ECONOMIC IMPLICATIONS OF LENDING OF MICRO FINANCE INSTITUTIONS ON MICRO AND SMALL ENTERPRISES IN KENYA

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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DEDICATION

To my wife Jane and Children who were very understanding when I would be a way for long hours, for their prayers and encouragement.

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ABBREVIATIONS:

ADEMI- Association para el Desarrollo de la Microempresa

AID- United States Agency for International Development

AMFIs- Association of Micro Finance Institutions

CBK- Central Bank of Kenya

CBS- Central Bureau of Statistics

GOK- Government of Kenya

MFIs- Micro Finance Institutions

MSEs- Micro and Small Enterprises

NGOs- Non Governmental Organizations

K-MAP- Kenya Management Assistance Programme.

K_REP- Kenya Rural Enterprise Program

SME- Small and Micro Enterprises

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ABSTRACT

The study was carried out to establish whether the credit schemes administered by MFI have an impact on MSEs performance in terms of parameters such as sales, net income, fixed assets, number of employees and space occupied by businesses.

The study established that MSEs that participated in the schemes achieved tremendous impact. The results showed that the MSEs which participated in the scheme longer and therefore took more number of loans experienced higher impact in the above-mentioned parameters.

Further, the study sought to establish whether MSEs which participate in the MFI credit schemes graduate to borrow from commercial banks upon attaining higher loan requirements than those offered by the MFIs and the rate of such graduation. The results obtained indicate that the rate of graduation is small despite the fact that many MSEs have attained the minimum loan levels that are obtainable from commercial banks.

The reasons for such low graduation rates include stringent bank requirements, which include collateral securities, guarantees, financial statements, interest rates and loan sizes. In addition to stringent bank requirements, other factors, which hinder graduation, include among other factors the fact that banks shun MSEs, entrepreneurs are afraid to go to banks, loan processing takes too long in banks.

Despite this apparent low rate of graduation, it is important to note that most MFIs are desirous of MSEs graduating from their schemes.

To promote graduation they train the entrepreneurs, provide them with incentives to enhance growth, monitor their business trends and recommend them to banks where applicable.

The study concludes that credit schemes provided by MFIs to MSEs have tremendous effect on MSEs performance. It further concludes that despite this impact, MSEs are hindered from graduating to borrowing from banks by various factors such as stringent bank requirements.

CHAPTER ONE

1.0 Introduction

1.1 Background

For a long time in Kenya, promotion of the micro and small enterprise (MSE) sector has been duly recognized as a viable and dynamic strategy for attainment of national goals such as job creation, poverty alleviation and development between diverse sectors. These form the cornerstones of a strong national industrial base and domestic production structure that are central to the Kenya Government's vision of achieving newly industrialized country status by the year 2020 (Mullei and Bokea, 1999).

This recognition has emanated from some of the social economic changes that have taken place in the operating environment in the last two decades or so.

Economic liberalization that was embraced in Kenya in the early 1990's soon started taking its toll in terms of collapse of local industries due to competition. To avoid total collapse, local enterprises started to down size their human resource requirements. This led to unemployment as most employees were laid off. Most of these staff took refuge in setting up micro enterprises to earn a living.

Funding of micro enterprises has been of great concern to various agencies in this country. These agencies include the Kenya Government, Non-Governmental Organizations, Donors, Multilateral organizations to mention but a few. To underlie the importance to this statement, the Government of Kenya has documented policy documents in that regard.

In the 1979 – 1983 Development Plan the Government of Kenya put forth a proposal that a credit scheme for Kenya Shillings 50 million be set aside for lending to small enterprises (GOK, 1979). The Sessional paper No. 1 of 1986, Economic Management for Renewed Growth, set out to create an enabling environment for MSEs. This was reinforced by 1986 GOK report on the Strategy for Small Enterprise Development which set out mechanisms for the removal of constraints to the Growth and development of the SME sector. A further effort by the Government was formation of a policy framework in sessional Paper

No. 3 of 1992, Small Enterprise and Jua Kali Development in Kenya. This paper sought to establish the necessary enabling environment for the development of the sector. The Development Plan for 1989 – 1993 declared "the Government would speed up the already initiated review of the local authorities by-laws and regulations that have proved restrictive to the development of MSEs. Further, the small enterprise policy implementation programme (SEPIP) mission report of 1994 was initiated to help Government formulate proposals that would translate the policy framework for small enterprise development as per sessional paper No. 2 of 1992 into concrete action.

The provision and delivery of financial services and credit to the sector by formal financial institutions has been below expectation (GOK, 2000). The 2001/2002 budgets revealed that only 10.4% of MSEs receive credit and other financial services from formal banking sector (GOK 2001) implying that 89.6% receive credit from the informal sector.

One of the outstanding funding agencies of MSEs in many decades has been the Micro Finance Institutions (MFIs) (GOK, 2000). MFIs mainly aim to provide credit and training facilities to MSEs so as to eradicate poverty.

Most of the MSEs rely on donor funds, as more often than not they are not financially viable to access commercial funds (Ledger wood, 1998). MFIs have thrived basically as a result of the formal financial sector shunning informal businesses as they consider them risky ventures.

The number of MFIs operating in Kenya has increased over the years since the 1972 ILO report. It is about time to pose and evaluate their achievements as financiers of MSEs. These achievements will be measured by how well off the MSEs that have been financed over time are. This is basically an impact analysis of MFI lending to MSEs.

Researches done in Latin America and the Caribbean have reported improved fortunes of MSEs that have participated in Credit Programs. Tremendous growth has been recorded in sales, income and employment rates (Stearns, 1989).

Other Researchers have gone further to find out what happens when the financial requirements of MSEs surpass the maximum amount of loans offered by MFIs- do they graduate to borrow from banks or formal financial Institutions? Graduation will certainly be one of the indicators of growth in this regard since it will imply the MSEs have attained the critical mass to meet the basic borrowing requirements of banks.

1.2 Statement of the problem

Provision of adequate credit to the informal sector has been identified as a critical vehicle for poverty alleviation (GOK, 2000). The credit is expected to lead to the enterprise growth, increased incomes, job creation, legalization and access to credit from formal financial institutions i.e. informal micro enterprises become formal businesses with a view to getting bank credit. Achievement of these expectations would be in line with MFIs goals, which have relently been financing these MSEs.

According to The Weekly Review (1998), MFIs have little to show on what they have achieved in financing the MSEs.

This statement is shared among many people in this country. From studies done in Honduras (1988) and Dominican Republic (1986), tremendous economic impact of Credit programs on MSEs has been recorded in terms of growth in sales, income, number of employees- is it any different locally?

In view of this, it has become imperative that a study be undertaken to ascertain the economic impact of MFIs' lending to MSEs. The study entails finding out whether MSEs on credit programs actually experience enterprise growth in terms of, among other variables, increase in sales, profits, fixed assets, employment and whether their financial requirements surpass those given in the programs and therefore graduate to seek finance from formal commercial banks which provide bigger loans than MFIs.

This country has seen a multiplicity of MSEs funding agencies operating for several decades now. One question, which has been lingering in the minds of many, is whether poverty alleviation, the main focus of the MFIs, is a mirage. Some observers have stated that these financiers have nothing to show for it (The Weekly Review, 1998).

Some researchers in this sector have studied the impact of credit on various economic variables like employment, increase in household income and enterprises output (Mutua and Oketch, 1991; Coppers & Lybrand, 1991). Others have studied capital and performance of SMEs in Kenya (Ondiege, 1996) and influence of credit rationing by MFIs on the operations of SMEs (Rukwaro, 2001)

No known study has been undertaken to assess the economic impact of these funding activities and on the rate of graduation of MSEs from borrowing from MFIs to borrowing from banks or formal financial Institutions.

Hypothesis

Null Hypothesis: The rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks is not significant.

Alternative Hypothesis: The rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks is significant.

1.3 Objectives of the study

The main objective of the study was to determine the effect of lending of MFIs to MSEs. The realization of this objective was anticipated to be through the following sub-objectives:

1. Determine the effect of the MFI credit schemes on the performance of MSEs.
2. Determine the rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks.

