CREDIT RATIONING BY MICRO FINANCE INSTITUTIONS AND ITS INFLUENCE ON THE OPERATIONS OF SMALL AND MICRO ENTERPRISES

BY

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DECLARATION

This Management Research Project is my original work and has not been presented for a degree in any other University.

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This Management Research Project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

To the Poor

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ABBREVIATIONS

AMFIs - Association of Micro Finance Institutions

CBS - Central Bureau of Statistics

CGAP- Consultative Group to Assist the Poorest

GOK - Government of Kenya

MFIs - Microfinance Institutions

MSE s- Micro and Small Enterprises

NGOs - Non Governmental Organizations

RFI - Rural Financial Institutions

K-MAP - Kenya Management Assistance Programme

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ABSTRACT

This study establishes how MFIs ration credit among MSEs. The hypothesis of the study was that credit rationing influences the operations of MSEs. Savings, business profitability, group membership, location of the business, ability to pay and the frequency of the borrowing were established as some of the criteria used by MFIs to ration credit.

Operations of MSEs were identified to include location, design and lay out of the equipment, distribution chain, stocking and production capacity. These operations constitute capital and working capital expenditure.

The MSEs mainly required credit to increase their stock levels and repair or add their capital equipment. The level of credit in terms of adequacy was related to the level of the operations in terms of expansion using Chi-square.

The analysis of the data collected revealed that higher levels of credit received enabled MSEs to meet more of their planned operations. MSEs that received high levels of credit were those with profitable businesses, high

savings, had ability to pay, had group guarantee and had received more than one loan from the MFIs.

The study concluded that a relationship exist between credit rationing by MFIs and the operations of MSEs. Thus, MFIs should design credit rationing programs that enhance the overall business operations of MSEs from the location of the business to the point at which the product gets to the consumer.

CHAPTER ONE

INTRODUCTION

Provision of adequate funds especially to Micro and Small Enterprises (MSEs) has been of concern to the government and development agencies in Kenya. This is clearly documented in government policy papers, for example, in the 1979-83 Development Plan, it was suggested that a credit scheme worth Kenya Shilling 50 million be set aside for lending to small enterprises (GOK 1979, 338). In Sessional Paper No. 2 of 1992, the Government of Kenya recognised the complementary role of the donors in promoting the MSEs (GOK 1992). The provision and delivery of financial services and credit to the sector by formal financial institutions has however been below expectations (GOK 2000 57). According to the 2001/2002 budget, only 10.4% of the MSEs receive credit and other financial services from formal banking sector (GOK 2001).

Formal financial institutions shy away from these enterprises because they consider them too risky and costly to serve. Recent increases in banks' minimum balances and closure of bank branches around the country also result in exclusion of MSEs from formal finance.

Further, Kenya is presently experiencing serious economic challenges, which include unemployment, poor performance of various sectors, retrenchments, as well as declining economic growth that has reached negative 0.3 per cent as of the year 2000 (Economic Survey 2001). This further aggravates the financial position of the MSEs.

In the last two decades, Micro Finance Institutions (MFIs) have been among organizations within the Non Governmental Organizations (NGO) framework that have been important sources of credit for a large number of micro and small scale enterprises (GOK 2000, 57). MFIs take the form of NGOs, private companies, donors and government institutions. The main objective of MFIs is to provide technical assistance in form of credit and training to the poor with ultimate goal of alleviating poverty. Most of the MFIs rely on donor funding as they are not financially viable enough to access commercial funding (Ledgerwood 1998). However, casual observations into the operations of MFIs show that there are new developments coming up in the microfinance field whereby the donors are emphasizing on self-reliance. This means that the MFIs have to lend to clients who are able to repay their loans.

Lack of working capital has been established as the most important reason for business closures and access to credit as the second most severe constraint facing MSEs after access to markets for their products (Central Bureau of Statistics-CBS 1999). How the MFIs determine how much and to whom they lend are thus critical and their decisions may influence the operations of the MSEs.

1.1 Statement of the Problem

Greater access to and sustainable flow of adequate credit to the informal sector operators are critical to progress in poverty reduction (GOK 2000, 57). The main sources of credit to MSEs are relatives and friends, formal banks and MFIs. There has been a lot of emphasize on provision of financial services to MSEs in form of credit, training and linkages to formal financial institutions by the MFIs. However, the MFIs have limited outreach to MSEs due to limited financial resources among other reasons. They only reach 3.5% of the country's poor (CGAP, 4).

The MFIs have little to show on what they have achieved in financing the MSEs (The weekly Review 1998,3). This means that the credit given to MSEs does not seem to change their levels of operations.

Oketch (1991, 89) found out that although many MFIs are giving credit to MSEs, they do not seem to be well informed on the relative sizes or kinds of loans needed by enterprises in different sectors. In light of the low levels of operations and lack of information on the relative sizes and kinds of loans needed by MSEs, there is a need to investigate how the MFIs ration credit to MSEs and establish the influence of such rationing on the latter's operations.

1.2 Objectives of the Study

The main objective of the study was to determine how MFIs allocate credit to MSEs. This was achieved through three sub-objectives namely:

1. Determine the operations of MSEs
2. Determine the criteria used to ration credit by the MFIs and
3. Establish the influence of credit rationing by MFIs on MSEs operations.

1.3 Justification of the Study

There has been paucity of literature on credit rationing in the MSE sector in Kenya. Most researchers in this sector have studied the impact of credit on various economic variables like employment, increase in household incomes and enterprise output (Oketch 1991; Coppers and Lybrand 1991). Other scholars have studied the MFIs on the cost of various credit programs, sustainability development, training, technical assistance methodologies, number of clients reached, client drop out from MFIs and repayment rates (Khandker and Pitt 1996; Gurgard, Pederson and Yaron 1994; Yoder 1993). The findings of this study will add to the existing literature on micro and small enterprises in the area of credit rationing.

The study will establish the credit rationing criteria that are used by different MFIs, thereby enlightening the MSEs and other lending institutions on the various criteria used to ration credit. This will assist the MSEs in soliciting for credit facilities from the MFIs.

Further the results of this study will contribute to an understanding of the MSEs financing through the MFIs and the influence such financing has on the operations of the latter. This knowledge is useful to policy makers in coming up with a regulatory framework for MFIs.

1.4 Scope of the Study

The study concentrated on financing aspects of MSEs. The aspects of finance considered included financial requirements and various sources of finances for MSEs. Further credit rationing by MFIs and its influence on MSEs' operations were the main focus of the study. The researcher collected data from a random sample of 30 MFIs, which had credit in their portfolio of services and are based in Nairobi. Data was also collected from a sample of 30 MSEs located in Nairobi that had been financed by the selected MFIs. The survey method was used to collect the data. Data was analyzed using descriptive and inferential statistics (Chi- square test).

1.5 Organisation of the Study

This research project constitutes five chapters. Chapter one consists of a brief introduction of the study, the problem statement, objectives, justification of the study and scope of the study. Chapter two presents the definitions of terms, sources of funds for micro and small enterprises, operations of micro and small enterprises, models of funding micro and small enterprises, credit rationing criteria and the hypothesis of the study.

Chapter three elaborates the research methodology with emphasis on the research design, sampling plan, data types, sources, collection procedures and data analysis.

