ASSESSING THE SUITABILITY OF A REGULATORY FRAMEWORK FOR OPERATIONS OF MICRO-FINANCE INSTITUTIONS IN KENYA

By

Margaret Oriaro

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DEDICATION

To my loving parents, Mama Luciana Awino and Mzee Damiano Apondi Ofware for the prayers and encouragement, offered throughout the two and a half years of my study.

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DECLARATION

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

Signed: -- Date: 20/10/01

Mrs. Margaret Awuor Oriaro

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

Signed: -- Date: 27/10/01

Mr. M. N. Anyangu

Lecturer and Chairman, Department of Accounting,

Faculty of Commerce, University of Nairobi

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ABBREVIATIONS

AMFIs	Association of Micro-finance Institutions
BPRs	Bank Perkreditan Rakyat
CAMEL	Capital adequacy, Asset quality, Management, Earning and Liquidity
CBK	Central Bank of Kenya
CBOs	Community Based Organizations
CBS	Central Bureau of Statistics
CERUDEB	Centenary Rural Development Bank
CGAP	The Consultative Group to Assist the Poorest Micro-finance Programs
CMA	Capital Market Authority
DFID	British Department for International Development
FFPs	Private Financial Funds
GDP	Gross Domestic Product
HAPAC	HIV/AIDS Prevention and Care Project
ILO	International Labour Organization
K-REP	Kenya Rural Enterprises Program
KUSCCO	Kenya Union of Savings and Credit Co-operative Society
KWFT	Kenya Women Finance Trust
MCR	Minimum Capital Requirement
MF	Micro-finance
MFIs	Micro-finance Institutions
MIS	Management Information Systems
MSE	Micro and Small Enterprises
NABARD	National Bank to Agriculture and Rural Development
NBFI	Non Bank Financial Institution
NCCK	National Council of Churches of Kenya
NGO	Non Governmental Organization
POSB	Post Office Savings Bank
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Societies
SMEP	Small Micro Enterprise Programme
USAID	United States Agency for International Development
WEDCO	Women Economic Development Company

ABSTRACT

The main objective of this research study is to identify and analyse the characteristics of Micro-finance Institutions (MFIs) operating in Kenya so as to assess the suitability of a regulatory framework, and the form that it can take. In order to meet this objective, the information sought for the study was collected through the use of a questionnaire, administered to a sample of 50 micro-finance institutions in Kenya. Out of this sample, 30 respondents (60%), completed the questionnaires and have provided the information used in this report.

The research study has found out that 37% of the organizations interviewed were registered as limited companies while 43% were registered as non-governmental organizations, dispelling the fear that private companies cannot mobilize funds, from donor agencies for charitable work. Although the eight different Acts under which the MFIs are registered have facilitated innovation and flexibility in performance, all the respondents agreed that there is an urgent need for regulation of the sector. The actual form of regulation needed is still however, controversial with the majority (50%) of the respondents preferring to be regulated by the Association of Micro-finance Institutions.

The Kenyan MFIs' characteristics are similar to those of similar institutions in other countries i.e. the existence of MFI investors with non commercial interest, dependent on donor funding and the client groups with highly concentrated portfolios. These characteristics, though call for a different form of regulation from that applied to traditional banks, have partly been a hindrance to the regulatory process. The study found

that the dominant characteristics that hinder regulation are targeting low-income asset less clients/MSEs, extending unsecured loans based on group guarantees and capitalization by donors. The issue of which particular characteristics do support regulation can only be examined on the basis of the type of regulation being pursued as organizations to be regulated by the CBK will have to fulfil different conditions from those being regulated through a third party or AMFI.

To take deposits, MFIs are required to satisfy capital adequacy, asset and management quality, earning and liquidity requirements otherwise known as CAMEL. Forty three percent (43%) of the respondents interviewed have never heard of the CAMEL tool, yet those who have were reluctant to suggest possible levels for the 5 components of the CAMEL tool.

The study has identified six regulatory groupings and has separated institutions that operate more like rotating savings and credit societies and/or that are basically projects managed by registered churches as Type I MFIs requiring no formal regulation. MF NGOs at infancy stage or old ones still heavily dependent on donor funding are categorised as Type II MFIs requiring self-regulation. Type III Organizations are those with credit only operations and forced deposit operations to be regulated by AMFI or a licensed third party organization. Type IV MFIs representing Deposit taking MFIs to be regulated by the Central Bank. Type V MFIs represents savings and credit co-operative societies undertaking MF business to be regulated by the Department of Co-operatives and finally, Type VI composed of commercial banks will be regulated by the Central Bank.

It is not certain how many of the MFIs wishing to take deposits will meet the requirements that may be imposed by the CBK. Ten percent (10%) of the respondents chose to go for deposit taking and hence be subject to CBK regulation. However, given the limited human, technical and financial resources, the CBK may need to establish which and how many MFIs it can effectively supervise, or the number that they wish to encourage to be regulated.