1.4 The importance of this study

Micro Finance Institutions

The study will help the understanding of whether graduation is a myth or it actually occurs and at what rate it is occurring. This is important to all MFIs that over the years have endeavored to finance these MSEs. It would boost their morale if they have actually made a difference for them.

Funding Agencies

The study will facilitate re-evaluation of programs by the funding agencies.

One of the things they may wish to revaluate is the amount lent or the methodology used. The study will help donors of MFIs as they assess the sustainability of these organizations.

Government and Policy Makers

The study will help the government and policy makers in their desire to create and facilitate favourable credit policies for MSEs. Requisite laws have not been enacted to regulate the micro finance industry. The findings of this study may trigger action in that direction.

Academicians

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

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

In recent years, the presence of micro-enterprises in all the major and secondary cities in the developing countries is no longer an issue of dispute among stakeholders.

In a World Bank study of lending for small micro enterprise projects, three objectives were more frequently cited (Webster, Riopelle and Child zero, 1996). These objectives are to create employment and income opportunities through the creation and expansion of micro enterprises, to increase the activity and incomes of vulnerable groups especially women and the poor and to reduce rural families dependence on drought – prove crops through diversification of their income generating activities.

A number of factors led to the growth in numbers of MFIs the world over such as Chronic unemployment, the apparently irreversible magnetic pull of the cities and the increasingly skewed income distribution patterns of many countries have placed on the development platter an enormous challenge: not only what to do about the growing mass of the self-employed, but more importantly, how to do it, and do it quickly and efficiently. (Otero, 1989)

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

In many developing countries the formal financial sector does not serve micro finance clients as they are viewed to be unprofitable. Little do they appreciate the demand for credit as an opportunity being missed (Robinson, 2001).

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

2.2 Definition of Terms

This section defines the terms and the terminologies used in the Micro Enterprise Sector.

Micro and Small Enterprises: A definition that could classify the enterprises on dimension of capital, employment 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 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.

Micro finance: Micro finance is defined by the Association of Micro Finance 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 Micro finance.

Graduation: of clients has a definition in three dimensions-the legal dimension which implies that a business fulfill all the requirements necessary to be a legally licensed enterprise, the social dimension which makes the personal development of the entrepreneur the focal point and the financial dimension which means an entrepreneur leave a credit program to become a client of the formal financial sector where he or she can seek financial services especially credit. The enterprise satisfies the collateral requirements of a bank and needs credit in sufficient amounts to make it profitable for the bank to lend to it (Stearns, 1989).

Micro credit: 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.

Impact Analysis: According to Otero (1993), an evaluation of the effect of financier's activities must consider three categories or types of impact namely the economic, social and employment. Economic impact is the changes in the life and the productive activity of a person resulting from a project intervention, which can be measured in monetary terms.

Social impact refers to those changes of a human development dimension without which the economic gains lose considerable thrust.

Impact on employment is the determination of whether the project has affected the employment potential of the micro-enterprise.

Operations: According to Johnstone (1997), these are resources and processes of organizations in producing goods and services for customers.

2.3 Sources of Funds for Micro and Small Enterprises

The assets of a business entity are financed by two sources of finance- Equity and/ or debt. Equity is made up of owners' share contributions and retained earnings whereas debt is provided by outsiders (Copeland and Weston 1992).

Bauman (1989) has identified sources of finance for MSEs to include Cooperatives, Credit Unions, Pawnshops, Rotating Savings and Credit Societies (ROSCAs) – both save and borrow, Regular (non-rotating) Savings and Credit associations (RESCAs) – members save but do not necessarily borrow, Mutual aid societies (Burial societies, self-help groups), Money Lenders who may be commodity sellers, shopkeepers, or landlords, employers and relatives, friends and neighbours for emergencies or special purposes rather than for ongoing working capital.

The 1999 National MSE Baseline Survey identified the sources of finance for MSEs as including; family sources, moneylenders, banks and NGOs.

Robinson (2001) has identified reasons for the vast unmet demand for Institutional Commercial Micro finance. She reckons that most people are misled as far as micro finance is concerned. They advise that formal institutions cannot provide micro finance profitably because of the high transaction costs the institutions would have to bear; warn of institutional risk because of asymmetric information, moral hazard and the adverse selection of borrowers, assert that institutions cannot compete successfully with the informal commercial credit markets, assume that low-income people cannot afford commercial loans and so require government or donor funded credit subsidies and think that low-income people are uneducated and backward and so unable to participate in the formal financial sector.

Meeting the demand for Institutional commercial Micro finance matters to MSEs, as it would lead to increase in their incomes, the entrepreneurs will send their children to school, increase in assets and eventually lead to the self-confidence of the entrepreneurs.

GOK (2000) has identified four main constraints that have impacted on MSEs. These are inadequate loanable funds for MSEs, stringent collateral requirements by commercial banks, lack of incentives for banks to lend and negative perception of MSEs by lending institutions.

2.4 Sources of Funds for MFIs

According to Ledger Wood (1999) the goal of MFIs as development organs is to service the financial needs of unserved or underserved markets as a means of meeting development objectives. These development objectives are to empower women and other disadvantaged population groups, to create employment, to help existing businesses grow or diversify their activities and to encourage the development of new businesses.

Robinson (2001) has identified sources of finance for MFIs as including; internally generated revenue, commercial loans, shareholders, savings and credit schemes. LedgerWood (1999) on the other hand has identified sources of finance for MFIs as including banks, international NGOs and non-bank financial intermediaries.

The CBK Report (2000) lists major sources of finance for MFIs to include the Government, donors, commercial banks and Cooperative Societies. Banks like Barclays, Cooperative Bank of Kenya, Kenya Commercial Bank have special sections to deal with micro lending. Lately, there are some banks in operation that have their main focus as micro finance. The leading one in this regard is K-Rep Bank Ltd.

The CBK report further notes that self-help groups (SHG) provide finances to MFIs through savings being surpluses from their income generating activities. These savings are then made available to MSEs as loans. In a recent study carried out by Rukwaro (2001), she found out that sources of finance for MFIs include foreign donors (20%), Internal Operations (20%), borrowing (25%) and savings (5%).

Khandker (1995), has identified the Bangladesh government as one of the major donors to some of the major financiers of MSEs in Bangladesh. One of these beneficiaries of Government donations is the Grameen Bank.

MFIs must harness adequate resources to enable them serve MSEs through provision of credit and other financial services like savings custodianship.

2.5 Operations of Micro and Small Enterprises

For a business to run smoothly, it must muster requisite resources. These resources include finances, the human capital, equipment and materials used in the production of goods and services. These resources have to be organized into processes so as to operate efficiently and effectively. Processes include location, design, layout and installation of equipment, sourcing of raw material, management of the human resource, production and distribution logistics. The processes must be synchronized to work so as to be able to produce products and the same to reach the consumer. Finances used in business processes constitute capital and working capital expenditure.

Packer (1993) noted that MSEs require finance to enable them make payments for services, license fees, working capital requirements, and as business capital both initial capital to start up and additional capital to be injected into the business.

Oketch and Kioko (1995) observe that most of the beneficiaries of loans from MFIs used their first loans to finance working capital (55.3%) while 10.6% used their first loans to acquire fixed assets. The authors further note that an increasing amount of second, third and subsequent loans are seemingly used to buy fixed assets such as land or to build houses (for personal use) or business premises.

2.6 Models for Funding Micro and Small Enterprises

According to Yoder (1993) the techniques of giving credit to MSEs have been changing. The techniques have changed from formal methods where credit appraisal is emphasized along with collateral to traditional moneylenders methods. MFIs in Kenya use diverse methods of micro finance 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 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 al 1995).

Yoder (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 the 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 MSEs (Dondo, 1994).

According to Dondo (1994), organizations give credit in two ways: individuals or through groups. Dondo (1994), Oketch (1995) and Yoder (1993) studies are consistent on the approaches used in Kenya to finance MSEs.

Though the Kenya 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.

2.7 Impact Assessment/Analysis

Micro finance impact analysis is the process by which one determines the effects of micro finance as an intervention aimed at for example reducing poverty. Rhyne (1992) observes that most entrepreneurs are poor when they obtain their first loan and that they become less poor as a result of borrowing and using the loan in the business. But a situation whereby they are stuck, cycle after cycle, earning low returns will certainly not be desirable.

