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ABSTRACT

In Kenya, like in many developing countries, Micro and Small Enterprises (MSEs) have become the main focus for achieving the much-needed social and economic development and alleviating poverty. However, their development has been hampered by lack of access to appropriate financial and related services. Micro financing has been seen as a viable alternative to providing financial services to entrepreneurs in the MSE sector.

The focus of this study was to explore the role of MFIs in the development of MSEs and to see if there are ways in which this role can be enhanced to better support the growth of MSEs. Such enhancement would contribute greatly towards government efforts to foster social-economic development.

The results of the research indicate that generally, MFIs appear to have positively influenced the growth of MSE in Kenya and have potential to further influence MSE growth. There were however a number areas that if paid attention to could enhance this influence. These include the need for MFIs to offer supportive services as opposed to merely credit facilities to MSEs and the need for government intervention by putting in place a suitable Act to regulate the operations of MFIs.

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EXECUTIVE SUMMARY

The need for MFI services to MSEs has arisen due to various factors. In periods of economic stagnation and without the MFI services, dearth of MSE entrants is expected to be even higher than in periods of economic growth, even as these enterprises are the only resort for those unable to find other employments. MFIs have become the main focus for achieving the much-needed social and economic development in Kenya. Micro financing has been acknowledged as one of the most effective means of getting credit facilities to entrepreneurs in the MSE sector (Kandie, 2005). According to Kandie (2005) access to credit has been identified as one of the greatest challenges in creating wealth and alleviating poverty in developing countries. In this respect, it would therefore be fair to argue that the provision of savings and credit services is a key instrument for economic empowerment of MSE provided some favorable conditions are in place (ECI and DPRU 2001). Compared to conditions set by traditional banks, MFIs have made it so easy for MSE to obtain loans. Muchiri (2005) emphasizes that micro-finance is increasingly attracting attention and has become the main focus for achieving social and economic development in Kenya. MFIs are also seen as a viable alternative to commercial banks, which have gained notoriety for fleecing their customers through exorbitant charges on withdrawals, banker's cheques, monthly ledger fees and service charges.

Like any industry, the MFI sector is faced by a number of challenges as it evolves in its path for growth. Some of the major challenges faced by MFIs include lack of government regulation, donor dependency, threat from unregistered MFIs, risk exposure and outreach. As United Nations Development Programme-Kenya (2005) puts it, many MFIs gauge their contribution to MSEs by the number of loans or the amount of funds advanced to their clients and look at their clients' satisfaction in

terms of loan repayments and repeat borrowing rates. Little effort has been made to establish how MFIs have influenced the growth of MSEs Sector beyond loan borrowing and repayment stage. This then creates a need to look at the MFIs influence to MSEs in a broader perspective, from the primary stage of loaning and repayment and beyond. To achieve this, the research focused on the following specific objectives. One, to describe the role of MFI as a tool for development of MSEs, two, to describe what services and products are offered by MFIs to MSEs, three, to describe what MFI services and products have been used by MSEs, four, to describe the MSEs Satisfaction with the current MFI products and services and, five, to describe MSEs Expectations of MFIs' services and product offered and then analyze the gap between current service levels and expected levels. The research therefore aimed at describing how MFI services have influenced the growth of MSE sector in Kenya.

The research was conducted within the interpretive paradigm. The qualitative technique was deemed fit for the research and the research methodology was a case study. The research population included all micro-finance institutions in Kenya, micro and small enterprises in Kenya using MFI services, Association of Micro-finance institutions (AMFI) and Kenya Association of Jua-Kali, Ministry of Co-operatives and Ministry of Trade and Commerce. In selecting the MFIs to interview, efforts were made to have a balanced representation from both urban and rural based organizations.

To achieve the objective of the research, the researcher used a purposive sampling. Out of all the potential respondents selected using purposive sampling, two interview were conducted with representatives of the ministry of trade, one with Co-operative bank, one with AMFI, two with association of Jua-Kali, eight with MFIs and 13 with

different MSEs in different geographical region, each lasting for about 45 to 90 minutes depending on the flow of information.

In-depth semi-structured interviews and document analysis were the two main methods of data generation used by the researcher. Information was also sought using documentation to support the accuracy of statements and action made by the respondents in their individual capacity during the interviews.

The researcher-analyzed data using explanation-building technique and the analysis was in narrative form and was aimed at establishing a set of links to a certain phenomenon (pattern-matching). It is worth noting that as the researcher only interviewed a few individuals per MFI, the results relating to each MFI cannot be taken as statistically significant. However, the overall trends established for the aggregated MFI data are in researcher's view a reasonably accurate reflection of the reality on the ground.

The most significant finding is the wide-ranging use of MFI products and services by its MSE clients. MSEs use MFI financial services for business growth, sustainability and personal use. Specifically, loans and savings are used to finance productive activities such as business expansion and starting up new businesses; coping with crises such as cash shortage, worn-out and lost assets replacement etc. MFIs also appear to have maintained distinctiveness in the service industry, as they tend to be customer-driven than product-driven. Since the market for MFIs is dynamic in nature, this client responsiveness has helped MFIs to regularly collect feedback from their clients, which has further assisted them to adjust their operations accordingly to match with the market demand in both urban and rural areas. Over time, MFIs have come in

to fill the financial services gap left by banks. MSEs have evidently benefited from the presence of MFIs, judging by the testimonies given by ROSCA members.

Overall, MFIs appear to have positively influenced the growth of MSE in Kenya and have a higher potential to influence further MSE growth if the highlighted dissatisfactions, and the resultant gaps and recommendations are addressed;

It is recommended that MFIs using the minimised approach enhance further their menu of products. Profit oriented MFIs should reconsider giving start up capital to support those business ideas that have high chances of succeeding. To reduce the probability of businesses failing, MFIs should have a research unit whose main work would be to review and research on business ideas and assist in preparation of business plans before funding is approved. To reduce the risk further, MFIs should have close supervision on the daily running of such newly formed businesses.

While MFIs are an important provider of financial services in both urban and rural areas, one major weakness has been to introduce products that are flexible to meet the needs of the diverse MSE sector. For the MFIs to be more effective in their area of operation, they should develop a regional mindset approach.

To protect potential loan seekers from unscrupulous loan sharks, and to provide a clear MFI framework in terms of their governance, operations and accountability, the government should provide sufficient legal protection. The government should embark on MFI restructuring program where all the existing MFIs will be controlled by one Act.

Chapter one

LITERATURE REVIEW

1.0.0 Introduction

This chapter provides background to the nature of Micro-Finance Institutions (MFIs) and their roles to Small and Micro Enterprises (MSE). A multidimensional approach forms the basis of the chapter's discussion on both MFIs and MSEs. In particular the chapter reviews the literature on MFIs from an international perspective, narrowing down to the specifics in Kenya. It highlights the history of MFIs in Kenya, how MFIs compares to the traditional Banks in Kenya, MFIs classifications and their business models, the supporters of MFIs in Kenya and the general challenges they face in their effort to meet their objectives. On the side of MSEs, the chapter reviews the literature by exploring the meaning of MSE sector, its development in Kenya and the challenges it faces.

1.1.0 MFI and MSE General Overview and definitions

The Asian Development Bank (ADB) (2005) defines micro-finance as the provision of financial services, which include financial advice, deposits, loans, payment services, money transfers and insurance to poor and low-income households and their micro-enterprises. Some micro finance institutions (MFIs) have further enhanced this core business by combining their services with business development services (BDS) based on their clients needs (Asociacion Para El Desarrollo Microempresarial Colombiano (ADEMCO) and Women's Opportunity Funds, 2001).

Micro financing has been a spectacular success in creating millions of self-sustaining micro-enterprises around the world. United Nations Capital Development Fund (UNCDF) (1999) reports that: 13.8 million people had been granted micro-loans in Africa, Asia, Eastern Europe, and Latin America; and loans to the world's poorest people were increasing by about 37% per year. The report has also indicated that there are about 3,000 micro finance institutions in the developing world.

According to UNCDF (1999) micro credit programs in many countries have proved to be an effective tool in freeing people from poverty and have helped to increase their participation in the economic and political processes of society. UNCDF (1999) further stresses the importance of micro credit in supporting the goals of growth and equity, which has resulted in a growth in the recognition of the importance of empowering all people by increasing their access to all the factors of production, including credit.

The growth of the Grameen Bank of Bangladesh (with more than 2.4 million borrowers in 40,000 villages, covering more than half of the total villages in Bangladesh) is perhaps the world's greatest micro credit success story (UNCDF, 1999). But there have been many other success stories, such as the Banco Solidario in Bolivia, and the Kenya Rural Enterprise Program. According to Rosengard, Rai, Dondo and Oketch (2000) the Kenya Rural Enterprise Programme (K-Rep), established in 1984, is one of the most innovative and successful microfinance schemes in Africa. It provides financial services to micro enterprises excluded from the formal financial sector, thereby generating income and employment opportunities for low-income micro entrepreneurs. K-Rep made 11,582 loans totaling to approximately US\$5.9 million in 1998.

Thyra and William (2000) define micro and small enterprises (MSEs) in Kenya as those businesses that have 1-49 employees. In addition, they suggest that such services as provided by MFIs are essential for the growth of any economy in the world. In Kenya for example, the services of MFIs to MSEs have been emphasized by the Government to enhance the economic growth rate as the growth of MSE have been recognized to create employment thus reducing unemployment (Thyra and William, 2000). In Kenya, as in many parts of Africa, a growing MSE sector has been in response to stagnating employment growth in the economy and the downsizing of parastatals and of private companies as they reduce costs in a liberalizing environment and as people look for an alternative means of living especially those pushed into unemployment (Thyra and William, 2000).

The need for MFI services to MSEs has also been given a lot of weight by other writers. Kandie (2005), states that, in periods of economic stagnation and without the MFI

services, dearth of MSE entrants can be expected to be higher than in periods of economic growth, even as these enterprises are the only resort for those unable to find other employment. In support of this argument, Thyra and William (2000) contend that MFIs have become the main focus for achieving the much-needed social and economic development in Kenya. Micro financing has also been acknowledged as one of the most effective means of getting credit facilities to entrepreneurs in the MSE sector (Kandie, 2005). This effectiveness is mainly as a result of the business model used by the MFI, both in Kenya and worldwide a variation of the so-called the Grameen Credit methodology which removed the need for collateral creating a credit system based on mutual trust, accountability, participation and creativity (Muchiri, 2005). The use of these models not only guarantees the access of credit to MSEs which do not have much to offer as collateral but also minimizes default rates to less than 5% (Kandie, 2005). Such models, according to Kandie (2005) and Masinde (1998) are group lending (peer group schemes), individual lending through savings and credit co-operative societies (SACCOs) and merry-go round.

Hulme, Kashangaki, and Mugwanga (1999) argue that the Kenyan micro-finance industry is one of the oldest and most established in Africa and that its interest in the MSEs sector in Kenya started as far back as the early 1970's. As the micro-finance industry matures, it becomes important to understand the financial needs of clients (and potential clients) and how borrowing and saving fits into their money management strategies and growth (Price Water House Coopers. 2003). On the same thinking, United Nations Development Programme-Kenya (2005) argues that many MFIs gauge their contribution to MSEs by the number of loans or the amounts of funds advanced to their clients and look at their clients' satisfaction in terms of loan repayments and repeat borrowing rates. Little effort has been put to establish how MFIs have influenced the growth of MSEs sector beyond loan borrowing and repayment stage. This then creates a need to look at the MFIs influence to MSEs in a broader perspective, from the primary stage of loaning and repayment and beyond.

1.2.0 History of MFIs in Kenya

According to Hulme, Kashangaki, and Mugwanga (1999), Church based organizations such as National Council of Churches of Kenya (NCCCK), Catholic Relief Services (CRS) and other smaller church based NGOs were the first to provide credit to MSE as early as in the 1970s. Other specialized organization, such as K-REP (funded by USAID), Kenya Women's Finance Trust (KWFT), CARE-WEDCO, PRIDE, FAULU, Tototo among others came in, in the 1980s through early 1990s (Hulme et al., 1999). These organizations used the integrated approach to assist micro-enterprises. This approach involves offering credit as well as training to clients. All of these institutions continued to be reliant on donor funds although others such as K-REP and FAULU have since been licensed as banks (Mugambi, 2005).

Findings in Kiiru and Pederson (1996) shows that although most of MFIs in Kenya were formed through donor supports, some have since been left to stand on their own e.g. KWFT, where the beginning of the 1990s saw the beginning and growth of non-donor funded MFIs. Although KWFT started its operations in the early 1980s with several donors providing grants, that support dwindled in the latter part of the decade due to poor performance. By 1990, general mismanagement had resulted in a relatively high number of non-performing loans. Operations had largely ceased and donor confidence was badly eroded. The institution was subsequently restructured with a new board of directors, (comprising professional women), management team and staff. A focused group-based credit methodology was also adopted (Kiiru and Pederson, 1996).

