THE PROSPECTS OF MICROFINANCE: THE POTENTIAL GROWTH OF KENYA'S MICROFINANCE INDUSTRY

BY

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Project funded by:
The Reinvention Centre for Undergraduate Research, University of Warwick
August 2008

ABSTRACT:

This report provides an overview of the ability of the microfinance industry to bridge the finance gap within Kenya's population. It also investigates the different aspects between Kenya's commercial and non-commercial microfinance institutions (MFIs).
The results of this project, illustrate clear evidence that there remains a large potential market for the microfinance industry in both rural and urban Kenya. These results also explain that commercial and self-sustaining MFIs are best suited to meet this growth.
The project concludes by stating that because of their ability to reach and serve clients more effectively, MFIs that meet their own costs and raise their own sufficient capital are best suited to attract and serve the large financially excluded adult population in Kenya.

Keywords: Microfinance institutions, Financially excluded, Commercialization

INTRODUCTION:

Microfinance refers to the small-scale financial services that involve mainly credit and savings services to the poor (Robinson, M. 2001). Microfinance has evolved to also include the provision of insurance, housing and investment services for low-income people. Globally, it is providing an avenue for the poor to enrich their livelihoods and to have a greater impact on their countries' economic growth. However, despite the exponential growth of the microfinance industry, its demand remains largely untapped.
This large gap in the supply and demand of microfinance services is evident in Kenya. A 2001 survey by Faulu Kenya Ltd, a leading Kenyan MFI, estimated that based on a 1999 Central Bank of Kenya (CBK) survey, the gap between supply and demand for credit in Kenya is 68 billion Kenya shillings; approximately $1 billion. (www.centralbank.go.ke/rates/exchangeindex.asp).
Micro and small-scale enterprises (SMEs) have generated a demand for credit and savings services that has resulted in the formation of over 100 microfinance organizations, half of which are non-governmental organizations (NGOs) practicing some form of microlending across Kenya. (www.amfikenya.com)
The Kenyan microfinance sector began in the late 1960s with a few NGOs that set up pilot programs providing donor funded credit services. Some of these organizations have evolved over time to become commercialized, self-sustaining and hugely profitable institutions with over 100000 clients. Microfinance is also rapidly becoming Kenya's most accessible and affordable financial service. It is for this reason that I wanted to study the nature and potential of Kenya's microfinance sector, specifically within and around Nairobi. This projects aim was simply to observe, study and document the growth and potential market of Kenya's microfinance industry. There has been extensive research carried out on the growth of rural credit lending (Atieno, R. 2001) and the subsidized loan lending by non-governmental agencies in Kenya. http://www.uncdf.org/english/microfinance/uploads/evaluations/uncdf_MF_kenya.pdf
However, there is little independent assessment of the success of commercial and private microfinance institutions. For that reason, this project focused mainly on observing the operations of the emerging commercial microfinance banks in Kenya.

METHODOLOGY:

The chronological stages of this research are as follows:

- January 2008: Initial Plan

The research project began with an initial 5-month plan from February 2008 to June 2008. Whilst drawing up the plan, my project partner, Nomsa Fulbrook, and I were invited to apply as delegates to the Global Engagement Summit 2008 in Chicago. Its attendance in April was included in the project plan. The final research plan was then submitted to The Reinvention Centre in the funding application.

- April 2008: The Global Engagement Summit (GES) 2008, Northwestern University

At this summit, held in April at the Northwestern University, Chicago, we attended seminars such as 'Economic Innovation: Microfinance and Microcredit' which discussed innovations in the microcredit field. Kathryn McElligot, a development manager of the global Microcredit Summit Campaign, led the seminar. I had the opportunity also to discuss my project with Alex Michel, Director of Communications and Organisational Development for the Foundation for Sustainable Development International. Alex's advice for me to focus the research on the field level proved invaluable throughout the project. We also interviewed Professor Kumal, a lecturer at Northwestern's Kellogg School of Management. She was extremely helpful in giving us an overview of the growth and future of global microfinance from her experiences. She gave us some fruitful advice on articles to study, such as the Grameen Bank's Sixteen Decisions, The Economics of Microfinance by Aghion and Murdoch and Banker to the Poor by Muhammad Yunus. We also had the opportunity to discuss our project with various students who had researched and interned at various MFIs in Africa and Asia.

- May 2008: Logistical Planning for Nairobi, Kenya

By this time the project was increasingly drawn towards focusing on field research primarily within Kenya, with an interest on concentrating on the nature of microlending and savings programs in Nairobi. At this point it was also decided that we would branch the project into two. I would be involved with traveling to Nairobi, acquiring the field data and writing out the final report. Nomsa would now be in charge of the post-report stages, involving planning the dissemination of the final findings and the microfinance mini-forum we planned to organize at the University of Warwick in Term 1 of 2008/2009.