Rhyne (1992) notes that for the most part, evaluations of credit programs are still based on the old-view ideas about causality. They are centered on the presumption of a direct line of causation between receipt of credit by individual borrowing and a particular desired response, for example, changed borrowers income resulting directly from receipt of a particular loan.

Further, Rhyne (1992) identifies the likely users of impact analysis as micro finance practitioners, donors, policymakers and academics.

The impact on credit programs can be economic, sociopolitical or cultural and personal or psychological. For the purpose of this study emphasis will be laid on the economic impact on the MSE in particular look for business expansion or transformation of the enterprise.

A number of studies have been carried out to ascertain the impact of credit programs on MSEs

Some of the variables that have been investigated are indicators of change on the enterprise increased or improved production, fixed assets, working capital, inventory, credit availability and its use, level of purchases and sales, net profit, organization of the work place – adequacy of arrangement of the work place, locale improvement, additions to the work place that enhance productive capacity (Otero, 1989).

Impact assessment studies done in Honduras (Tegucigalpa and Choluteca) revealed some interesting findings. A study undertaken in Tegucigalpa which involved a survey of 85 micro-enterprise firms in the Capital City as the basis for an impact evaluation revealed that carpenters, seamstress, tailors and shoemakers made up the bulk of those surveyed (Reichmann, 1988). Each firm received an average of $820 in working capital over a one-year period; when the baseline data was compared with the survey information, it yielded the following results: - the added working capital enabled 62% of those surveyed to increase their sales, and nearly all of these – 50% of the surveyed experienced increases in income. The average in income among all borrowers was 27% (an average increase of $54 per month) though there appeared to be no correlation between size of firm or type of activity and positive changes. For every enterprise assisted with an average of $820 in working capital loans, 0.75 full-time jobs were created that is for every four micro-enterprises assisted over a period of about one year, three new full-time jobs were created. The second study was undertaken in Choluteca – South of Honduras. A sample of 50 MSEs chosen took into account the number of loans and amount received as measures of the length of time each firm had participated in the program; a representative distribution of types of activities for that area; and a representative number of women. The 50 persons surveyed fall into three categories: twelve had received one to three loans, or an average of $785, and had been in the program on an average of ten months; twenty-six received four to five loans averaging $1,195 over a 14-month period. the remaining twelve received six to seven loans averaging $1,825 over a 19-month period.

The results were that 82% experienced average sales doubling while 86% of those surveyed recorded an increase in income. The greatest changes were in among those that had received six to seven loans in which 92% considered that they lived better due to their participation in the program, 50% used additional income for food, health, education and home improvement.

Another such study was carried out in the Dominican Republic by ADEMI from January to December 1986. The study centered on the effect of borrowing by MSEs on variables as fixed Assets, sales, savings, salaries and employment. Some of the major results are that fixed assets recorded an increase of between 8% and 50%; sales increased between 18% and 54%; employment increased by between 2% and 27%; savings by participating MSEs increased by between 543% and 62347%.

The study concludes that the program has had positive short-term effect on the beneficiaries.

Mosley (2000) asserted that micro finance makes a considerable contribution to the reduction of poverty. He finds significant increases in incomes and assets for micro finance clients relative to their non-borrowing counterparts.

According to CGAP (2003), microfinance allows poor people to protect, diversify, and increase their sources of income, the essential path out of poverty and hunger. The ability to borrow a small amount of money to take advantage of a business opportunity, to pay for school fees, or to bridge a cash-flow gap can be a first step in breaking the cycle of poverty. Similarly poor households will use a safe, convenient savings account to accumulate enough cash to buy assets such as inventory for a small business enterprise, to fix a leaky roof, to pay for health care, or to send more children to school.

Microfinance also helps safeguard poor households against the extreme vulnerability that characterizes their everyday existence. Loans, savings, and insurance help smooth out income fluctuations and maintain consumption levels even during lean periods. The availability of financial services acts as a buffer for sudden emergencies, business risks, seasonal slumps, or events, such as a flood or a death in the family that can push a poor family into destitution (CGAP, 2003)

According to CGAP (2003), various studies, both quantitative and qualitative, document increases in income and assets and decreases in vulnerability of microfinance clients. Here below are findings from some of the studies.

Barbara MkNelly and Chris Dunford report that the incomes of two-thirds of CRECER (Bolivia) clients had increased after joining the program. Moreover clients reported, "consumption smoothing" over the year as a result of diversifying income sources and purchasing food in bulk. 86 percent of clients said their savings had increased; 78 percent did not have any savings prior to program participation.

In another study of Freedom form Hunger clients in Ghana, MkNelly and Dunford found that clients had increased their incomes by $36 compared to $18 for non-clients. Clients had also significantly diversified their income sources. 80 percent of clients had secondary sources of income versus 50 percent of non-clients.

In Indonesia borrowers increased their incomes by 12.9 percent compared to increases of 3 percent in control-group incomes. Another study on Bank Rakyat Indonesia borrowers on the

Island of Lombok in Indonesia reports that the average incomes of clients had increased by 112 percent and that 90 percent of households had moved out of poverty.

A study of SHARE clients in India documented that three-fourths of clients who participated in the program for longer periods saw significant improvements in their economic well-being (based on sources of income, ownership of productive assets, housing conditions, and household dependency ratio) and that half of the clients graduated out of poverty. There was a marked shift in employment patterns of clients-from irregular, low-paid daily labor to diversified sources of earnings, increased employment of family members, and a strong reliance on small business. Over half of SHARE clients indicated that they had used their microenterprise profits to pay for major social events rather than go into debt to meet such obligations.

In 1997-1999, there was a downward trend in food expenditures in Zimbabwe. This was probably a cash-management strategy to cope with the rising cost of living. Participation in the Zambuko Trust, however, led to a positive impact on the consumption of high protein foods (meat, fish, chicken, and milk) for extremely poor client households.

A detailed impact assessment study of BRAC in Bangladesh suggested that members who stayed in the program for more than four years increased household expenses by 28 percent and assets by 112 percent. Another analysis of household level data demonstrated that access to financial services enabled BRAC clients to reduce their vulnerability through smoothing consumption, building assets, and receiving services during natural disasters.

A comprehensive study of microfinance conducted by the World Bank in the early 1990s on three of the largest programs in Bangladesh-Grameen Bank, BRAC, and RD-12-found that female clients increased household consumption by 18 takas for every 100 takas borrowed, and that 5 percent of clients graduated out of poverty each year by borrowing and participating in microfinance programs. More importantly households were able to sustain these gains over time. There were also spillover effects in the village economy. Average rural household incomes in program villages increased even for non-program households. One of the programs even influenced village wage rates. Increases in self-employment and subsequent withdrawals from informal labor pools led to a 21 percent increase in wages in the program villages.

An important, earlier study of the Grameen Bank also found statistical evidence of economic welfare. The incomes of Grameen members were 43 percent higher than incomes of control groups in non-program villages and 28 percent higher than non-members in Grameen villages. Grameen members were also able to rely more on savings and their own funds to cope with crises rather than borrow from moneylenders. Wage rates in program villages increased as well.

2.8 Graduation

The issue of graduation of program MSEs may be a good indicator of growth for them as they are financed by MFIs. They would start borrowing small loans and the loan sizes would increase leading to growth in assets. Eventually, they would outgrow the maximum amount of loans granted by the MFIs and this would necessitate borrowing from formal financial institutions like banks that normally lend bigger amounts than MFIs. At this stage, the MSEs would be expected to satisfy all bank requirements for bank credit including collaterals, (Stearns, 1989).

Otero (1991) observes that the graduation of beneficiaries from credit or Solidarity Group programs depends, in part, on the policies and goals of each MFI. As a general concept, graduation implies that an MSE leaves the Program to seek credit and training from other sources. It assumes that a borrower has undergone social and economic growth through participation in the programs, but has not moved out of an informal sector activity to become part of the formal sector.

Otero (1991) further notes that MFIs or Solidarity Group Programs give three reasons for graduating participants. These reasons are that the MSEs credit needs surpass the MFI's established maximum and continuation in the program constrains the productive activity of the enterprise, graduation increases the MFIs ability to bring new MSEs into the program who are at a much lower level of capitalization and need small loans and finally that graduation encourages program participants to become more self-reliant by turning to other sources of training and credit rather than developing a dependency relationship with the program.