1.2.1 MFIs versus Traditional Banks in Kenya

According to Kandie (2005) access to credit has been identified as one of the greatest challenges in creating wealth and alleviating poverty in developing countries. In this respect, it would therefore be fair to argue that the provision of savings and credit services is a key instrument for economic empowerment of MSE provided some favorable conditions are in place (Ebony Consulting International (ECI) And Development Policy Research Unit (DPRU). 2001).

Compared to conditions set by traditional banks, MFIs have made it easy for MSE to obtain loans. MFIs do not ask for collateral when advancing loans while it is a must in traditional banks (Kandie, 2005). Kandie (2005) further argues that such requirements by the banks do not stimulate entrepreneurial activity and efficient use of entrepreneurship skills, and frustrates self-help innovation hence the popularity of MFIs. The financial or administration charges requested on loan application by traditional banks are beyond the capability of most MSE while MFI do not levy these charges for example, SACCOs do not levy other charges levied by traditional banks such as the exorbitant charges on withdrawals, banker's cheques, monthly ledger fees and service charges (Koigi, 2005). When some of these banks closed their branches in the rural areas in early 2000, citing increased costs of operation, MFIs widened their outreach to fill the void. According to Kandie (2005) Micro-finance typically takes place where the MSE businesses are located and not at the premises of the lender. This helps to forge close working relationships while ensuring that issues and problems that could precipitate negative repayment are addressed on time. Kandie (2005) further argues that in spite of the very good intentions that banks may have, the banking sector is faced with real constraints, both internal and external, in its attempt to avail credit to the MSE sector. The highly specialized and formal structure of the banking business model for instance, is not suited to the needs of the highly informal MSE sector. This structural mismatch has necessitated the formation and continued growth of micro-finance providers to bridge the gap. On the other hand, the structural flexibility of micro-finance makes it the appropriate tool for availing credit to the MSE sector. They provide low minimum account balances and long term loans at lower interest rates (Koigi, 2005). Consequently the majority of the 2.2million or so micro-enterprises in Kenya owe their breath to MFIs (Koigi, 2005).

Muchiri (2005) emphasizes that micro-finance is increasingly attracting the attention of the Kenyan Government and has become the main focus for achieving social and economic development in Kenya. In its (2003/2004) fiscal plan the Kenyan Government introduced an economic recovery and growth strategy that identified the need for credit to the MSE sector as a key objective. Price Water House Coopers (2003), states that the Kenyan government in trying to achieve this objective, introduced changes in the banking

sector, whose aim was to release more credit into the productive sector, and particularly to the MSE sector. This included reduction of the cash reserve ratio, which released bank resources, held at the Central Bank, for lending purposes. This together with the reduction in government securities rates, proved to be a success as banks shifted their investment strategies of investing in government securities to provision of more loan products to the markets. However, in spite of the banks concentrating on growing their loan portfolios MSEs did not benefit, as most of this credit was targeted at consumer credit and to a lesser extent the mortgage industry, while the MSE sector remained largely unable to access the credit (Kandie, 2005).

1.2.2 Types of MFIs and Business Models applied

Muchiri (2005) gives the business models as another reason behind the effectiveness of MFIs as credit providers to MSEs. He says that most of the business models used by the MFI, both in Kenya and worldwide are a variation of the so-called the Grameen Credit methodology. Commonly used models in Kenya are:

- (i) According to Kandie (2005) one of the methods used by MFI in developing MSE is by way of group lending (peer group schemes) which provides economies of scale to the lender. Beside the economies of scale, the lender depends on the group to utilize the power of peer pressure in loan repayment. Peer pressure mechanism is intended to mitigate the risk of default without the need for tangible collateral. The idea is that the groups members will not only assume joint liability but will monitor their peers to ensure repayment obligations are met. Another name for this model according to UNCDF (1999) is the solidarity group system.
- (ii) The second model is given by UNCDF (1999) as the Mutualist or co-operative savings system commonly used by co-operative societies such as Co-operative Savings and Credit Societies (SACCOs) and farmers' co-operative societies. SACCOs mobilizes savings through individual members share contributions and then channels the funds to individual members for specific development projects (Masinde, 1998). Irungu (2005), explains further that, the SACCO system is a mutual membership organization, which involves pooling of voluntary savings

from members in form of shares. The savings/shares form the basis for extending credit to members and unlike the peer group schemes, individuals are advanced loans normally three to four times their shares contribution with a repayment of between 36 to 48 months. The individual Member's share contribution is used as collateral together with that of the guarantors (Masinde, 1998). According to Mugambi (2005), an estimated 4,500 SACCOs hold over Ksh.105 billion (USD1.5 billion) in deposits (share contributions). This shows how liquid SACCOs in Kenya are and their potential for credit generation to their members. According to Irungu (2005), the size of deposits held by SACCOs amounts to a tenth of the total wealth or gross domestic product. The figure is 31% of national savings.

Farmers' co-operative societies on the other hand provide farmers with farm inputs and services such as collection; transportation, processing and marketing of agricultural produce and then reclaim these expenses from individual farmers' sales proceeds (ECI and DPRU, 2001).

Hospes et al., (2002), SACCO societies, regulated by the Co-operatives Societies Act, respond to people's need for food and food production, housing, education, small enterprise, transport, medical care, clothing and expenses in weddings, birth and death. Additionally, co-operatives are guided by the so called Rochdale principles namely; voluntary and open membership - open to all persons able to use their values into practice; democratic member control – members actively participate in settling their policies and making decisions; member economic participation – members contribute equitably to, and democratically control the capital of their co-operative; autonomy and independence – self help organizations controlled by the members.

Masinde (1998), explains that co-operatives as vehicles for social-economic development contribute to economic growth and development in many ways, the following being the main ones;

- (ii) Mobilization of savings and channeling the funds to individual members for specific development projects at a reasonable interest rate and guarantee being other members.
- (i) Provision of credit to members for defraying urgent expenses such as school fees, hospital bills etc at affordable costs.
- (ii) Act as an institutional framework through which; otherwise small uneconomical surplus can be harnessed by tapping economies of scale, poverty can be alleviated by planning, organizing, implementing and managing income generating economic activities, development funds can be channeled to individual members, members can be educated on economic and social issues affecting them including development of entrepreneurial skills, wealth and capital can be created and owned jointly by large groups of low income earners
- (iii) Collection, transportation, processing and marketing of agricultural produce.

According to Hospes et al., (2002), MFIs applying either of the above two models can be classified into two broad types based on their purpose and formation. The first and most commonly classification is on the basis of formality where providers are categorized as formal or informal depending on the extent to which the MFI is registered and regulated under formal law and transactions are governed under the various statutes of the law of contract or rather by self-regulation or group-based rules.

The second categorization is based on the customer/provider relationship in the management and ownership of the financial service-providing entity. Under this categorization, micro finance providers could further be dividend into two:

1.2.2.1 Client-based micro finance agencies (CMFAs)

These comprise of all Micro-finance providers, formal or informal, where customers are not also owners of the institution, have little direct involvement in the management of the institution, and do not have a share in the returns made by the institution. In Kenya, the

formal ones include; K-REP Bank, KWFT, Faulu Kenya, Wedco, Pride Africa, SunLink, Pride Kenya, MSEP, Jitegemea, (Nb. not the same as Jitegemee Trust), Vintage, Eclof, BIMAS, Co-op Bank Micro-finance units etc. Informal ones include; Traders, shopkeepers, and moneylenders. By mid 1999, it was estimated that the formal segment of this category comprised of 86 institutions, with a total of 134,612 active clients and a loan portfolio of USD33.8 million (K-REP, 1999).

1.2.2.2 Member-based Micro-finance agencies (MMFAs).

MMFA comprise of formal and informal mechanisms where resources are mobilized from members and management of the arrangement is in the hands of members and it is members who constitute the main target group for service provision (Hospes et al., 2002). The formal segment of this category largely comprises of both urban and rural SACCOs. The informal segment of this category of micro finance providers is mainly the many rotating/accumulated savings and credit associations such as Friends Rotating Savings and Credit Associations (FROSCAs), and Accumulating Savings and Credit Associations (ASCRA) also locally known in Kenya as 'merry-go-rounds', "*itega*" or "*gitati*" (K-REP, 1999). Some of them are registered with the Ministry of Social Affairs while others are not. Since self-regulation or group-based rules provide the most decisive regulatory framework for FROSCAs and ASCRA in mobilizing, rotating, accumulating and disbursing money, they are all labeled as informal whether registered or not.

1.2.3 MFI umbrella body and major Supporters in Kenya

According to United Nations Development Programme-Kenya (2004), there is increasing demand for Micro-finance in Kenya and although the demand of credit is vast, it is largely unmet. The report also indicates that many entrepreneurial owners in the country operate within the informal sector, which has grown from 1,730 businesses in 1966 to over 910,000 in 1993 (5,260, 116% increase in 28 years). The sector employs 2 million people and 99% of these enterprises that employ less than 10 workers each.

Hospes, Musinga, and Ong'ayo, (2002) say that Government of Kenya in recognizing the potential of MFI to the growth of the MSE sector has indirectly provided a boost to the Micro-finance sector. Between the years 1992-1994, the Government of Kenya implemented a Structural Adjustment Program (policy), which resulted in the liberalization of the economy. The programme was meant to promote the MSE sector as a means of accelerating economic growth and generating employment opportunities. In this regard the MSE sector is seen as a motor of economic development, rather than a social safety net for micro-entrepreneurs to make a living.

The Government of Kenya involvement in the development of MSEs is also evidenced by the 2003/2004 fiscal plan where the government reduced banks credit reserve ratio (CRR) and reduced its borrowing rates prompting banks to redirect their investments to advancing loans to the market. Other foreign governments and non-governmental organizations have further supported this through the following bodies: Ford Foundation, European Union, Embassy of Netherlands, and United States Agency for International Development (USAID), The World Bank and the Department of International Development (DFID) (United Nations Development Programme-Kenya, 2004).

The simplicity of the Micro-finance business models and its popularity with donors, coupled with the lack of regulation governing MFIs in the Kenyan market has resulted in a considerable increase in the number of MFIs (Kandie, 2005). For example, there are about 9,000 Co-operative savings and credit society (SACCO) registered by the commissioner of co-operatives. The following are the major supporters of MFIs in Kenya:

1.2.3.1 The Association of Micro-finance institutions (AMFI)

According to Association of Micro-finance institutions (2005), the fast growth of MFI necessitated the formation of AMFI whose main aim is to develop a sustainable Micro-finance industry to mobilize resources from the local financial market and outlive donor funding. It is an umbrella body of leading Micro-finance institutions whose current members are K-Rep Group Ltd, K-Rep Bank Ltd, Kenya Women Finance Trust (KWFT),

Wedco Ltd (formerly under Care Kenya), Faulu Kenya Ltd, pride Ltd., Jitegemea, Kenya Ecumenical church Loan fund (KECLOF) Small and Micro Enterprise Programme (MSEP), Co-operative Bank of Kenya and Post office Savings Bank (Postbank).

Association of Micro-finance institutions (2005) informs us that AMFI has taken a leading role in consultations with the government in the drafting of a Micro-finance Bill that will soon be tabled in Parliament and hopes that the creation of a regulatory framework for Micro-finance will be a major contribution towards a more enabling environment for the sector.

1.2.3.2 Jitegemea Trust

This is another supporter of MFIs and according to Association of Micro-finance institutions (2005), Jitegemea Trust was established in 1999, as a second tier financial institution for micro finance. Its Board of Trustees comprises professionals from a cross section of the society including bankers, accountants and micro financiers. It operates as a wholesale financier of all and operates two accredited micro finance institutions: Vintage Management Limited (VML) and Kenya Women Finance Trust (KWFT). The trust fund exceeds USD6.85 million and the committed portfolio with MFIs amounts to USD6.6 million. This finances over 20,000 micro-enterprises in the informal sectors, with more than half of the clients being Women (Association of Micro-finance institutions, 2005)

The objective of Jitegemea trust is to promote commercial viability and stimulate innovation among the MFIs by giving special merit to those who create innovative delivery mechanisms which improve access to micro finance services and products by micro-entrepreneurs (Association of Micro-finance institutions 2005). Through supporting programs in semi-arid regions, the Trust has supported new approaches to Micro-finance. Retail credit delivery, is done through community based financial institutions and lending operations including the agricultural and livestock sector. Jitegemea Trust has also done a preliminary study on tax issues affecting Micro-finance

operations in Kenya, which may assist in creating awareness on the importance of taxation.

