

UNIVERSITY OF NAIROBI

SCHOOL OF ECONOMICS

**ACCESS TO FORMAL AND IN-FORMAL CREDIT BY
RURAL HOUSEHOLDS IN KISUMU DISTRICT**

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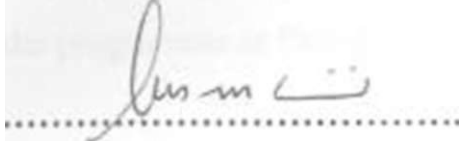
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DECLARATION

This project report is my original work and has not been submitted for a degree in any other university.



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Abbreviations

ANOVA	Analysis of Variance
CDF	Constituency Development Fund
GDP	Gross Domestic Product
ICDC"	Industrial and Commercial Development Corporation
Ma	Hectares
GoK	Government of Kenya
K-REP	Kenya Rural Enterprise Programme
LICs	Low Income Countries
Ksh	Kenya Shilling
Km	Kilometre
NBIFs	Non-Bank Financial Institutions
NGOs	Non-Government Organisations
OLS	Ordinary Least Square
POSB	Post Office Savings Bank
PRIDE	Promotion of Rural Initiatives and Development Enterprise
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Cooperative Societies
SCAs	Savings and Credit Associations
SMEs	Small and Micro-Enterprises
SSA	South Saharan Africa
UNDP	United Nations Development Programme

Abstract

The study was aimed at determining factors that influence accessibility to formal credit by the rural households, i.e. farmers, fishermen and the small and micro entrepreneurs in Kisumu district. So as to establish the empirical evidence on the link between credit use and poverty alleviation, the study attempted to make an assessment of the impact of credit on income.

Using survey data as well as secondary information this study also reviewed the operational mechanism of the existing formal and informal credit arrangements in Kisumu district with the view to assess their performance in serving micro-enterprise sector with particular reference to smallholder rural farmers and fishermen. The study aimed at providing useful information to aid the decision making process for the enhancement of access to credit by the majority of rural small-scale producers and entrepreneurs.

In collecting the primary data, questionnaires were administered to an estimated 200 randomly selected rural households in some villages of Kisumu district. The analysis was done using STATA 7 computer software. Cross tabulation, regressions and t-tests were also done, to determine factors that influence an individual's ability to obtain a loan from formal or in-formal financial institutions.

Study results show that there was inadequate flow of credit to farming and fishing sub-sectors in Kisumu. The existing formal banks namely, Kenya Commercial Bank, National Bank of Kenya, Barclays Bank, Standard Chartered Bank and Cooperative Bank of Kenya provided a minimal percentage of credit to the agriculture and micro-enterprise sector.

Government institutions and donor-funded development projects extended piecemeal credit services that were made available to farmers and small entrepreneurs. Available evidence shows that services rendered by these sources were inadequate, at best targeted to specific groups and to promotion of specific technologies. Generally, the performance of most of these micro credit programmes was not encouraging. Poor loan recovery is also a big constraint to most of these schemes.

The empirical evidence indicates that age, gender, education, income levels affect access to credit by farmers and small scale entrepreneurs. The results suggest that there is need to address key factors that inhibit access to credit by small farmers and entrepreneurs in order to alleviate poverty in Kisumu district.

Table of Contents

Declaration	i
Acknowledgement	jj
Abbreviations	iii
Abstract	iv

1.0 BACKGROUND, PURPOSE AND OBJECTIVES OF THE STUDY 1

1.1 Introduction	1
1.2 Overview of Kisumu district	3
1.2.1 Poverty status of Kisumu district	4
1.3 Problem Statement	6
1.4 Study Objectives	7
1.5 Hypotheses of the Study	7
1.6 Significance of the Study	8
1.7 Limitations of the Study	8
1.8 Organization of the Study	9

2.0 SITUATION OF THE FORMAL AND IN-FORMAL CREDIT SOURCES IN KENYA 10

2.1 Structure of Kenya's Financial Sector	10
2.2 Recent reforms	II

3.0 LITERATURE REVIEW	13
3.1 Financial Markets in Low Income Countries (LICs)	13
3.2 The role of Credit in Household Economy	14
3.3 Access to Formal Credit by Rural households	16
3.4 The Experience of Micro-credit Initiatives in LICs	18
3.5 Linkage of Credit to Poverty Alleviation	19
4.0 METHODOLOGY FOR ANALYSING THE DETERMINANTS OF ACCESS TO CREDIT	21
4.1 Theoretical and conceptual Framework	21
4.2 Data Collection and Sources	22
4.3 Sampling procedure and study design	23
4.4 Data Analysis	23
5.0 EMPIRICAL RESULTS	25
5.1 Demographic and socio-economic characteristics	25
5.1.1 Age and Gender of the Respondents	25
5.1.2 Main Occupational activities	25
5.1.3 Household Size	26
5.1.4 Farm size and Land Tenure Status	26
5.1.5 Educational Status of Respondents	27
5.1.6 Annual income of the Respondents	27
5.1.7 Use of Bank for Savings and borrowing	27
5.1.8 Value of Productive Assets of Respondents	28
5.1.9 Access to Credit	28

5.2	Determinants of Access to Formal and informal Credit in Rural Kisumu District	29
5.2.1	Age	29
5.2.2	Gender	29
5.2.3	Years of Education	30
5.2.4	Income Levels	30
5.2.5	Awareness	31
5.2.6	Farm Size	31
5.2.7	Occupational Activity	31
5.2.8	Location	32
5.3	The Impact of Credit Use	33
5.4	Qualitative Assessment of Some Important Credit Aspects	34
5.4.1	Attitudes of Respondents Towards Credit	34
5.4.2	Respondent's Opinion on Factors Limiting ones chances to Formal credit	35
5.4.3	Production Constraints	35
5.4.4	Credit Impact on Household Income and Expenditure Pattern	36
5.4.5	Reasons for Borrowers Failing to Repay Loans	36
6.0	CONCLUDING REMARKS	38
6.1	Conclusion and Policy Implications	38
6.2	Study Recommendations	40
6.3	REFERENCES	45
6.4	APPENDICES *	52

1.0 CHAPTER ONE:

BACKGROUND, PURPOSE AND OBJECTIVES OF THE STUDY

1.1 Introduction

Financial markets in developing countries and particularly the sub-Saharan African (SSA) region are largely underdeveloped, lacking in depth, highly inefficient, concentrated in urban areas and dominated by a few, often foreign-owned commercial banks. In particular, credit, savings and insurance markets in the rural areas are generally non-existent, and of those that do exist, many work imperfectly (Morduch, 1995)

In Kenya, the rural financial market is basically fragmented and unable to meet the needs of the rural population, especially for investing in agriculture, the predominant sector. This is not only because of weakness in the financial institutions, but more critically because of constraints in the rural financial environment. These include disparities in ability to access information (information asymmetries), between lenders/banks and the rural households, and the high and covariant risks in rural areas, especially in agriculture. Rural households often lack the resources they need to mitigate risk, hence the myth by commercial banks that the rural poor are not bankable, and uncreditworthy (Adera, 1995). Rural borrowers therefore present a high credit risk and this, combined with the high administrative costs of service delivery, make the rural market unattractive to formal financial intermediaries. The rural financial sector is therefore dominated by informal financial service providers, who undertake minimum intermediation and often specialise in either deposit taking or lending. The few who intermediate do so within group based systems with little or no access to external resources. Consequently the informal sub-sector lacks the capacity to meet the requirements of rural populations.

The **significance of** rural credit services can be best understood by examining **their potential** contribution to the development of the agricultural sector. **Agriculture** forms a significant part of the lives of the rural households, who **in the case of** Kenya constitute about 80% of the population, staying in the rural **areas** (Republic of Kenya, 2002). The Kenyan economy depends mainly on the **agricultural** sector. The sector accounts for 24.0 % of value added and therefore **the largest** contributor to Kenya's GDP. It accounts for 23 % male's and 25% **female's** employment. Despite its contribution, it only receives about 5.0% of **loans and** advances from financial institutions (World Bank, 2001).