To continue reaching the smallest and poorest among micro entrepreneurs, the Institution must gradually release those participants whose acquired level of investment and skills warrant additional resources.

Some studies have been done to establish the rate of graduation of MSEs from credit programs. Katherine Stearns (1989) did one such a study in Latin America and the Caribbean. To determine the frequency of client graduation from micro enterprise credit programs, information was gathered from ten micro enterprise programs in Latin America and the Caribbean through a questionnaire. Four of these enterprises operate in Costa Rica whereas the other through conversations with program directors administered the questionnaire. The remaining six programs in this study are in Guatemala, Bolivia, Dominican Republic, Mexico and Paraguay and are affiliated to ACCION International/AITEC (Stearns, 1989)

Some of the programs work through solidarity groups of three to five entrepreneurs that join together to guarantee a loan. Other programs extend individual loans and others use both modalities. Initial loans are generally small for short periods of time and subsequent loans increase both in amount and payback period and are disbursed automatically upon prompt repayment of the prior loan. Interest rates are generally equal to or higher than commercial rates in each country.

Findings regarding graduation

Out of 16000 micro entrepreneurs, 287 (1.8%) entrepreneurs have gone on to formal sources of credit and nearly half of those (0.9%) continue to participate in the various programs.

These findings are similar to those obtained by Tendler (1983) in the study of UNO Programs in Brazil and Jim Boomgard's 1989 study of AID-Supported micro enterprises programs world-wide. They found that graduating clients to formal financial institutions is quite uncommon (Tendler, 1983; Boomgard, 1989; Blayners and Otero, 1985).

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

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

3.1 Research Design

A survey method was employed in this study.

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 over the years.

3.3 Accessible Population

Accordingly to K-Rep (1997) most of the MFIs are concentrated in Nairobi.

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. The population frame for the study was all MSEs financed by MFIs in Nairobi. The MFIs located in Nairobi and with credit programs formed the sampling frame.

3.4 Sampling Plan

A random sample of MFIs was selected from the sampling frame using random numbers This was to ensure equal chance that each MFI was be selected and therefore minimize sampling bias.

Due to the large number and informal nature of the MSEs cluster sampling was used to select them. 100 MSEs were selected. The MFIs to be studied were clustered under church, bank, NGO and company. At least one MFI from each category was randomly selected. Care was observed that proportional representation from each cluster was taken. The selected MFIs gave the researcher the days that their clients held meetings. The researcher attended these meetings and randomly selected a representative sample of MSEs that had received a loan(s) from the time the credit program commenced from each MFI. Both new entrant MSEs and old MSEs which had participated in the credit programs for long were selected for reasons explained in section 3.5 below.

3.5 Data Types, Sources and Collection Procedures

The study employed primary and secondary data. The primary data was collected by use of a semi-structured questionnaire The primary data obtained from MFIs included: MFI background (name, location and ownership), sources of funds, amount of loan disbursed, lending limits (if any), number of customers requiring more loans than they are able to lend, whether graduation is one of their goals, the number of MSEs which have graduated to banks, factors that determine graduation. The drop and pick method was used to collect data from the Credit Officers of MFIs.

The primary data that was 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, how they utilized loans received, growth of sales, fixed assets, net profit (Income).

In order to make more informed conclusions as to the implications of lending by MFIs to MSEs, it was necessary to have a control group which had not participated in the credit programs. The control group consisted of those MSEs joining the credit programs just before they start borrowing. The experimental group was those MSEs that were established at the same time as the control group but have participated in the credit programs for some time. Therefore a comparison has been made between 'agemates' of MSEs in the control group and experimental group in Section 4 below.

To solicit the pertinent data, a semi-structured questionnaire was administered to the MSEs.

Where the respondents had time, the researcher held discussions with a view to obtaining as much information related to the study as possible.

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 has been presented using tables.

The data has been analyzed using descriptive statistics (mode, mean, frequencies and percentages and inferential statistics. Descriptive statistics has enabled researcher to describe the distribution of the various variables in the study. The simple arithmetic average was used to establish the relationship set out in the hypothesis. Comparative analysis has been done to identify differences among MSEs that borrow from different clusters of MFIs: church, bank, NGOs and company.

Further comparative analysis has been done between the control group of MSEs and the experimental group of those MSEs that have participated in the credit programs and inferences drawn from the data collected.

CHAPTER FOUR

4.0 DATA ANALYSIS AND INTERPRETATIONS

This chapter presents data on economic impact of credit programs and the graduation of MSEs from borrowing from MFIs to banks. The study had two objectives namely to determine the effect of the MFIs credit schemes on the performance of MSEs and to determine the rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks.

Data was collected from the field and was presented, analyzed and interpreted under data collection and response rate; background (general information) of the studied MFIs and MSEs; MSEs business activities; financial needs operations of MSEs; impact on credit programs; experience on graduation of clients from MFIs to commercial Banks and finally testing and accepting the null hypothesis that the rate of graduation is actually not significant.

4.1 Data collection and Response Rate

As indicated in Table 1, 25 out of 35 selected MFIs responded to the questionnaire representing a 72% response rate, implying that 28% of the questionnaires were not received. The 72% response rate is considered adequate for drawing conclusions on the study. The reason for non response include suspicion that the information being sought could be used for other purposes other than academic purposes, lack of policy by institutions on what or who to give the information and lack of information due to poor Information Systems (MIS).

Table 1: Response Rate of MFIs and MSEs

Respondents	Number of questionnaires		Percentage		Total	
	Received	Not received	Received	Not Received		
MFIs	25	10	72	28	35	100%
MSEs	75	25	75	25	100	100%

Source: Research Data

100 questionnaires were administered to MSEs at either business locations or during their weekly/monthly meetings. 75 questionnaires out of the 100 administered to the MSEs were received representing a response rate of 75% (Table 1), which was considered adequate as a basis for deriving conclusions on the study. The non-response on the part of some MSEs is attributed to lack of records, fear that the information could be used against them by MFIs, illiteracy and lack of time to respond to the questionnaire.

The findings and conclusions were based on the 72 per cent and 75 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, kind of client's activities and the source 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 2.

Table 2 shows that the MFIs take different forms. However, the majority are NGOs (56%), followed by companies (16%), Church related MFIs (12%), Banks (8%) and others such as sole proprietorships constituted (8%) of the MFIs.

The provision of micro credit services is therefore dominated by NGOs.

Table 2: Form of Organizational Base of MFIs

Form	Frequency	Percentage (%)
NGOS	14	56
Banks	2	8
Company	4	16
Church	3	12
Others	2	8
Total	25	100

Source: Research Data

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 (25 %), internal operations (33 %), borrowing from banks (17 %) members' savings (17 %) while 8% is obtained from other sources such as shareholders. Table 3 shows that on average, the highest proportion of finances was from internal operations (33%) and the least were from other sources such as shareholders (8%).

Table 3:Average Sources of Finance for the MFIs

Source	Mean Percentage of the Finances
Foreign donors	25
Internal operations	33
Savings	17
Banks	17
Other (E.g. Shareholders)	8
Total	100

Source: Research Data

According to MFIs the internal operations involved operating revolving funds that resulted from credit programs that were initially funded by donors. The donors later pulled out of the programs leaving the MFIs to operate on their own. Increasingly, at the time of cash flow problems, they turn to banks to borrow short term to finance their customer needs (17 %). Other sources of finance include shareholders capital injection into the MFIs. The low proportion of members' deposits was explained by the fact that part of their savings are deposited with banks.

Apart from giving credit to MSEs, 62 per cent of the MFIs also give business training while 24 per cent participate in welfare development programs, for example, in health and agriculture and 30% offer savings services (Table 4).

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.

Table 4: Other Services Offered by MFIs to MSEs

Type of Service	Frequency	Percentage
Savings	8	30
Training	16	62
Welfare/Development programs	6	24
Other	3	12

Source: Research Data

Some of the MFIs surveyed have both individual and groups-based clients (solidarity credit schemes). Others deal exclusively with either solidarity groups or individual clients. Table summaries this information

Table 5: Nature of Clients

Nature of clients	**MSEs (clients)**		**MFIs offering services**
	Number	Percentage	
Individual	29,628	22	4
Solidarity groups	104,789	78	23
Total	134,417	100	27*

Source: Research Data

*Two MFIs offer both individual and solidarity based group programs.