1.2.3.3 Micro-start Kenya

Micro-start Kenya is UNDP sponsored program that has as well contributed to the support of the MFI sector in Kenya. United Nations Development Programme-Kenya (2004) reveal that Micro-start Kenya has been built to initiate or expand existing micro-finance activities in order to supports the development of new and existing enterprises in Kenya. It aims at contributing to poverty alleviation through improved access to appropriate financial services offered by Micro-finance institutions on a sustainable basis to low income entrepreneurs.

Its main objectives according to United Nations Development Programme-Kenya (2004) are:

- (i) Have at least six Micro-finance institutions with an increased capacity to provide Micro-finance services to clients consisting of micro-entrepreneurs.
- (ii) Increase the financial capacity of participating institutions to provide Micro-finance services to micro-entrepreneurs.
- (iii) Contribute to the development of knowledge, expertise and information in Micro-finance in Kenya.
- (iv) Participate in the coordination and collaboration between the different actors in the Micro-finance sector to promote a regulatory framework
- (v) Enhance the local capacity to provide technical assistance on a sustainable basis to ensure the continuity of the initiatives taken in the pilot program.

So far 16 financial services associations or village banks have been established in the targeted areas and are fully operational, with over 1,800 members of whom 80% are women. A total of US\$ 223,000 has been mobilized in over 1,000 businesses. Additionally a provision of concession grants to the poor rural has been expanded to reach over 2,000 businesses using the voluntary support of fifteen community-based organizations (CBO's) (United Nations Development Programme-Kenya, 2004)

1.2.4 Challenges in MFI

Like any industry, MFI sector is faced by a number of challenges as it evolves in its path of growth. Below are some of the major challenges faced by MFIs.

Both Kandie (2005) and Mugambi (2005) argues that the growth and development of MFI in Kenya, and its effectiveness in MSE development is dependent on four main issues namely regulatory framework, donor-dependency, operational risk and MFI outreach.

1.2.4.1 Regulatory

Regulatory framework provides an enabling environment in which MFI can thrive without converting to micro-banks with the attendant structural limitations. Such regulation should be simple and development oriented to keep the cost of compliance at a minimum. This implies that Kenya needs a regulatory framework that supports the industry's growth but MFI's should not be subjected to rules applicable to mainstream banks. MFIs handle a unique market and should not be judged using the same parameters as banks. Though Central Bank of Kenya (CBK) is drafting a bill to be presented to the parliament for enactment, the Act should not set a high capital reserve, as MFIs will not be able to conform to it thus negatively impacting on their main objective. This is mainly because MFI's include institutions that deal with rotating savings and credit associations (ROSCAs), institutions that take savings as security for loans, and institutions that accept savings from the public (Association of Micro-finance institutions, 2005).

The absence of Micro-finance legislation has however paved way for loan sharks (Mogusu, 2005). Delays in enacting the Micro-finance Bill has led to the mushrooming one man show and/ or group organizations (under the client based agencies category) claiming to offer Micro-finance services. According to Mogusu, (2005), the Association of Micro-finance Institutions (AMFI) has warned that loan sharks who are controlling over Ksh6 billion (USD 82.2 million) have invaded the sector. The sector therefore urgently needs a law to safeguard the interests of borrowers and Micro-finance

institutions. The activities of these dubious institutions are threatening to reverse the gains made over the last ten years by genuine Micro-finance institutions in alleviating poverty in Kenya (Mogusu 2005). The informal member based micro-finances such as FROSCAS, ASCRAS are however safe as they are self regulated by the members.

1.2.4.2 Donor dependency

Donor dependency is the other main issue of MFIs in MSE development. According to Kandie (2005), MFIs need to look beyond donor funding to being able to attract private investments both in the form of equity and loans. There is need to create avenues for partnership and collaboration with the banking industry and explore the capital market in order to access the vast resources that are already available in order to expand operations. Faulu Kenya, one of the oldest Micro-finance institutions in Kenya has already reduced its donor dependency by floating a Ksh.500 million (USD 6.8 million) corporate bond at the Nairobi Stock Exchange as a way of raising capital to bolster its expansion plans (Koigi, 2005).

1.2.4.3 Risks exposure

MFIs especially those that use fund mobilization methods such as SACCOs, despite providing billions in loans annually to thousands of Kenyans, they are not regulated like other financial institutions (Mugambi, 2005). Since they operate outside the normal banking laws and conventions, they are likely to make shaky lending decisions that risk their members' deposits. This is also because the management committee managing SACCOs is not elected based on management skills but by their popularity.

As co-operatives are free to invest in various types of projects including real estates, unregulated investments may also lead to wrong decisions that may result in huge losses (Masinde, 1998). According to Irungu (2005), SACCOs are hardly efficient entities and have grown big and complex yet their management of risk has not become equally sophisticated. Such reasons coupled with high level of mismanagement and high rate of

defaulters puts members' funds at great risk and may lead to collapse of SACCOs, thereby wiping out members' lifetime savings.

1.2.4.4 Outreach

According to Kandie (2005), Micro-finance typically takes place where the MSE business are located and not at the premises of the lender. This she says is based on the Grameen credit principal where people should not go to the bank but the bank should go to the people. Field officers representing the lender should meet the borrowers on a predetermined regular basis. This should help to forge close working relationships while ensuring that issues and problems that could yield negative repayment are addressed on time. The existing diverse environmental and poor infrastructure development in some part of the country presents a big challenge to MFIs outreach to the intended market.

1.3.0 Micro and Small Enterprises (MSEs) in Kenya

MSE in Kenya as already defined by Thyra and William (2000) are those businesses that have 1-49 employees. Sievers, Haftendorn and Bessler (2003) emphasise that MSEs usually create a high percentage of total employment in developing and transition countries and that they play an essential role in securing income and employment for millions of people and in creating new jobs. Governments, donors, MFIs and technical agencies have been trying to overcome constraints on small enterprises to boost their employment creation and growth potential by applying various measures such as financial schemes, interventions to improve the business environment at local level and increasing access to Business Development Services (BDS) (Sievers, et al., 2003).

1.3.1 MSE Development in Kenya

Githeko (1993) states that, MSEs are widely recognised as major movers of economic development; owners translate ideas (vision) into action. They have the ability to scan and identify opportunities in their environment, gather the resources necessary to take advantage of the opportunities and implement successful action to utilise the opportunities.

On recognising the prime-mover status of business entrepreneurs, the Government of Kenya (GoK) has implemented a wide range of strategies to encourage people to initiate their own small businesses. The major focus for this effort is the Small Enterprise Development (SED) which has traditionally involved establishing an enabling environment for prospective small business owners (Githeko, 1993). SED's main objectives are:

- (i) Formal small enterprise development which encompasses entrepreneurship development programs.
- (ii) Provision of responsive small enterprise credit facilities.

Githeko (1993) also argues that small business development involves introducing youth to entrepreneurship education with the aim of getting them to think about entrepreneurship and the role of business entrepreneurs in economic development. The youth are encouraged to change their mind-set from job seeking to self-employment as a career choice in the current state of high unemployment. These concepts and practices are integrated into teaching of technical subjects and students are encouraged to initiate Micro-businesses while still in college as a way to enable them acquire an insight into the operation of a business.

In Kenya, the Jua-Kali sector (defined below) has witnessed a rapid expansion since independence not only in providing jobs, but also as a means for many Kenyans to enter the manufacturing and service industry. Since independence, the government has been spending substantial amounts of money to implement policies and programs aimed at building institutions and promoting the small-scale enterprises. The government has been organizing training and seminars for entrepreneurs to enable them acquire skills in order to produce quality products that can compete favorably with other similar products in both local and export markets Price (Water House Coopers, 2003).

1.3.2 MSE (Jua-Kali) – Kenyan Context

The term Jua-Kali literally means "hot sun" in Kiswahili referring to enterprises which carry out their businesses in the hot sun without adequate shelter or workshop space. This

meaning has however been broadened to include the self employed in both informal sector as well as those owning fully formalized small-scale firms with substantial number of employees. Jua-Kali therefore implies to mean those that are self-employed irrespective of the registration status of their businesses. The business skills undertaken by the self-employed are as varied as the skills of those employed in formal institutions (Transparency international 2005). The types of businesses in the Jua-Kali sector also vary based on the skills of the owners or the managers they employ. Many are very similar to formal employment as in doctors, nurses, artisans, computer technicians, computer programmers and free-lance everything. There are also those in the crafts and fabrication of all manner of wares needed on a daily basis, second hand goods traders, informal traders or hawkers of large or smaller magnitudes and indeed the so called consultants who have only their mobile phone and a head to present proposals through cyber café operations as offices (Transparency international, 2005). This is loosely what is referred to as the Jua-Kali sector. For the purpose of this research, this meaning will apply.

1.3.3 Main Challenges Facing MSE (Jua-Kali Sector)

Transparency international (2005), gives two main challenges facing the MSE sector:

The first challenge is the lack of market linkage, which some people have confused with lack of money, is a major challenge. This has made many people seek money first before engaging in activities that have no markets; thereby killing their business spirit, as people who start with money and no market or plan soon become disillusioned when the businesses they start cannot generate the money they invested to start with. This is supported by Kirby (2003), who argues that many new ventures fail, especially within the first two years of start-up mainly because many new ventures are created without the requisite planning and preparation, and without the owner-manager having established the feasibility of the venture or appreciated the difficulties involved in its operation.

The second challenge is the lack of appropriate guidance in business skills formation since there is very little that is offered in business start-up by the existing training institutions.

Other challenges discussed by Younkins (2000) include competitiveness and government interference. The development of new improved products, services, and processes means that some established products, services, and technologies will not sell. As a result, firms offering outdated products, services, and using outdated methods may experience business failure. SMEs are often trapped in this situation due to the nature of their capital base and limited financial services.

The greatest enemy of the small enterprises is government intervention in the form of regulation, paperwork, taxes, high interest rates, occupational licensing fees, government-conferred monopolies, etc. Such obstacles actively discourage innovative activity and risk-taking and arrest the wealth-creating process for example the compulsory requirement for purchase and installation of the value added tax vendor machine by all business sectors resulted in closure of many small enterprises that could not afford the machine.

In addition, information is lost when price ceilings, rent controls, minimum wage laws, etc subdue price signals. The entrepreneur requires accurate information regarding incomplete or mistaken market responses in order to know which actions should be taken.

Sievers, et al., (2003) also adds the following challenges to the list:

Lack of managerial skills: Lack of management capacities, marketing knowledge and information about markets and how to access them.

Insufficient access to finance: MSEs are often considered poor risks by traditional financial institutions; usually only a small number of MSEs have access to loans with very high interest rates from the banks. While others are not aware of the existence of legal MFIs, others still seek for funds from loan sharks.

Hostile business environment: Registration procedures are complex and burdensome for MSEs, the social costs are very high, the tax system is complicated, the potential

workforce is untrained, markets are not readily accessible because of new political frontiers, and some MSEs lack pressure groups that could speak in their favour.

Chapter two

RESEARCH METHODOLOGY

2. 0.0 Introduction

This chapter covers the research methodology that the researcher used in collecting and analyzing data. It includes a description of the study, research design, targeted population, sampling design and procedure, research instruments, reliability of data collection instruments and data analysis and presentation. This is in the effort of establishing how the activities of Micro-Finance Institutions (MFIs) have influenced the development of Micro and Small Enterprises (MSEs) in Kenya since (MFIs) have become to be the main focus for achieving the much-needed social and economic development in Kenya (Thyra and William, 2000).

2. 1.0 Research Goal

The aim of the research was to describe how MFI services have influenced the growth of MSE sector in Kenya focusing on the following central objectives:

- Describe the role of MFI as a tool for development of MSEs
- Describe what services and products are offered by MFIs to MSEs
- Describe what MFI services and products have been used by MSEs
- Describe the MSEs satisfaction with the current MFI products and services
- Describe MSEs expectations of MFIs' services and product offered and
- An analysis of the gap between current service levels and expected levels

The research findings are expected to serve as a contribution to the body of knowledge on the influence of MFIs on the economic development in Kenya.

2. 2.0 Research Paradigm

The research was conducted within the interpretive paradigm. This paradigm is characterized by a particular ontology, epistemology and methodology. The ontology

being that people's subjective experiences are real, epistemology being that their experiences can be understood by interacting and listening to them and that, qualitative techniques are best suited to this task (Terre and Drrheim, 2002). The qualitative technique was deemed fit for the research because it describes and interprets some human phenomenon, often in the words of selected informants and further tries to be clear about their biases, presuppositions, and interpretations so that others can decide what they think about it (Lincoln and Guba, 1985).

An interpretive paradigm entails understanding and interpreting the meanings, and intentions that underlie everyday human action (Yin, 1984). Babbie, Mouton, Vorster, and Prozesky (2004) argue that the interpretive paradigm is based on the belief that reality can best be understood by interpreting the meanings that people in specific settings attach to it. This is because individual experiences or the meaning that they ascribe to phenomena needs to be studied by taking the context into account.

