, very few of them are known to the entrepreneurs studied.

Overall study indicate that there is high revealed demand for loans because out of the total sample, 56.7 percent had at various times, applied for loans for the present business, while 43.3 percent had never applied (Fig. 5.2.1). On average entrepreneurs had applied at least once for bank loans. These results indicate a strong demand for bank credit. Kibera has a higher application rate (70.0%) as compared to Gikomba (43.4%). In Gikomba, 56.6 percent had never applied for a loan while in Kibera this only accounted for 30 percent.

Fig. 5.2.2



5.2.2 Collateral Requirements

The availability of collateral plays a very significant role in the readiness of banks to meet the credit demand of the private sector. Collateral provides both an incentive to repay and offset losses in case of default, but on the other hand it is one of the critical bottlenecks in lending to the MSEs sector.

Raising acceptable collateral and security is a major problem for MSEs entrepreneurs because only a few are able to meet the marketable collateral and personal guarantee requirements of commercial banks. Ondiege (1995), notes that few of the MSEs own land, which is the most accepted form of security, and even in cases where it is owned, the titles may be unproved as the process of land titling and adjudication has yet to be completed. Landed property is therefore not suitable as a general collateral requirement, because very few entrepreneurs have a clear title to land. Despite the fact that the commercial banks attempts to extend credit to MSEs, they have been slow in exploring other forms of security appropriate to MSEs. As shown above, current collateral requirements are too stringent to allow most MSEs borrowers to qualify for loans.

Out of the successful loans applicants who accounted for 41.7 percent, collateral was required of nearly 99 percent of the sample entrepreneurs that received loans. Guarantors were given as the main collateral accounting for 72 percent while landed property accounted for 28 percent. It appears however, that banks have been overly rigid in their demand for collateral required to support MSEs. This finding suggests that a guarantor system need be developed as an acceptable alternative.

5.2.3 Reasons for Not Applying for Credit

Various reasons were given by those who did not apply for credit. Lack of knowledge of the lending institutions and their loaning procedures accounted for about 37.2 percent. Lack of collateral requirements accounted for 42 percent, high interest rates 62.3 percent, while long and bureaucratic procedures accounted for 23.4 percent. The above reasons, were viewed as some of the major constraints in the loan application process. These made the loaning process expensive and hence the entrepreneurs abandoned it. About 3 percent of the entrepreneurs stated that they did not require credit. From the study, it is evident that lack of adequate information about lending institutions and their loaning procedures, high interest rates and long and bureaucratic procedures limit credit accessibility to the MSEs entrepreneurs.