Chapter four presents a qualitative evaluation of the data obtained from the sample. The last chapter dwells on conclusions and recommendations based on the data analysis. Potential areas of future research are also suggested.

CHAPTER 2

LITERATURE REVIEW

Finance deals with the basic economic problem of scarce resources with unlimited wants. It is the key to investment and growth. Profitable invest opportunities may exist but the financial resources required to invest may be beyond the capacity of the investor. Under such circumstances, investment decisions are made under limited capital budget resulting in capital rationing (Pandey 1999, 561). Limited capital budgeting may also be imposed to check on controls. In either case, criteria have to be set to determine how much is allocated to each activity to achieve optimum results.

2.1 Definition of Terms

This section defines the term operations and the terminologies used in the Micro Enterprise sector.

Operations: Operations refer to the resources and processes of organizations in producing goods and services for customers (Johnston 1997). The study emphasized on the financial resource provided by MFIs in form of credit and investigated how it is availed to the MSEs.

Micro and Small Enterprises: A definition that could classify the enterprises on dimension of capital, employment and output is best. However, data on capital and output is often missing or unreliable, forcing analysts to rely on employment data alone (Dondo, 1994). This study adopts the definition given by the 1999 National MSEs Baseline Survey whereby a micro enterprise is taken to be one employing 10 people and below while a small enterprise is one employing between 11 and 50 people (CBS 1999). Employment here refers to people working in the enterprise whether they are paid or not. Business, enterprise or firm are used interchangeably to refer to an economic unit producing goods or providing services, for example, Kiosks, salons, and shops among other entities.

Microfinance: Microfinance is defined by the Association of Microfinance Institutions (AMFI) as the provision of micro-credit as well as other services such as savings, deposits, insurance services and other financial instruments/products aimed at the poor or low income people. This study considers only the provision of micro-credit aspects of Microfinance.

Microcredit: Reinke (2001, 1) defines micro-credit as credit extended by formal institutions to individuals or informal groups. The formal institution has been set up or is currently financed or supported by donor aid. This study defines micro credit as funds provided by MFIs to MSEs that are to be repaid at a cost and under specified conditions.

2.2 Sources of Funds for Micro and Small Enterprises

Debt and equity are the two sources of finance for a business. Debt refers to finances provided through borrowing while equity is finances provided by the owners of the firm (Copeland and Weston 1992). In the context of MSEs, the external sources of finance are limited due to their inability to gain access to funds from the mainstream formal financial system in Kenya (Parker 1993). Alternative sources of external funds in the form of self savings are almost impossible to accelerate in Kenya. This is because of many factors inhibiting the saving rate, for example, the poor economic status of most of the MSEs arising from unemployment, high cost of living and inadequate services provided by the government. In early

1990s there was rapid development of informal finance in form of Microfinance Institutions. These institutions provide credit to MSEs. The 1999 National MSE Baseline Survey identified various sources of MSEs finances. They include family sources, moneylenders, banks and NGOs among many others.

2.3 Operations of Micro and Small Enterprises

Resources of organizations comprise of finances, the human capital, equipment and materials used in the production of goods and services. Processes include location, design, layout and installation of equipment, sourcing of raw material, management of the human resource, production and distribution logistics. The processes are interrelated. They are performed to produce a product or service; and get it to the intended consumer. Finances used in business processes constitute capital and working capital expenditure. According to (Parker 1993) MSEs require business finances for; payment of services, license fees; working capital requirements, for example, buying stock, repairs and maintenance and raw materials; and as business capital both initial capital to start up and additional capital to be injected into the business.

2.4 Models for Funding Micro and Small Enterprises

The techniques of giving credit have been changing (Yoder 1993). The techniques have changed from formal methods where credit appraisal is emphasized along with collateral to traditional money lenders methods. MFIs in Kenya use diverse methods of microfinance molded from the Grameen Bank model. This model is based on use of informal community delivery systems to administer credit and savings; MFIs organize clients into groups for purposes of attaining economies of scale from the small scale transactions and instituting small group guarantee mechanisms; credit appraisal is based on character assessment rather than viability of projects to be financed and collateral; and the focus is on financing very small businesses and the poor (Khandker et al1995).

Yonder (1993) identified two approaches of giving credit to MSEs in Kenya namely the integrative and the minimalist approaches. Under the minimalist approach, only credit is provided to the borrowers. The model is based on believe that the provision of credit is the means to success of MSEs. The integrative approach provides training and relative technical assistance in addition to credit. Within the two approaches, many other approaches have been developed which include, the individual, group, and the rotating savings and credit societies. Further a study by Oketch (1995) on the demand and supply of MSEs finance in Kenya identified four methodologies mainly individual credit, individual credit with technical assistance, group credit and group credit with technical assistance. Similarly in a survey of 81 organizations with support programs for MSEs, 41 organizations were found to have a credit component in their assistance package to MSE (Dondo 1994). According to Dondo (1994), organizations give credit in two ways; individuals or through groups. Dondo, Oketch and Yoder studies are consistent on the approaches used in Kenya to finance MSEs.

Though the Kenyan situation is consistent, Gurgand (1994) did not identify any one single model for successful rural financial intermediation, rather a variety of operating models to improve savings mobilization, provide credit and increase flexibility in service delivery were being used.

2.5 Credit Rationing Criteria

Credit rationing takes two forms. Lenders may refuse to make loans even though borrowers are willing to pay a higher interest rate or make loans but restrict the size of the loans to less than the borrowers would like (Mishkin 1997). Financial institutions engage in the second form of credit rationing to reduce their risks.

There are two arguments on how much the MSEs should be given. One school of thought argues that the MSEs know best what they want to invest in and thus they should be given what they apply for (Reinke 2001). Reinke states that some credit schemes assume that the poor people themselves know best how to better themselves and thus credit should not be targeted to particular activities. In Cameroon and Togo, for example, consumer and investment credit is provided and there is no constraint on how loans are used Gurgand(1994).

The other argument contends that credit should be made available according to repayment capability based on current. Some of the factors of determining the size and target for credit include:

Savings: Gurgand (1994) notes that mandatory and voluntary savings schemes have been used effectively by RFIs where savings play a significant role in gaining access to credit. *Cr'edit e'pargne-logement* in Rwanda provides 5 to 15 years credit for home construction after one year of recorded saving effort. Reinke (2001) identifies saving as a means of determining who to give credit and how much, whereby a borrower is required to accumulate savings both prior to and during borrowing. The borrower may also be required to pledge such savings as collateral. This excludes the potential borrowers and contradicts logic of micro lending in that the borrowers may not have funds to save.

Ability to pay: In Burkina Faso and Malawi, failure of one member to repay was used to block access to new credit for all group members, increasing repayment performance due to social pressure (Gurgand 1994). Reinke (2001) notes that access to future larger loans may be made dependent on punctual and full payment of small initial loans.

Evaluation of business viability: This approach is practiced in Burkina Faso whereby a careful analysis of the economic opportunities available in the villages where credit is provided is carried out. Use of credit is discussed with borrowers and includes variety of farm or non-firm investments. The scheme is flexible in allowing reallocation of funds to activities that had not been previously planned.