Within the interpretive paradigm, the grounded hermeneutic approach, which is concerned with the generation rather than the testing of theory, was used. The advantage of this approach is that it allows for the theory to be developed from conceptualized empirical data hence providing a more holistic picture of the whole context (Babbie et al., 2004).

2.3.0 Methodology

The methodology of the research was a case study. According to Yin (1984:23), "a case study is an empirical inquiry that: investigates a contemporary phenomenon within its real-life context, when the boundaries between phenomenon and context are not clearly evident, in which multiple sources of evidence are used". Yin (1984:13) further argues that, "it is the preferred strategy when "how" and "why" questions are being posed, when the researcher has little control over events, and when the focus is on a contemporary phenomenon within some real-life context". The researcher's desire to understand how MFIs have influenced the development of MSEs was explored through a case study as it

allowed the investigation to retain the holistic and meaningful characteristics of the real-life events in the sector (Yin, 1984). Such events are;

MFIs and MSEs managerial processes,

The provision and implementation of MFIs services,

The real impact of the MFIs services to the MSEs compared to the perceived impact, and

The acceptability of MFIs services by the targeted beneficiaries.

In looking at the above events, the researcher's intention was to establish a trend on how MFIs influences MSEs from the formation stage through the various stages of their growth. The researcher also aimed at establishing the impact of MFIs on the emergence of more MSEs.

Another reason for using the case study method in this research was its unique strength or ability to deal with a wide variety of evidence such as documents, artifacts, interviews, and observations (Yin, 1984). In this study, the researcher mainly used interviews and documents in sourcing data thus adding more weight to the evidence.

The case study has however its own traditional shortfalls which the researcher had to consider. It is argued that many a time, the case study investigator tends to be sloppy and allows equivocal evidence or biased views to influence the direction of the findings (Yin, 1984). On the same note, the entire nature of the case study may shift unbeknownst to the researcher, during the course of study. The initial question may have reflected one orientation but as the case study proceeds, a different orientation may emerge and the evidence begins to address a different question (Yin, 1984:45). The researcher was aware of the possibility of such slippages and had to constantly refer to the original question to avoid going out of context. The fact that the researcher understood the purpose of the case study research also helped in staying on target.

The other shortfall of the case study methodology according to Yin (1984) is that they take too long and result in massive, unreadable documents. The researcher remained focused on the research aim and only recorded relevant information from the interview. This helped the researcher to work within the limited time by reducing unnecessary information.

2. 4.0 Population and Sampling

Research population included all micro-finance institutions in Kenya, micro and small enterprises in Kenya using MFI services, Association of Micro-finance institutions (AMFI) and Kenya Association of Jua-Kali, Ministry of Co-operatives and Ministry of Trade and Commerce. The location of AMFI, Jua-Kali associations and ministries headquarters are all in Nairobi enabled the researcher to conveniently collect data from them all within a very short time thus saving time. MFIs are widely spread in the entire country with their head offices situated in Nairobi (the capital city of Kenya) although the activities of some are urban based while others are rural based. In selecting the MFIs to interview, efforts were therefore made to have balanced representation from both urban and rural based organizations. Likewise, the activities of MSEs in Nairobi and its environs may not necessarily be a replica of those in other parts of the country. Based on this, the researcher selected three MSEs in Nairobi and one each from four different towns in upcountry.

To achieve the objective of the research, the researcher used purposive sampling. Purposive or judgmental sampling is a type of non-probability sampling method in which the researcher uses their own judgment in the selection of sample members (Babbie et al., 2004). It is the most appropriate sampling method when selecting the sample on the basis of one's own knowledge of the population, its elements and the nature of the research aims (Terre and Drrheim, 2002).

The use of this approach helped the researcher in selecting the specific ministries that relate to the research subject as well as organizations that represented all the various types of MFIs and respective users of their services.

Out of all the potential respondents selected using purposive sampling, two interview were conducted with representatives of the ministry of trade, one with Co-operative bank, one with AMFI, two with association of Jua-Kali, ten with MFIs and seventeen with different MSEs in different geographical region, each lasting for about 45 to 90 minutes depending on the flow of information.

2. 5.0 Data Gathering Tools

In-depth semi-structured interviews and document analysis were the two mains methods of data generation used by the researcher. Information was also sought using documentation to support the accuracy of statements and action made by the respondents in their individual capacity during the interviews.

2. 5.1 Semi-structured interviews

As Terre and Drrheim (2002) put it, interviews are tools for gathering data through conversation between the researcher and the researched. They are an essential source of case study evidence, as most case studies are about human affairs that should be reported and interpreted through the eyes of specific interviewees and well-informed respondents who provide important insights into a situation (Yin, 1984). The semi-structured interview was a useful tool for this research because it gave room for flexibility and allowed the researcher to conduct exploration of issues relevant to the case study as they emerged from the interviews (Yin, 1984).

The researcher prepared an interview guide (appendix 1) that was applicable to specific segments of the population namely Ministries, associations, MFIs and MSEs. To ensure validity of the research instrument, a pilot case study was done on a few representatives of the population. The pilot case study helped the researcher to develop relevant lines of questions and even provided some conceptual clarification (Yin, 1984).

In addition to the interview guide, respondents were allowed to propose their own insight into the subject matter and such propositions formed the basis for further inquiry (Yin, 1984). In some instances informants provided the researcher with more vital insights and also suggested other sources of corroborative evidence to an extent of initiating the

access to such sources. To avoid becoming overly dependent on such informants, the researcher independently and carefully sought for other sources of evidence to corroborate any insight by such informants and also searched for contrary evidence (Yin, 1984). In the final analysis, the data collected in this form proved to be very rich as it captured the emotions, excitement and disappointments of the respondents in revealing their feelings either as providers or recipients of the MFIs services. Efforts were also made to interview both urban and rural based organizations and enterprises in order to get a varied perspective. In addition, detailed discussions were held with key senior officers in the selected organizations knowledgeable about MFIs.

Besides performing one interview each at AMFI and Co-operative bank, two each at Jua-Kali associations and the ministry, the researcher aimed at conducting as many interviews with respondents in various MFI and MSE sectors. The aim was to gather as much information as possible that would assist the researcher to finally form an opinion through an explanation-building technique.

Out of all the potential respondents selected using purposive sampling. As shown in table 1, a total of thirty three interviews were conducted with representatives of the ministry of trade, AMFI, association of Jua-Kali, different MFIs and MSEs.

Table 1: Interviews conducted

Institutions	No. of organizations	1st Interview	Follow-up interview	Total	%
Ministry of Trade	1	1	1	2	6%
Chairman, Co-op Bank	1	1		1	3%
AMFI	1	1		1	3%
Jua Kali Association	1	1	1	2	6%
MFIs	7	7	3	10	30%
MSEs	12	12	5	17	52%
Total	23	23	10	33	100%

Due to reasons beyond the researcher’s control, it was not possible to interview a representative from the ministry of Co-operatives. As an alternative, the researcher

managed an interview with the National Chairman of Co-operative movement in Kenya who also doubles as the Chairman of the Co-operative Bank of Kenya.

On the interviews with various MFIs the researcher took advantage of the financial services and marketing exhibition held in Nairobi on 18th to 20th May, where he met and interviewed senior and middle level managers representing five different MFIs. Follow up meetings in their respective offices were arranged with the same officers where further information and documentation were availed to the researcher.

Interviews were conducted in an informal manner either in English or in the national language (Swahili) and were conversational in nature to allow the interviewees to freely talk about as many issues as possible. Interviews with representatives from the ministry, Jua-Kali Association and AMFI were done within their respective offices but MSE representatives especially those based in Nairobi, preferred to hold the interviews after office hours due to time constraints. MSE representatives based up-country were flexible and availed themselves to the researcher during their working hours. Research notes were taken during each interview with the permission of the respondent, and after the informal dialogues. A summary of each day's fieldwork was produced for the purpose of documenting the research effort and generating additional insights from each site visit.

To reach out for the MSEs in the arid and semi arid area, the researcher got a boost from the pastoralists' week trade fair held in Nairobi on 27th November through 1st December 2006. In the trade fair, the researcher managed to interview additional three 'community based' micro-finance institutions and four group based MSEs. The micro-finance institutions were either donor funded or supported by Government of Kenya in collaboration with the World Bank agents.

2. 5.2 Documentary information

The researcher made use of documentary information such as; letters, memoranda, minutes of meetings and progress reports among others that were deemed relevant to the case study. The documentary information was useful in this case to corroborate and augment evidence from the interviews and where contradictions were noted, the researcher inquired further into the topic (Yin, 1984). Documents were further helpful in verifying the correct spellings and titles or names of organization that were mentioned

during the interviews. The documents further supplemented the interviews and gave added value and depth to the statements and findings from the respondents.

In addition, the researcher made reference to statistical data from Central Bureau of Statistics on the extent of MFIs outreach. Similar records were also available from Ministry of trade as well as from AMFI.

2. 6.0 Data analysis

The researcher-analyzed data using explanation-building technique i.e. analyzed the case study data by building an explanation about the case (Yin, 1984). The analysis was in narrative form and was aimed at establishing a set of links to a certain phenomenon (pattern-matching). The final explanation of the data analysis was therefore a result of a series of iterations whereby the case study evidence was examined, theoretical position revised and the evidence examined once again from a new perspective (Yin, 1984).

As there was a danger of the researcher drifting away from the original topic of interest as the iterative process progressed, the researcher made a constant reference to the original purpose of the inquiry. By so doing, the researcher was sure of remaining focused and on the target.

It is worth noting that as the researcher only interviewed a few individuals per MFI, the results relating to each MFI cannot be taken as statistically significant. However, the overall trends established for the aggregated MFI data is in the researcher's view a reasonably accurate reflection of the reality on the ground.

2. 7.0 Ethical implications

Ethical issues arise out of our interaction with other people and the environment, especially where there is potential for, conflict of interest (Babbie et al., 2004). In many cases, ethical choices involve a trade-off or compromise between the interests and rights of different parties, for example; in this study, the researcher had the right to collect data through interviewing people but not at the expense of the interviewee's right to privacy.

To overcome such issues, the researcher explained the purpose of the research to the respondents and signed an ethical agreement covering the following potential issues:

2. 7.1 Voluntary participation

Before engaging respondents in interviews, the researcher made prior arrangements with potential interviewees from the various organizations and obtained their consent. Due to the time factor, these arrangements were all done and accepted on phone except for the respondents at the financial services and marketing exhibition who were eagerly waiting for any visitor. The researcher however ensured that all phone bookings were immediately formalized in writing to potential respondents giving the detailed purpose of the interview. Interviews were therefore voluntary and nobody was forced to participate. In spite of this prearrangement, the researcher experienced last minutes cancellation by some potential respondents especially from the ministry and some MSEs representatives. Some called the researcher a few hours before the agreed time postponing the meeting, others cancelled without giving an alternative date while others simply failed to show up at the meeting point. This in essence frustrated the effort of the researcher and proved to be very expensive especially in terms of hours lost.

2. 7.2 No harm to the participants

Like voluntary participation, not harming people is easy in theory but often difficult in practice (Babbie et al., 2004). It has also been established that just about any research one might conduct, carries the risk of injuring other people somehow (Babbie et al., 2004). To minimize these possible injuries, the researcher was very careful on sensitive issues especially when dealing with respondents who were not familiar or seemed suspicious of the objective of the interview. The researcher also used a language that was understandable to the respondent and avoided probing questions that would be interpreted as infringing to their rights.

Isolated cases were however witnessed where the researcher had to take time explaining the purpose of the interview to the respondent. Some feared that the researcher was a Government agent out to gather information for tax purposes. It was not until the

researcher produced his student identity card and reemphasized the purpose of signing an ethical agreement that they relaxed for the interview. On understanding the purpose of the interview, they were willing to provide more personal opinions in less formal surroundings. For example, interviewees from Nairobi were happy to share their views openly in the pub after working hours. This reflected not only the value of informal dialogues, but also emphasized the need for an environment where interaction between the researcher and the respondent can be effectively facilitated.

2. 7.3 Anonymity and confidentiality

In all the interviews conducted by the researcher, there was a mutual agreement that the name of the respondent will remain anonymous and their names and addresses confidential in the final report. The researcher thus made sure he removed any identifying information as soon as he verified the interviews and was certain that he did not need further information from the respondents.

2. 8.0 Limitations

The main difficulty experienced in collecting data from the MSE sector was getting the attention of the enterprise owners during their working hours. The researcher was however able to overcome this by rescheduling his timing to late evenings when the various business owners would be available for a meeting in a more relaxed atmosphere. The timing however turned to be more fruitful than expected as the researcher had not only more uninterrupted time with the respondents but the respondent was more focused and prepared for the interview.