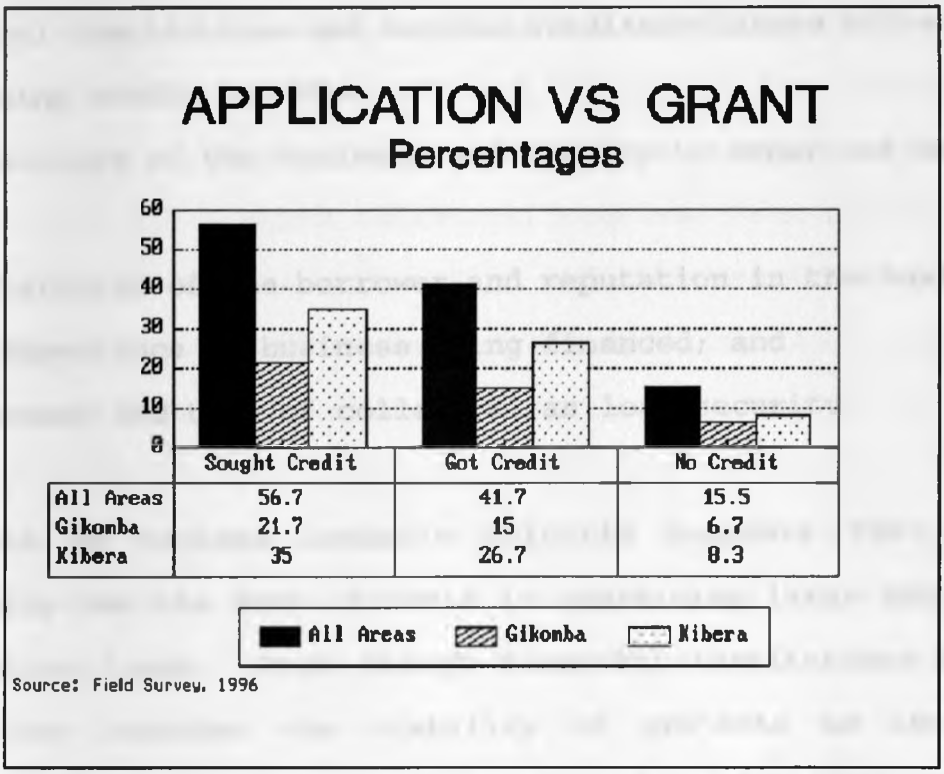
5.3 Supply of Finance to the MSEs

This section focused on the financial institutions responses to loan applications, creditworthiness and the lending risks perceived by financial institutions, in an attempt to evaluate the potential for effectively meeting the present demand.

5.3.1 Financial Institutions Responses to Loan Applications

Out of the total applicants, 41.7 percent of the applicants received credit while 15 percent did not get (Fig. 5.4.1). Despite the apparent access to financial institutions by sample entrepreneurs, loans were neither automatic nor adequate. For MSEs that had put in loan applications, there was an almost 2:1 probability that the application would be rejected.

Fig. 5.3.1



On average entrepreneurs had applied once for bank loans. Most entrepreneurs indicated that they received loans for much less than they requested, with the ratio rising sharply with firm size. Reasons for loan application rejection showed that 68 percent lacked collateral requirements, while 23.6 percent indicated that long and bureaucratic procedures made them abandon the whole issue of borrowing the credit.

5.3.2 Creditworthiness Criteria

Financial institutions use various creditworthiness criteria in appraising credit to MSEs:

(i) Viability of the business and ability to repay out of cash flow;

(ii) Character of the borrower and reputation in the business;

(iii) Experience in business being financed; and

(iv) Amount and type of collateral as loan security.

Analysis of various lender's criteria suggests that banks basically use the same criteria in appraising large and small enterprise loans. Even though financial institutions insist that they consider the viability of projects as the most important criterion in assessing applications, the entrepreneurs indicated that their loan applications were usually not rejected on that account. Majority of the respondents felt that their applications were rejected because they were not seen to have good collateral.

Collateral requirement is a criterion for every loan, whether the enterprise is small or large. However, it ranks high for new businesses especially the MSEs, while the financial institutions do not require collateral for loans to established large-scale customers.

Recently, both commercial as well as development bankers have not been restricting disbursement of loans to only those who can secure land and buildings as collateral, but are looking for alternatives. An interview with the bankers show that there are attempts of substituting collateral required from the borrower for specific financial information and other securities. More emphasis is being laid on project's viability than about the land and buildings needed to back up the loan as follows:

(i) Group securities:

This has been a form of collateral used by most NGOs who are lending to MSEs in Kenya. With a few exceptions, recovery rates under these schemes are remarkable, sometimes more than 90 percent;

(ii) Self-Selection:

In obtaining the information required to assess the viability of a business and on the character of the applicant, the lending institutions makes the candidate perform a series of tasks. For example, the K.I.E. requires that applicants keeps a record of all raw materials purchased and all assets for four weeks. Information is then available on the basic gross margin of the business and the commitment of the entrepreneur to the enterprise. A program field officer then compiles a simple balance sheet and compares the sales with the capital employed and verifies that the entrepreneurs meets the criterion of being in business for at least one year.

(iii) Business Support Services:

The Barclay's K-MAP credit schemes was seen to substitute information for collateral. To qualify for support, a prospective borrower is expected to have received business and/or technical training or counselling services through K-MAP for a minimum period of 18 months. K-MAP also assists in the preparation of business proposals in support for bank credit which may be in various forms such as loans, overdraft facilities, letters of credit and bank guarantees, among others.