Target group: Target groups are also used to allocate credit. Gurgand (1994) found that Smallholder Agricultural Credit Administration (SACA) in Malawi concentrates on small holder farmers, *Cr'edit Soudure* in Burkina Faso concentrates on poor people in rural Sahel that suffer from lack of capital with emphases on women. Other organizations have no well-defined target population. Reinke identifies several ways of determining target group. Among the ways identified include: target women who are seen as economically less independent, the youth due to high unemployment and insufficient jobs, and the rural people who are seen not to benefit from development and employment creation in the cities and towns. A lender has to decide how to reach his target group and ensure that the targeting objectives are met.

Character assessment: The Grameen bank model bases credit on the character assessment and trust of the groups. However, if an individual does not belong to a group and is able to pay, he may be denied credit if the MFI is purely using this model.

Others: Other factors identified by Reinke (2001) include such factors like ethnicity, nationality or factors of social disadvantage such as physical disability, location and objective of the microcredit institution and mandatory training. Objectives of the lender may be to fund activities away from trading activities so as not to dilute the sector's profit thus undermining the viability of all trading activities. An MFI serving the poor may locate its offices where the poor live. Such criterion may sometimes lead to poor choices as cities and towns have the best infrastructural connections. Access for credit may be conditioned on undergoing credit training. This may be worth as more borrowers will succeed in their business and be able and willing to repay their loans. However, training is costly and it will exclude some potential borrowers.

Oketch, (1995) when studying the demand and supply of MSEs finance in Kenya established that the size of loans to various borrowers depended on the lending technology. Where funds were lent to individuals, appraisal depended on business assessment, collateral, business needs and repayment capacity, type of business and availability of funds. For group based loans, it depended on age of the group, group appraisal of the project, past repayment records demand by clients and availability of funds. Oketch used the MSEs financiers and did not consider the influence of rationing on MSEs operations. Oketch's findings contribute to this study in defining the possible variables from the perspective of MSEs such as credit size and security. This study took the perspectives of both the MSEs and their financiers and went further to determine the influence of credit rationing on operations of MSEs.

This literature identified savings, ability to pay, target group, business viability, lenders' objectives, location of the lender, funds availability and mandatory training among the many variables of determining the credit size. Some of these variables are beneficial to the MSEs while most of them ensure that the MFIs get back their funds. The variables identified in the literature were investigated in the field. The influence of credit size on MSEs operational levels was then established.

2.6.0 Hypothesis

Null Hypothesis: Credit size (in terms of adequate or inadequate) does not have influence on the operational levels (in terms of increasing either capital or working capital) of the MSEs.

Alternative Hypothesis: Credit size (in terms of adequate or inadequate) does influence the MSEs operational levels (in terms of increasing either capital or working capital.

CHAPTER THREE

METHODOLOGY

This section discusses the research design, sampling method, and, data collection and analysis.

3.1 Research Design

A survey method was employed in this study. A semi-structured questionnaire was used to collect the primary data.

3.2 Population

The population of the study was all the MFIs providing Credit to MSEs in Kenya and all the MSEs in Nairobi that had been financed by the MFIs between January 2000 and June 2001.

3.3 Accessible Population

Most of the MFIs are concentrated in Nairobi (K-REP 1997). This factor in addition to time, finances and logistic problems limited the study population within Nairobi. The directory of MFIs produced by K-REP in 1997 lists 61 organizations giving various types of services ranging from credit to training. In its sources of business capital, Kenya Management Assistance Program (K-MAP) lists two more sources of loans for micro, small and medium scale companies that are not in the list of K-REP. The register of AMFI consists of 11 MFIs, three of which are not in the K-REP list. Thus, the K-REP list is not inclusive of all the MFIs in Kenya. Nachmias (1996, 182) suggested that when the sampling frame is incomplete, one may use supplemental lists to come up with the population frame. In this case, the population frame for the study was a combination of the K-REP list as of 1997, K-MAP list as of 2000 and the register of AMFI as of 2001. The MFIs located in Nairobi and had a micro credit were 44 in number and formed the sampling frame.

3.4 Sampling Plan

A random sample of 30 MFIs was selected among the 44 using random numbers. This was preferred as it ensured equal chance that each MFI would be selected and minimized sampling bias.

Due to the large number and informal nature of the MSEs cluster sampling was used to select them. The studied MFIs were clustered under church, bank, NGO, company and others. One MFI from each category was randomly selected.

The selected MFIs advised the researcher on the days that their clients hold meetings. The researcher attended these meetings and randomly selected six MSEs who had received a loan between January 2000 and June 2001 from each MFI. This period ensured that data was available from the respondents. Most of the MSEs studied were informal and their businesses were run under either a family or owners name. For this reason a list of selected MSEs could not be composed.

3.5 Data Types, Sources and Collection Procedures

The study employed primary and secondary data. The primary data obtained from MFIs included: MFI background (Name, location and ownership), sources of funds, amount of loan disbursed, lending criteria, conditions on lending, loan repayment, and other services offered to the client in form of training, business advise, and business monitoring. A drop and pick semi-structured questionnaire was used to collect data from the Credit Officers of MFIs (Appendix C).

The primary data collected from MSEs included; the background information, for example, name of business, location, and type of business; financial needs and operations of the MSEs and sources of funds. A semi-structured questionnaire was administered to the MSEs entrepreneurs (Appendix D). The respective micro finance institution giving credit to the selected MSEs assisted the researcher in locating the MSEs.

The secondary data was obtained from relevant literature and records available in libraries, government offices and respective offices of MFIs and MSEs.

3.6 Data Analysis

The data was presented using tables and descriptive statistics.

The data was analyzed using descriptive statistics (mode, mean, frequencies and percentages) and inferential statistics (chi-square). Descriptive statistics enabled the researcher to describe the distribution of the various variables in the study, for example, credit amount, sources of funds, and expenditure types of MSEs. The chi-square test was used to establish the relationship between the level of funding provided by MFIs as determined by the rationing criteria and the operations implemented by the MSEs, and whether this relationship was significant.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATIONS

This chapter presents data on credit rationing and the operations of MSEs. The study had three objectives namely to determine the operations of MSEs, determine the criteria used to ration credit by the MFIs and establish the influence of credit rationing by MFIs on the operations of MSEs.

Data on MSEs operations and the criteria used to ration credit assisted to achieve the relationship between credit rationing and operations of MSEs. Data was collected from the field and was presented, analyzed and interpreted under data collection and response rate; background of the studied MFIs and MSEs; MSES business activities; operations and financial needs of MSEs; operations of MSEs financed by MFIs and MFIs funding methodology. The chapter concludes by proving the hypothesis that credit rationing has influence on the operations of MSEs.

4.1 Data Collection and Response Rate

Data from 24 out of 30 selected MFIs was obtained through a questionnaire using the drop and pick method. Where MFI credit officers had time, the researcher held discussions with them on their rationing methodology in addition to them responding to the questionnaire. This was used to validate the data in the questionnaire. A response rate of 80 per cent was received (Table 1). The few cases of non-response were attributed to two factors. Firstly, some of the sampled MFIs said that they have a policy of not releasing information to outsiders and secondly, others stated that they were too busy.