Another limitation was finance based. Some MFIs, have fixed charges to various categories of information seekers where PHD and masters degree researchers pay between a 100 to 150 US dollars. This caught the researcher by surprise especially when he made a follow-up meeting with the MFIs after the first meeting at the trade fair. The exercise became more expensive and a lot of time lost as the researcher had to make financial arrangement.

The distance to the various up-country MSE also presented another limitation. The researcher had to make a whole day arrangement for each up-country MSE visit thus spending a whole week traveling.

2. 9.0 Conclusion

Despite the various limitations encountered by the researcher, the research went on well and very rich information gathered that helped the researcher formulate an opinion. As notes are the most common component of a database in a case study, all notes either as a result of the researchers interviews or document analysis were safely stored (Yin, 1984). The main reason for storing the raw data is for ease of future reference or review by either the researcher or other interested persons.

Chapter three

RESEARCH FINDINGS

3. 0.0 Introduction

This chapter presents the empirical research findings of the case study which focused on describing how MFI services have influenced the growth of MSE sector in Kenya.

The findings are presented according to respondent categories namely; MFIs, MSEs, AMFI, Jua-kali Association, Trade Ministry and the Co-operative Bank of Kenya.

In presenting data collected from the MFI category, we shall look at the role they play in the development of MSE, the range of services they offer to and those that are most frequently used by the MSEs.

In the MSE category, data will describe the background of MSEs, MFI services frequently used, service satisfaction, dissatisfaction and expectations from MFIs.

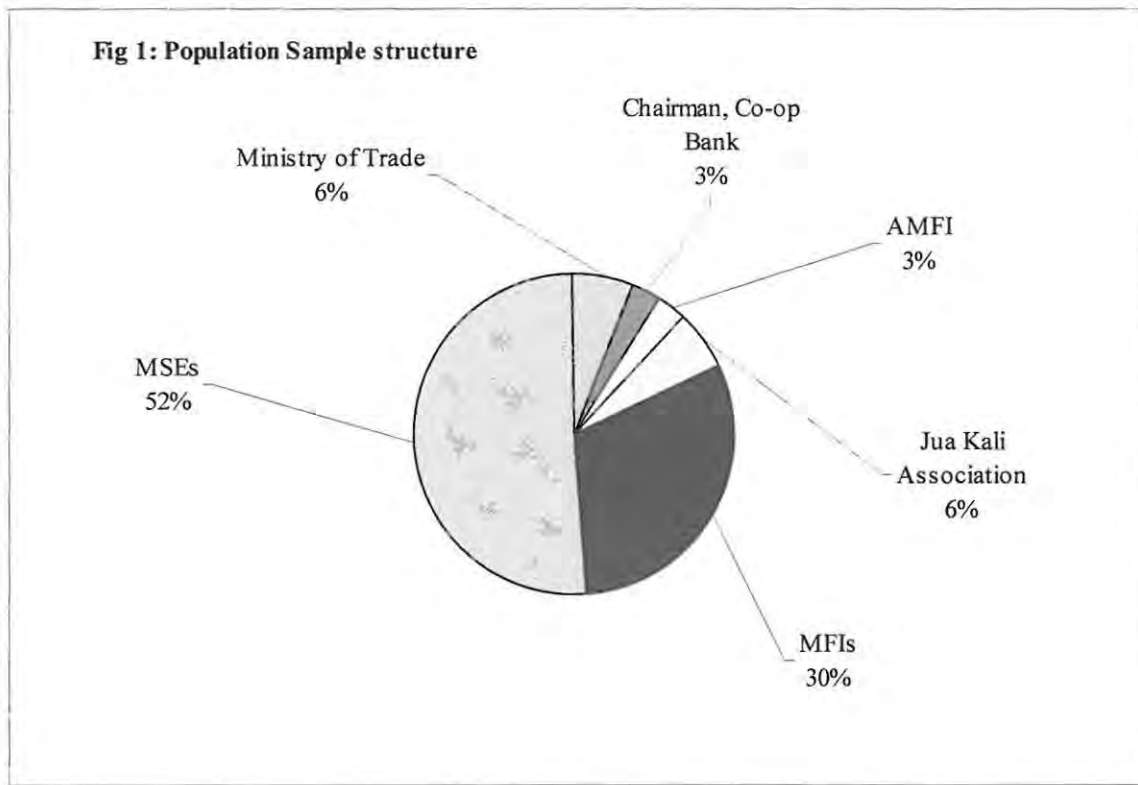
The data collected from the Trade Ministry and the Co-operative bank, describes their relationship to MFIs.

The data collected from the Jua-kali Association and AMFI, describes their relationship and role they play to MSEs and MFI respectively.

3. 1.0 Data presentation

3. 1.1 Sample Proportion representation

Figure 1 below shows the proportion of various sample categories. MSEs and MFIs deliberately formed a bigger proportion of the sample as they form the bulk of the population. All respondents in the MSEs category were the business owners, while respondents from the remaining segments of the sample were from middle to senior management levels.



3. 1.2 The MFI Sector

3. 1.2.1 MFIs Role to the development of MSE

In terms of MFI outreach, all the respondents said they had branches in the major cities, in most major urban towns along the major highway and in urban centers within the cash-crop growing zones. Representation in the arid and semi arid area was unfortunately found to be very low. The few MFIs that operated in the arid and semi arid areas were the donor funded MFIs. Table 2 below shows presence of MFI in various parts of the country.

Table 2: MFI outreach

Common Branch network	Number of MFIs	Percentage of representation
Cities	23	100%
Major Urban centre on major highways	20	90%
Major Urban centre in cash-crop zones	20	90%
Arid and semi arid areas	2	10%

On their role in the development of MSE, the majority of the MFIs described the primary purpose of their establishment as that of catering for the small-scale business savers who were unable to access the traditional banks for various reasons. One of these reasons was that the traditional banks had either pulled out or had never operated in the region. Another reason was the exorbitant fees levied by banks for services offered and what they referred to as the endless official procedures involved when applying for loans and advances.

The respondents described themselves as falling into two main types of MFIs; the profit oriented ones and the community development oriented ones. The profit oriented MFIs being those that make money out of their services and community development oriented ones being those whose objective is promotion of community development. Both types of MFIs work with the group structures, involving group members in meetings with a distinctive difference in their meeting agenda. In profit oriented MFIs meetings, the agenda is to monitor members weekly savings and or loan deposits and in the process exchange business experiences or ideas. On the other hand, meetings in community development oriented MFIs are mainly meant for business educational activities/seminars where members are educated about business management and record maintenance amongst other things. Community development oriented MFI meetings also form a good forum for the MFI field officers to gather information in the form of feedback from group members on services offered and or opinions. In the process of our discussions with MSE owners, a third category of informal MFIs emerged where individuals on a gentleman's agreement periodically contribute an agreed amount of money and then give the money

to a member of the group on rotation basis. Worth noting is that this category is very popular with women and is commonly referred to as Friends Rotating Savings and Credit Association (FROSCA) or merry-go-round.

Some of the FROSCA only give a portion of the contributions and retain the remainder for the purpose of group investments while others retain all the contributions for group investments on the stock market, purchase of plots of land or investment in the transport sector.

A more direct role of profit oriented MFIs as described by the respondents is that they encourage savings and disburse different types of loans and advances to small-scale businesses at attractive interest rates with a repayment period ranging from 3 months to 36 months.

In the Co-operative sector the respondent believed that they played a significant role in mobilizing funds and disbursement of loans. They indicated that there were about 9,000 registered SACCOs across the country by July 2006 with a total of 6 million active members, a savings base of Kshs 110 billion (\$1,507 million) of which about 75% was in outstanding loan portfolio. This, they said, is evidence of their additional role of supplementing the government's effort of fighting poverty, reducing unemployment as well as encouraging groups to create wealth as more and more small-scale businesses have access to their loan facilities enabling the businesses to grow.

Different views were expressed by respondents on the influence of the legal framework on their activities. They said various MFIs in Kenya were brought into existence through various laws: the Non Governmental Organizations Co-ordination Act, the Building Societies Act, the Trustee Act, the Co-operative Act, and the Societies Act. Some expressed fear that the fact that MFI are not under one Act has created gaps of as each law addresses different issues and there is no clear way of unifying the regulations governing their operations, accountability, ownership and governance. Others were worried that the gaps have facilitated the mushrooming of bogus and unscrupulous MFI's

who have spoilt the good name of the genuine MFIs. The main agenda for these unscrupulous MFIs was said to be exploiting desperate MSEs seeking quick loans.

3. 1.2.2 MFIs Services to MSEs

In relation to the services offered, the data collected indicated that there were two approaches used by MFIs. The first was the minimized approach used by the profit oriented MFIs, which offer financial services only. The second one is the integrated approach used by the community development oriented ones which offered both financial and non-financial services. The majority of the MFIs claimed to be using the minimized approach while only a few used the integrated approach.

Those that use the minimized approach said that they only offered capital to finance expansion activities. They indicated that they had narrowed down their target clientele and only offer financial services to established entrepreneurs, and not those who need to be trained to become entrepreneurs.

Those that use the integrated approach (minority of the two MFI types) said that they receive funding from donors. The services they offer include funding group start-up ventures, expansion activities and training and technical assistance.

A follow up on this revealed that almost all MFIs initially used the integrated approach. The trend has since changed whereby the majority favors the minimized approach concentrating on such activities as loan provision and savings acceptance. The main reason given for changing approaches to service provision was on cost management and concentrating on their core business. The cost of running their organizations on the integrated approach was becoming very expensive and their overall financial sustainability was either by loading cost to their customers or to apply the minimized approach hence adoption of the latter.

Provision of factoring facility and business linkages and subcontracting services were other critical services found offered mainly by community based MFIs. Factoring facility

as explained by the respondents was initiated to address financial constraint faced by MSEs. Participation by small-scale producers in the mainstream mass markets was explained to be significantly restricted by lack of financial capacity that would enable them maintain healthy cash flow and take advantage of new and profitable orders hence the need for factoring. This factoring service or short term and flexible financing was described as an arrangement where the MFI (factoring house) pays cash to MSEs against accepted deliveries and /or deliveries to reputable and credit worthy customers whose purchasing practices include credit periods that MSEs cannot sustain.

Business linkages and subcontracting services was on the other hand described as another wealth creation service by MFIs. The service aims at facilitating market access for MSEs by linking with large manufacturers while subcontracting seeks to exploit the fact that corporate companies' production costs are high as compared to those of MSEs, yet MSEs lack sustained market access, thus linking the two yields a win-win relationship. A good example given by the respondents is where an integrated based MFI identified and facilitated business linkage between a company manufacturing hurricane lanterns and kerosene stoves with a group of Jua-Kali artisans. The MFI identified the company as potential partner in promoting market access for a group of 40 MSEs in the tinsmith Jua-Kali business and the hurricane lantern identified for subcontracting. The MFI facilitated this link by building the capacity of the artisans to make high quality and standardized parts including, handles, hooks, bulb guards and plastic tank caps. By so doing, the artisans (MSEs) increased their production that resulted in creating more job opportunities and sustaining their (artisans') livelihoods.

Another fundamental service offered by some respondents using the minimized approach was the provision of supportive services. Such services were given by profit oriented MFIs as guidance services to loan applicants. Applicants are asked to give detailed explanation supporting the purpose of the loan, which are then professionally analyzed. Applicants are then taken through the analysis based on the information provided and if the purpose is found worthwhile, then a loan is disbursed. If not, the applicant is advised on the best course of action. This as explained prevents people from taking loans for the sake of it and has helped in safe guarding the interest of both MFIs and their customers. As a result of the guidance processes, applicant are advised on the size of the loan to take so that they are able to repay without affecting the business cash flow which in most cases forces enterprises to close down.

In response to the question on the frequently used products; all profit oriented MFIs said that they offered a saving product, which was compulsory to loan seekers. The compulsory saving is security for loans and advances. A pre-agreed amount of money was contributed at an agreed interval and penalties levied for failing to do so. In case of SACCOs, the practice was for individual members setting up their own monthly contributions against which they borrowed money from the society.

Nearly all the MFIs said that they run micro-lending schemes whereby they provided group savings facility. Individuals running businesses in one catchment area were encouraged to come together and form small enterprise group (Gitati) of about eight people each. Five to six small enterprise groups then combined to form a bigger group made of the smaller enterprise groups of forty to fifty members called Rotating Savings and Credit Association (ROSCA), which was then registered with the Ministry of Culture and Social Services. Each ROSCA registered with the affiliate MFI where it opened a savings account with at least three signatories. The group then set up the amount of money to be deposited by each member at an agreed interval usually weekly. The savings were then retained in the group account with the MFI as collateral for group members' use in borrowing.

In addition to MFIs acting as custodian of collateral for participants in the micro-lending program, some respondents said that they had special arrangements for individual small business owners in their neighborhood to deposit savings with them. These were business owners who would not normally qualify to open savings accounts with the traditional financial institutions or were in areas where there were no other financial institutions.