The study also sought to find out whether availability of funds is a constraint to their lending activities.

The findings are tabulated in Table 6 below.

Table 6: Funds Availability as a Constraint

Answer	Frequency	Percentage
Yes	4	17
No	21	83
Total	25	100

Source: Research Data

The study therefore revealed that 83 % of the MFIs did not think availability of funds is a constraint to their lending activities.

The study established further that about ten thousand MSEs have loans big enough to qualify for bank credit. For the purposes of the study loan size to qualify for bank credit was taken to be Sh 200,000. The study established that out of the ten thousand customers with loans big enough to qualify for a bank loan, 32% had attempted to get a bank loan out which only 13% managed to obtain a bank loan. 68% of those who qualify had never attempted to get a bank loan.

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 seem to be thriving in low-income areas like slums, namely Kangemi, Kariobangi, Dandora, Kawangare and Kibera. The businesses were established through the initiatives of the entrepreneurs and many of them had evolved from one type of business to another or an entrepreneur could diversify into several other activities.

The businesses were either sole proprietorship (84%) and run by the family or partnerships (16%). Thus all the businesses selected were micro enterprises that were participating in Solidarity Group Credit Schemes. Those operating as individuals were rare and did not form part of this study.

4.2.2.1 MSEs Business Activities

The activities of the MSEs varied from hotel to manufacturing of simple items like soap. The following table summarizes the activities.

Table 7: Type of Businesses Undertaken by MSEs

Business	Frequency	Percentage
Hotel/Butchery	18	24
Suppliers of educational materials	10	13
Transport	9	12
Manufacturing	8	11
Salon / Boutique	8	11
Hardware	10	13
Retail	12	16
Total	75	100

Source: Research Data

The most popular activities included, hotel/butchery (24%), retail (16 %), supply of educational materials (13 %), hardware (13 %). Other business activities included general shop business, manufacturing of furniture (11 %), and salon and boutique (11 %).

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

4.2.2.2 Operations, Financial Needs and Sources of Finance for MSEs

Most of MSEs are operating in the informal sector. That they are required to have operating licenses which they pay for and display at their workstations. Those in permanent premises meet operating costs like utilities. They from time to time expend Monies on working capital, fixed assets and personal maintenance like buying food for their families.

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 8.

The Table shows that 55 per cent of MSEs' finances is from MFIs, 20 per cent from personal savings, 10 per cent from friends and relatives and 15 per cent from business income.

Table 8: MSEs Sources of Finance

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

Source: Research Data

The MSEs surveyed indicated that MSEs sometimes obtain loans from more than one MFI (27 %) while 73 % indicated that they deal with only one MFI.

This is partly attributed to the fact that 55 % of the respondents think that the loans granted by MFIs are inadequate whereas 45 % think they are adequate. Again from the study we note that they also get business finance from friends and relatives (10 %) and business income (15 %). Some of the respondents (20%) indicated that they receive finance from personal savings made from other activities that they are involved in like farming.

Table 9: Utilization of Various Loans Received by MSEs.

	Loan usage (%)						
Utilization	1st	2nd	3rd	4th	5th	6th & above	Average
Fixed Assets	28	26	28	34	35	45	33
Working Capital	49	49	45	37	44	39	44
Personal needs	14	12	12	18	17	9	13
Others	9	13	15	11	3	8	10

Source: Research data

These results indicate that the loans advanced mainly go towards boosting working capital (44 %), purchase of fixed assets (33 %), personal consumption (14 %) and other needs (10%). It is important to note that expenditure on fixed assets went up each time new loans were received. The reason for this is that MSEs start acquiring assets like motor vehicles and land as they continue in business. In this kind of businesses it is difficult to separate the business from the entrepreneur.

Utilization of loans on the other parameters remained relatively stable with minor fluctuations from the average.

When entrepreneurs (respondents) were asked whether they considered their living conditions having changed since they started participating in credit programs, their responses are as shown in the following table:

Table 10: Status of Living Conditions

Living conditions	Frequency	Percentage (%)
Improved	64	85
Remained the same	0	0
Worsened	11	15
Total	75	100%

Source: Research Data

The study revealed that the majority (85%) of the respondents feel their living conditions have improved. However the researcher was curious to find out what happened to those who feel their living conditions had worsened. The reason given was that when fires broke out in some locations in Nairobi some time back, they were unfortunate to lose their business stocks. They had to start anew. There were no insurance arrangements for their informal businesses to make good their losses.

Others indicated that calamities like death stuck in their families and they had to spend a lot of business resources to handle the same.

The study also sought to establish whether the period taken before the MSEs received loans had any effect on their growth economically.

Table 11:Period Taken from Establishment to Receiving Loans

Period inception to taking 1st loan	Frequency	Percentage (%)
0 – 6 months	5	7
6 - 12 months	19	25
1 – 2 years	20	27
3 years and above	31	41
Total	75	100

Source: Research Data

The findings indicate that 7% of the MSEs waited for six months or less, 25% between half and one year, 27% between one year and two years while 41% of the MSEs waited for over three years before taking a loan.

The respondents were also requested to indicate how many loans they had taken The results were as follows:

Table 12: Number of Loans Taken by MSEs

No. Of loans	Frequency	Percentage (%)
0 – 1	13	18
2 – 3	30	41
4 – 6	24	30
Over 6	8	11
Total	75	100

Source: Research Data

The research findings reveal that 18% of the MSEs had taken zero or one loan, 41% had taken two to three loans, 30% had taken between four and six loans while 11% had taken more than six loans.

Table 13: Length of Time from when Established to when they Started Participating in Credit Programs.

Year Established	When started participating in Credit Programs (%)				
	0-6 Months	6-12 Months	1-2 Years	3 years and Over	Total
1985 – 1990	17	-	-	83	100
1991 – 1995	-	14	29	57	100
1996 – 1999	-	27	64	10	100
2000 – 2003 (May)	-	64	36	-	100

Source: Research Data

The study revealed that of the MSEs that started operating between 1985 and 1990, 17% received loans within six (6) months since operation and 83% from three years. Of those that were established between 1991 and 1995, 14% received loans within 6-12 months, 29% within 1 – 2 years and 57% from three years.

Of those that were established between1996 to 1999, 27% received loans within 6 – 12 months, 64% within 1 – 2 years and 10% from three years.

Of those that were established from 2000 to 2003, 64% started receiving loans within 6 – 12 months and 36% within 1 – 2 years.

Table 14: Other Products in the Market that MSEs would like their MFI to Offer

Product	Frequency	Percentage (%)
School loan scheme	27	36
Medical scheme	9	12
Low interest rates	12	16
Training	17	23
Insurance scheme	10	13
Total	75	100

Source: Research data

The study also sought to find out whether MFIs provide all products that MSEs desire.

Table 14 indicates that of the total respondents 36% felt that MFIs should offer a school loan scheme, 12% felt they should offer a medical scheme, 16% felt that they should lower interest rates, 23% felt that they should offer training services to MSEs and 13% felt they should offer an insurance scheme.

4.3 Impact Analysis

The study aimed at finding out whether credit programs have economic impact on the performance of MSEs that participate in them. Table 15 shows the results of the study.

Table 15: Change in Performance After Participation in Credit Programs

Parameter	Before Loan	After Loan(s)	Percentage Growth (%)
Sales (Shs.'000'	37,587	51,566	37
Fixed assets (Shs.'000')	15,710	25,566	63
Net profit (shs'000')	13,699	22,292	63
Savings (shs'000')	2,581	3,925	52
No. of employees	108	182	69
Space occupied (square ft)	926,114	1,125,605	21
Average			50.8

Source: Research Data

The study reveals that of the MSEs' sales, fixed assets, net profit, savings, number of employees and space occupied grew by 37%, 63%, 63%, and 52%, 69% and 21% respectively. The highest growth was therefore on the number of employees whereas the least growth was on space occupied by the businesses.