5.3.3 Lending Risks to Lenders

Tomecko and Aleke-Dondo (1992) points out for the existing non-commercial banks to meet the current MSEs demand for credit they would have to double their portfolios, necessitating an increase in their present institutional capacity. The portfolio is considered more of a constraint than disbursements because management of the portfolio means having additional trained staff to monitor the extra load. This indicates that there will continue to be an unmet demand for credit for the MSEs sector for the foreseeable future unless commercial banks radically change their policies, enough to accommodate more MSEs in their lending operations.

In assessing the risks involved in lending, financial institutions ranked "default by borrower" as the major risk for both MSEs and larger businesses. Non-wilful default by the borrower (due to cash flow problems) leading to large arrears was frequently ranked as the primary concern in risk assessment. In an attempt to reduce defaulting, institutions and especially banks are now decentralizing some of the responsibility for project review and analysis to branch offices.

Most bankers cited high risks and high transaction costs as justification for their reluctance to lend to MSEs. The banks had a view that small loans are relatively expensive to administer and therefore can only be extended in return for higher rates of interest. All commercial bank's interest rates registered increases in 1996. The average weighted saving deposits interest rate increased from 9.5 to 11.2 percent while the interest charged on loans and advances for less than 3 years rose form 33.1 percent to 34.6 percent. Most of the MSEs entrepreneurs are discouraged by the high interest rates charged by the banks. However, it was realised that many of the commercial banks have neither the technology nor the incentive to lend to the MSEs.

One of the complaints from the formal financing institutions is that small business traders lack a track record, and most entrepreneurs are generally not able to prepare business plans suitable for bank's needs. The absence of information is a significant block to extending credit to the sector. It is difficult for financial institutions to obtain the information necessary to assess the risks of new businesses especially because the success of small firms often depends heavily on the abilities of the entrepreneur. K.I.E. notes that when applicants are required to prepare a business plan, despite having classrooms instructions to prepare the plan, about 15 percent drop out at this point.

The financiers indicated that most MSEs entrepreneurs lack secure tenure which disqualifies them from acquiring loans. They noted that permanent sheds help, because they would like to have permanent address and location of the establishments before loans are advanced.

The study revealed that negative perception of MSEs by lending institutions is caused by negative attitudes of bank officers towards MSEs. Most financial institutions indicated that MSEs lack business skills and experience in dealing with financial institutions. They are therefore not familiar with the bank loan regulations, variations in terms and conditions for repayment of loans. Although some of the MSEs entrepreneurs indicate that the interest rates charged are high, the institutions indicate that they may not have any idea about the interest rates.

Major lenders complained about local political impediments to debt recovery in sale of repossessed land or the legal system where cases are reportedly delayed. The banks are therefore have remained highly risk-averse because of the effect of these impediments on their cash flows for disbursement.

5.4 Preferred Loan Conditions by Entrepreneurs

Majority of the entrepreneurs felt that credit accessibility can be improved by relaxing the stringent collateral requirements needed to advance loans to MSEs and by popularising other alternative criteria adopted by lending institutions to the informal sector entrepreneurs, through the radio and Jua Kali magazines. This will help to keep them informed. It was evident that the information available to borrowers is inadequate and majority of the entrepreneurs (about 57.2%) are not aware of the procedures undertaken when applying for a loan.

Majority of the entrepreneurs (56%) would prefer to have credit from the NGOs. Preference is given for NGOs because they seem to be the only ones that are known to them, as they have made an effort to physically contact them e.g. K-REP has offices in Kibera. About 22 percent would prefer borrowing from the private sector while only 7% prefer to borrow from the Government. 15 percent of the studied sample indicated that they were not interested in credit provision because some felt that did not need it at the moment while others felt that the whole process is very complicated for their comprehension.