In responding to the question on the type of loans offered by MFIs, a series of loans and their respective disbursement trend was given by the business oriented MFIs. The interest rate varied from one MFI to another. Table 3 shows the average interest rate charged and other conditions on the various loans offered by MFIs applying minimized approach.

Table 3: Loan size and disbursement trend given by business oriented MFIs other than SACCOs

	Loan amount (depending on savings)	Max repayment period	Interest rate (pa)	Condition
1 st loan (test/character loan)	Less than \$300	6 months	18%	After 4 to 8 weeks monitoring by group members
2 nd loan	Up to \$700	12 months	16%	After successfully repaying the first loan
3 rd loan	Up to \$1500	24 months	15%	After successfully repaying the second loan
4 th loan	Up to \$7000	24 months	15%	After successfully repaying the third loan

Note: Loan sizes are reviewed from time to time depending on repayment performance of the group

Loans range from US\$138 to US\$7,000 and bear a flat interest rate of between 15% and 18% per annum. Loans in this category are secured through the deposit of cash into

ROSCAs savings account held with MFIs as well as through group members' trust guarantees. In each ROSCA, group members are jointly responsible for all aspects of loan management, appraisals, approval, disbursement, repayment and recovery. The maximum repayment period in most of the MFIs was one year although a few allowed a maximum of 36 months. Group members could however decide on a shorter loan term ranging from three to nine months.

SACCOs were excluded in table 3, as their services are slightly different. They give all their loans at lower interest rate of 0.8% to 1.5% per month on the outstanding balance. The amount of normal loans in SACCOs is based on individual's total contributions and members can be granted the equivalent of up to three times of their individual shares with the repayment period ranging from one to four years. Other loan products given by SACCOs were; emergency loans and education loans with the majority giving a maximum of \$1500 with a repayment period of twelve months. Interest earned on borrowings was distributed to members and either paid out as dividend or retained for reinvestment.

The community development oriented MFIs, said that their loans were given to community groups only at no interest charged with a repayment period of between one to three years. They however put in place control mechanisms, which included audit of their books to ensure funds are properly utilized for the purpose they were borrowed.

From the informal sector of MFIs, an interview with officials of some women groups revealed that with the merry-go-round also known as Friends Rotating Savings and Credit Association (FROSCA) members' contributions were given to one member at a time as a form of interest free loan.

Other services provided especially by the integrated MFIs, were business skills training to their members. The training they provided was mainly in three modules namely: orientation to business practices, management of business activities, book and record keeping. It was said the purpose of such training was to encourage people to become

entrepreneurs and to strengthen the business skills of those existing entrepreneurs wishing to improve their business skills.

Another service that was said to be offered by most MFIs was the business outreach service: where MFIs established group-based business development officers to support loan clients, assist in loan recovery and identify potential clients.

3. 1.3 The MSE sector

3. 1.3.1 Background

Two thirds of the MSEs have been in the business for over three years and the remaining third had been operating for between a few months to two years. Their lifecycle distribution is as shown in table 4 below.

Table 4: Period MSE has been in operation

Age bracket	Percentage	Growth stage
Less than 2 year	30	Infancy stage
Between 2 years and 7 years	65%	Growth stage
More than 7 years	5%	Mature stage

Explaining how they raised their start-up capital, a number of the MSEs gave various sources. Majority said they financed their start up capital from a combination of family and personal savings while a very small proportion sourced from MFIs. The few that sourced their start up capital from MFI were the group projects that were funded by the donor funded MFIs. Table 5 shows the various sources of start up capital in order of preference.

Those MSEs that had been in operation, those had been in operation for less than two years were still in their infancy stage. The proportion that had been in operation for two to seven years, were in their growth (expansion) stage where funding for extra working

and expansion capital is heavily required while those in operation for over seven years were in their maturity stage.

Table 5: Ranking of the sources of MSEs start-up capital

Sources of capital	Preference
Family members & own savings	1
Own savings only	2
Family members only	3
MFI and a combination of either of the above	4
MFI only	5

In response to how they had been funding their expansion and increasing working capital, the majority of the respondents said that they have been funding their expansion mainly with loans from MFIs supplemented with their own savings. They further clarified that the loans were sourced from both formal and informal MFIs. The informal MFIs played a big role in boosting their cash flow as most of them operated on a weekly merry go round basis. Members of a merry-go-round met on a weekly basis and contributed an agreed amount of money weekly. This is given to a member. This, they said is well controlled by the fact that before the beginning of the merry go round, members decide how they will take turns to receive the money. It was however found that members swap their turns by individual arrangement if one was in urgent need of money or depending on when one had projected to use the money. This, they said helped them to meet their urgent business commitment. On the other hand, the funding from the formal MFIs was obtained on the basis of the conditions shown in table 3 above.

Business growth trends were another area of interest, which was discussed. Those in business for just less than two years said that they were in their infancy stage (refer to table 4) as they were still trying to solve their teething problem. They were however appreciative of the support they were receiving from MFI as most had already obtained their 'character testing' first loan to meet some business needs and were already planning

to borrow again. Besides the loans from the informal sector, they claimed to have sustained their cash flow through participating in the merry go round. In addition to the monetary help, they also claimed to have gained a lot from exchange of business ideas in their weekly FROSCA and ROSCA forums.

The group that seemed to benefit most from utilizing MFIs services is the one in the growth stage. This is the group who by virtual of their business size, loans from MFIs are substantial enough to meet their business needs i.e. have out grown the infancy stage and just taken off in the growth trend but not reached the stage of requiring more than the loan amount given by MFIs. The owners of the MSEs in this growth stage said that their growth rate was very high thanks to the help they were getting from the MFIs, which supplemented their own business savings. Some claimed to have borrowed the maximum amount of US\$7,000 on several occasions and have not had difficulties in repaying the loans.

The third category of MSEs that was in the mature stage was unsatisfied with the MFI services, as they could not obtain loans that were adequate to meet their business needs. They said that although their businesses grew through the ladder of MFI loans, they have outgrown the size of the loans they were receiving and were being forced to look for additional funds from other sources. They associated their reducing growth rate to this factor.

On the commonly used services, all the users of MFI services said that they use the group compulsory saving scheme (ROSCA) more often than the other services.

Another product commonly used by MSE owners was in the informal segment of micro finance. All MSEs said that beside the use of formal MFIs, they also use FROSCAS. Other groups only give a portion of the contributions and retain the remainder for the purpose of group investments while others retain all the contributions for group investments such as on the stock market, purchases of plots of land and investments in the transport sector etc.

3. 1.3.2 MSEs Satisfaction from MFI services

In response to the question on how satisfied they are with MFI services, many respondents felt that by keeping their savings locked in MFIs, they safeguard themselves from trivial and unplanned expenditure that people are often tempted to when they have money in their pockets. Others said that they joined these schemes in order to save for major business expansion such as expanding their business. Some said they saved the money for 'a rainy day' such as when cash flow was poor and there was an urgent business delivery or for meeting other emergencies like medical expenses instead of drawing from the business. They said saving with MFIs, had provided them with collateral for loans with which they had been able to purchase business assets such as trolleys, bicycles, motor cycles and even second hand vehicles which were used for delivery. Some respondents said that they had been able to buy their own business premises using such loans.

Some respondents testified how they had benefited from utilization of MFI services saying their businesses had grown. One respondent was very happy to disclose how from the proceeds of her business she had been able to afford to move from the slums to better housing. A dairy business owner was very proud of having increased his livestock from two cows to twenty milking cows, a former street vegetable vendor "mama mboga" said she graduated from operating on the streets to a modern green vegetable shop through MFI financial services. A former street shoe shine said he was now a proud businessman having graduated from the streets to owning a shoe shop and was able to provide quality education to his children from the proceeds of the business.

Those using factoring facility especially the new and growing MSEs said that although it is at a fee, they were satisfied by the arrangement as it allows them to convert their accounts receivables (approved invoices and delivery documents) into instant cash allowing them to service other orders. They further said that through factoring, they are able to carry many customers who pay their invoices much beyond thirty days unlike before where they were forced to turn down some of their more profitable orders because of slow-paying customers. Another satisfaction given as derived from factoring is

reduction in expenses related to credit and debt collection and since the fee is based on the MSE's sales volume, expenses are easily projected. In addition, MSEs claimed to have gained control over their cash flow because payment of invoices purchased by the Factor is contractually guaranteed and is made on a scheduled basis. As a result of certainty regarding their businesses cash flow MSE owners said that they are able to aggressively market and sell their products since funds are available when new orders are raised.

3. 1.3.3 MSEs Dissatisfaction and expectations

Most of the MSEs under ROSCA felt dissatisfied by some of MFI rules particularly the requirement to attend the weekly meetings saying the meetings were time consuming. For instance, those primarily interested in saving said that attendance of the weekly meeting which lasted from one to three hours and normally held during working hours was costly to them in terms of time. Group officials also complained about the time they spend carrying out MFI rules, like recruiting new members when other members exit, or inspecting the businesses of prospective members.

They also complained that there was no flexibility on the amount of the weekly deposits they had to make as it was a fixed amount, in some cases, a fixed fraction of their current loan. An example was given by a ROSCA member who due to his fluctuating cash flows found himself having to sell assets including his household goods in order to meet the weekly savings and loan re-payments. This he said in effect left him poorer than he was before joining the ROSCA.

MSEs in the rural area felt that there was need for credit services that accommodated their business style. A good example was a livestock trader who was in the business of buying young livestock and selling them during the high demand season. A hundred dollars gave the trader sufficient purchasing power to acquire about 10 goats from the local market. The trader was able to triple the market value of the livestock in four to six months but MFIs demanded a weekly repayment and saving from the trader. This he said forces him to look for alternative means of meeting the weekly demand due to the nature

of his business cash flow though he is able to pay both the principal and interest in a lump sum at the end of the season when the demand for goats is high. Another example was that of a trader who made carvings to sell to tourists. During the peak season his carvings were in high demand along the tourist attraction points. The trader travels many kilometers and spends weeks away from the business premises. The nature of the business does not therefore allow the trader to abide by the weekly requirements of MFIs.

To resolve both issues of inflexibility and cost, the MSE owners affected would have preferred to be allowed to contribute monthly as long as they achieve the agreed amount at the end of the month. They also suggested that at least a monthly ROSCA meeting would be more convenient to the majority of members preferably on an afternoon of non-working day.

Another dissatisfaction voiced by some MSE owners is on the low interest earned on their savings with MFIs. They complained that this was too low compared to that charged on loans. They proposed that the interest earned on their savings be competitive to match with the market rate.

All ROSCA members felt that there was uncertainty over the term of their savings. If other members in the group were overdue in their loan repayments, they said that the release of other members' loans was uncertain as savings were held up for an unpredictable period. According to the members this has resulted in a scenario where group members were left looking for elusive defaulters with MFI officials breathing hot on their backs. Some members confessed having lost some assets, even their entire savings as a result of MFIs auctioning them to recover money they had guaranteed to some group defaulters. They also felt frustrated by the legal system which provides too little to discourage bounty defaulters who are out to fleece genuine and serious group members.

A viable solution to this as expressed by ROSCA members would be for the Kenyan Parliament to expedite the enactment of micro finance bill to strengthen the legal framework and safeguard members' savings. In addition they felt that independent audit

should be done annually on MFIs and a report submitted to the regulators such as Central Bank of Kenya.

Some ROSCA members raised concern that the mechanism for releasing savings was unsatisfactory. As a result, members wishing to get some of their savings end up leaving the ROSCA, as it is impossible to make withdrawals of part of their savings. By leaving ROSCA members forgo the right to make future savings and the right to take loans. In addition to the above agony, re-joining MFI is either forbidden or made very difficult since the client has to go through the orientation and monitoring/waiting period again.

Members felt that they should be allowed to withdrawal part of their savings as long as it is not below the amount guaranteed against loans.

Some respondent felt that the repayment period was too short for long-term investments. Their wish was for MFI to introduce long-term facility of say 3 to 5 years with a grace period to allow for cash flow.

ROSCA members also said that there had been instances where some members had withdrawn from the group leaving only a few to carry the burden of loans already taken by other members. Their feeling was that this could also be resolved by a comprehensive micro finance policy framework to safe guard the interests of all concerned.

There was a common concern among members that the interest rate on loans appeared low but were in effect high, sometimes higher than the market rate.

Members felt that instead of applying the interest rate on the loan amount it should be applied on the outstanding balance and the rate should effectively be lower than the market rate. After all the money loaned out were the members rotating funds.

A comparison of the two approaches at the same rate of 1.5% per month clearly shows the difference (refer to tables 6 and 7)

From the workings, a loan of \$400 at a monthly rate of 1.5% on the reducing rate (table 6) had an effective rate of 9.75% while a similar loan at monthly flat rate of 1.5% (table 7) had an effective rate of 18%, almost twice that of the latter.