Further analysis of the impact based on the type of business revealed the following results in the table below:

Table 16: Type of Business Activity and Impact of Credit Programs

Nature of Business	Growth (%)				
	Sales	Fixed Assets	Net Income	No. Of Employees	
Hotel/Butchery	48	53	92	132	73
Supplies of Education and Materials	33	113	24	0	24
Transport	6	52	25	25	27
Manufacturing	150	74	99	168	38
Salon/Boutique	81	81	78	18	109
Retail & Others	45	31	73	72	42
Hardware	19	56	42	28	41

Source: Research data

The table indicates that impact on sales based on the nature of business was that manufacturing experienced the highest (150%), followed by salon/Boutique (81%), Hotel/butchery (48%), Retail (45%), supplies of educative materials (33%), hardware (19%) and transport (6%).

The highest impact on fixed assets was in supplies of education materials (113%), followed by salon/boutique (81%), manufacturing (74%), hardware (54%), hotel/butchery (53%) and retail (31%).

The highest impact on net income was in manufacturing (99%), followed by hotel/butchery (92%), salon/boutique (78%), retail (73%), hardware (42%), transport (26%) and supplies of education materials (22%).

The highest impact on number of employees was in manufacturing (168%), followed by hotel/butchery (132%), retail (72%), hardware (28%), transport (25%), salon/boutique (18%) and supplies of education materials (0%).

The highest impact on the savings was in salon/Boutique (109%), followed by hotel/butchery (73%), Retail (42%), hardware (41%), manufacturing (38%), transport (27%) and supplies of education materials (24%).

Table 17: Length of Time from Establishment to Time the MSEs Started Participating in Credit Schemes.

	GROWTH (%)				
Operation period before Receiving loan	Sales	Fixed Assets	Net Income	No. Of Employees	Savings
0 – 6 months	139	114	96	97	88
6 – 12 months	62	96	82	81	63
1 – 2 years	31	72	65	66	55
3 and over years	10	29	44	60	38

Source: Research data

The study reveals that the sooner MSEs entered into the credit programs, the higher the impact. In other words, participation in credit programs from early periods of MSEs establishment resulted in higher growth i.e. impact. As indicated above, MSEs which entered into the credit program within the first six months recorded the greatest increase in sales (139%), fixed assets (114%), net Income (96%) number of employees (97%) and savings (88%).

Table 18: Impact of Number of Loans Taken

No. Of Loans	GROWTH (%)				
	Sales	Fixed Assets	Net Income	No. Of Employees	Savings
0 – 1	27	71	44	47	38
2 – 3	32	55	55	59	43
4 – 6	39	52	73	82	61
Over 6	66	113	97	107	84

Source: Research data

The study shows that those MSEs that have borrowed more loans experienced higher impact on a number of parameters under study.

As indicated above MSEs that had borrowed up to one loan, 2-3 loans, 4-6 loans and over 6 loans experienced growth in sales of 27%, 32%, 39% and 66% respectively. MSEs that had borrowed up to one loan, 2-3 loans, 4-6 loans and over 6 loans experienced growth in fixed assets of 71%, 55%, 52% and 113% respectively. MSEs that had borrowed up to one loan, 2-3 loans, 4-6 loans and over six loans experienced growth in net income of 44%, 55%, 73% and 97% respectively. MSEs that had borrowed up to one loan, 2-3 loans, 4-6 loans and over 6 loans experienced growth in number of employees of 47%, 59%, 82% and 107% respectively. MSEs that had borrowed up to one loan, 2-3 loans, 4-6 loans and over six loans experienced growth in savings of 38%, 43%, 61% and 84% respectively.

Impact comparison between MSEs that were founded at the same time but started participating in credit programs at different times was made. The table 19 shows the results.

Table 19: Impact Based on Year of Establishment

Year Established	Period started participating after established	Frequency	Growth (%)				
			Sales	Fixed Assets	Net Income	Savings	No. of Employees
1986	0 – 6 months	3	185	160	158	195	149
	3 years & over	4	126	152	132	156	133
1992	6 – 12 months	5	151	148	127	134	132
	1 – 2 years	6	148	120	111	134	130
	3 years & over	4	118	122	108	120	130
1996	6 – 12 months	5	84	66	51	80	81
	1- 2 years	7	60	71	42	69	51
	3 years & over	4	29	43	35	51	42
2000	6 – 12 months	4	30	42	38	38	32
	1 – 2 years	5	35	18	31	30	10
	3 years & over	5	6	15	28	9	0

Source: Research data

The study revealed that MSEs that were established at the same time ("age mates") experienced different rates of growth in the various parameters under review. Those that participated in the programmes for longer periods since establishment experienced higher growth.

Thus sales grew by 185% for MSEs that were established earliest in 1986 and the growth decreased to 6% for established in year 2000.

Fixed assets grew by 160% for MSEs that were established in 1986 and the growth decreased to 15% for MS Es established in year 2000. Net incomes grew by 158% for MSEs that were established in 1986 and the growth decreased to 28% for MS Es established in year 2000.

Savings grew by 195% for MSEs that were established in 1986 and the growth decreased to 9% for MS Es established in year 2000.

Number of employees grew by 149% for MSEs that were established in 1986 and the growth decreased to 0% for MS Es established in year 2000.

Thus the higher growth can be attributed to the credit schemes

4.4 Experience with Graduation

The aim of this section was to collect data on whether MFIs had experienced graduation of Clients from the group-based loans, which are small, to banks which offer bigger loans.

The study revealed that a total of 104,789 group based clients joined and borrowed from the various credit programs offered by the MFIs from inception to 31st May 2003.

Out of this, 56,120 were women. This represents 54% of the total clients.

The study revealed further that out of the 104,789 clients only a party 528 graduated from groups to borrow as individuals from banks out of which 80% still continue to participate in the programmes.

When asked what the MFIs have done for banks to accept the graduating MSEs, the results were as follows:

Table 20: Effort to Promote Graduation

Factor	Frequency	%
Training business people	8	33
Giving recommendations for those who qualify	4	15
Giving incentives to business people	7	30
Monitoring the trend of the businesses	6	22
Total	25	100

Source: Research Data

The study therefore reveals that there is deliberate attempt by MFIs to enable the MSEs to graduate to borrow from banks. 33% of the respondents indicated that they offer training services to their clients in addition to loans, 30% give incentives to them, 22% monitor their business trends and 15% give recommendations for the clients to get loans from banks. They however indicated that their recommendations do not guarantee a customer to get a loan.

The incentives cited that are given to customers to grow include gifts for the best loan payers, highest savers, trophies for the members of groups with the best attendance record and so on.

The importance the MFIs attach to graduation is epitomized by the high rate of positive response as revealed by this study. To the question as to whether graduation was a goal from the beginning revealed that 83% had it as a goal and still remains so while 17% did not have it as a goal.

The respondents were requested to state what conditions they thought were difficult to be met by MSEs starting with the most difficult. The results were as tabulated below:

Table 21: Difficult Bank Requirements for MSEs (Clients) to Meet

Factor	Rank	Frequency (%)
Collateral	1	40
Guarantee	2	60
Financial Statements	3	40
High Interest rate	4	60
Low loan size required	5	40
Other	6	40

Source: Research Data

The study reveals that 40% of the respondents identified collateral as the most difficult condition of bank requirements that most of their clients fail to meet and low loan size required as the least difficult of the specific conditions.

Further, the respondents were requested to rank various factors (from the most important to the least) that are thought to hinder graduation over and above bank requirements. The results were as in table 22.

Table 22: Other Factors that Hinder Graduation

Factor	Rank	Frequency (%)
Bank shun MSEs	1	80
Entrepreneurs are afraid to go to the bank	2	80
Banks take too long to analyze a loan application	3	80
Entrepreneurs financial needs are adequately catered for	4	60
Culture or religion	5	60
Illiquidity of MFIs	6	80
Other factors	7	80

Accordingly, the respondents felt that the most important of these factors is that banks shun MSEs (80%). They rated unavailability of loanable funds or illiquidity of MFIs as least important of the specified factors (80%).

Respondents (MFIs) were further requested to comment on comparative interest rates and period taken to process loans between MFIs and banks. Their responses were as tabulated here below.