The provision of credit has increasingly been regarded as an important tool for raising the incomes of rural populations, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to the rural poor to facilitate their taking advantage of the developing entrepreneurial activities. The generation of self-employment in non-farm activities requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the poor to accumulate their own capital and invest in employment-generating activities (Hossain, 1988)

In the recent past, there has been an increased tendency to fund credit programmes in the developing countries aimed at small-scale enterprises. In Kenya, despite emphasis on increasing the availability of credit to the rural households, their inaccessibility to credit still remains their major constraint. (Braverman and Guasch, 1980) A 1995 survey of small and micro enterprises found that up to 32.7% of the entrepreneurs surveyed mentioned lack of capital as their principal problem, while only about 10% had ever received credit (Daniels et al., 1995) The failure of specialized financial institutions to meet the credit needs of such enterprises has underlined the importance of a needs-oriented financial system for rural development.

It is notable that previous government policy and most of the existing literature on provision of rural financial services focused on the scarcity of providers of these services (or the supply side), with little attempt to explore the rural households demand for the services (or the demand side). For instance the targeted and the highly subsidised government credit schemes of the 1970s and 1980s, which were based on the supply leading approach, are thought to be among the principal causes of the financial crisis in Africa (Adams, 1994). These government-provided credit schemes have been plagued with the culture of default and the presence of political interest, which limit their efficacy even if the credit scheme were otherwise well intended. One of the reasons for the failure or at least poor performance of these forms of credit is that they were not adapted to the demand of the service by the rural households.

This paper tries to fill this gap in the literature and to provide empirical evidence on the determinants of demand for credit in the rural areas and how this credit is important for; one, agricultural expansion and development (agriculture accounts for 75% of rural economic activities), two, for establishment and growth of small and medium scale rural enterprises that are not agriculture oriented, and three, for the general improvement of the standards of living for the rural people of Kisumu.

1.2 Overview of Kisumu district

Kisumu district is one of the 12 districts of Nyanza province of Kenya. This district is host to Kenya's second city, and a harbour on lake Victoria. In addition, it is an important regional centre linking Uganda, Tanzania and Kenya, who all share lake Victoria. The district lies in a depression that is part of the larger Nyanza gulf with a protruding part of the lake Victoria on whose shores is Kisumu city which lies at a height of over 1100 metres above sea level and has a humid climate that yields an average annual rainfall of 1245 mm. The district borders Nyando district to the east, Nandi to the northeast, Vihiga to the north, Siaya to the northwest, Bondo to the west, and Rachuonyo district to the south. Notable also is the Lake Victoria to the south.

Based on the 1999 census, the estimated population size for the district is 535,664 people of whom 271,470 are female and 264,174 are male. (GOK, 1999 census) The average population growth rate is 2% per annum with crude birth and death rates of 39/1000 and 29/1000 respectively. The average population density is at 549 persons per sq. Km (the 4th densely populated district in the province) An estimated 65% of the population live in rural areas with over 75% directly or indirectly involved in agricultural activities. The district covers an area of 918.6 sq. km of which water mass is 259 sq. km. Kisumu's natural resources include wildlife & marine life, e.g. Lake Victoria water mass, fisheries, rivers, dams, sand, minerals (e.g. gold, phosphanites, kisan granites, diatomite . etc), and pockets of indigenous forests.

The average size of land holding per family is less than 1.5 ha. Women perform most of the farm operations. About 25% of the households are directly involved in fishing as the main component in the family production system. The other important economic activities in the area include crop production (e.g. rice, sugarcane, cotton, maize, sorghum, groundnuts, etc) animal husbandry, sand harvesting, brick making, industrial production and general merchandise. Hooding, drought and epidemics are the biggest natural hazards experienced in the area

1.2.1 Poverty status of Kisumu district

Various sources (UNDP 1996, UNDP 2001 and GoK 2000), indicate that Kenya is still under the grip of poverty, which is more pronounced in the rural areas and the sub-urban slum areas. Many households in the country are considered to live below the poverty line. Those considered poor based on income poverty make 53% and severely poor form 24% (GoK, 2000). Kisumu district has an absolute poverty level of 65.44% being ranked 38th of 46 nationally ranked districts. It has a 54.99% food poverty level being ranked 26^h of the 42 nationally ranked districts. The monthly mean income is estimated at Kshs 6,493.00, a figure lower than Kenya's urban average Gok, 2000).

Low productivity in agriculture, livestock keeping and fishing due to poor technology (a consequence of limited access to credit facilities), poor infrastructure and inadequate markets are the major underlying causes of **poverty** in Kisumu, not mentioning the rampant impact of the HIV/AIDS **disease** (adult prevalence rate of 33%). According to information from the Association of Micro-finance institutions in Kenya (AMFI), financiers are reluctant to finance business in such HIV/AIDS prone areas because of the **losses** encountered when the owner is infected and suddenly closes down the **business**

In an effort to address poverty problems, the Government of Kenya, starting from mid 1990s, has commissioned the preparation of a number of policy documents such as Grassroots Initiatives for Poverty Reduction (UNDP, 1996), Common Country Assessment (UNDP, 2001) and the recent comprehensive Kenya Poverty Reduction Plan (GoK, 2001), whose overall goal is to promote sectoral transformation from a predominantly rural based subsistence agricultural economy to a modern economy, the primary target groups for poverty reduction under this Plan include small rural farmers, Fishermen and small-scale entrepreneurs.

1.3 Problem statement

About 65% of Kenya's population lives in rural areas, of whom 75% are involved in agricultural activities while the rest are involved in other off-farm small-scale enterprises. The rural sector contributes to the national objective of creating employment opportunities, training entrepreneurs, generating income and providing a source of livelihood for the majority of the low-income households in the country, accounting for 12-14% of GDP (GoK, 1989, 1992, 1994). Whereas a small number of NGOs finance an increasing number of rural households activities, most formal institutions still deny these sector access to credit. Credit is crucial for the general improvement of the household's standard of living.

Improving the availability of affordable credit facilities to the rural population is one of the incentives that have been proposed for stimulating rural growth and the realization of its potential contribution to the economy (GoK, 1994). Hence, governments and their development partners have sponsored and/or initiated supply-led rural finance institutions without considering the factors that may hinder demand for the credit. Yes, credit may be available but effective demand for it may be hindered by several socio-economic factors that affect both the borrowers and the lenders.

Given the above scenario, a relevant issue for empirical investigation is therefore, that of identifying factors that influence demand for credit and those that lead to credit rationing of the poor by the lending institution. Assessing the impact of credit on the income and the standard of living of the credit user is another point of interest. An understanding of both these set of determinants could assist in policy formulation to enhance productivity of the rural poor through improved access to credit. The following questions guided the study:

- What socio-economic factors influence accessibility to credit by small farmers and micro-entrepreneurs?
- Do lending procedures of lending institutions deter rural households?
- Is there a link between credit use, income and poverty alleviation?

1.4 Study Objectives

This study involves a general assessment of formal and in-formal credit accessibility by the rural households of Kisumu district. The study also attempts to assess the impact of credit on the standards of living of credit users. More specifically, the study aims at:-

- i) Determining factors that influence credit accessibility by the rural households in Kisumu district;
- ii) Assessing the operational procedures and performance of the existing formal and informal credit sources in availing credit services to the rural households in Kisumu District;
- iii) Assessing the impact of credit on income and the livelihood of the credit users.

1.5 Hypotheses of the Study

The study hypothesised that: One, Rural household have limited access to credit facilities. Two, socio-economic factors e.g. age, gender, level of education and income have direct influence on individual's chances to access credit. Third, lending procedures of credit institutions deter small farmers and micro-entrepreneurs to access credit facilities. Fourth, there is a link between credit use, increase in income and poverty alleviation as a consequence.

The study will therefore attempt to test the following main hypothesis:

'An individual's socio-economic characteristics and the attributes of financial institutions influence the demand for and participation in credit market.'

1.6 Significance of the Study

The study provides useful information on the status of rural households, especially in Kisumu district, in accessing credit from formal and in-formal credit facilities. This information is vital for policy makers in taking appropriate actions toward facilitating the establishment of comprehensive and sustainable financial institutions, involved in the provision of credit facilities to small farmers and rural micro-enterprise sector. Moreover, the study has also highlight on the possible link between credit use and increase in income and more importantly on its contribution to poverty alleviation (impact of credit).

1.7 Limitation of the Study

The study was based on the assumption that the sampled farmers, fishermen and the small and micro-entrepreneurs were a fair representation of the rest of rural households (population) because of their homogeneous characteristics in cultural and socio-economic status.

Due to the fact that most households do not keep records, the accuracy of most of the data collected is depended on individual's ability to recall. However, it is believed that the data obtained provide a useful basis of information for making recommendations to improve access to credit by the majority rural poor and in the enhancement of the effectiveness and efficiency of the credit delivery and recovery mechanisms of various credit institutions and micro-credit programmes.