Some MFI customers felt that the incremental loan amount system from the first to the subsequent loans was too small. They said that the loan amount was too little to make a significant impact to growth of their business. They concluded that the loan amount they get was only helpful for short-term survival and not for major expansion.

Table 6: Reducing balance approach

Applicant:		S. Another				
Month	Total Repayments	Principal Monthly installments	Loan bal	Int. at 1.5% / month on reducing bal	Monthly workings	Average monthly repayment
		12.00		1.50		
1	400.00	33.33	366.67	6.00	39.33	
2	366.67	33.33	333.33	5.50	38.83	
3	333.33	33.33	300.00	5.00	38.33	
4	300.00	33.33	266.67	4.50	37.83	
5	266.67	33.33	233.33	4.00	37.33	
6	233.33	33.33	200.00	3.50	36.83	
7	200.00	33.33	166.67	3.00	36.33	
8	166.67	33.33	133.33	2.50	35.83	
9	133.33	33.33	100.00	2.00	35.33	
10	100.00	33.33	66.67	1.50	34.83	
11	66.67	33.33	33.33	1.00	34.33	
12	33.33	33.33	-	0.50	33.83	
Total Repayment					439.00	36.58

Summary		Less Insurance	Net loan amount		
Loan amount	400.00	4.23	395.77		
Total interest	39.00				
Monthly repayment	36.58				
Total repayment	439.00				
Effective interest rate	9.75 %				

Table 7: Flat interest rate approach

Applicant:		N. Another				
Month	Total Principal Repayments	Principal Monthly installments	Loan bal	Int. at 1.5% / month on flat rate	Monthly workings	Average Monthly Repayment
		12.00		1.50		
1	400.00	33.33	366.67	6.00	39.33	
2	366.67	33.33	333.33	6.00	39.33	
3	333.33	33.33	300.00	6.00	39.33	
4	300.00	33.33	266.67	6.00	39.33	
5	266.67	33.33	233.33	6.00	39.33	
6	233.33	33.33	200.00	6.00	39.33	
7	200.00	33.33	166.67	6.00	39.33	
8	166.67	33.33	133.33	6.00	39.33	
9	133.33	33.33	100.00	6.00	39.33	
10	100.00	33.33	66.67	6.00	39.33	
11	66.67	33.33	33.33	6.00	39.33	
12	33.33	33.33	-	6.00	39.33	
			Total Repayment		472.00	39.33

Summary		Less Insurance	Net Loan amount
Loan amount	400.00	4.23	395.77
Total interest	72.00		
Monthly repayment	39.33		
Total repayment	472.00		
Effective Interest rate	18.00 %		

ROSCA members said they would like MFIs to allow them take as much as their businesses could afford to repay even on the first loan based on individual total contribution. They also wished to be allowed to provide other forms of security such as pledging chattel as collateral in order to take substantial loan amounts.

Other complaints were about lack of provision of start-up capital by the profit oriented MFIs discourages the development of good ideas into viable enterprises. Some narrated how they had to struggle to raise funds to start their businesses as no financial institution was ready to fund their new enterprises. They had to borrow from friends and relatives and they claimed that this was not easy. They wished profit oriented MFIs would emulate the community development oriented MFIs in providing start-up capital.

3. 1.4 The ministry of trade and Co-operative Bank

The role of Co-operative Bank of Kenya was said to be to serve the co-operative movement in Kenya. The respondent further elaborated that the bank was the main channel through which savings within the co-operative sector were mobilized and passed for investment to the movement.

As a banker for co-operative (SACCOs), the respondent said that the bank received all co-operative financial inflows and made various payments on behalf of SACCOs as well as offering all other banking services such as safe custody of SACCO money, receiving deposits and making payments to SACCO members. Based on this, the bank was said to be the link between the SACCOs and the Kenyan money market.

The bank was also said to cater for all the SACCO financial needs thus creating an enabling financial environment that the co-operative movements needed for future growth and development. The bank gave short term advances to SACCOs to bridge their members' financial need. This it was said was mainly in instances where SACCOs had exhausted their savings and had pending loan applications

On training, the respondent said that beside the financial services offered by the bank to SACCOs, it also provided technical know-how and a range of other banking services. It assisted the SACCOs by appraising new projects, financing them and monitoring and evaluating their implementation thereby ensuring proper utilization of funds.

The role of the ministry of trade to MSEs was said to be that of creating an enabling environment for the latter to trade. The ministry worked hand in hand with the Jua-Kali Association on issues raised by MSEs and expanding trade and marketing of the MSEs products. It promoted MSEs products by organizing trade fairs locally and assisting in foreign promotion through its foreign attaché. This had worked well especially in the carving, weaving and art businesses of the Jua-Kali sector.

3. 1.5 The AMFI and Jua-Kali Association

3. 1.5.1 AMFI

The AMFI was said to represent 26 out of approximately 60 registered MFIs in the country. The small membership was because potential members had to meet various conditions before being accepted as members of AMFI. The conditions were that an MFI wishing to join AMFI must have at least 2,000 clients, must have been in business for at least three years, must produce their audited accounts and should never discriminate on the basis of race, colour, sex or religion. The MFI must also demonstrate a capacity to manage its operations according to the internationally accepted norms.

On their role to MFIs and indirectly to MFIs customers, the AMFI respondent said that its main role was to facilitate the development of an environment that allows smooth operation of its members. An example that was given in carrying out this role was pushing for the Micro-finance Bill to be tabled in parliament and passed into an Act. It was said that the drafting of the said bill was initiated by AMFI in consultation with the Central Bank of Kenya.

Through the draft Micro-finance Bill, the AMFI made a major contribution towards creating a more enabling environment for the MFI sector.

Although it is not a regulatory body, the Association was said to set ground rules within which its members operate. In addition, it acted as the central voice for its members on issues affecting them.

The respondent expressed regret that AMFI was neither a regulatory nor a licensing body to the MFI sector. The association was therefore helpless when it came to disciplinary matters as it had neither control over non-members nor vetting powers on new entrants.

3. 1.5.2 Jua-Kali Association

The role of the Jua-Kali Association to the MSEs was said to be to safe guard the interests of its members by ensuring that they work in a suitable environment. The Association said that it helps its members by linking them to the market by organizing for trade fairs locally and assisting them to attend for such held outside the country

Besides assisting its members in marketing, the Association said that it fought for its members' rights by listening to their problems and or resolving them with the relevant people such as the local authority, income tax authority etc. It acted as the voice of its members on issues both internal and external to the sector.

The association was also responsible for educating its members in business management skills, market development and behavior, product development and marketing, and familiarization with government requirements.

The Association however said that although it looks at the issues of its members, other MSEs who were not members indirectly benefited from its work as most of the decisions made on issues affected all MSEs.

3. 2.0 Discussion and Recommendations

The data collected shows that MFIs operate all over the country. However their distribution is skewed in favor of urban areas, wealthier rural areas and busy rural markets connected to main roads (refer to table 2), their presence in these areas is seen as a blessing by their customers. In spite of the dissatisfactions highlighted, the fact that some MFI customers have grown from "mama mboga" (woman street vegetable vendor) to owners of modern green vegetable shop, from street shoe shiners to owning their own shoe shops, from living in slums to decent houses, is in itself an indication of the positive influence of MFIs.

Further to this, MSEs have grown through acquisition of assets over time through the use of MFI services. Such assets as mentioned in the findings are trolleys, bicycles, motor



cycles and hand vehicles which were used for delivery. The growth trend by MFI customers is a good indicator that the financial services they receive have contributed to higher business income, which is demonstrated by a strong upward trend in spending on assets expansion. Respondents attributed this growth to several factors, the most important of which were easier loans accessibility resulting in higher incomes and a greater propensity to save. The extent to which this trend is better among MFI clients as opposed to those using other sources of finance is beyond the scope of this research. The fact however remains that MFIs have had their share in contributing to the overall growth of MSEs as evidenced by the growth trend discussed above.

It is however worth noting that due to the small size of loans available from MFIs, MSEs expansion through the use of MFI services is limited such that the growth rate of MSEs was slower than it would be if loans were availed in large amounts. MFIs therefore facilitated growth up to the growth stage (refer to table 4) beyond which MSEs required colossal amounts of money with long-term repayment periods. These were only available in the traditional banking institutions at higher interest rates. One would then argue that MFIs accelerates or jump starts the growth of small businesses and fails to sustain them on attaining the maturity stage. The research revealed that due to this limitation, MFI clients were likely to patronise other financial service providers more frequently as they grew to supplement the MFIs services thus making MFIs services an integral component of a “portfolio” of business growth strategies. It can therefore be deduced from this that MFIs fail to satisfy their MSE client demand for the whole growth range, which implied, in turn, that its impact on MSE growth was limited to a certain level. Thus, while the evidence from the research points to a positive impact of MFI services on MSE growth, the actual size of this impact is only realised in the initial stages.

The data collected indicated that MSE owners used MFI loans and savings for a wide variety of purposes such as business expansion, asset acquisition, emergencies and school fees. It is clear from these that access to loans and savings through MFIs provides MSEs with an important and highly valued mechanism to meet business and personal cash flow needs and to cope with emergencies.

Given that one of the primary causes of business closure is extreme vulnerability to cash flow distress, the multiple ways in which MSE use their loans and savings demonstrates how MFI products help them to manage risks, and to meet business cash flow demands. While this does not necessarily represent a breakthrough from the vicious cycle of the cash trap, MFIs nonetheless contribute to alleviation of business failure by helping its clients to cope with one of the primary causes of business closure by cushioning them against its effects. Whether coping with cash flow shocks, investing in expansion or meeting day-to-day personal needs, the evidence suggests that loans and savings from MFIs play an important role in all these activities. This finding suggests that participation in MFI services can and does enhance the overall performance of MSEs.

Evidence from the respondents strongly suggested that loans and savings from MFIs are integral to the MSEs' ability to improve their operations to higher levels than when they had no external sources of finance. It can be concluded from the above that access to MFI loans and savings provides MSEs with additional, appropriate, and relatively low-cost financial alternatives that meet a wide variety of cash flow needs. However, since MSEs are able to access multiple credit facilities simultaneously, thereby increasing their indebtedness, care should be exercised in granting them loans as their ability to meet repayment schedules may be eroded, resulting in business closure.

The minimized approach taken by the profit oriented MFIs may be seen as a cost reduction measure by the MFIs but there may be a danger in it. Although ROSCA members exchange their business ideas and experiences in their weekly meetings, this may not be enough source of business knowledge. Provision of funds by MFIs with an assumption that the MSE owners are well experienced in business management may not be correct, may be riskier and perhaps more expensive in the long run to both MFIs and MSEs. In today's business world, business management was ever evolving and one cannot be contented by the knowledge acquired years ago. The risk MFIs take by not providing training services was high because they may be lending to people whose business management approach was outdated and may not survive in the long run. This may result in MFIs losing as there is a likely hood of high default rate as MSEs fail to make profit to repay their loans. The MSEs may end up closing down as they may be

operating without the necessary tools of knowing whether they are doing business the right way. In the effort of minimizing operating cost, MFIs may in effect be postponing it. In support of the need for equipping business owners Kirby (2003) stated that many ventures fail within the first two years of start up mainly because they are started with the owner not having access to appropriate guidance in business management since there is very little that is offered in business management training to would be entrepreneurs.

On the other hand the community development oriented MFIs should not sit in their comfort zone waiting for donor funds. For now they are doing well in reaching the marginalised poor in the arid area but as Kandie (2005) put it, dependency has its own danger because the survivor is purely in the hands of donors. In the event of such donor withdrawing their funding, the future of those MFIs and the community they serve is uncertain. Along the same lines Kandie (2005) emphasized the need for MFIs to look beyond donor funding to being able to attract private investments both in form of equity and loans.

The influence on the policy and regulatory environments in which MFIs operate in Kenya is worth noting. The research revealed that MFIs in Kenya operate in a vague setting as they were founded under various uncoordinated laws mentioned earlier. Some are not registered under any act. This, as was found out has necessitated manipulation by insincere people who operate MFIs purely to exploit the desperate loan seekers.

The argument by the ROSCA members that the weekly meetings were time consuming conflicted with their praise for the benefits derived from them. It was the same team that claimed to benefit from such meetings as they created a forum for learning from each other through exchange of ideas and sharing of their business experiences. Without any business training available the forums should be taken seriously as they remain the only source of business know-how. The time taken in such meetings should not be seen as wasted but should be exploited fully. The researcher's recommendation on this is to reschedule the meetings to less busy days such as weekends.