Table 4.1 Response Rate

Number of questionnaires sent	Number of Questionnaires Received	Percentage
MFIs 30	24	80
MSEs 30	27	90

Source:Research Data

Thirty questionnaires were administered to MSEs at their business locations. 27 questionnaires out of the 30 administered were received representing a response rate of 90 per cent (Table 1). The non-response of the three MSEs was attributed to the fact that some of them were too busy on their businesses to give comprehensive and relevant data. The others were limited in terms of their understanding of the MFIs credit programs and ability to communicate information about their businesses. This led to inadequate response to the questionnaire.

The findings and conclusions were based on the 80 per cent and 90 per cent response rates of the MFIs and MSEs respectively.

4.2 Background of the studied Micro Finance Institutions and Micro and Small Enterprises

The background information includes the form, location of operations, activities and the sources of funds

4.2.1 The Micro Finance Institutions

The sample of MFIs selected ranged from NGOs to church based organizations as shown on Table 4.2

Table 4.2 shows that the MFIs take different forms. However, the majority are NGOs (50%). A few commercial banks (13%) were also involved. The banks have established special units to serve MSEs and in some cases they work in collaboration with the MFIs.

Table 4.2: Form of Organizational Base of MFIs

Form	Frequency	Percentage
NGOs	12	50
Banks	3	13
Company	3	13
Church	4	17
Others	2	8
Total	24	100

Source: Research Data

These results demonstrated some discrepancy in the sector whereby though the MFIs encourage the MSEs to save, majority of the latter do not have direct access to their clients deposits. This may lead to transfer of wealth from those who do not qualify for loans from the commercial banks to those who qualify as the latter's deposits are lent out.

The MFIs operate in different regions of the country and carry different development programs that vary from one organization to the other.

Sources of finance for MFIs include foreign donors (20%), internal operations (20%), borrowing (25%) and members' deposits (5%). Table 4.3 shows that on average, the highest proportion of finances were from internal operations (50%) and the least were from members deposits (5%). A similar trend was observed in Table 4.4 which shows the frequency of MFIs and their sources of finances. Table 4.4 shows that majority (79%) of MFIs generated funds from their internal operation and least (17 %) got their funds from members' deposits.

Table 4.3: Average Sources of Finance for the MFIs

Source	Mean Percentage of the Finances
Foreign donors	20
Internal operations	50
Members deposits	5
Borrowing	25
Total	100

Source: Research Data

The MFIs credit officers stated that the internal operations involved operating revolving funds that resulted from credit programs that were initially funded by donors. 75 per cent of the MFIs reported that the donors had pulled out of the programs leaving the MFIs to operate on their own. The low proportion of members' deposits was explained by the fact that apart from the banks, the other MFIs do not have access to the members' deposits.

Table 4.4 Sources of Finances for MFIs

Source	Frequency of MFIs	Percentage
Foreign donors	16	67
Internal operations	19	79
Members deposits	4	17
Borrowing	6	25

Source: Research Data

Of the 24 MFIs studied it was established that they received between 0 to 50 per cent of their total finance from borrowing. Proportion of finances from donors, internal operations and members' deposits varied from 0 to

100 per cent of the total finances for different MFIs (Table 4.5). Most MSEs obtain finances from more than one source and only a few obtain from a single source.

Table 4.5: Sources of Finances and Range of Proportion of Total Finances

Source	Percentage Range of Proportion
Foreign donors	0-100
Internal operations	0-100
Members deposits	0-100
Borrowing	0- 50

Source: Research Data

Apart from giving credit to MSEs, 75 per cent of the MFIs also give business training while 33 per cent participate in development programs, for example, in health and agriculture (Table 4.6).

The type of training offered includes book keeping, filling in savings passbooks, and developing business plans. This training is geared towards introducing MSEs to banking. MFIs finance capital equipment and working capital requirements of the MSEs (Table 4.7).

Table 4.6: Services Offered by MFIs to MSEs

Type of Service	Frequency of MFIs	Percentage
Credit	24	100
Training	18	75
Development Programs	8	33

Source: Research Data

Table 4.7: Type of Operations of MSEs and Frequency of Funding by MFIs

Type of operation	Frequency MFIs	Percentage
Initial capital	3	13
Working Capital	24	100
Additional capital	10	42

Source: Research Data

All the MFIs finance working capital expenditure of the MSEs. The results indicate that a big proportion of initial capital for the MSEs were not from MFIs, but from other sources. Generally, MFIs tend to finance working capital and to a limited extent additional capital for the MSEs as indicated in Table 4.7. All (100%) MFIs finance

MSEs working capital, 42% of MFIs finance MSEs additional capital while 13% of the MFIs finance MSEs initial capital.

4.2.2 The Micro and Small Enterprises (MSEs)

The survey targeted the MSEs located in Nairobi that have been financed by MFIs. Most of the MSEs financed by MFIs are located in the low class areas of Nairobi mainly Dandora, Kariobangi, Kayole and Kawangware. The businesses were established through the initiatives of the entrepreneurs and many of them had evolved from one type of business to another, for example, from selling second hand clothes to providing food or from selling green groceries to a general shop.

The businesses were either family owned (40%) or sole proprietorship (60%) employing between one and five employees. Thus all the businesses selected were micro enterprises. This could be due to the methodology used by most MFIs in giving credits whereby individuals are required to form groups (Table 4.10). Of the MSEs studied, 30 per cent of the entrepreneurs engaged in more than one business. However, in collecting the data, the researcher concentrated on the businesses that had been financed by the MFIs.

2.2.2.1 MSEs Business Activities

The activities of the MSEs ranged from running shops to timber sales as shown on Table 4.8.

Table 4.8: Type of Businesses Undertaken by MSEs

Business	Frequency of MSES	Percentage Entrepreneurs
Dress making	6	22
General Shop	4	15
Embroidery Shop	1	4
Sale of cereals	5	19
Sales of charcoal	1	4
Food	5	19
Printing	1	4
Saloon	1	4
Second hand clothes	2	7
Timber Sales	1	4
Total	27	100

Source: Research Data

The most popular activities included, dress making (22%), sale of cereals (19%) and food (19%). Other business activities included general shop business (15%), sale of second hand clothes (7%) and embroidery, sale of charcoal, printing and timber sales each representing 4% of the MSEs surveyed.

The enterprises were either pure trading activities or involved some small scale processing.

4.2.2.2 Operations, Financial Needs and Sources of Finances for MSEs

MSEs were in the informal sector. The studied entrepreneurs did not have licenses from the local authority and they paid minimal or nil amounts on charges like electricity, water and rents. The main expenditure was on purchase of stocks and capital equipment. Thus the businesses required funds to increase their stock or buy more capital items for expansion.

The MSEs surveyed stated that their sources of funds were from business income, from MFIs and from friends and relatives. The contribution from each source was as per Table 4.9. The Table shows that 55 per cent of MSEs' finances is from business income, 20 per cent from personal saving, 15 per cent from friends and relatives and 10 per cent from MFIs.

Table 4.9 MSEs Sources of Finances

Sources	Average Percentage Contribution
Business income	55
Friends and relatives	15
MFIs	10
Personal savings	20

Source: Research Data

Thus, the highest proportion of MSEs' sources of finance was business income and the lowest was from micro finance institutions.

The high income from businesses could be attributed to the fact that these enterprises paid minimal amounts on many of the general business expenses like salaries, rent electricity, and water because of their locations and informality. The results indicated that the contribution of MFIs to MSEs finances was minimal compared to other sources.