1.8 Organization of the Study Report

The report has six chapters. Chapter one covers the general introduction, the research problem, study objectives, study hypotheses, significance of the study **and** study limitations. Chapter two highlights on the situation of formal and informal credit sources in Kenya. Chapter three reviews the literature that is relevant to the study topic. Chapter four describes the methodology to be used in the study such as data collection methods and sources and methods of data analysis. In chapter five, field results on the demographic and socio-economic characteristics of respondents and the determinants of access to credit in the study area are discussed with highlights on the linkage of credit use to poverty alleviation. Chapter six gives the conclusion and recommendations for the promotion of effective credit services for the poor small-scale farmers, herders and the entire micro-enterprise sector.

2.0 CHAPTER TWO:

SITUATION OF FORMAL AND IN-FORMAL CREDIT SOURCES IN KENYA

2.1 Structure of Kenya's Financial Markets

Kenya's financial sector is a composition of. Commercial banks, Non bank financial institutions. Foreign exchange bureaus. Micro-finance institutions. Mortgage finance companies, building societies among others. The formal segment of the sector is. however, dominated by a few commercial banks. Some of these banks have roots in the colonial period and were historically oriented towards meeting the financial needs of external trade and large-scale commerce. These banks do not therefore have a track record of lending to small enterprises and smallholder agriculture.

Perhaps in recognition of this shortfall, the government of Kenya backed initiatives such as the small Enterprise Finance Company, the Kenya Industrial Estates and other alternatives to formal banks to fill the financing gap. However, these government-backed schemes and development finance initiatives performed unsatisfactorily and in retrospect may have distorted the evolution of financial markets in the country. Studies shows that when credit is advocated as the primary remedy for low-level productivity or when loans are used to stimulate growth, these strategies often lack mechanisms for excluding **risky** borrowers (von Pisehke. 1992). As a result, many borrowers fail to repay ~~and~~ the credit programmes are left with a progressively drying pool of fund for **lending**. This phenomenon, referred to, as the exit problem of credit programme, has been evident in Kenya.

Kenya's financial sector grew steadily in the 1990s as indicated by the growth **of the** share of the financial sector in GDP from 7.9% to 9.6% in 1994. and to **10% in 1997** (GoK. 1997.1998). The composition of the institutions as at 1998 **consisted** of 55 commercial banks, up from 48 in 1997; 16 non-bank financial

institutions from 24 in 1997; 4 building societies; and 2 mortgage finance companies (CBK, 1998). In 1999 the total population of banking institutions grew to 67, with 53 commercial banks, 8 non bank financial institutions, 2 mortgage finance companies and 4 building societies. In the 1980s, Savings and Credit Co-operatives (SACCOs) and non-bank finance institutions (NBFIs) expanded rapidly to fill the gap created by commercial banks, but were only useful for salaried employees for whom the lending and borrowing entitles were clearer. The continuing gap in the MSE sector attracted the attention of non-governmental organizations (NGOs), including the Kenya Rural Enterprise Programme (K-REP), FAULU and PRIDE Africa. All these programmes attract support from the donor community and are potentially exposed to the exit problem.

Kenya also boasts a wide range of informal institutions that extend financial services to different segments of the community. The most widespread are the rotating saving and credit associations (ROSCAs) which are found almost everywhere in the country and acts as conduits for converting small regular savings into lump sums, especially among women. These associations are based on trust and close familiarity that is, in turn, based on social institutions, such as kinship. Entrepreneurs also rely on friends, relatives, customers and suppliers of materials and provisions as sources of working capital. These divergent credit sources are therefore important components of the financial/credit markets in Kenya.

2.2 Recent reforms

During the mid-1980s, the government's stated policy was to get markets to determine interest rates. There was therefore a shift toward positive real interest rate. The gap between interest rates applied by commercial banks and non-bank financial institutions narrowed but the gap between minimum deposit rates and maximum lending rates widened (John, 1999). The interest rates were fully liberalised in 1991. This did not increase rural households access to credit because in addition to broader market imperfections, withholding taxes

increased the administrative costs of small accounts. Treasury Bills enjoying tax exemption status were also introduced and reduced the incentive to hold savings in the formal financial institutions. There was also no improvement in the efficiency of the financial sector as evidenced by a widening of the interest rate spread. More significantly, the Government of Kenya became a dominant borrower in the domestic market, mopping out existing financial resources from the market and in the process crowding out the productive sector. Since credit does not ordinarily flow to the MSB sector, excessive domestic government borrowing further reduced financial resources that were trickling down to the sector.

The recent period has also been marked by a banking instability resulting from lax licensing of financial institutions, poor enforcement of prudential regulations, and bad debts. Liberalisation reduced some of the entry barriers and opened new opportunities for extending financial services to the business community. The financial sector reforms freed interest rates, restructured weak institutions and consolidated others to forestall their eventual collapse. But the financial health of many local banks has still the same remained weak. Kenya's banking sector is characterised by an ever-looming crisis. The Central bank has been addressing the problem by pushing banks to close loss-making branches and improve loan recovery. Banks have also been allowed to set minimum balances, limiting the access of small clients to banking services and reducing the potential for mobilising savings. Concerns about depositor protection have led to conservative liquidity and cash ratios and increased the reserve requirements. These measures are likely to increase the cost of funds and further distance the MSHs from the banking sector. Equally, following the fiscal indiscipline that characterised the nineties, government recourse to the banking system converted banks to sources of government funding rather than private sector development. This has complicated monetary management and hostility towards bank customers, especial potential borrowers.

3.0 CHAPTER THREE: LITERATURE REVIEW

3.1 Financial Markets in Low Income Countries(LICs)

Financial markets in Low Income Countries are characterized by fragmentations and imperfect market conditions. Ghate (1992) categories the market into two forms: formal and informal financial markets. He defines formal financial markets as those financial market activities that are controlled by government, which are largely urban-oriented in terms of distribution of bank branches and the concentration of deposits and lending activities. Informal financial markets are defined as activities of various financial intermediaries ranging from farmers, moneylenders, friends, relatives, shopkeepers, merchants, traders and Rotating Savings and Credit Associations (ROSCAs). Quasi-formal financial intermediaries are therefore falling between **these** two continuums and could include credit unions, village banks and various forms of credit schemes run government or non-governmental organizations.

Formal institutions are more inclined to provide its services to the public sector, upper-income household, large-scale enterprises and non-agricultural activities, **while the** informal financial institutions tend to match their products and **services** to the characteristics and demand of the predominantly private, low-**income**. small-scale and rural population of most developing countries (Germidits, Kessler and Meghir 1991). The coexistence of informal finance **serv ing the** latter market can be seen as: healthy and dynamic, permitting more **people** to participate in financial markets" (Von Pischke 1991).

Literature has viewed the informal sector as the consequence of policy **distortions** and emphasized the negative consequences of financial dualism for **»llocative** efficiency, equity and economic development (Taylor, 1983, Roe 1990). However, the recent development have seen the informal financial

institutions to have a comparative advantage in some market segments due to its ability to enhance efficiency in resource allocation by mobilizing household savings and financing small business activities that are beyond the reach of the formal system (Ghate 1988 and Adams 1992).

In Kenya, like other LICs, the financial market is a complex mix of formal, quasi-formal and informal lending activities. The financial markets operate not according to market forces, a condition that discourages domestic savings and hence a need for support the poor and vulnerable rural producers (Mchujuko 1991).

3.2 The Role of Credit in Household Economy.

Most LICs* economies are agriculturally based and thus credit is as a major component of agricultural and rural development programmes and also considered as an important instrument in helping small farmers and micro-entrepreneurs as an important instrument in helping small farmers, fishermen and micro-entrepreneurs increase their income. Numerous programmes have been established to increase the volume of credit to serve this purpose.

Advocates of credit as a poverty alleviation measure (see. e.g. House 1978. Adam et al 1984, Boomgard 1989, and Mutua 1996) contend that limited availability of credit services has undermined rural micro-enterprise activities due to lack of capital for investment and has prevented farmers to adopt improved farming practices because of their inability to purchase the necessary inputs required in the production. Low productivity in agriculture, livestock and fishing is generally attributed to the use of poor technology resulting from limited access to credit. Moreover, it is perceived that inadequate credit facilities has to a large extent discouraged the entry of youth to the farming and fishing sectors, and leave majority of them unemployed because of lack of investment capital and incentive.