At Warwick University, I was able to email Ann Mutahi, chairperson of the Association of Microfinance Institutions (AMFI) Kenya, concerning my research project and my need to interview her. She was more than helpful in not only guaranteeing the interview but by also providing the contacts of three chief executive officers of leading microfinance institutions in Kenya. Through these contacts I was able to plan and arrange interviews and work placements at three MFIs in Nairobi.

- July – August 2008: Field Research in Nairobi, Kenya:

1. Week 1: A General Overview of the Microfinance Sector in Kenya

I spent my first week in Nairobi conducting interviews with MFI officials so as to familiarize myself with the general nature of microfinance in Kenya. My first interview was with Ann Mutahi. Her analysis of the gap between supply and demand of finance amongst Kenya's population was also insightful. My last two interviews were with Lydia Koros, CEO of Faulu Kenya Ltd and Rose Wanjohi, CEO of Kenya ECLOF Ltd; two leading MFIs in East Africa. Both their organizations had seen enormous growth over the past decade mainly by diversifying their products and services and by marketing themselves on the field more aggressively. I also spent this week studying books and articles on microfinance. Most explained that the commercialization taking place amongst Kenya's MFIs was similar to that of Bank Rakyat Indonesia and BancoSol Bolivia in the 1980s (Robinson, M. 2001).

2. Week 2: A look into changing patterns in Labour and Technology

I spent my second week attending a training programme for a new management information system (MIS) at the Kenya Eclof Ltd head office in Nairobi. This training week allowed me to see the increasing need for efficient software that can accommodate rapid growth and product enrichment. I was also observed the increasing demand by MFIs for a skilled and formal-banking experienced workforce. The growth of skilled labour in MFIs and the large client numbers has forced these organizations to adopt technological management systems that increase the speed of their transactions and operations.

3. Week 3-7: Observing the Field Operations of Commercial MFIs

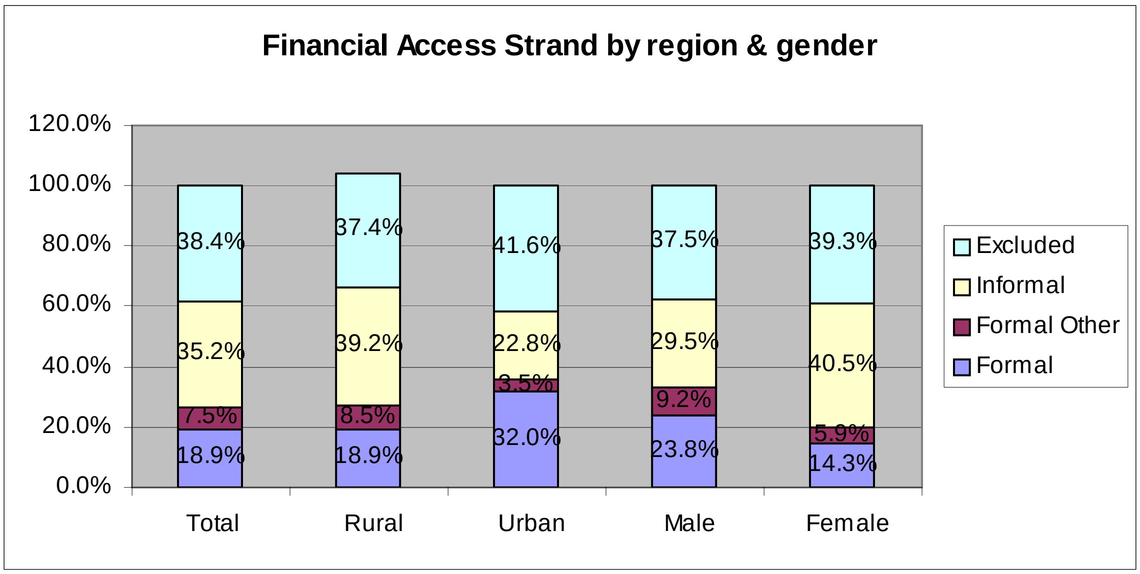
I spent the next four weeks on attachment at the Nairobi Central branch of Faulu Kenya Ltd. Working with the loan officers, I attended about 150 group client meetings, from which I was able to observe the group lending methodology; group activities in approving and co-guaranteeing their members' loan applications; the role of the loan officers; collection of loan payments and loan disbursement and the characteristics and views of clients. I attended group meetings in Nairobi's locations of Eastleigh, Mathare Githurai, Kahawa West, Kiambiu, Pangani and Ruiru.
Working from the field allowed me to observe the various challenges faced by MFIs, such as high default rates in certain areas and the vulnerability of the industry to political instability caused by ethnic disputes. The labour intensive nature of the industry was also evident, with loan officers in some cases acting as advisors, debt collectors, default managers and even auctioneers.