4.3 Operations of MSEs Funded by MFIs

On inquiring from the MSEs the purpose for which they request loans, 27 per cent of the loans were for additional capital while 73 per cent were for working capital. Thus, all the studied MSEs had already started their businesses before borrowing from the MFIs.

4.4 MFIs Funding Methodology

87 per cent of the studied MFIs stated that they lend to individuals through groups (Table 4.10). In addition 14 per cent of the 87 per cent also lend to groups of MSEs for on-lending to individuals. The MFIs stated that credit is granted to MSEs groups only if the groups are cohesive. Where groups are not cohesive, the MFI reverts to funding individuals through groups.

Table 4.10: The Proportion of MFIs Giving Funds Through Groups or Individuals

Category	Frequency	Percentage
Individuals through groups	21	87
Direct to Individuals	3	13
Total	24	100

Source: Research Data

The MFIs stated that where groups are not cohesive, group members may use the funds to intimidate their colleagues, delay loans or lend less than the amount the MFI could have lent to individual members. Such behaviour may stifle the MSEs' businesses.

13 per cent of the MFIs (mainly banks) fund individuals through their normal procedures of assessing the credit worthiness of their customers. However these banks have come up with products that provide concessionary terms to the MSEs. Such terms require the client to produce acceptable security such as household goods, be guaranteed by a third party and be operating an account with the bank.

4.4.1 Group Methodology of Giving Credit to Micro and Small Enterprises

The methodologies used by different MFIs have very little variations. The MFIs have adopted the Grameen Bank Model. The methodology entails the MSEs forming nuclear groups of five members and six such groups combine to form a bigger group of thirty members. The bigger group is registered as a self help group with the Department of Social Services at Division Head Quarters. This group is also registered with the MFI. The bigger group opens a savings account whereby the MFI is a mandatory signatory. Group members save in this account on weekly basis. The savings in the account are used to guarantee loans to the members. Each member of the group of five grantees each other and their savings act as security for the loans borrowed. In addition to pledging savings as security, 50 per cent of the MFIs also required the MSEs to pledge their household goods as security. This means that in case of default the MFIs can repossess the entrepreneur household goods.

Both MSEs and MFIs explained that the groups are based on social interactions of the members. The researcher found out that group formation vary from one MFI to another. 10 per cent of the MFIs assist the MSEs to come up with groups. The rest of the MFIs have groups which have formed on their own. The researcher found out that where the MFI facilitated the formation of the groups from different individuals, the groups were not as cohesive as those formed by members on their own. It was also found out that members who formed groups on their own had other objectives, for example, health care and merry go rounds apart from soliciting for credit from the MFIs.

4.4.2 Credit Rationing

All the MFIs surveyed indicated that they ration credit. 78 per cent said that they do not have sufficient funds, 63 per cent would like to reduce the risk involved in lending, 52 per cent needed to introduce credit to their clients gradually, 37 per cent did not have credible borrowers, and 22 per cent needed to develop the management capability of the their clients (Table 4.11).

Table 4.11 Reasons For Credit Rationing

Reasons	Frequency	Percentage of Response of MFIs
Insufficient funds	21	78
Reduce risk	17	63
Introduce credit gradually	14	52
Lack of credible borrowers	10	37
Improve Management capability of their clients	6	22

Source: Research Data

These results indicate the scarcity of finances as well as the character assessment used by MFIs to guard against risk. Over 50 per cent of the MFIs introduce credit gradually to their clients as they learn their character through the saving process. Banks stated that they mainly ration credit to guard against risk of default as they have enough funds from deposits. Table 4.12 depicts the extent of rationing by five MFIs that provided data on their average loan requests and the amount they lend on average per year. The Table indicates that not all loan requests are honoured and the amount granted is far much less than the amount requested.

Table 4.12 Extent of Credit Rationing

Amount Requested	Amount Granted	Amount Granted as % of requests	No. of Applicants	No. of Applicants who got loans.	Applicants who got loans as a % of total applicants
425,000	250,000	59	10,000	9,000	90
1,000,000	600,000	60	80	75	94
15,000,000	2,400,000	16	1,000	100	10
350,000,000	80,000,000	23	5,000	1,600	32
6,000,000	4,000,000	67	300	200	67

Source: Research Data

The total number of loans given to the studied MSEs were 43 whereby 16 of the MSEs had received two loans and rest 11 had received one loan each. 4 per cent had moved from one MFI to another in search of suitable terms while 4 per cent were dissatisfied by the conditions of the various MFIs and had decided not to borrow again in future. Their main complains were delays, high interest rates, low amount of credit and offsetting of their savings against group member defaulters' loans.

85 per cent of the first loans were less than Kenya shilling 20,000. The amount ranged from Kenya Shillings 3000 to Kenya Shilling 15,000. 15 per cent had received a loan ranging from Kenya shillings 3,000 to 75,000 and had mainly borrowed from the banks. On those with the second loan, the amount ranged from 10,000 to 46,000 but only 31 per cent had got over 20,000. It was noted that for those who got two loans, the second loan was higher than the first loan. For the first loan, 48 per cent got what they had requested for while 52 per cent got less than they had applied for. On the second loan, 50 per cent got what they had applied for and 50 per cent got less than what they had applied for. This shows the confidence that MFIs gain as they start interacting with the MSEs and learn their character. Thus as the number of loans increase, more MSEs may be expected to receive an amount equal to their requests.

Credit terms included the waiting period on requesting for a loan, the repayment period, interest rate and periodic installment. MSEs waited for a period between two weeks and two months to receive funds after approval of the loan. Interest rates varied from 2.5 per cent to 22 per cent. The variation of interest rates was based on the operation cost of managing the credit program. Some of the MFIs reported that their operation costs were low as they were involved in other development programs and thus shared the operation costs. Their interest rates were therefore low. Repayment period varies from weekly to monthly. On average, 60 per cent to 98 per cent of borrowers paid their loans on the due date reflecting good repayment rate. Borrowers who paid after the due date were between 2 per cent and 20 per cent of the total borrowers and they paid within one week and three months after the due date. The MSEs who paid before the due date were negligible.

17 per cent of the MFIs stated that they auction the business of the MSEs if they fail to pay, 21 per cent reschedule the loan and all the MFIs deny any further credit to an MSE who defaults. Other measures identified

were to repossess the pledged security, offset the loan from the clients savings, group leaders follow up with the defaulters, discussions are held with the defaulters and as a last resort, the MFI may take legal action.

4.4.3 Rationing Criteria

MFIs reported that an MSE was eligible for a loan on meeting various criteria as shown on Table 4.13. The very important factors had scores ranging between 1.0 to less than 2.0, important factors had scores ranging between 2.0 to less than 3.0 and less important factors had scores ranging between 3.0 to less than 3.5. The most important factors were considered to be the nature of business, location of business and savings as security (Table 4.13).

Businesses funded were micro scale run by entrepreneurs who met the requirements of the MFIs. 13 per cent of the MFIs with different programs gave credit to only their clients in their other programs. On location, each MFI had delineated its region of operations.

Business viability and group cohesiveness were rated as important factors. Business viability was in form of proper books of accounts, ability to save regularly, and less outstanding debts.