Fafchamps (1997) notes that with insufficient funds, farmers and fishers cannot invest in new equipment and machinery, and it becomes difficult to reach out to new markets and products. He further contends that without financial assistance, small farmers and fishermen cannot cope with temporary cash flow problems, and are thus slowed down in their desire to innovate and expand. The general perception is that access to external finance is critical for poor entrepreneurs, who may never have funds proportional to their ambitions.

Gilla and I assalle (1994) show that rapid development reached in Europe and Asia was highly facilitated by the availability of credit to the majority. Countries like India, Indonesia, Burma and even China were reported to have recorded a good pace of development after managing to solve problems of credit availability for the majority.

However, Gulli and Berger (1999) point out that access to credit is important for micro-enterprise development but not necessarily the main constraint. This view is shared by Von Pischke (1992), who observed that lack of funds is not the most important problem of small farmers and micro-entrepreneurs noting that product prices, poor education system and training, low output, land tenure, modern input costs and availability and risk turn out to be more important factors limiting small farmers and micro-enterprise development.

The access to credit by small producers in many African countries is rather disappointing. Very few small farmers and rural micro-entrepreneurs have been integrated into formal financial markets and many do not use credit or if they do, they continue to borrow from informal market lenders (Adams. 1984). Gonsalex-Vega (1983) reports that only a small fraction of farmers in LCIs have received formal loans. It is estimated that only 15 percent of farmers in Asia and Latin America and just five percent in Africa are financed through formal credit sources (Gonzalez-Vega 1983. Braverman and Huppi, 1991).

In a survey carried out in rural Zanzibar, Krain (1998) observed that credit from formal financial sources meets only a small portion of the total credit

demand of the agricultural sector. He found out that credit from the formal financial sources accounted for only 9.9 percent of the total credit available to the agricultural sector. The remaining 90.1 percent is from the informal financial sources comprising mainly loans from relatives, neighbours, friends, rotational savings groups and one's superior at work ("boss") and other sources.

3.3 Access to Formal Credit by Small Farmers and Micro-enterprises

The majority of people in LICs. do not have access to banks and other formal financial institutions. The development and commercial banks view the small-scale and micro-entrepreneurs as risk borrowers and extending loans to them is to cut down their profitability in the transactions and to incur irrecoverable losses to the banks (Levitsky 1993). Small borrowers are regarded riskier than large ones for reasons often related to the difficulty in obtaining accurate information about them. Banks associate small and micro-enterprises to high transaction costs because they are widely dispersed geographically and their inaccessibility. Illiteracy and unreliable income of small borrowers are also regarded as reasons for the reluctance of banks to lend to them.

Bottomley (1975) argues that the ceiling on interest rates also imposes a considerable constraint for banks to advance small loans since they prevent banks to incorporate the additional administrative costs involved in processing small loans and not also permit banks to offer risk-adjusted interest rates. Thus banks attend to advance loans only to those who offer lower risk and better security, which implies that only rich and wealthy people receive loans at cheaper rates leaving the small and poor borrowers to seek loans from the unorganized credit market.

Mchujuko (1991) reports that in Tanzania, small farmers, though not officially stipulated in various bank lending policies, are discouraged by the institutional framework to individually apply for loans from the banking system. He notes the situation as perpetuated by cumbersome and costly tender formalities and

sometimes necessitating client to tip a bank official in order for his loan application to be processed. Banks also link credit to possession of immovable assets, which are taken as loan security. Collateral is considered as an important part in the lending process. Mutua (1994) argues that since lender takes calculated risk, borrowers must demonstrate their good faith by showing that they too have something to stake in the deal.

Farmers and rural entrepreneurs in Kenya, particularly women, are much at a disadvantage as far as their ability in offering collateral for loans is concerned (Omar and Shaidi, 1992). Poor farmers lack title deeds for the pieces of land they own and as a result they do not qualify for bank loans with which they can expand their businesses and improve their incomes. Insecurity in land tenure in Kenya reduces the innovativeness and willingness of poor smallholders to invest and as a consequence has limited their chances to receive financial support from formal financial institutions.

Reliance on collateral by banks often, however, excludes many otherwise creditworthy small-scale borrowers in many African countries where land titles are not well documented or readily transferable (Stcela et al 1997). Discrimination of women in formal financial market is also widely spoken (I-'AO, 1984, Otera and Downing, 1989). It is argued that women's lack of control over economic resources and the nature of their economic activities restrict their access to formal credit more than men's. Other factors pointed out as constraints for women in accessing credit are related to institutional requirements, cultural and social norms and to the type or reproductive activities that women are engaged. McKee (1989) observes that gender-based credit constraints, such as limited education, inferior legal status and unpaid reproductive responsibilities aggravate the problems for women when operating small businesses.

3.4 The Experience of Micro-credit Initiatives in LICs

The inability and reluctance of formal banking sector (private and state-controlled banks) to serve the small borrowers' credit and saving needs, many governments of LICs and development partners have shifted attention to quasi-formal credit arrangements. Donor-funded development projects, state-controlled credit schemes and various NGOs have over the recent years increased their role in the provision of credit to small-farmers and rural micro-entrepreneurs. Billions of dollars are spent each year in efforts to improve terms and conditions under which small-scale producers obtain access to credit and financial services.

The majority of these efforts focus on ways of extending institutional aiming to provide credit to finance agricultural inputs and other micro-enterprise investments needs. Adams and Von Pischke (1992) report a number of assumptions behind the move to establish targeted credit schemes. Some of the assumptions include: the target group is too poor to adopt new technologies without loans and is also too poor to save, operators of small farms are thought to be very much in need of training and technical assistance in order to progress, informal finance plays little or no positive developmental role and that most of the target groups have 'credit needs' that commercial bankers refuse to fulfill for reason that are neither commercial nor economic and that many of the small borrowers have good chances of improving their status and to obtain conventional bank loans.

Even targeted credit schemes have shortcomings as far as financing agriculture and rural micro-enterprises is concerned. Krain (1998) observes that targeted credit schemes offer only small short-term working capital loans and are limited in scope mostly serving the urban and peri-urban clients. Further, he observes that credit schemes usually concentrate on financing micro-enterprises that have

high turn over and generate regular income flows, unlike in agriculture where the income flow is seasonal and profitability and turn over is low.

Furthermore, many small credit programmes tend to concentrate primarily on "productive" credit and neither offer easy-access consumption loans or flexible savings facilities which would contribute to poorer households coping strategies (Hulme and Mosley, 1996). Political influences (particularly in state-owned credit schemes) combined with problems of low loan recovery and unrealistic interest rates charged, to a large extent, limit the effectiveness of these credit schemes as are left to rely on external sources of loanable funds which are difficult to sustain (Krain op.cit). Adams and Von Pinscher note that most of credit programmes that extend loans to farmers and micro-enterprises lost money, and collapsed or were sustained only by recapitalization.

3.5 Linkage of Credit to Poverty Alleviation

Man attempts to evaluate the impact of loans on borrowers turned out to be notoriously difficult, ambitious and misleading (Adams and Von Pischke 1980). Establishing the causal role of credit is complicated by household economics, which involve multiple sources of incomes. Feder et al. (1990) point out that the difficulties in getting the data and the intrinsic 'fungibility*' of money often obscures an exact link between a loan and changes in a household's situation, **thus** studies that compared changes in economic activities between individuals with loans and those without loans encountered serious methodological problems. However, it should be noted that changes to both individual enterprises and local economies occur gradually and can be structural and be sustained over the long term. It is also cumulative rather than immediately evident.

Results from several studies attempting to measure the impact have given rise to debates over the effects and value of credit. A survey conducted by Khandker (1998) to three major micro-credit programmes in Bangladesh

revealed an 18 percent increase in household consumption from micro-credit borrowing by women, and an 11 percent increase in consumption when men are the borrowers. He suggests that 5 percent of participating families can escape poverty each year because of the increased consumption resulting from micro credit. Other impact results of micro credit reported by Khandker are consumption smoothing, employment smothering and improved child nutrition. Khandker warns, however, that these effects will only be sustainable only if micro-credit is targeted at areas and economic activities with high growth potential.

On a more similar situation, Morduch (1998) examines the impact of micro-credit and results show no increase in consumption among micro-credit borrowers but find beneficial impacts through consumption smoothing among borrowing households, as well as an increased ability to diversify employment. These effects obviously reduce the vulnerability of borrowing households compared with non-borrowing households.