Majority of entrepreneurs (67%) felt that if they had access to credit they would use it to purchase an operation site. They felt that they would run their businesses better if they had security of tenure of their operation sites. Most of them cited harassment from the council askaris and they are always threatened with evictions which destabilises their activities. About 43 percent felt that they would use the credit for expanding the business generally, buy raw materials (28%), buy tools and equipment (37%), and increase the number of employees (16%). It is therefore evident that inadequate credit facilities is a major constraint to the expansion of the businesses and its productivity, and if this can be overcome the MSEs could perform better.

However, the entrepreneurs felt that the Government should help them improve their business by increasing credit accessibility through formulation of clearer lending policies, providing serviced worksheds/sites and promoting the local and export markets.

CHAPTER SIX: POLICY, PLANNING IMPLICATIONS, RECOMMENDATIONS AND AREAS FOR FURTHER RESEARCH

6.1 Summary of Findings

Government policy documents have to a large extent adequately addressed MSEs sector development, by laying out measures that will help develop the sector. Since 1963, substantial funds have been spent on the implementation of Government policies and programmes and building institutions specifically aimed at promoting the MSEs sector. Despite this, the level of implementation has not been satisfactory. The mechanism for coordination, monitoring and evaluation of the various activities envisaged in the policy framework has not been effected. About 95 percent of the interviewed entrepreneurs indicated that they have not benefitted from the Government in any way.

There was no indication that access to financing for MSEs improved after financial reforms brought about by the liberalisation of the money market. Indeed, a temporary worsening resulted from the tightening of monetary controls, introduction of high yielding securities to absorb liquidity, and efforts to raise the performance of loan portfolios. In implementing reforms, banks centralised credit analysis, decision making and loan supervision, and maintained their insistence on landed property as collateral.

Despite, some efforts to extend loans under the World Bank-financed MSEs credit, financial institutions have done little to improve their information base and appraisal capacity for small clients. Banks tend to underestimate bankable demand for credit because they have not developed techniques for overcoming high transaction costs and risks for substituting collateral. The study found out that there is a high rate of application for loans among sample MSEs (56.7%), and about 13 percent of those who have never applied also indicated a will to apply. However, quite a number of MSEs are often distrustful of banks, sceptical about their chances of getting credit, and reluctant to undergo the application process.

Lack of financial institutions capability to extend and service MSEs loans is a function of:

(i) Negative attitudes of bank officers towards MSEs;

(ii) Lack of business and management skills and MSEs are therefore, unable to present convincing investment proposals to banks;

(iii) Lack of knowledge about bank loans regulations and

(iv) Internal organisation of the lending organisation.

In majority of banks interviewed, internal organisation and bank procedures were not geared to working effectively with MSEs, whose location are often distant from bank headquarters, on whom information is difficult and costly to obtain, and whose scale of operations cannot absorb costly delays in processing loans.

While banks argue that under their existing procedures, there are not many bankable MSEs coming forward, they are usually not willing to lend out money to the MSEs entrepreneurs because of a (supposed) lack of collateral. Out of 56.7 percent who had sought for loans only about 44 percent qualified. The banks had a view that small loans are relatively expensive to administer and therefore can only be extended in return for higher rates of interest. All commercial bank's interest rates registered increases in 1996. The average weighted saving deposits interest rate increased from 9.5 to 11.2 percent while the interest charged on loans and advances for less than 3 years rose form 33.1 percent to 34.6 percent. A change in procedures may yield a greater volume of bankable MSEs loans, and eliminate bias of existing institutions against smaller economic units for example through special guarantee funds.

Banks have tended to centralise their decision making, whereas effective MSEs lending requires a decentralised approach. However, banks such as the Barclays Bank of Kenya have decentralised some of the responsibility for project review, and analysis to branch offices. These usually rank the risk of project non-viability significantly lower, suggesting the high confidence they have in the quality and accuracy of judgements when project analysis is closer to the business site.