Table 23: Average Period Required to Process a Loan in Banks

Period	Percentage of MSEs	
	Bank	MFI
0 – 7 days	10	33
7 – 14 days	10	40
14 – 21 days	12	12
21 – 28 days	30	12
Over 30 days	38	3
TOTAL	100	100

Source: Research data

The study revealed that, in general, MFIs (100%) belief they process loans faster than banks. The interest rates charged by banks were thought to be lower on average than those charged by MFIs.

4.5 Testing of hypothesis

The hypotheses that were put forth for testing are:

Null hypothesis HO: - The rate of graduation of MSEs from borrowing from MFIs to borrowing from banks is not significant.

Alternative Hypothesis HA: The rate of graduation of MSEs from borrowing from MFIs to borrowing from banks is significant.

Test statistics: - The arithmetic average of MSEs that have graduated as a percentage of the total number of MSEs that had joined the Credit Schemes surveyed is given by:

$$\text{Overall, Rate: } \frac{528}{104{,}789} = 0.5\%$$

This study indicates that of the total MSEs that had participated in the credit programmes only 0.5% had graduated from borrowing from MFIs to borrowing from banks. This rate is certainly low. The study therefore proves and accepts the null hypothesis that the rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks is not significant.
Further, the study established that most of the graduated MSEs were from bank MFIs (57%), followed by those from NGO MFIs (36%) and Church affiliated MFIs (7%).

CHAPTER FIVE: SUMMARY OF RESEARCH FINDINGS AND CONCLUSIONS RECOMMMENDATIONS, LIMITATIONS OF THE STUDY AND SUGGESTION FOR FURTHER RESEARCH

The study set out to determine the effects of the MFI credit schemes on the performance of MSEs and to determine the rate of graduation of MSEs from borrowing from MFIs to borrowing from commercial banks.

5.1 SUMMARY OF RESEARCH FINDINGS AND CONCLUSIONS

5.1.1 Summary of Research Findings

5.1.1.1 Micro and Small Enterprises

The study established that the MSEs financed by MFI are micro enterprises mainly located in slum areas of Nairobi and other towns.

They engage in business activities like hotel business (24%), supply of educational materials (13%), transport (12%), manufacturing (11%), salon/boutique (11%), hardware (13%) and retail (16%).

These MSEs finance their activities from various sources which include MFIs, (55%), personal savings/start up capital (20%), friends and relatives (10%) and business income (15%).

The loans borrowed from MFIs are used for boosting working capital (44%), purchasing of fixed assets (33%), personal consumption (13%) and other needs (10%).

Through these loans the entrepreneurs have experienced tremendous growth (impact) in their business as indicated by the growth in sales (37%), fixed assets (63%), net income (63%), savings (52%), number of employees (69%) and space occupied by business (21%). The study established that the more the number of loans taken and the bigger the period of participation in the credit programs the higher the growth experienced by the MSEs.

Whilst the MSEs are grateful for the loans granted by MFIs, most of them feel that they need other products in the market hitherto not offered by their MFIs. These services include provision of school loan scheme (36%), medical scheme (12%), low interest rates (12%), training (23%) and insurance scheme (13%).

The respondents indicated that their living conditions have improved since they started participating in the credit schemes (85%) whereas others (15%) feel their living conditions had worsened. The study established that those whose living conditions had worsened had been occasioned by calamities beyond their control such as fire destroyed their businesses and death of an important member of their families who is key to their business success.

5.1.1.2 Micro finance Institutions (MFIs)

The study established that most of the MFIs operating in Nairobi fall into the categories of NGOs (56%), company (16%), church affiliated (12%), banks (8%) and others (8%).

To fulfill their objectives, they source their finances from foreign donors (25%), internal operations (33%), savings (17%), banks (17%) and shareholders (8%).

The study established that main objective was to provide credit to MSEs. But over and above that they provide other services to MSEs like training (62%), savings (30%) welfare/development programs (24%) and others (12%).

The loans are granted to either individuals or clients in solidarity groups. The study established that the MFIs' majority clients are those in solidarity groups. These groups co-guarantee one another which action reduces the need for collateral securities.

MFIs (83%) aim to develop their clients so that they graduate from their programs, which normally give small loans, to borrow from banks. To prepare these clients for eventual graduation, they train them on record keeping (33%), give them incentives (30%), monitor their business growth trends (22%) and recommend them to local banks wherever they attain loan amounts big enough to be given by banks.

The study established that despite these efforts by MFIs, MSEs still encounter a lot of hurdles whenever they apply for bank loans. The bank requirements that they find difficult to meet starting with the most difficult are collateral, guarantees, financial statements requirements, high interest rates and size of loan required.

In addition to bank requirements, the MSEs are further hindered from obtaining bank loans by other factors. Ranked from the hardest to the simplest, the factors are, generally banks shunning MSEs, entrepreneurs are afraid to go to the banks, banks take too long to process loans, entrepreneurs financial needs are adequately catered for, complexes in culture or religion and illiquidity of MFIs.

All these factors may explain why the number of MSEs graduating to borrow from banks is low. Of the 104,789 who participated in the credit schemes only 528 graduated! This is a meager 0.5%

5.1. 2 Conclusions

The study concludes that MFI credit schemes have an impact on the performance of MSEs as measured by business parameters such as sales, fixed assets, net income, number of employees and space occupied by the businesses.

Further, the study concludes that the number of loans taken by the MSEs and the period of participation in the said schemes have a direct relationship with the performance of the MSEs. The more the number of loans and the longer the period of participation, the higher the impact.

Regarding graduation of MSEs from participating in MFIs credit programs to borrowing from banks, the study concludes that such graduation is not significant. Only 0.5% had graduated.

The factors attributable to this scenario include stringent bank requirements like collateral securities, guarantees, financial statements, high interest rates and size of loan required.

In addition to bank requirements, the MSEs are further hindered from getting bank loans by other factors such as generally banks shunning MSEs, entrepreneurs being afraid to go to the banks, banks taking too long to process loans. entrepreneurs financial needs being adequately catered for, culture or religion, and illiquidity of MFIs.

Despite all these frustrations MFIs are still desirous of promoting graduation through training of the business people, giving them incentives, giving recommendations for their clients to obtain loans from banks.

5.2 Limitations of the study

It is important to take cognizance of some of the limitations that could have impacted on the results of the study.

These limitations include:

It was difficult to get a clearly defined set of control groups of MSEs. MSEs may be established at the same time but their growth may be determined by other factors other than loans received from MFIs.

The level of literacy of most entrepreneurs was low rendering accuracy of interpretation and understanding of the issues in the questionnaire doubtful. This could introduce some bias in the data analyzed.

Due to lack of time, some MFIs could not fully explain the answers they had given in the questionnaire.

5.3 Recommendations.

The study recommends that:

MFIs take baseline data of MSEs at the time of entry into the credit schemes and annually thereafter. This will help them to do an impact analysis of their programs at a later date. The study found out that this is not happening at the moment. Such information can be very useful to researchers, academicians and policy makers.

The policy makers should explore creation of credit institutions that would link MFIs to commercial Banks. The borrowing conditions of these middle institutions to be less stringent than those of commercial Banks and grant loan sizes bigger than those granted by MFIs. This will greatly promote graduation of MSEs at the various levels of their development.

Alternatively, special arrangements could be made by MFIs with Commercial Banks to make it easier for the MSEs to borrow from them upon confirmation by MFIs that their business are reliable and on sound footing. The study established that at the moment, no such arrangements exist.

MFIs should consider introducing new loan products to cater for school fees, medical insurance cover. This will discourage diversion of business loans to other uses. This will lead to higher impact experienced by the MSEs. However, due diligence must be exercised so that portfolio quality is not compromised through overburdening of MSEs with several loans which could be difficult to repay.

MFIs should make compulsory insurance arrangements to cover MSEs businesses. This would cushion them against calamities like fire, which the study established, had destroyed some entrepreneurs' livelihood and therefore making them retrogress to poverty.

5.4 Suggestions for Further Research

A study should be done to find out why despite the fact that MFIs aim to eradicate poverty the interest they change is much higher than what commercial Banks charge. Is there a contradiction as far as their mission of poverty eradication is concerned? A study done on this will be enrich the knowledge in the public domain as far as this area is concerned.