Hulme and Mosley (1996) note that credit gives poor people a means of investing and breaking out of the vicious circle' of poverty. He notes that credit has the potential of improving credit user's income and savings and as consequence enhance investment and reinforce high incomes. This argument is highly supported by the findings of Kashuliza et al. (1998) who observe that income of the credit users are significantly higher than the income of non-credit users in the Southern highlands areas of Tanzania.

4.0 CHAPTER FOUR: METHODOLOGY FOR ANALYZING THE DETERMINANTS OF ACCESS TO CREDIT

4.1 Theoretical and Conceptual Framework

Many surveys on formal and informal credit sources in Kenya have been mainly qualitative in nature (Raikes, 1989; Alila, 1991; Aleke Dondo, 1994; Daniels et al., 1995). Zeller (1993, 1994) used a univariate probit model to estimate the factors that determine an individual's borrowing decisions, in terms of their participation in formal or informal credit markets in Madagascar. The market segments are treated separately in order to identify similarities and differences between the sectors in credit applications and rationing. The results show that among the informal lenders, age, schooling, wage, income, sick days and household headship are significant determinants of applications for credit. On the other hand, gender and social events are not significant. Age, the years of schooling and the ratio of outstanding loans increase the probability of being supply constrained. Higher household wealth reduces the probability of being supply constrained. In the formal sector, being male significantly increases the probability of applying for a loan.

Zeller divides the factors into individual characteristics, labour assets, household events that affect credit demand, and reasons for participation. This approach assumes that an individual's decision is only affected by internal factors. However, external factors also play an important role in influencing participation in credit markets. This approach was adopted in this study, modified to focus on those external factors related to institutional credit lending policies.

A number of conceptual difficulties have been identified in establishing credit demand, especially in fragmented markets with imperfect information. In most models where there is the possibility of loan default due to imperfect contract

enforcement, and an upward sloping supply curve, it is assumed that lenders offer borrowers a choice of points on the supply curve, to which they are restricted. It therefore becomes difficult to identify the loan demand schedule using information on observed loan amounts since this reflects only the existing supply. The credit demand function can only be identified from the borrower's participation decision; namely, the decision to borrow or not and from which sector to borrow.

In the study, data will be collected on all loans from different lenders available to the borrowers. To achieve the stated objectives, the study will use both descriptive and analytical methods. These include cross-tabulations, tests of differences between the means, and analyses of variance (ANOVAs).

4.2 Data Collection and Sources

Data collection was largely through interviews, both semi and formal structured. The former was conducted through key informants from various organizations and government institutions. It aimed at catching up their views and experiences and accessing the various unpublished documents. The formal structure interviews involved a total of about 200 small-scale entrepreneurs engaged in fanning, wholesale and retail trade, and primary processing of agricultural products were selected as the units of study for the purpose of identifying key socio-economic factors that influence credit accessibility among rural population. These respondents were randomly selected from 12 randomly selected villages in Kisumu district, and issued with questionnaires. The survey was carried out during April and May 2006 in market centers in the rural areas of Kisumu district. The information obtained was sorted and used in the logistic regression and t-test analysis in order to isolate socio-economic factors that influence credit accessibility by smallholder farmers and rural entrepreneurs and assess impact of credit use.

4.3 Sampling procedure and study design

The data collection process required a preliminary survey in order to construct the sampling frame and draw a sample. A pilot survey was conducted for this purpose during the third week of April. A population of small-scale enterprises in agricultural and non-agricultural activities was identified in the study region of Kisumu district with the help of the district offices of the Ministry of Planning and National Development. Because there existed no official register of individual entrepreneurs operating in these markets, it was not possible to have a listing of the traders. Respondents were therefore randomly picked from this population in the selected markets using a random start. Systematic random sampling was then used to pick subsequent respondents. The entrepreneurs were also used to identify the available informal sources of credit from which they had benefited. This was necessary in order to avoid the problem of sample bias and also the possibility of informal lenders not known in the formal system. A sample of 300 respondents was initially targeted, however, only 200 respondents were successfully interviewed.

The formal financial institutions considered in this study were commercial banks, Post Office Savings Bank (POSB), non-bank financial institutions, Savings and Credit Cooperative Societies (SACCOs), and development financial institutions, mainly Kenya Industrial Estates. The informal financial institutions in the study consisted of rotating savings and credit associations (ROSCAs), savings and credit associations (SCAs), Self help groups (SHGs), welfare associations, friends and relatives, community-based organizations and NGOs

4.4 Data Analysis

(a) Logistic regression model was used to determine factors that influence an individual's ability to access loan from formal and informal financial institutions. Logistic regression is useful for this kind of a situation where prediction of the presence or absence of an outcome based on values of a set of

predictor variables is needed. The logistic regression coefficient can be used to estimate adjusted odds ratios for each of the independent variables in the model. In this analysis, the major interest is the likelihood or probability of access to credit. The binary response in this study is whether the respondent has accessed credit ('success') or not accessed credit from a formal or informal institution ('failure').

If Y is the random variable (dichotomous), it can then be assumed that Y_i takes on the values 0 or 1, where 0 denotes the non-occurrence of the event in question and 1 denotes the occurrence. If X_1, \dots, X_p are characteristics to be related to occurrence of this outcome, then the logistic model specifies the conditional probability of event (ie.. that $Y = 1$) given the values of X_1, \dots, X_p is as follows:

$$P(Y) = \frac{1}{1 + \exp(-(a + \sum_{j=1}^p \beta_j X_j))}$$

Where

$Y_i = 1$ if success (respondent obtained a loan from an institution)

$Y_i = 0$ if failure (respondent did not obtain a loan)

a = Constant term

X_i = A vector of independent variables

β_j - Coefficients for the independent variables. X_j ,

e = Error term

5.0 CHAPTER FIVE: EMPIRICAL RESULTS

5.1 Demographic and Socio-economic Characteristics

5.1.1 Age and Gender of the Respondents

The household survey results show that the mean age of the household head was 42 years. The mean age for male respondent was 42.2 (n = 155) and that for female was 42.4 (n = 45). Respondents were grouped into four categories based on age: those below 30 years of age 24 (12%), those between 31 and 40 years 76 (38%), those between 41 and 50 years 58 (29%) and those above 50 years 42(21%). Of the total number of household heads . 170 (85%) were male and 30 (15%) were female. About 156 (78%) of the sample were married. 99 (64%) male compared to 57 (36%) married women.

5.1.2 Main Occupational activities

The survey focused on three main occupational activities into which respondents were grouped: crop farming, livestock keeping/fishing and entrepreneurship. These are, however, not mutually exclusive and exhaustive, as a good number of respondents simultaneously engaged in two or more occupations in varying degrees. Out of 200 household heads, 92 (46%) reported crop farming as their main occupation and income, while 60 (30%) and 48 (24%) reported livestock keeping/fishing and entrepreneurship respectively as their main occupations and sources of income.

5.1.3 Household Size

On average the sampled household had about seven family members with an average of two members working with the head of household in the main occupational activity. About 134 (67%) of the surveyed households had family size ranging from five to nine members, while 36 (18%) had a family size ranging from one to four and 30 (15%) had about nine members.

5.1.4 Farm size and land tenure status

The farm size, was expressed in terms of amount of land actually cultivated in any farming season. Of the 92 crop farmers, 67 (73%) were found to work on pieces of land ranging between one and three acres, 16(18%) worked on pieces of land ranging between three to six acres and 8 (9%) worked on more than six acre plots. The average farm size in the sampled households is 2.8 acres. About 16 (8%) of the total respondents reported having no land. 156 (85%) of landowners do not have title deeds.

The land tenure system is rather complex. About 62 (31%) indicated that they have borrowed the land from their relatives, and only allowed to grow annual crops. About 38 (19%) cultivate on inherited pieces of land and 36 (18%) reported to use family plots for food crops. 32 (6%) reported to have purchased

5.1.5 Educational status of respondents

Proximately 46 (23%) of the respondents have not had formal education. Those with primary education were about 76 (38%) while 78 (39%) of those interviewed had attained secondary or post secondary education. The survey found that women without formal education out-number men in the same category by a ratio of 2:1

5.1.6 Annual income of the respondents

The average annual income of the respondents was shs. 49,793.00. About 74 (81%) of crop farmers earn less than shs. 40,000 per year and 18 (19%) earn between shs 40,000 and shs 80,000. Of the livestock farmers and fishermen, 34 (56%) earn between shs 40,000 and shs 80,000 and 10 (16%) earn between shs 80,000 and shs 120,000. About 16 (28%) of the livestock farmers and fishermen earn less than sh 40,000. Entrepreneurs are better off compared to farmers with about 25 (53%) Earning between shs. 250,000 and shs 400,000, 7 (15%) earning between shs 80,000 and shs 120,000 and 4 (7%) earning above shs 120,000. Crop farmers are poorer than any other occupational group in Kisumu district.