6.2 Policy and Planning Implications

Major policy implications stems from the observations that most MSEs operators are seriously financially constrained and rely heavily on limited self finance, and the fact that majority of the activities are discriminated against access to formal credit. The MSEs areas of operation are also not planned which limits their access to credit due to lack of These points argue persuasively for policies designed to improve MSEs accessibility to the formal credit market.

MSEs specific legislation does not exist. Majority of the entrepreneurs operate businesses that are not licensed. Often MSEs are squatting on Government or other vacant land and therefore do not hold titles and hence cannot put up a permanent building from which to operate. Majority also conduct their businesses on roadsides, shop pavements and alleys. Most of the structures do not meet the standards required by Local by-laws or under the Public Health Act. Insecurity of tenure disqualifies MSEs entrepreneurs from acquiring loans, while the threat of harassment and eviction discourages reinvestment of profits.

Various studies have shown that business location is of great importance for promoting and accommodating MSEs. Most MSEs activities located in open spaces within the neighbourhood create a conflict of land use in areas planned for other purposes. Planners need to recognise the existence and importance of the MSEs. Planners need to come up with strategies that facilitate the MSEs existence and at the same time reconciling this with other conflicting interests. There is therefore a need to plan MSEs working sites and provide supportive infrastructural services in order to enhance the performance of the activities. If entrepreneurs can be provided with tenure security, through issuance of certificates of occupancy/ownership, this could improve credit accessibility.

6.3 Recommendations

The study revealed that in the last two decades, the Government has initiated a lot of policies touching on enhancing finance accessibility to the MSEs. However, only a few of the suggested strategies in the past have been implemented and some to very insignificant levels. The study recommends that the Government attempts to promote MSEs should be backed by comprehensive long-term and clear policies. This should be supported by well-organised, effective and purposeful organisations carrying out a balanced programme of stimulatory, support and sustenance of MSEs activities. Such efforts should also be backed up by systematic research, effective training and educational programmes.

Very few of the entrepreneurs own their business premises. The study revealed that about 63% of the entrepreneurs did not have security of tenure. Entrepreneurs identified inadequate provision of suitable land, acquisition, allocation and ownership procedures as some of the major constraints they face. Majority of the entrepreneurs (82 %) felt that poorly developed infrastructural facilities was a major constraint to their business development. Most of the roads are impassable during the rainy season, and the MSEs operators lose most of their customers during this time. Lack of electricity and water was identified as a major handicap in the area as only 13 percent of those operating from permanent structures had both water and electricity. This shows that there is need for rationalising use of space through suitable Government interventions. The study recommends that procedures for site acquisition, ownership, tenure, location, and site development be clearly set to ensure suitable and adequate worksites for MSEs. The current conflict manifested in evictions of licensed MSEs operators from their areas of operation should also be addressed.

To facilitate allocation of land to MSEs, the study recommends that the Government should provide clear policy guidelines to guide the Local Authorities, Provincial and District Administration and the Ministry of Lands. This will help to minimise the congregation of MSEs entrepreneurs at the road sides or the town centre at the expense of a good physical and business atmosphere. The study recommends that certain types of businesses should be allocated a specific place. For example, those who need water and electricity such as carpenters and food kiosks operators can be allocated a specific place. This could facilitate sharing of infrastructural facilities among other advantages.

The study also revealed that nearly all lending (99%) to the MSEs is security based and loans are not given on the basis of potential cash flows to be generated by the loans. Raising acceptable collateral and security is a major problem for MSEs entrepreneurs because only a few are able to meet the collateral required before loans are advanced. All commercial bank's interest rates registered increases in 1996, which makes the process of acquiring loans expensive for the MSEs entrepreneurs. The study recommends that collateral requirements and interest rates need to be reviewed, and lending terms made more favourable to MSEs.

The study recommends that modalities through which the Government in collaboration with the private sector and NGOs can assist MSEs to access credit and finance, for instance, through guarantee schemes should be explored. Current NGOs efforts such as K-REP's in establishing guarantee schemes should be encouraged.