Table 4.13: Order of Importance of Credit Rationing Criteria: Qualification for a Loan

Credit Rationing Criteria	Average Score	Categories
Particular nature of business	1.3	Very Important
Location of business	1.3	
Savings as security	1.9	
Proper books of accounts	2.2	Important
No outstanding debts	2.2	
Group cohesiveness	2.2	
Active group	2.4	
Savings as assurance of ability to pay	2.4	
Saving for on lending	3.0	Least Important
Membership duration in a group	3.2	

Source: Research Data

On group membership, group cohesiveness and active groups were also rated as important. The main reason for this was that 89 per cent of MFIs disbursed credit to individuals through the groups. This implied that groups formed needed to be cohesive and active.

Factors that were rated as least important were savings for on lending and duration of membership in the group. Non bank based MFIs do not have direct access to members savings and thus they could not use savings for lending. Whether members were old or new in a group did not indicate the extent of being cohesive or proactive and thus was considered to be least important.

From the data collected on the studied MFIs, it was noted that the criteria to qualify for a loan was systematic whereby the most important ranked criteria had to be fulfilled before the next level of importance. A client had to be in the area where MFIs is operating before joining a group to solicit funds from the subject MFI.

Three factors were identified as determinants of the amounts of credit granted to MSEs. These factors were, business profitability, ability to pay installment and interest, and regular savings.

Profitable business and ability to pay were ranked as very important in determining the amounts to lend. Profitable business ensures the sustainability of the business while

Installment and interest payments were important as these made the MFI remain in business. Regular savings were important because they acted as security for the loans given. Again, there was a hierarchy whereby a business had to be profitable to meet its obligations. Once interest and periodic installments were fully paid, the MSE could borrow more funds. The MSEs was only entitled to higher funds if he had saved enough to secure the loan.

From this analysis, it was evident that the factors considered in determining the amount to lend to an individual were business profitability, ability to repay the loan and ability to save. The MFIs explained that they use the saving period to study the character of their potential clients. The criteria for determining the loan amount are innovations that enabled the MFIs to learn the character of their clients and increase the amounts as the clients became familiar. This was consistent with the received literature.

On inquiring from the MSEs as to whether the funds granted were enough to carry on the operations they intended to perform, out of the 43 loans given, only 17 per cent of the loans were enough. 83 per cent of the loans were not enough. Of the 83 per cent, 60 per cent of the loans were equal to the request. This was common where the MFIs had set different levels of loans which the MSEs could apply depending on whether the MSEs were borrowing for the first, second, third, or the n^{th} time. Some of the MFIs set the levels arbitrary while others tried to relate to the needs of the MSEs or to the gross domestic product of the country. The MSEs had to go by these levels irrespective of their financial needs. The level of inadequacy of funds reported by MSE (60%) implied that the MFIs levels of the amounts to be borrowed were not commensurate with MSE business needs.

For the loans that were inadequate MSEs had two alternatives. To look for other sources of finances (19%), or operate at the affordable level (81%). This reflects the inability of the majority of MSEs to get funds. The MSEs business needs were not adequately met and thus their businesses did not expand. The bulk of MSEs finances came from business income and with inability to expand their businesses, the MSEs continued operating at low scale. Sentiments were expressed by one of the MSEs entrepreneur who commented that MSEs would remain at a micro level because they did not get enough finances to inject in their businesses to increase their level of operation. Such views have made MSEs to be complacent on their low level of operation.

89 per cent of the MSEs reported that business income was able to finance periodic installments including interest and savings required by MFIs. 22 per cent were not able to finance the initial installment as businesses needed time to generate income. 15 per cent of the MSEs used the loan given to pay the first two installments. MSEs reported that they were finding it difficult to meet some credit conditions. They felt that the interest rates were too high for the kind of businesses they were involved in and lack of grace period especially for the few who were not in direct trading activities put them in a difficulty situation.

4.5 Testing of the Hypothesis using Chi-square

The hypothesis for testing were:

Null Hypothesis: Credit size (in terms of adequate or inadequate) does not have influence on the operational levels (in terms of increasing either capital or working capital) of the MSEs.

Alternative Hypothesis: Credit size (in terms of adequate or inadequate) does influence the MSEs operational levels (in terms of increasing either capital or working capital).

Test statistics: Chi- square at 5% level of significance. Since the computed chi-square is greater than the tabulated chi-square, we reject the null hypothesis and conclude that credit rationing has influence on the operations of the MSEs (Table 4.14).

Table 4.14 Contingency Table for Observed and Expected Frequencies

Action of MSEs

Loan	Expansion of operations	Non expansion of	Total
Adequacy	Operations	Operations	
Enough	4 (1.7)	1 (3.3)	5
Not enough	4 (6.3)	15 (12.7)	19
Total	8	16	24
Level of Significance 5% DF = 1		Tabulated Chi-square value (χ) = 3.84 Calculated Chi-square (χ) =5.97	

Source: Research Data

The strength of this influence as indicated by phi square $= \phi^2 = 5.97/24 = 0.25$, which means that 25 per cent of the variance of expansion of MSEs businesses was accounted for on the basis of the loan size given by MFIs and whether the loan is adequate or not.

4.5.1 Interpretation of the Hypothesis

From the literature review and the research findings, the variables that constitute credit rationing were ability to pay, profitable business, savings, frequency of borrowing, group membership and delay in giving loans. Operations result from incurring business capital expenditure and working capital expenditure which in turn result to business expansion.

The study has shown that MFIs rarely give credit to business starters. The study has further shown that the highest percentage of MSEs finance is from business activities. Thus, without a profitable business, the MSEs ability to pay a loan is limited. This means that MSEs can not get adequate loan to expand. 11 per cent of the respondents used the loaned funds to finance some of the installments. When MSEs use the loaned funds to repay the installment, the purpose for which the loan was made is not met. 44 per cent of the respondents said that repayment schedules put the entrepreneur under pressure to first raise the weekly repayment installment. The fast the MFI required its periodic installment, the more committed the MSE entrepreneurs were in their businesses. A MSEs having a loan is committed to his business because of the obligations ahead of him in terms of periodic repayments.

The higher the savings, the higher the credit given because savings act as security. However, continuous saving was only possible if the MSEs business was profitable. Profitability of the businesses depended on the level of capital and working capital expenditure invested in the business.

The more times a MSE borrows and repays the loan the more the amount of credit one could get from MFI and thus expand his business. However this had a limit as the MFIs explained that once an MSE requested an amount that exceeded the maximum credit for their target group, the MSE was referred to the formal bank.

Group membership creates confidence in MFIs to give credit to MSEs. This confidence results from group pressure which instills some motivation in the MSEs to be committed and responsible to their businesses. 30 per cent of the MSEs respondents stated that, when credit is given through group guarantee, defaulting repayment of installment could lead to business closure due to group pressure. Thus, the MSEs had to be very keen on the performance of their business.

Delays in giving loans, as stated by 67 per cent of the respondents, delayed their expansion plans as they were not able to increase their capital equipment or stocks.