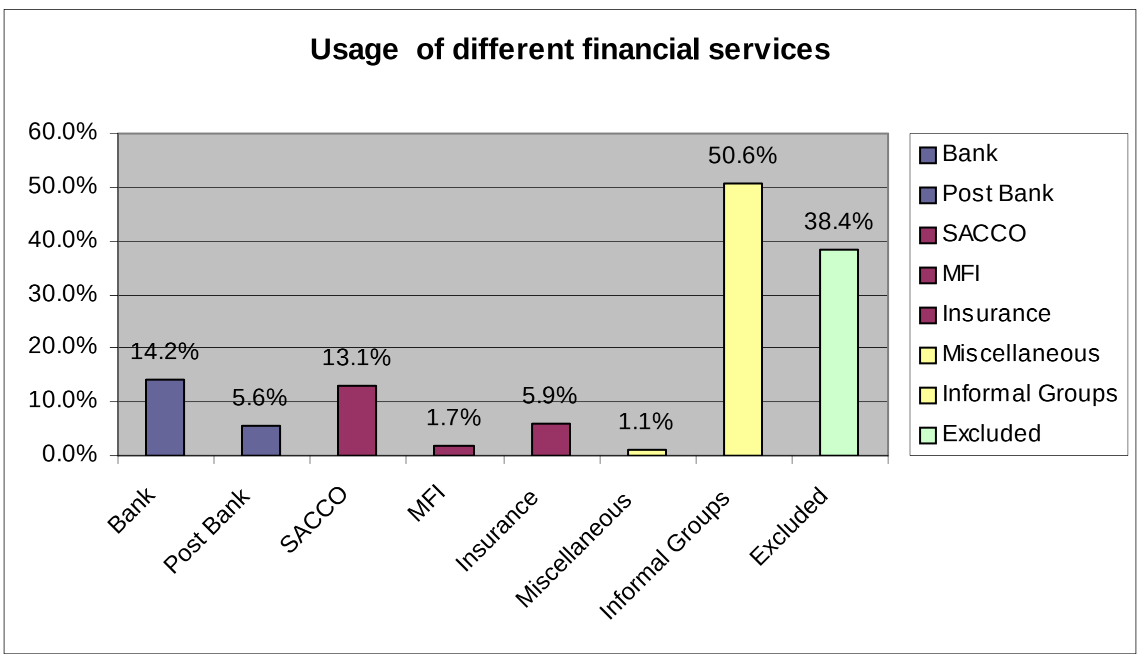
4. Week 8-9: Observing the nature of a non-commercial, donor-funded MFI

I spent this week observing the operations at the Kenya Rural Enterprise Programme (KREP) Development Agency (KDA), a donor funded research and development MFI. At KDA, I identified some key differences between donor-funded MFIs and commercial ones. I then spent my ninth week organizing and compiling my field notes into one final project report.

RESULTS:

Below are results of a 2006 national survey carried out by Financial Sector Deepening (FSD) Kenya on the financial access strand and use of different financial services by Kenya's adult population:





Source: Financial Access in Kenya, Financial Sector Deepening (FSD) Kenya, October 2007

From the above it is clear Kenya's MFIs currently serve a very small percentage of Kenya's adult population; with only 1.7% of adults using MFI services. But the potential for them to increase this is also evident. MFIs' clients currently come mostly from users of informal financial service providers e.g. Rotating Savings and Credit Associations (ROSCAs). This group made up 35.2% of Kenya's estimated adult population of 17.4 million in 2006. With the growth of microfinance and its easy access, more financially excluded low-income Kenyans have formed groups and began borrowing and saving with MFIs. The financially excluded made up 38.4% of the adult population in 2006, providing a potential market growth for MFIs of approximately 6 million clients.
Many MFIs have identified this potential and are targeting women especially. Women provide a larger untapped market than men as 40.5% of women relied only on informal financial service; almost double the percentage of men within this group. 39.3% of women were also financially excluded in 2006, a percentage larger than the national financially excluded percentage.
It is also now widely accepted that only commercial and profitable MFIs can survive and exploit this potential market (Robinson, M. 2001). Increasing competition between banks, Savings and Credit Cooperatives (SACCOs) and MFIs has hastened commercialization of MFIs in Kenya. MFIs have had to take out loans, issue bonds, etc and charge much higher interest rates than formal banks (The Economist. June 28th – July 4th 2008).

CONCLUSIONS AND OUTCOMES:

This research project's main conclusions are:

- There remains a large potential market for formal financial services in Kenya.
- The growth of microfinance in Kenya can only be sustained by commercial and profitable institutions.

Through this project I have come to appreciate microfinance as one of the fastest growing developmental tools of the 21st Century. I have enjoyed traveling and studying a topic that both complements and enriches my student learning experience at Warwick Uni. Apart from releasing the project findings on Warwick Blogs, the next aim of this project is to engage the rest of the Warwick community on this topic. By organizing a mini-forum for students and academics in Term 1 2008/2009, we hope to contribute to more participation of Warwick students in the global microfinance movement.

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