5.1.7 Use of Bank for savings and borrowing

The survey results show that few rural people actually make use of bank for savings and borrowing. It was revealed that only 70 (35%) of the respondents have bank accounts. The proportion 23% of crop farmers who had bank

accounts is smaller than that of livestock keepers and fishermen 36%, and entrepreneurs 58% These results confirm that the agricultural sector neither depends on formal financing nor benefits from its operations.

5.1.8 Value of productive assets of respondents

The mean assets value the productive assets owned by the respondents was shs 41,780 with borrowers having higher average assets value of shs. 69,383 than non-borrowers which was only shs 32,240. Crop farmers were found to possess low value productive assets with majority of them 90 (98%) owning productive assets valued at less than shs. 30,000. Many livestock keepers and fishermen about 23 (38%) were found owning productive assets valued at between shs 33,000 and shs 45,000. About 16 (26%) were in the range of shs 50,000 and shs 100,000 and only 5 (8%) owned productive assets valued at over shs 100,000. In entrepreneurship, about 14 (30%) of respondents owned productive assets valued at above shs 90,000. 11 (22%) had assets of about shs 50,000 to shs 90,000. 14 (23%) had assets valued between shs. 30,000 and shs 50,000

5.1.9 Access to Credit

About 52 (26%) of the respondents have accessed loans from informal institutions. The average amount received as loan was shs. 78,216.00. About 26 (50%) received loans of less than shs. 50,000, 13 (25%) obtained loans in the range of shs. 50,000 to 100,000, 6 (12%) obtained loans ranging between shs 100,000 and shs 150,000. Only 7 (13%) of the applicants obtained loans above shs 150,000. Most of these loans were granted between one to three years back..

5.2 Determinants of Access to Formal and In-formal Credit in Kisuniu District

Logistic regression analysis was conducted to ascertain factors that contribute significantly to credit accessibility by respondents. Access to credit variable was regressed on age, level of education, gender, farm size, land tenure status, income level, location, marital status, main occupation, land title deeds and credit awareness. Of these factors, only level of income, gender, age, level of education and credit awareness were found to influence an individual's chances to access credit from formal and in-formal credit sources. (*Table 1*)

5.2.1 Age

The results revealed a negative but significant relationship between credit access and age. This implies that old people have lesser chances of accessing credit. This relationship was expected because the older people are always risk averse and would not like to enter into debt obligations. In addition, the older people find it difficult to understand the operations and conditions of financial institutions and are also afraid of loan conditions.

5.2.2 Gender

The coefficient on gender is also significant and has a negative sign, implying that women had low access to both formal and informal credit compared to men. It is evident from the results that despite the presence of some targeted credit schemes in favour of women, they still face credit access difficulties compared to men.

5.2.3 Years of Education

Years of formal education were found to have a significant effect on one's chances to access credit. However, the negative coefficient was not expected for this variable, as it was believed that chances to access credit from formal and informal financial institutions improve with increase in levels of education. Nevertheless, the implications of these results are that the available credit services from the small credit schemes targeted the poor and vulnerable people in the rural areas and the majority of those who had benefited had low education levels.

5.2.4 Income Levels

The relationship between income levels and access to credit was also significant but the coefficient was negative implying that those with low income had better chances to access credit from formal and informal financial institutions. The negative coefficient was not expected because most of the credit that was made available to farmers and fishermen was from informal financial institutions, targeted to the very poor. In addition, most of the available credit schemes had eligibility criteria favouring people with relatively low income in rural areas.

5.2.5 Awareness

Awareness on credit availability had 3 positive effect on access to credit, implying that those individuals who are aware of the availability of credit services have better chances to access credit than those who are not aware of its availability.

5.2.6 Farm Size

Farm size related positively to the chances to access credit because the owner of the large farm would usually have a higher capital requirement and this could induce the owner to look for external formal financing opportunities. However, farm size was not a significant variable in the analyzed sample. Land tenurial status and having land title deeds were also not significant variables. These results were expected since all borrowers (those who have accessed credit) obtained their loans from informal financial institutions where no collateral was asked and issues of land tenure and ownership were not considered in loan approval and disbursement processes.

5.2.7 Occupational Activity

The main occupational activity was expected to be significant because it was thought that type of activity and investment requirements could influence individual decisions to request for additional money and hence access to credit. However, the coefficient for the main occupation was not statistically significant.

5.2.8 Location

The regression results show that there is no significant relationship between location and one's chances to access credit from both formal and informal financial institutions. In a related study, Kashuliza *at al* (1998) pointed out that gender, the level of education and awareness of tanners on the available credit facilities in their areas are important factors in determining access to credit.

Table 1: Results of Logit Analysis on Credit Accessibility in Rural Kisumu, 2006

Variable	Parameter estimates	Standard Errors	P - values
Age in years	-0.1585464*	0.0754659	0.037
Years of formal education	-0.01004'	0.0049231	0.042
Location (1=urban)	-0.0476971	0.0356125	0.1H2
Gender (1 -male)	-0.2669831**	0.063019	0.001
Marital status (1 ^married)	0.012031	0.03006	0.689
Occupation (1-niain)	-0.002585	0.025479	0.919
Farm size (hectares)	0.0094489	0.0157805	0.550
Land title deed (1-title)	0.0201518	0.0149685	J). 179
Land tenure (1=ha\$ tenure)	-0.0112845	0.120405	0.349
Annual income earned (kshs)	-0.3057918**	0.0322302	0.001
Awareness (1 -aware)	0J044144**	0.0411209	0.001
Constant	6.2888327**	0.5249399	0.001
No. of observations	=	200	
F(11. 188)	=	35.19	
Prob>F	=	0.0000	
R-squared	=	0.5934	
Adj.R-squared	=>	0.5751	

Source: Field survey. 2006

Note: *Sif>nifiant at 5%, ** Significant at 1%

5.3 The Impact of Credit Use

The income and assets values of borrowers are almost twice the incomes of non-borrowers. Nevertheless, lack of baseline data makes it difficult to ascertain with full certainty that the observed differences are due to the loans obtained by the borrowers. Also it is appreciated that establishing a causal role to credit is complex due to multiple sources of income of household and the problem of reliability of data and the fungibility of credit funds. However, it was evident that the majority of those who accessed credit (67%) were individuals earning income less than Kshs 80,000 per annum. The implication is that the increase in income of borrowers who belonged to the low-income groups might have been caused by the credit facility. In addition much of the assets that borrowers had were the ones bought through credit and hence the observed differences in assets values between borrowers and non-borrowers could be attributed to credit availability.

Furthermore, the fact that 61 percent of the borrowers obtained their loans between one and three years ago shows that with time, credit had impacted positively on income and asset values of borrowers. Credit enables the producers to acquire more and efficient productive assets and hence contributes to poverty alleviation.

5.4 Qualitative Assessment of Some Important Credit Aspects

Some qualitative information was also collected and the responses of the respondents on issues raised are as follows:

5.4.1 Attitudes of Respondents towards Credit

Out of the 200 respondents 184 (92 percent) showed a positive attitude to credit, pointing out that credit is a very essential element for increased production and that it enables the borrowers to get a working capital to start with or expand profitable enterprises and were ready to receive it if given an opportunity. However, about 16 (8 percent) of the respondents showed total reservations on credit from formal institutions arguing that conditions attached to such credits are difficult to meet and involve high risks of failing to repay, a situation which may lead to confiscation of borrowers' properties. This group of respondents, even after being given adequate awareness and clarifications by the interviewers showed reluctance to accept credit from formal financial institutions. It was observed that there are very scarce successful loan beneficiaries that can be emulated. Poor loan usage/management and subsequent defaulting led to heavy penalties to previous loanees. and these have served as bad examples to potential loanees.

5.4.2 Respondents' Opinions on Factors Limiting their Chances to Formal Credit

The study aimed at capturing respondents' views and opinions on factors that limit their chances to access credit from formal financial institutions. Five factors were mentioned. They include lack of awareness 80 (40%), difficult loan conditions 74 (37%), long distance to travel to get credit services 10 (5%), cumbersome and difficult bureaucratic procedures 16 (8%) and favouritism 20 (10%).