Although the expansion of MSEs operations was related to the size of MFIs' loans, it was not strongly related as suggested by Phi Square (25%). The factors that could have contributed to the influence not being strong were that the funds given by MFIs were too little to have major influence on MSEs operations. Both the MSEs and MFIs shared this view. Another reason cited by 26 per cent of the MSE respondents was that they diverted part of the loans they got to other non-business activities. Finally all the MSEs respondents stated that the interest rates of about 22 per cent was too high for the kind of businesses they are involved in. Further the MSEs stated that they would have wished the interest rates to be on the declining balance rather than being on a flat rate.

CHAPTER FIVE

SUMMARY OF RESEARCH FINDINGS AND CONCLUSION

5.1 Summary of Research Findings

This study set out to determine the operations of MSEs, determine the criteria used to ration credit by MFIs and establish the influence of credit rationing on the operations of MSEs.

The study established that the MSEs financed by MFIs are in the low class areas of Nairobi, mainly Dandora, Kariobangi Kayole and Kawangware. The businesses were micro in nature employing less than five employees. Majority of the businesses were informal and family or sole proprietor owned. The most popular activities carried out by the MSEs were dress making (22%), sale of cereals (19%) and food (19%). Other activities included general shop business (15%), sale of second hand clothes (7%) and, embroidery, sale of charcoal, printing and timber sales each representing 4 per cent.

MSE operations were established to include getting space, procuring and installing equipment, managing the human resource, actual production of goods and services, and distribution of the same. In carrying out these operations, the MSEs incurred either capital or working capital expenditure. However, it was established that the MSEs pay minimal or nil amount of the normal business expenses like rent, electricity and water because of their location and informality. Most of the MSEs finances come from their operations while the least is from the MFIs.

The study established that MFIs involved in credit to MSEs take different forms that include NGOs, churches banks, and companies.

Sources of finances for MFIs were established to be from internal operations (50%), borrowing (25%), donors (20%) and members' deposits (5%). It was noted that most MFIs obtain finances from more than one source and that internal operations involved revolving funds established by donors. 70 per cent of the MFIs stated that the donors had pulled out of the revolving fund programs. It was further noted that despite most of the MFIs encouraging the MSEs to save, only the banks had access to the savings for lending to borrowers.

The methodology of giving credit was not very different from one MFI to the other. Apart from the banks, the other MFIs had adopted the Grameen Bank model with very little variations. The MFIs lend to individuals through groups while banks followed their normal procedures of assessing the credit worthiness of the MSEs. However, the banks had introduced products that favoured the MSEs.

Apart from giving credit, the MFIs offer business training and participate in development programs. Generally, MFIs financed working capital and to a limited extent additional capital for MSEs. The MSEs had raised the initial capital for their businesses.

The research found out that not all loans requested were received and those granted were far much less than the amount requested. Under such cases, the MSEs looked for other sources of funds or used the available amount to carry out the planned activities. As the number of loans granted to a MSE increased, the amounts received each time also tended to increase.

The MFIs credit terms were waiting period, repayment period, interest rate and periodic installment. MSEs wait for a period of two weeks to three months to receive the funds after approval of a loan. The interest rate vary between 2.5 per cent to 22 per cent. Some of the MSEs stated that an interest rate of 22% on a flat rate was too high for the kind of businesses they are involved in. The periodic repayment varied from weekly to monthly. Majority of the MSEs pay within the repayment schedule. However, a few who were required to repay on weekly basis complained that this period is too short for the business to have generated funds that could be used to pay the installments. They thus used part of the borrowed funds to repay the first installments.

MSEs who failed to pay as scheduled were denied further credit, and the pledged security repossessed to offset the loan.

It was established that MFIs ration credit due to lack of enough funds(78%), the need to reduce risk of default (63%), the need to introduce credit to the MSEs gradually (52%), lack of credible borrowers (37%) and the need to improve the management capability of the MSEs (22%).

The various criteria that MFIs consider in lending to qualify for a loan were; nature of business, location of business, savings, proper books of accounts, no outstanding debts and group cohesiveness. The criteria used to determine the amount that a borrower received were ability to pay, profitable business and regular saving in that order.

The study found out that credit rationing has influence on the operations of MSEs in the following ways:

Savings; More savings led to more credit to finance the business.

Repayment ability: The more loans received and repaid, the more credit was received for financing the business.

Group: The more cohesive MSEs groups were, the more confidence the MFIs had on the groups and the more likely that individual group members received credit.

The extent to which the entrepreneurs met the set rationing criteria determined the level of operations of their businesses in terms of business expansion.

5.2 Conclusions

The study concludes that the operations of MSEs involve acquiring operating space, equipment, stock, human resource, production of goods and services, and distribution of the same. MSES finance the initial capital of their businesses from their personal savings while the MFIs provide loans to pay for additional equipment and stocks.

Further, this study concludes that the credit rationing criteria used to determine the amount that a borrower received from MFIs were ability to pay, profitable business, regular savings and group membership, among other factors.

Finally, the study found out that credit size has influence on the operation levels of MSEs in terms of the expansion of the businesses. Thus, MFIs should design credit rationing programs in a way that considers the entire processes and resources of the MSEs and not just capital equipment and stocks.

5.3 Limitations of the Study

These study findings have to be viewed in account of certain shortcomings that occurred in the course of the conduct of the study. The limitations include:

1. Majority of MSE entrepreneurs were semi illiterate and the interview had to be conducted in a language that most of them understood. This might have lead to misinterpretation of the questionnaires.
2. The MSEs were entrepreneurs in the informal sector. Because of the nature of the business they keep, varying their operating location and being widespread, it was not possible to get a random sample of the MSEs studied. This might have introduced limited bias of the data collected.

5.1 Recommendations

1. The study recommends that the MFIs consider the needs of MSEs when fixing the various levels of loan amounts. While the MFIs consider risk, they should also have a credit level commensurate with the MSEs business plans.
2. MFIs should consider the nature of business when determining the repayment and grace periods. This would overcome the problem of some of the MSEs using the loaned funds to pay the initial installments when

business is not in a form to generate income fast enough especially where the business undertakes some processing activity.

3. MFIs should let members form groups on their own or use the already existing groups involved in other social and development programs to ensure group cohesiveness.

5.5 Suggestions for Further Research

1. There is need to study the group social dynamics in the group lending methodology. Most respondents reported that initially when the groups are being formed they are very cohesive but when they start defaulting or getting different amounts of loans, animosity tends to develop among the group members and this affects the social interactions of the communities involved as well as their businesses.
2. There is a need for a study on the effects of the interest rates charged by MFIs on the performance of MSEs' businesses. A risk return relationship should be established to determine whether the expected return on investing the funds lent out by MFIs covers the cost of such funds as most of the MSEs studied stated that the interest rates charged are too high for the kind of activities they invest in.

3. A study should be carried out to establish what happens to the character and business performance of MSEs as they graduate from small loans to bigger loans. The MFIs explained that the various graduation levels are used to sieve their clientele. Thus it is important to establish whether there are any MSEs who start borrowing from the MFIs and graduate to borrow from formal banks and the rate of such graduation.