The complains raised by ROSCA officials about the time they spend carrying out MFI rules such as recruitment exercise of new members or inspecting the businesses of prospective members also contradicts the basis or principals under which the MFIs are founded. According to the arguments by Muchiri (2005) and Kandie (2005), it is through such cautions that have necessitated MFIs to create a credit system based on mutual trust, accountability, and participation without the need for collateral. It is therefore important for the MFI officials to look at such rules positively because without them, MFIs would be forced to operate on security basis as collaterals which would in effect leave out the target clientele.

3. 3.0 Conclusions

The most significant finding was the wide-ranging use of MFI products and services by the clients. MSEs use MFI financial services for business growth, sustainability and personal use. Specifically, loans and savings were used to finance productive activities such as business expansion and starting up new businesses; coping with crises such as cash shortage, worn-out and lost assets replacement etc. All said and done, one can detect a rise in business income among MFI clients, which can credibly be associated with the influence of MFI role.

MFIs also appear to have maintained distinctiveness in the service industry, as they tend to be customer-driven than product-driven. Since the market for MFIs is dynamic in nature, this client responsiveness had helped MFIs to regularly collect feedback from their clients, which has further assisted them to adjust their operations accordingly to match with the market demand in both urban and rural areas.

Over time, MFIs have come in to fill the financial services gap left by banks. MSEs have evidently benefited from the presence of MFIs, judging by the testimonies given by ROSCA members. The testimonies further described how MSEs through the use of MFI services had evolved from small set ups to bigger ones.

Overall, MFIs appeared to have positively influenced the growth of MSEs in Kenya. The MFIs therefore have potential to further influence further MSE growth if the highlighted dissatisfactions and gaps in service delivery were addressed.

3. 3.1 Recommendations to MFIs

Based on the above observations, the following recommendations are made for the various role players: -

- a) It is recommended that MFIs using the minimised approach enhance further their menu of products. Only community development oriented MFIs provide start-up capital and since they are very few in number, they cannot satisfy the high demand from those with viable business plan looking for funds to start-up businesses. New businesses are always associated with high risk of failing but a well thought through business plan has a higher chance of success. Profit oriented MFIs should reconsider giving start up capital to support those ideas that have high chances of succeeding.
- b) To reduce the probability of such businesses failing, MFIs should have a research unit whose main work would be to review and research on business ideas and assist in preparation of business plans before funding is approved. To reduce the risk further, MFIs should have close supervision on the daily running of such newly formed businesses. Alternatively MFIs should fund start up capital on a joint venture basis and only pull out once the business becomes stable.
- c) While MFIs are an important provider of financial services in both urban and rural areas, one major weakness has been to introduce products that are flexible to meet the needs of the diverse MSE sector. The need for an urban MSE is not necessarily the same as that in the rural area meaning a standard product is not applicable to all. For the MFIs to be more effective in their area of operation, they should develop a regional mindset approach. A mind set that will embark on gathering relevant strategic information by means of environmental scanning that will enable them formulate products that are strategic to development of MSEs in specific geographical region (Hugh, Neuland and Bothman, 2004). For example, the standard rule that ROSCA members must give their savings and or loan repayment on weekly basis is

self-defeating in the rural area. Cash flow in the rural area is not as high as in the urban area. A rural MSE owner is unlikely to meet the weekly savings requirement but is likely to do so at the end of the month. This is in line with the rural spending trends as high cash flow is experienced at the end of the month when salaried rural dwellers are paid, when farmers are paid proceeds from their farm outputs or when the rural people receive financial assistance from their family members living in the urban centres. A monthly savings interval would therefore be more accommodating to the rural SMEs.

- d) Although MFIs do not look at micro-finance services with the mentality used by formal banks i.e. they consider the industry from their own perspective, high interest rate on loans and low interest rate on savings is a concern for some but the major one raised by MSE owners was on the loan amount and loan repayment terms. If the primary objective was to fill in the gap created by traditional banks as already highlighted, MFIs should be flexible in their loan policy. They should change their loan policy to accommodate especially those MSEs that are in the maturity stage and require more funding than the current policy allows. In so doing the growth rate of such MSEs will be sustained and they will not need to seek loans from other expensive sources. The policy should allow needy MSEs to get loans that were commensurate with their savings and ability to repay. Where need be, the policy should allow for MSEs to pledge chattel as collateral in order to take substantial loan amount. Bigger loan amounts should be accompanied by a longer repayment period to reduce the burden of monthly repayments. In addition, a repayment grace period should be introduced to allow cash generation. Currently, the practice was for loan repayment to start within a week of loan disbursement. This was too short a period and insufficient to generate cash. Two to three month's grace period would be sufficient to allow cash flow generation.
- e) The minimized approach adopted by the profit oriented MFIs does not guarantee cost reduction due to the dangers already mentioned. It is recommended that MFIs introduce a training cost sharing approach with their members. MFIs should prepare management training packages or modules, provide facilitators and training calendar and then sensitize their customers to attend training at a minimum fee that will enable

them to break even. The idea should not be to make money on training but to create sustainability to both MFIs and MSEs which in the long run yields growth to both.

- f) The research revealed that there is a significant difference in the interest rates charged among the existing MFIs. Although some MFIs argue that the unregulated interest environment boosts the MFI sector by cushioning the risks of their financial operations, which are collateral free, a regulated environment would protect MSEs from the loan sharks. MFIs should therefore discuss and come to a common ground on their differences in this respect. Better still the MFI bill should bring MFIs under one Act where they will easily be regulated and monitored. This should however not compromise the respective incremental overhead cost with increasing MFI outreach since cost is expected to increase unless they are donor supplemented. The recommendation here is for AMFI and Jua-Kali Association as well as the respective MFIs to create an infrastructure that will disseminate information to MSEs educating them on such incremental overheads so that those in the more expensive zone will not feel exploited.

3.3.2 Recommendations to the Government

- a) To protect loan seekers from unscrupulous loan sharks, and to provide a clear MFI framework in terms of their governance, operations and accountability, the government should provide sufficient legal protection. To start with, the government should embark on an MFI restructuring program where all the existing MFIs will be controlled by one Act. This way the gap created by the existence of MFIs operating under different Acts will be eliminated and there will be no room for mushrooming of illegal MFIs. An institution to regulate MFIs the way banks are regulated by the Central Bank of Kenya under the Banking Act should be created to further regulate MFIs activities and enhance accountability. Alternatively a sub-section can be introduced in the current Kenya Banking Act specifically to manage and monitor the activities of the MFI sector under the already established Central Bank of Kenya.
- b) The long outstanding micro-finance bill that was drafted by AMFI in 2002 in conjunction with the Central Bank of Kenya should be debated and passed by the parliament into a law without further delay in order to give MFIs their due

recognition under one Act. This will regulate the activities of MFI as well as protect them from dishonest clients and MSEs from loan sharks. According to Association of Micro-finance institutions (2005) the debate on this bill is long overdue and should be passed as an Act of parliament without further delay to facilitate an enabling environment for the sector.

- c) While MFIs are found operating all over the country there is a limit beyond which profit oriented MFIs operations would not be sustainable. Currently, MFIs are found in the cities, urban centers along the major highways and in the cash crop regions although community development oriented MFIs are present in a few parts of the arid and semi arid areas. As already established, MFIs activities are a necessity to the growth of MSEs across the country. To enhance this service provision and reach greater parts of marginal areas in Kenya where the bulk of the poor live, the Government of Kenya should through its rural development programs take over from where the profit oriented MFIs are able to reach. It can do this by encouraging the community development oriented MFIs activities to widen their outreach through Government subsidies. Alternatively the Government should set up Government sponsored revolving funds in the arid and semi arid areas and customize its products to suit the businesses environment in the area. The youth development funds created in the 2006/7 Government of Kenya annual budget should form a good starting for creating the revolving funds (Fiscal plan, 2003/2004). Whether the Government subsidizes or starts its own revolving fund. This should work well to resolve the donor dependency issue raised by Kandie (2005).
- d) A general pointer to the Government and all stake holders that came out of the research is on women. As already mention in our findings, the informal sector of MFIs is dominated by women. Although this is beyond the scope of this research, the fact that women dominate in the merry go round should be a subject of concern that would call for further research. It is an indicator of a potential area that needs to be exploited on economic basis or it could be an indicator that women's needs are not fully satisfied by the formal sector of MFI. The Government, AMFI and all other stake holders should therefore reach out deliberately to women participating in the

informal sector of MFIs, to establish what can be learned and how the sector can be economically enhanced.

3.3.3 Recommendations to the Associations

- a) Medical services in Kenya are very expensive and MSEs are in most cases unable to raise the high insurance premiums levied on medical insurance covers. Under the circumstances MSE operators keep on drawing from their businesses to meet their medical fees as and when they arise. A high rate of such drawings drains operating capital from businesses, and this has resulted in closure of so many MSEs that would otherwise be doing well. Both AMFI and the Jua-Kali Association should negotiate for a reasonable medical insurance scheme where MSEs who are MFI customers will be allowed to join. Payment of premiums should also be negotiated in such a way that it is spread across six and if possible twelve months. Arrangements with MFIs can be made for premiums to be remitted from members' accounts to guarantee the payment.
- b) Another recommendation would be for AMFI to encourage its members and the MSEs through their umbrella representative - the Jua-Kali association to review the proposed bill before it is debated in Parliament and send their proposals to enhance the quality of the expected Act.

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Appendix 1

Point of reference

1. Describe the role of MFI as a tool for development of MSEs
2. Describe what services and products are offered by MFIs to MSEs
3. Describe what MFI services and products have been used by MSEs
4. Describe the MSEs satisfaction with the current MFI products and services
5. Describe MSEs expectations of MFIs' services and product offered
6. Analyze the gap between current service levels and expected levels

MFI section

Please give a brief description of your organization

What type of services do you offer to MSEs?

What is the organization's objective in providing these services?

Is there customer preference for one service compared to other services?

If yes, what is the reason behind their preference?

How flexible are your services in meeting unique MSE demands?

What is the significance of your organization to MSEs?

To what extent would you say your organization has made a difference to your clients?

What guideline policies and practices do you use in selecting and supporting your client?

What follow up mechanism do you have in place?

How do you measure the extent of your success?

How do your clients assess the assistance by your micro-finance?

What major problems do you face with MSEs in trying to meet your objective?

How do you resolve or intend to resolve these problems?

Are there other external/internal limitations to your operations?

What makes you better than other conventional financial institutions offering similar services to MSEs?

To what extent would you say you have met the expectations of MSE?

MSEs section

Please give a brief description of how your enterprise started.

Describe your enterprises growth over time.

At what point of your business growth did your enterprise start using MFI services?

What made your enterprise go for MFI services?

To what extent would you say MFIs have assisted in the growth of your enterprise?

What kinds of services are availed to your enterprise by MFIs?

What has your experience been with the type of services offered by MFIs?

Does your enterprise have a preference to a specific type of MFI service?

If yes, why?

How often does your enterprise use MFI services?

Are there other related services that you would like to obtain but are not currently available?

Are such services currently available from other financial institutions?

Are you obtaining such services currently?

From where/who do you currently obtain them?

Have you ever obtained similar services as those offered by MFIs from other financial institutions?

If yes, how do you compare the service quality of the two?

Are there areas in which you would like MFIs to improve in the way they provide their services?

To what extent would you say MFIs have met your expectations?

Ministry section

What is the role of the ministry in relation to MFIs and MSEs in Kenya? In the literature review do you touch on government regulations governing operations of MFIs? Regulations could impact on the type of products offered as well as the product/service quality.

From the ministry's point of view;

What is the nature of the relationship between MFIs and MSEs?

What are the key success areas of MFIs in the growth of MSEs

Have MFIs made any contribution to the growth of MSEs?

If yes, how?

Are there areas of MFIs operations that the ministry feels have negatively influenced the growth of MSEs.

What is the quality of MFIs service delivery to MSEs?

How appropriate do you think the MFIs products are to the needs of MSEs?

What other operational activities would the ministry recommend to MFIs?

AMFI section

What is the role of AMFI in relation to MFIs services?

What % of Kenya's population do you think MFIs serve?

To what extent do MFIs services cover the country?

How appropriate do you think the MFIs products are to the needs of MSEs?

Are there any regulatory requirements that hinder/ assist MFIs operations

What are the major problems faced by MFIs in general in their effort to meet their objectives?

What has been the specific contribution of the MFIs to the development of MSEs in Kenya?

What has been the quality of MFIs services from your organization's point of view?

Jual-Kali Association

What is the role and objectives of the Association to its members?

What proportion of your members use MFIs services?

What has been the specific contribution of the MFIs to the development of MSEs in Kenya?

What has been the quality of this contribution from your organization's point of view?

How appropriate do you think the MFIs products are to the needs of MSEs?

Are there areas of MFI operations that the association feels have negatively influenced the growth of MSEs?

What are the major problems experienced by MSEs in respect to the services provided by MFIs?