This study focused on economic impact in financial terms of credit schemes. Could there be other factors that led to the growth of MSEs other than loans? It would be interesting to do a research to ascertain whether other factors played a part in the tremendous growth observed in this study.

This study has established that the rate of graduation experienced by MSEs has so far been minimal. This has been largely attributed to stringent bank requirements and apparent shunning of MSEs by Banks. A study needs to be done on why, despite the huge business potential that exists in MSEs, banks continue to react that way.

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APPENDICES

APPENDIX A: LIST OF SELECTED MICRO FINANCE INSTITUTIONS

1. K –Rep Bank Limited
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 Bank – 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 Centre

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

31. Care International

32. Smallholder Irrigation Scheme Development Organization (SISDO)

33. KADET

34. Dan Church Aid

35. Equity Building Society

APPENDIX B: INTRODUCTORY LETTER

Julius O. Mokogi

C/O Faculty Of Commerce

University of Nairobi

P.O. Box 30197

Nairobi.

23rd April 2003

To whom it may concern

Dear Sir/Madam,

Ref: Request for Research Data – Impact of Lending of Micro-Finance Institutions on Micro and Small Enterprises

I am a post graduate student at the University of Nairobi undertaking research in the Micro enterprises sector with specific reference to impact of MFI lending on Micro and Small Enterprises. 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.

Thank you.

Yours faithfully,

J. O. Mokogi

APPENDIX C: MICRO AND SMALL ENTERPRISE (MSE) QUESTIONNAIRE

A. Background information

i Name of business ....

Ii Nature of business ....

3. Number of employees in your organization ....

4. Tick the form of ownership

Sole proprietor ( ) Partnership( )

Company ( ) Others/Specify...............

5. Location of business ....

6. When established ....

7. Gender of entrepreneur---------------------------

B. Financial needs and operations

i. How is your business financed?

- Micro Finance Institution (MFI) loan--------%
- Business income--------------------------------%
- Friends & Relatives----------------------------%
- Others (specify)---------------------------------%

ii. For how long did the business operate before you received a loan from the MFI financing the business?

0-6Months ( ) 6-12Months( ) 1-2years ( ) 3years & over ( )

iii. Please give the following information relating to your business just before you received the first loan.

- Sales (maximum per year) KSh.------------------------
- Total cost of fixed assets KSh.-------------------------

- Net income (maximum per year) KSh.---------------
- Number of employees--------------------------------
- Space occupied by business (Square feet)-------------
- Savings held KSh.--------------------------------------

iv. How many MFIs are financing your business? Please tick whichever is applicable

One ( ) More than one ( )

v. Please indicate here below how you have utilized the loan(s) received so far.

	1st	2nd	3rd	4th	5th	6th	Others
Fixed assets	(----%)	(----%)	(----%)	(----%)	(---%)	(---%)	(---%)
Working capital	(----%)	(----%)	(----%)	(----%)	(---%)	(----%)	(----%)
Personal needs	(----%)	(----%)	(----%)	(----%)	(---%)	(---%)	(---%)
Others (specify)	(----%)	(----%)	(----%)	(----%)	(---%)	(---%)	(---%)

vi. How many years has the business operated since you received your first loan?

Less than 1 year ( ) 1-3 years ( ) 3-5years ( ) Over 5 years ( )

vii. Please give the following information relating to your business at the close of business on 30th May 2003.

- Sales (maximum per year) KSh.------------------------
- Total cost of fixed assets KSh.-------------------------
- Net income (maximum per year) KSh.----------------
- Number of employees-----------------------------------
- Space occupied by business (Square feet)-------------
- Savings held KSh.---------------------------------------

viii. Do you consider the loans given by the MFI adequate for your business needs?

Yes ( ) No ( )

ix. If no, have you attempted to get a bigger loan from a bank?

Yes ( ) No ( )

x. If yes, did you succeed?

Yes ( ) No ( )

xi. If yes, why are you still participating in the MFI credit programmes?---

xii. If no, please give reasons why you failed to get bank credit---

How would you rank the following as constraints to businesses like yours starting with the most important-1 to the least important-5?

- Inadequate loanable funds for MSEs ( )
- Stringent collateral requirements by banks ( )
- Lack of incentives for banks to lend to MSEs ( )
- Negative perception of MSEs by lending Institutions ( )
- Others (specify) ( )

xiii. What other services are provided to your business by the MFI? Please list them in order of importance.---

xiv. Generally, how would you describe your living conditions since you started participating in this credit program?

- Improved ( )
- Remained the same ( )
- Worsened ( )
- Other (specify) ( )

xv. Are there any services or products in the market that you require that are not provided by the MFI? Please list them.--

Thank you for your assistance.

APPENDIX D: QUESTIONNAIRE TO MICRO-FINANCE INSTITUTIONS (MFIs)

A. General Information.

i. Name of MFI---

ii. Form of MFI: NGO ( ) Company ( ) Bank ( ) Church ( ) Other (specify)--- ------------------------------

iii. Year established--

iv. Geographical area covered by operations--

v. Number of Individual Clients as at 31th May 2003---------------------------------

vi. Number of Clients in Self-Help Groups as 31th May 2003-----------------------

vii. Percentage of Female Clients--

viii. Average Loan Size for Individuals as at 31th May 2003--------------------------

ix. Average Loan Size for Groups (per member) as at 31th May 2003-------------

x. Maximum loan amount (if applicable)

Individuals Ksh.-------------------------- Groups Ksh.--------------------------

xi. Please list other services provided to MSEs other than credit-------------------------------

----

B. Source of Funds for the MFI

1) Please specify the sources of funds that your Organization uses for operations.

Banks (%) Foreign Donors (%) Government (%) Internal Operations (%)

Savings (%) Other (specify) (%)

2) Is availability of funds a constraint to your lending activities?

Yes ( ) No ( )

3) If yes, why?

a) Lack of adequate savings for on-lending(   )

b) Lack of support from donors (   )

c) Weak financial position hindering funds from commercial sources (   )

d) Other (specify) ---

C. Experience with Graduation

1) How many MSEs joined and borrowed since your credit program started to the end of May 2003?--

2) How many of these MSEs have received bank loans since they entered your program?----------

3) Please indicate how many of the MSEs in 2) above are run by women----------------------------

4) How many of those MSES that received bank loans continue to participate in your programs?-- --

5) What has the MFI done for the bank to accept these MSEs?--

If the program has a special arrangement with the bank, please give details about it---------

Approximately how many active clients in your program have loan amounts large enough to qualify for local bank loans but have not sought bank credit ?-- -------------

6) Please estimate the average length of time between a client's application for a loan with a local bank and the disbursal of the loan

0-7 days day (   )   7-14 days (   )   14-21 days (   )   21-28 days (   )

Over 30 days (   )

7) What is the average length of time between a client's application for a loan with your program and the disbursal of the loan?

0-7 days day (   )   7-14 days (   )   14-21 days (   )   21-28 days (   )

Over 30 days ( )

8) What is the interest rate in your programs?-----------------------------------

9) What is the average rate of interest in the local banks?---------------------

10) Please list, in order of importance, the bank requirements that are most difficult for your clients to meet (1-Easiest: 6- Most difficult)

Collateral ( ) Guarantees ( ) Financial statements ( ) Low loan size required ( )

Interest rate high ( ) Other (specify)--

11) There is a likelihood that instead of or in addition to the bank's requirements, there are other factors that limit the entrepreneur's access to bank credit. In your view how can you rank some of these factors starting with the 'Most important'-1 to the 'Least important'-7:

Entrepreneurs are afraid to go to the bank ( )

Entrepreneurs' financial needs are adequately catered for ( )

Banks take too long to analyze a loan application ( )

Banks shun MSEs ( )

Culture or religion ( )

Illiquidity of MFIs i.e. unavailability of loanable funds to MSEs ( )

Other (specify)--

12) When your program began was client graduation to the formal financial sector one of the goals?

YES ( ) NO ( )

13) If yes, is it still a goal?

YES ( ) NO ( )

14) If no, Why?--

15) What does the MFI do to promote graduation?---

Are there any comments that you think will be important to mention regarding this study?

Please list them.--

Thank you for your assistance.