5.4.3. Production Constraints

For further analysis, respondents were asked to identify the most important constraints limiting increased production in their main occupational activities. 127 (42 %) of the respondents pointed at lack of capital as the main constraint. Marketing problem was mentioned by 59 (20 %) of the respondents, while technical related problems (such as pests and diseases, lack of technical know-how, soil fertility and others) were mentioned by 68 (23 %), weather related problem was indicated by 15 (5%) respondents and about 31 (10 %) claimed that vermin (thieves, wild and domesticated animals) to be their major problem.

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5.4.4. Credit Impact on Household Income and Expenditure Pattern and Enterprise Operations

77 respondents who received loans were asked to register their views with regard to changes in their income and expenditure pattern and to the changes of their enterprises) operations after receiving loans. About 78% of those who took a loan, indicated that there was an increase in their income and expenditure levels and the operations of their enterprises expanded after the loan. While 19 % indicated that no changes occurred and the remaining two (three percent) complained of declined performance in their income and expenditure levels as well as a decrease to their enterprise^) operations.

5.4.5. Reasons for Borrowers Failing to Repay the Loans

borrowers were also asked to indicate whether they were on arrears or have completed repaying their loans. 24 % (n=77) reported that they had completed repaying their loans in time and without difficulties while the remaining 76 percent were still in arrears and faced difficulties in servicing their loans. Reasons attributed to the delays and difficulties in loan repayment are summarized in Table 3 hereunder.

Table 3: Reasons Rendering Borrowers to Fail to Repay their Loans

Reasons	No. of cases	Percentage
Enterprise failure	25	43
Natural disaster (eg drought. Floods, pest diseases)	5	8
Distress consumption	7	12
Poor loan follow-up system	5	8
Marketing problems	17	29

Source: Field survey, 2006

1 lie reasons given by respondents for the delays and difficulties they face in making repayments contradict the information they gave on performance of their incomes and expenditure patterns after loan. On one hand, they are proud that the credit has improved their welfare fearing that saying otherwise will jeopardize their future chances of getting more loans. On the other hand, they indicate several factors inhibiting their ability to repay loans in time with belief that contrary information may influence the credit staff to demand repayment of their loans. It is therefore important that information should be critically assessed to determine the impact of credit intervention. The situation is more complex because the recording system of most small borrowers is poor and can't be relied much. However, during the survey, it became evident that credit had some observable effect on income and assets values of the borrowers.

6.0 CHAPTER SIX: CONCLUDING REMARKS

6.1 Conclusion and Policy Implications

Overall, the study results suggest that farming and fishing sub-sectors in rural Kisumu have limited access to credit services, a situation which has seriously constrained the agriculture sub-sector development and to a large extent floundered attempts to alleviate poverty in the country. The study results indicate that both formal and quasi-formal credit institutions are inadequate facilities in meeting saving and credit needs of the farming and fishing communities. Commercial banks were found to have limited credit schemes for small borrowers and above all, most of the credit conditions are too difficult for poor small farmers and fishermen to meet. Commercial interest rates charged by the banks and collateral requirements largely restricted farmers from seeking loans from these sources.

The existing micro-credit programmes were also found to be inadequate. These programmes had limited scope and many were plagued by serious operational inefficiencies. Lending procedures, conditions, scope and target beneficiaries among different credit programmes differ significantly. While some of these programmes target their credit services to women, others were found to target unemployed youths and organized productive groups. Interest rates charged by these programmes also varied widely, mostly concessionary. Low loan recovery and interest rates have virtually led to gross operational inefficiencies

of most of these small credit programmes, some of which have even collapsed thus escalating the problem of credit availability to the target beneficiaries.

These results conform with the first hypothesis of the study that smallholder households (farmers, fishermen and small entrepreneurs) of Kisumu district have limited access to financial services. The results also show that lending procedures and conditions influence rural households in accessing credit.

Furthermore, the study managed to establish five socio-economic factors important in influencing individual chances to access credit from formal and informal financial sources that include age, years of formal education, gender, income, and degree of awareness on available credit services. The level of education of an individual was found to be an important factor in influencing an individual chances to access credit as evidenced by the borrowers group in the study sample who were found to be better education than the non-borrowers.

Further, it was also found that although some of micro-credit programmes target women, they do not benefit equally with men from the available credit services. These findings have serious implication for poverty reduction initiatives, since women form the majority of farmers and are among the most vulnerable groups in the society and show a serious weakness of the credit system in targeting the right beneficiaries for poverty alleviation.

Majority of the respondents in this study complained that lack of awareness (40 %) of the respondents and difficult loan conditions (37 %) were the major factors that constrained their access to credit from formal sources. It was claimed that people were not aware of the availability of credit and the information on conditions and procedures of getting loans from formal and

informal financial institutions was limited among smallholder producers, particularly those living in the rural areas. The findings show that awareness of people on available credit facilities is an important factor in enhancing crediting access by smallholder farmers and fishermen.

The findings of this study show that majority of people in rural Kisumu lack a culture of saving in the banking institutions. Of those interviewed, 65 % were found to have no bank accounts. Lack of saving implies that the long-term sustainability of the credit institutions is not assured and chances of growth is limited for the small producers confirming the hypotheses that some socio-economic factors do influence rural households' chances to access credit. They also provide answers to the study question number two.

On impact assessment, the study revealed that the income and assets values of borrowers are almost twice those of non-borrowers but lack of baseline data makes it difficult to associate the differences to the loans obtained by the borrowers although the changes in income and assets values among borrowers is linked to use of credit confirming the fourth study hypotheses that credit has positive effect on income and improvement of living conditions of credit users and gives an answer to the study question three.


6.2 Study Recommendations

There is recognition of the crucial role played by financial institutions in economic growth and improvement of livelihood. It is thus recommended that the credit policy for rural and micro-enterprise lending needs to be formulated

in order to mobilize savings und maximize the availability of credit to the population in rural and sub-urban areas of Kisumu district. New legislation is required to enable the banks lo make unsecured loans and to allow loans to be made to potentially productive activities, (*see Appendix 2i*)

The existing commercial banks need to be encouraged to set up village banks and lend to smallholder farmers and micro-enterprise sector. Cooperative bank has to take a leading role in opening up credit facilities for the poor rural produces. Commercial banks in the area have to take deliberate initiatives, which could include the restructuring of their operations in order to reduce their costs of lending. This restructuring exercise should make bank loans more accessible and affordable to small borrowers. In addition, the government in collaboration with various development partners should consider the possibility of establishing a specialized credit institution to cater for specific credit and saving needs of the small farmers, fishermen and micro-enterprises.

The establishment of a wider network of bank brandies to serve the farming and micro-enterprise sub-sectors may not be possible to the banking institutions thus the formation of cooperatives, farmers associations or other forms of group responsibility for the administration and supervision of credit programmes at the local level should be promoted. Group lending approach may not only reduce the high overhead costs associated with small lending but may also encourage the establishment of good credit culture and help in achieving acceptable loan repayment levels. The emergence of saving and credit cooperatives (SACCOs) and saving and credit groups (such as the 'self-help' groups) offers an excellent opportunity as a starting point for the use of group mechanism in accessing credit to the poor majority.



The Department of Cooperative societies should facilitate the group formation process such as assisting in registering and strengthening the existing productive organizations and cooperatives through capacity building. Strong cooperatives and associations can be a very useful instrument not only for channeling credit but also in the mobilization of savings from small producers.

Furthermore, policies to enhance the role of informal credit institutions to bring about closer linkage between formal and informal institutions should be formulated. Better linkages would enable banks to benefit from the outreach and local knowledge of informal agents, expanding financial savings mobilization and credit delivery and improving the overall efficiency of the financial system.

In-formal credit arrangements need to be promoted and encouraged to continue providing credit to small farmers, fishermen and micro-entrepreneurs. However, suitable mechanism should be explored to provide coordination of various formal credit schemes in order to streamline their basic operations with a view to instituting common conditionalities and guidelines for lending to agriculture and the entire micro-enterprise sector. Proper coordination of various credit schemes will not only eliminate the present confusion confronting both lenders and borrowers but might also improve operational efficiencies of the schemes and bring about good repayment performance.

Gender differences with respect to access to credit facilities have to be critically looked into. Extending credit to women will not only accelerate production in agricultural and micro-enterprise sectors but also improve rural livelihood and

reduce poverty and as such women should be encouraged to form their own credit and saving groups and take new viable economic forms of income generation.