Lack of incentives for banks to lend to MSEs and a negative perception of MSEs borrowers by lending institutions were identified as some of the problems encountered by MSEs in acquiring credit. However, banks such as the Barclays Bank of Kenya identified the need to expand the range of skills of its branch managers to include not only those needed to manage a branch and to evaluate securities, but also those needed to examine the cash flows, balance sheets, and business plans of their potential borrowers. The study recommends that greater collaboration among lending institutions would work to improve the situation.

The study indicated that although there are a number of NGOs financing MSEs activities there seems to be limited publicity of the lending agencies to most of the MSEs entrepreneurs. About 37.2 percent of the MSEs operators were not aware of lending institutions and their loaning procedures. The above shows that there are no forums for disseminating information, which limits loans applications. The study recommends that information dissemination should be improved. The lending institutions should popularise their activities either through the mass media or by organising exhibitions.

The study found out that there are no specific MSEs sector policies. There is usually no follow-up in what has been laid out in various subsequent plans. There is no clear guideline of the Government departments responsible for the implementation of these policies. The study recommends that MSEs policies should be reviewed constantly.

The study found out that the operational linkages between the Government, private sector, Non-Governmental-Organisations is poor. The study recommends that the role of institutions need be strengthened by formulating a clear national policy to guide existing institutions and strengthen the coordination among these institutions. This will also help to coordinate policies meant to benefit the MSEs.

From the study, about 69 percent of the entrepreneurs had joined a Jua Kali association and were contributing to a common fund. However, these funds have not been fully utilised. The study recommends that banks should consider the revolving fund raised by the Jua Kali associations as security to acquire loans.

The study revealed that less than 45 percent kept a track record of their businesses. This makes the process of screening and pre-qualifying MSEs for further consideration an expensive process. Local banks should set up credit reference bureau to provide information on clientele creditworthiness and facilitate easier processing of loan application.

The study found out that only about 5 percent of the entrepreneurs had an insurance policy safeguarding their property against risks. The study recommends that financial institutions should work together with insurance companies to consider the development of risk insurance schemes for loans taken. This might require the borrower to share the cost of a policy to insure (guarantee) a bank loan, with an appropriate repayment structure to ensure that payment of both interest and insurance premium does not overly burden the borrower and that timely repayment is rewarded by partial refund of premiums paid.

6.4 Areas for Further Research

There still remains some issues that need to be addressed in determining how to improve finance accessibility to the MSES and hence requiring further research.

Further research should address the role of all stakeholders in the formulation and implementation of policies affecting the MSEs. This will facilitate the establishment of a clear institutional framework for the formulation and implementation of explicit MSEs policies and avoid duplication caused by lack of coordination. The policies need to be specific, with clear objectives and set targets to improve the performance of the MSEs sector.

Further research should carry out a credit needs assessment of the MSEs, to determine the potential volume of credit that could productively be absorbed by the MSEs, given the current limitations in the domestic markets. This should involve identifying the basic input requirements of the MSEs, how they are procured and the sort of assistance required. This would enable the Government and other institutions to design appropriate policies to assist in the provision of these inputs e.g. credit facilities.

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Appendix 1 Entrepreneurs Questionnaire

UNIVERSITY OF NAIROBI

DEPARTMENT OF URBAN AND REGIONAL PLANNING

M.A. PLANNING YEAR II 1996/1997

ENTREPRENEURS QUESTIONNAIRES

NAME OF INTERVIEWER..................................

DATE OF INTERVIEW....................................

NAME OF RESPONDENT (OPTIONAL) ....