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APPENDICES

APPENDIX A

LIST OF SELECTED MICROFINANCE INSTITUIONS

1. Kenya Rural Enterprises Programmes - (K-Rep) Bank
2. K-Rep Development Agency
3. Kenya Women Finance Trust (KWFT)
4. Faulu Kenya
5. Pride Africa
6. Young Women Christian Association (YWCA)
7. Ecunemical Church Loan Fund (ECLOF)
8. Jitegemee Trust
9. The Co-operative Bank of Kenya
10. Post Bank
11. Small and Micro-Enterprise Programmes (SMEP)
12. Action Aid
13. Dandora Catholic Church - Welfare Advisory Services (WAC)
14. Hope Africa
15. Archdioceses of Nairobi
16. ADRA Kenya
17. Vintage Management Consultants
18. Kenya Commercial Banks- Special Loans Unit
19. United Disabled Persons of Kenya (UDPK)
20. Kenya Small Traders and Enterprise Society
21. Private Sector Development Unit
22. St. Johns Community Center
23. Undugu Society of Kenya
24. Family Finance
25. Trio Caire
26. Small Enterprises Credit Association
27. World Vision

28. Daraja Trust
29. Christian Health Association of Kenya
30. Skills Across Kenya

APPENDIX B

INTRODUCTORY LETTER

Margaret Rukwaro
C/o Faculty of Commerce
University of Nairobi
P.O. Box 30197
Nairobi
August 31, 2001

To whom it may concern

Dear Sir/Madam,

Ref: Request for Research Data - Credit Rationing by Micro Finance Institutions and Its Influence on the operations of Micro and Small Enterprises

I am a post graduate student at the University of Nairobi undertaking research in the Microenterprise sector with specific reference to credit rationing and its relationship to Micro and Small Enterprises operations. Your organization has been selected randomly for this study. I would greatly appreciate if you could provide the requested information in the questionnaire at your earliest convenience.

All responses are strictly confidential and are only used for research purposes into credit rationing and its influence to MSEs operations`.

Thanks.

Yours faithfully

Margaret Rukwaro

APPENDIX C

MICRO FINANCE INSTITUTION QUESTIONNAIRE

Background information

i. Name of MFI........................

ii. Form of MFI - NGO ☐ Bank ☐ Private Company ☐
Church ☐ Other (Specify)......

iii. When established ....

iv. Geographical area of operation --------------------

v. What proportion of your funds come from the following sources?
Foreign donors --------% Internal operations -----%
Borrowing-------% Others (Specify) ----------%

vi. Tick the type of business services offered to MSEs
Credit ☐ Training ☐ Any other (Specify) ....

vii. Tick the type of MSEs' operations financed by the MFI
Initial capital ☐ Additional capital ☐
Working capital ☐ Other (Specify)------------

viii. Tick the categories through which you lend funds to MSEs?
Groups -------% Individuals through a group ----%
Direct to the individual ---------------%

Credit Rationing

i. Do you ration credit? Yes/No

ii If yes give the reason for credit rationing
Lack of funds to give to the clients ☐
Lack of credible borrowers ☐
Need to introduce credit gradually ☐
Need to develop the management capability of the borrowers ☐ Any other (specify) ....

iii If no give the reason for not rationing credit

Have enough funds to meet borrowers requests ☐

Lack of enough borrowers ☐

Any other (specify)..................

iv. Tick the criteria used to lend to the borrowers in order of importance

1 Very important 2 Important 3 Least important 4 Not important

Viable business

Sound financial systems ☐

Proper books of accounts ☐

Profitable Business ☐

No debt outstanding ☐

Savings

Regular saving ☐ Saving as security ☐

Saving for onlending ☐

Saving as assurance that client can pay ☐

Group membership

Active group ☐

Memberships duration in the group ☐

Group cohesiveness ☐

Location of the business ☐

Particular nature of business ☐

Ability to pay their Interest and installments ☐

Others (Specify) ....

v. How many applications on average do you get annually?

vi. What is the average amount (Kenya Shillings) of requests per year? -------

vii. How many MSEs did you give credit in calendar year 2000?.........

Viii How much (Kenya Shillings) did you lend to MSEs in calendar year 2000? --------

ix What are your credit terms

Waiting period on applying for credit ----------

Interest rate ----- Repayment period ....

Periodic installment (weekly, monthly)------

Grace period................... Any other (Specify)...........

viii. Tick the percentage of entrepreneurs on average who pay periodic installment and applicable interest by the following time periods

On the due date............%.

Past the due date:

One week past due -----% One month past due..................%

Two months past due.........%

Three and above months past due ---- %

Before the due date:

One week before due date -----%

One month before due date ....%

Two months before due date.........%

Three and above months before the due dates----- %

ix. What action do you take on those who fail to pay as specified

Auction the business ☐ Reschedule the loan ☐

Deny any further credit ☐ Any other (Specify).........

Thank you for your assistance.

APPENDIX D

MICRO AND SMALL ENTERPRISE QUESTIONNAIRE

Background information

i. Name of business..............................

ii. Nature of business..............................

iii. Number of employees in your organization..............

iv. Tick the form of ownership

Sole proprietor ☐ Partnership ☐

Company ☐ Others Specify -------

v. Location of business..............................

vi. When established..............................

Financial needs and operations

i. Tick your business financial needs between January 2000 and June 2001

Initial capital equipment ☐

Additional capital ☐

Working capital ☐

Any other (Specify) ☐

ii. Tick your business expenses between January 2000-June 2001 in order of magnitude

1 Not paid 2 Low 3 Medium 4 High 5 Very high

Rent ☐ Water ☐ Electricity ☐ Stock ☐

Salary ☐ Capital ☐ Any other specify------

Sources of Finances

i. Tick the sources of finance for your business during January 2000 and June 2001

MFIs ☐ Friends and Relatives ☐

Business income ☐ Others (specify)-------

ii Indicate the percentage of finance from each source

MFIs -----% Friends and relatives ------%

Business income --------% Others (specify)-------

iii. Name of MFIs financing your business ----------------

iv. State the number of loans received from the major MFI that financed your business between January 2000 and June 2001

1 loan ☐ 2 loans ☐ 3 loans ☐

Over 3 loans ☐

v. Tick the amount of each credit requested from the MFI in year 2000 for each loan

	1st	2nd	3rd	4th
Less than Kshs. 20,000	☐	☐	☐	☐
Kshs. 20,000 to Kshs. 50,000	☐	☐	☐	☐
Over Kshs. 50,000	☐	☐	☐	☐

vi. What amount did you actually receive for each request in year 2000

	1st Loan	2nd Loan	3rd Loan	4th Loan
Amount Requested	☐	☐	☐	☐
Less than amount requested	☐	☐	☐	☐

vii What percentage of credit granted was utilised directly on the business ?

0 to 50% ☐ 51 to 80% ☐ 81-100% ☐

viii How much were the funds granted by the MFI in relation to your business financial requirements?

	1st loan	2nd loan	3rd loan	4th loan
Adequate	☐	☐	☐	☐
Inadequate	☐	☐	☐	☐

ix If inadequate, what other sources of funds were available to meet the shortfall

Other MFIs ☐ Friends and Relatives ☐

Personal saving ☐ Others specify-------

x If no other sources were available, how did you deal with the shortfall?............

xi Is the business income able to finance the periodic repayment including interest required by the MFI?

Yes/No

xii If No, indicate the percentage of the other sources of funds that finance the repayments including interest

Personal saving -----% Personal income -------%

Borrowing ------% Any other, (specify)------%

Thank you for your assistance.