Provision of training to credit beneficiaries in aspects of credit management, saving mobilization, basic accounting, financial management, cash flow management, technical and on marketing aspects of agricultural, fisheries and other micro-enterprise products should be enhanced. Beneficiaries also need to be well informed on their obligations, particularly in loan repayment needs.

Furthermore, for credit to be effective as a poverty alleviation measure, its provision has to be well supported by relevant research activities and good extension services. Research should aim at developing appropriate innovations to improve agricultural and micro-enterprise performance. Extension services need to be effectively linked to research activities and to the target group in order to facilitate smooth flow of developed innovations to farmers and to give feedback to researchers for further improvement of the technologies. Promotion of effective linkages of researchers, extension officers and producers will, to a large extent, reduce the chances of enterprise failures and in so doing give value to credit through the improvement of the performance of assisted enterprises.

The issue of marketing for agricultural and fisheries products, produced after the acquisition of credit, has to be seen as a critical factor in poverty reduction efforts. Thus the government should aim at improving the necessary infrastructures in the rural and urban areas (eg through CDF funding) in order to create market incentive to small-scale farmers, fishermen and small rural producers. Improvement has to focus on the road network, communication.

power and water supply. Also agro-processing cottage industries need to be promoted and producers should be trained on quality aspects of their products. Moreover, the government should take serious actions to promote an obvious link between agricultural and fisheries sectors and the expanding tourism industry in the country.

The government needs to develop concrete strategies for mobilizing the saving culture among the general public, both in urban and rural areas for sustainability of financial institutions and poverty reduction. The use of SACCOs and micro-financing institutions, which have proved very successful in a number of countries, e.g. India, needs to be promoted and encouraged in order to provide a grassroots instrument for mobilizing savings and extending credit.

Furthermore, there should be an effort to keep people informed on the availability of credit services through village barazas. meetings and in social gathering or through mass media such as the radio and television.

Land ownership issues, though complex in their very nature need to be keenly scrutinized and accordingly acted upon to ensure security of land ownership by the majority of small-scale agricultural producers. It is thus recommended that land registration exercise already approved by the government be immediately carried out to benefit majority of poor farmers who remain insecure in the land they use and also to give them an opportunity of using their land as collateral to obtain loans from formal financial institutions.

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APPENDICES

Appendix li

A COMPARATIVE ANALYSIS OF VARIOUS INFORMAL CREDIT INSTI TUTIONS

Institution	Target	Organization In credit Deliver}	Training Of Client	Type Of Credit	Security Require- ments	Interest- Rate	Loan Ceiling Kshs	Loan Period (Months)
Faulu Kenya	Micro- entrepreneurs Aged 30 yrs in groups of five	Hull fledged credit NGO	One week training for starters	Cash via bank accounts	Group guarantee & regular savings	15-20% p.a on straight line method	1,000,000	Up to 12 months
KADET	Micro- entrepreneurs In groups of 15 & more members	Registered NGO	One week training	Cheques released at intervals	Group guarantee & regular savings	19-24% p.a on reducing balance	800,000	Up to 12 months
CARE	Pre-existing Organized women group investors based on proposals	Registered NGO	Critical assessment of business proposal	Cash via bank accounts	Business assets or group guarantee	15-20%	3.000.000	Up to 24 months

Source FieIJSurvey. 2006

Appendix Iii

A COMPARATIVE ANALYSIS OF VARIOUS INFORMAL CREDIT INSTITUTIONS

Institution	Target	Organization (In credit deliver)'	Training or Client	Type or Credit	Security Require- ments	Interest- Rate	Loan Ceiling Kshs	Loan Period (Months)
K.I.E	Small scale traders and entrepreneurs society-	Government funded	Members briefed on loan use thro publications	Equip- ment & Cash	Group members guarantee one another	15-25% p.a com-pounded	3,000,000	Up to 36 months
Kenya Small Traders and Entr- preneurs society	Members traders only	Co-operative movement	N/A	Cash	Members shares	9-15% p.a com-pounded	Based on members shares. No limit	Up to 36 months
K-REP	ROSCAs who then lend to members	Government funded	On site group training	cash	Group's savings & group guarantee	11-20% pa reducing basis	Ten times savings	Up to 24 months

Source FieIJSurvey. 2006

Appendix liii

A COMPARATIVE ANALYSIS OF VARIOUS FORMAL CREDIT INSTITUTIONS

Institution	Target	Organization (In credit deliver)'	Training Of Client	Type or Credit	Security	Interest- Rate	Loan Ceiling Kshs	Loan i'eri od (Months>
ICDC	Retail & wholesale traders	Govt Corporation	N/A	Cash	Business assets	12-20% p.a	5m to 10m	24 - 36 months
A.C.K Diocese of Maseno South	Farm and non Farm rural enterprises	Church funded	N/A	Cash and equip- ment and advisory services	Title deeds	6-10% p.a com-pounded	1,500.000	Up to 24 months
Banks BBK, KCB, CO-OP. NBK. STD, Baroda. Equity etc	Individuals and groups engaged in business or farming	Formal credit institutions	Small brief by personal bankers	Cash plus advisory- services	Title deeds and also group guarantee	16-28% p.a reducing balance	Not limited subject to ability to repay	Up to 5 years

Source: Field Survey, 2006

Appendix 2i

STRATEGIES FOR INCREASING ACCESS TO CREDIT BY SMALL AND MICRO-ENTERPRISES

In a tabular format, I summarize the strategies for addressing the institutional impediments that limit SMEs access to credit with a view to identifying specific impediment, reasons for the impediments, and possible interventions for reducing the bottleneck.

Institutional impediment	Details of the problem	Corrective interventions/strategies
1. Female entrepreneurs have poorer access to credit than male entrepreneurs	This problem relates to power relations at the household and community unfavourable to women. These relations manifest themselves in ownership of property especially property with collateral value.	Continue empowering women education -e.g. free primary education. Facilitate formation of women self-help groups for promotion of joint liability. Strengthen and expand micro-finance programmes that target women entrepreneurs.
2. Rural based SMEs have distinctively less access to credit	Rural areas are less attractive to credit suppliers due to: Have less concentration of business and hence costly to serve Are more affected by deteriorating infrastructure Are poorer hence less effective demand and therefore less profitable business opportunities.	Improve rural infrastructure to open up rural commerce and increase profitability of rural enterprises. An increased pool of rural business should act as a pull for business services including financial services.

<p>3. Less educated entrepreneurs show little interest in credit and also receive little credit</p>	<p>There is possible positive con-elation between an entrepreneur's education level and ability to:</p> <ul style="list-style-type: none"> - Pursue profitable business - Understand the workings of credit arrangements - Successfully manage loans 	<ul style="list-style-type: none"> -Continue to expand educational opportunities to improve the literacy -Encourage self-financing adult literacy classes for business persons
<p>4. The current credit regulatory environment reduces SMEs' access to credit</p>	<p>Existing regulations have a stranglehold on micro-finance programmes and institution extending financial services to SMEs.</p>	<ul style="list-style-type: none"> -Make the regulations more flexible by allowing use of collateral substitute for securing loans to SMEs •Create exceptions to the minimum capital requirements for institutions that target SMEs -Reduce entry and exit barriers in the financial sector to make the sector more contestable and therefore customer friendly.
<p>5. There is low incidence of supplier credit. This credit is an important supplement to other financial services.</p>	<ul style="list-style-type: none"> - Business shy away from extending credit to their customers due to problems in enforcing contracts. 	<p>Establish dispute resolution mechanisms that can handle small claims cost effectively such as Small Claims Courts.</p>

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<p>6. Given the importance of enterprise age in access to credit, short life expectancy of SMEs, especially informal ones, is an impediment to credit access.</p>	<p>The high mortality rate of SMEs means lost opportunities not only for accumulating business experience but also for building credibility and reputation that are necessary for accessing credit from financial institutions and suppliers of inputs and products. Most business die due to lack of credit.</p>	<ul style="list-style-type: none"> - Put in place business clinics for extending managerial and 'financial first aid' - Develop terms of reference for a study on enterprise survival and explore non-commercial risks peculiar to SMEs
<p>Informality) inhibits access to credit</p>	<p>Although the SMEs sector has limited access to credit, the informal segment has even less access than the rest of the sector, because of:</p> <ul style="list-style-type: none"> - Uncertain legal status - Higher mortality rates - Less visibility - Low exit and entry barriers that create intense competition 	<p>Develop mechanisms for mainstreaming informal enterprise such as reducing registration costs and delays whose avoidance necessitates informality</p>