1.0 INTRODUCTION

1.1 Background

Kenya has a well-developed financial sector, providing 10% of Gross Domestic Product (GDP) in 1997 (Mullei & Bokea, 1999). In March 1998, there were 17 different types of financial institutions including 53 commercial banks, 16 non bank financial institutions (NBFIs), 57 hire purchase companies, 4 merchant banks, 39 insurance companies, 2 investment advisory firms, 20 securities and equity brokerage firms, a stock exchange, bureaus, a social security system, numerous pension plans, 4 building societies, 2 mortgage finance companies, 10 development finance institutions, a postal savings bank, and 2,670 savings and credit societies (SACCOs).

Despite the rapid expansion of the formal banking sector, a large number of poor Kenyans involved in micro and small enterprises have been left out of the mainstream-banking sector, which considers the informal sector to be risky and not commercially viable (Mullei & Bokea, 1999). The local micro-finance organizations have attempted to fill this gap by using new technology to deliver services to the poor while borrowing from the experience of Grameen Bank of Bangladesh, Bank Rakyat of Indonesia and the Bancosol Bank of Bolivia (CBK Report, 2000).

Micro-finance involves the provision of thrift credit and other financial services to the poor and small scale enterprises to enable them to support their productive activities and therefore raise their income and living standards. More than 100 micro-finance organizations and a few commercial banks provide financial services to Micro and Small

Enterprises in Kenya (Dondo, 2000). About 20 NGOs, out of the estimated 100 MFIs in Kenya, practice micro-financing exclusively (minimalist approach) while the rest practice it alongside social welfare activities (integrated approach).

These MFIs have however, operated without proper policy or legal framework (CBK Report, 2000). Existing MFIs are operating under eight different Acts. Namely, Companies Act, Banking Act, Societies Act, NGO Co-ordination Act, Post Office Savings Bank Act, Trustees Act, the Building Societies Act and the Co-operative Society's Act. The lack of appropriate regulation to guide their operations, has led to a diversity in institutional form, inadequate governance and management capacity, limited outreach and limited access to funds. As a result, an unfavourable image and poor performance standards continue to hinder the growth of the sector.

The 1999 baseline survey undertaken by Central Bureau of Statistics (CBS) indicated that there are about 1.3 million Micro and Small Enterprises (MSEs) employing nearly 2.3 million persons, 29% of the country's total employment. The sector also contributes 18% of the overall GDP and 25% of non-agricultural GDP though only 10.4% of the sector received credit and other financial services.

Since the publication of the Sessional Paper No.2 of 1992, and the 1999/2000 Finance Minister's Budget Speech, a number of strategies have been put in place to support the sector. These include strategies geared towards identification and application of less stringent collateral requirements, and addressing the attitude of formal financial institutions. De-regulation of interest rates has also assisted the operation mechanisms of micro-finance evidenced by the licensing of K-REP Bank in July 1999.

A fully-fledged Micro-finance Unit has been established in the Central Bank of Kenya (CBK) to monitor activities of micro-finance organizations. The Association of Micro-finance Institutions (AMFIs) has been registered by the Government to liase with it and other stakeholders in developing regulatory and accounting framework for the sub sector. AMFIs has drafted the first Micro-finance Bill 2001, that will seek, *inter alias*, to establish an avenue for MFIs to be recognized as equal players in the financial sector and to create a means for them to access deposits.

To facilitate regulation and supervision of MFIs, a *tiered* approach that recognizes in-appropriateness of the existing banking legislation for the regulation of the specialized activities of the micro-finance and diversity of the institutions engaged in the un-regulated sector, has been recommended. The three *tier* approach consists of informally constituted MFIs, formally constituted credit only MFIs and formally constituted deposit taking MFIs.

The Micro-finance Bill, when enacted will empower CBK to licence, regulate and supervise formally constituted MFIs intending to take deposits from the general public. Specific performance parameters will be developed to facilitate supervision of this group of MFIs. The Banking Act will also be amended to specifically allow and recognize that

MFIs licensed under *tier* 2 can take deposits in a limited way in the form of cash collaterals tied to loan contracts.

1.2 The Research Problem

Various statements have been made in Kenya, by both the practitioners and the government on the need to regulate the micro-finance sector. To this end, the government has already initiated a number of steps to facilitate this move, including, registering AMFIs and the drafting of a Micro-finance Bill. Therefore, there is already a belief among the practitioners that there are benefits to be derived from being regulated. Further, the high competition among the players and the limitation in donor funding (the main source of funds for MFIs), leads, almost inevitably, to preference of regulation as a way of accessing funds and expanding outreach.

The decision whether a MFI should be subject to regulation or not depends on a number of factors. Vogel (1997) lists these to include profitability, management information and control systems. Commercial banks, Vogel argues, are subjected to external auditing and bank examinations, which require certain traditional standards, e.g. --- audited financial statements and evidence of collateral, which are not applicable in the area of micro-lending. Vogel advises policy makers considering the regulation of MFIs to recognize the difference in risk characteristics of banks and MFIs.