A. PERSONAL DETAILS

1. Respondents age ______________________________

2. Sex (1) Male __________ (2) Female ______________

3. Marital Status (1) Single ________ (2)Married ________

(3) Widowed ______________ (4) Divorced ____________

(5) Separated ____________

4. How many dependants do you have? ____________________

5. Please give your educational background

(1) No education _______ (2) Lower Primary(1-4) _________

(3) Upper Primary (5-8)_____ (4)Secondary ______________

(5) University _________ (6) Other(Please Specify)____

7. Position of respondent in the enterprise

(1) Owner manager ______ (2) Employee manager __________

(3) Relative __________ (4) Employee __________________

(4) Other (specify) _____

8. Where do you reside? ______________________________

B SOCIO-ECONOMIC ASPECTS

9. Location of business ______________________________

10. Year of establishment ______________________________

11. Number of employees ______________________________

12. Nature of business premises ______________________________

13. Form of tenure ______________________________

14. On-site utilities

(i) Telephone ______________ (ii) Electricity ______________

(iii) Piped water __________ (vi) Road access ______________

15. Number of Employees ______________________________

16. Is this business your main source of income

(1) Yes ________________ (2) No ________________________

17. What are your other sources of income and amount?

Sources Amount

(1)

(2)

(3)

18. (a) What is your monthly income? ______________________

(b) What is your monthly expenses on

(i) Rent _____________ (ii) Education __________________

(iii) Food ___________ (iv) Clothing ___________________

(v) Transport ________ (vi) Others (specify) ____________

19. What was your initial capital? ______________________

20. What was the principal source of funds you used to start the business?

(1) Personal savings ____________________

(2) Loans from friends ____________________

(3) Loans from the private sector (specify) ____________________

(4) Loans from government institutions (specify) __________

(5) Spouse support ____________________

(6) Others (specify) ____________________

C. ACCESS TO CREDIT

19. Which organisations do you know that advance credit to small scale entrepreneurs?

____

____

____

20. Have you ever applied/received any type of credit since you started your business?

(1) Yes ______________ (2) No (Go to Q.25) ____________________

21. If Yes, please specify source and amount

(1) Source __________________ (2) Amount ________________

22. Did you require any type of collateral/security?

(1) Yes ___________________ (2) No ____________________

23. If Yes, please specify ______________________________

24. If no collateral was needed please explain why

____

____

____

____

25. If you applied for credit and did not get it what were the reasons?

(1) ____

(2) ____

(3) ____

(4) ____

26. If you did not apply for credit, what were the reasons?

(1) ____

(2) ____

(3) ____

(4) ____

(5) ____

(6) ____

27. What are the major limitations to the development of business within your sector?

(1) ____

(2) ____

(3) ____

(4) ____

(5) ____

(6) ____

28. What support do you get from the following bodies?

(1) Government

(2) NGOs (Specify)

(3) Private sector (specify)

(4) Others (Specify)

29. In your opinion how can the following bodies promote your activities (in terms of improving accessibility to finance, credit, working capital and risk insurance)?

(1) Government

(2) NGOs

(3) Private sector

(4) Others (Specify)

30. Do you belong to any business support group or informal business network such as a women's group, trade association or co-operative? Please explain

31. (a) If yes, do you have any common fund and how do you use it? Please explain

(b) Have you benefitted from this common fund? Explain

32. If no, explain why you have not joined and suggest how you would like to benefit by joining such an organisation.

33. Suggest ways in which you as entrepreneurs either individually or collectively can improve your access to credit facilities (e.g. collateral required by lending institutions).

____

____

____

____

34. What precautions have you taken in safeguarding your property against risks such as fire, loss of property, theft and b u r g l a r y ?

____

____

____

35. Are you aware of the existence of insurance covers?

(1) Yes ______________ (2) ____________________

36. Have you made use of them?

(1) Yes ______________ (2) ____________________

37. If no, please explain why.

____

____

____

38. Are there any specific changes on the Jua Kali sector in the last 4 years that you can attribute to Government policies / programmes?

____

____

____

____

THANK YOU FOR YOUR COOPERATION

Appendix 2 Interview Schedules

1. Which are the existing credit schemes aimed at benefitting the MSEs?

2. What is the creditworthiness criteria used by the bank in lending to MSEs?

3. What are the problems experienced in debt recovery?

4. Do you experience default rates?

5. If yes, what could be the main reasons?

6. Has the financial liberalisation removed many of the constraints that gave banks little incentive to lend to the MSEs?

7. What are the major problems of lending to MSEs?

Appendix 2 Interview Schedules

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