Studies carried out earlier in this area have given contradictory results as some support regulation while others do not. CGAP (2000) argues that the creation of a special regulatory window for MFIs is probably premature in countries without a critical mass of licensable MFIs. Christen (USAID Conference, 1997) advises that, although MFIs are structurally different from traditional financial institutions, bank superintendencies must establish distinct rules and procedures for their oversight, with equally rigorous standards.

Gallardo (1998) observes that the blanket regulation of MFIs has the potential to discourage innovation and hinder flexibility possible with informality and that regulations do not necessarily correct market efficiencies in discriminating sustainable and non-viable providers of micro-finance services and, it does not guarantee against the failure in operations, of regulated financial institutions.

CGAP (2000) argues that the absence of a special licensing regime for MFIs is not the binding constraint to the development of micro-finance. Rather, the bottleneck is the scarcity of MFIs that are not dependent on continuing availability of subsidies that can operate profitably enough to be able to pay a commercial cost for a large proportion of their funds without decapitalizing themselves. In developing countries, self-supervision, (according to the report) has a long history of failure, and is highly unlikely to work for MFIs.

Rosengard, Rai, Dondo & Oketch (1999) advised that, without drastic and substantial modification of current operations of MFIs in Kenya, the CBK regulation and supervision of MFIs would most likely stifle rather than foster the growth of micro-finance in Kenya.

The Micro-finance, like the banking sector, forms an important economic sector in any economy and its performance is hence important. The foregoing paragraphs have highlighted the arguments advanced for and against the regulation of MFIs. This research study identifies and analyses the characteristics of MFIs' operations in Kenya and assesses the suitability for a regulatory framework applicable to these institutions.

1.3 Objective of the Study

The study will:

i. Identify the characteristics of the local MFIs that may support or hinder the regulatory process.

ii. Identify appropriate regulatory approaches that could be suitable to MFIs in Kenya

1.4 Significance of the Study

The findings of the study will:

i. Provide comprehensive materials that would assist policy makers and regulators in critically analysing the basis for adopting varied regulatory measures for the sector

ii. Provide information to practitioners and donors in understanding what is involved

iii. Provide guidelines to MFIs wishing to review alternative regulatory options and information on the effects on a MFI when it becomes regulated

iv. Be valuable addition to the existing body of knowledge in the micro-finance sector.

2.0 LITERATURE REVIEW

2.1 The History of Micro-finance Institutions in Kenya

Dondo (2000) traced the history of MFIs in Kenya to the mid-1950s when the Joint Loan Board Scheme was established to provide credit to indigenous Kenyans with small trading businesses. Mugwanga (1999) states that micro-finance activities in Kenya started in early 1970s, that is, after the 1972 ILO Seminar Report on employment. Initially, supported by church based institutions like National Council of Churches of Kenya (NCCK) and other smaller church based NGOs, the programmes were *ad hoc* and done as additions to other social outreach programmes.

In the 1980s two other specialized organizations i.e. Kenya Rural Enterprise Fund (K-REP) and Kenya Women Finance Trust (KWFT) began operating. These organizations were heavily subsidised, relied mainly on donor funding and used the integrated (credit and training) approach to assist micro-enterprises. They extended small loans without the requirement of tangible collateral.

The "minimalist" approach was adopted by a number of MFIs in the 1990s and other ancillary activities like training were either stopped or hived off into separate programmes. More specialized product based organizations emerged in the sector as many church based organizations died out or collapsed due to lack of funding. The most prominent institutions that emerged were Pride-Kenya and Faulu-Kenya. NCCK established the Small Micro Enterprise Program (SMEP) while CARE created WEDCO. In March 1999, K-REP became the first MFI to convert to a commercial bank.

2.2 Characteristics of Micro-finance Institutions

Drake and Otero (1992) say the following on MFIs: "The Board is composed of individuals with interest in development. It sets parameters for operations but spends little time reviewing the same. The governance issues for the board are not well defined. Clients are mainly individuals operating micro and small enterprises (MSEs) while capital is mainly provided by donors through grants for loans, training and operational costs. The methods for financial services involves initial testing with small groups, and thereafter, combining credit and training with focus on project design, outreach and staffing. Financial management involves low level of sophistication with simple bookkeeping, though lately, a number are computerised. Many MFIs have self-sufficiency difficulties and high operating costs". These characteristics mark an important difference between a micro-finance institution and a formal commercial bank.

Christen (1997) argues that NGOs wishing to be regulated should transform from "living on donor funds to living on borrowed funds". Christen narrates further that, a successful MFI should have a clear vision; access to funds through demonstrated viability and sustainability; quality performance; high quality standardized product that can be sold to the banking community; ability to apply CAMEL based tool (capital adequacy, asset quality, management, earnings and liquidity); good information, auditing and control systems.

The CAMEL based tool applied in the ACCION Network has proven to be a powerful impetus to improving the achievement of programmes as it allow the comparison of performance among firms and encourages competition. Although this approach has not yet reached a rated agency type of exercise, it has set the ground for the understanding of the performance of an institution in a manner that would convince the financial market of its bankability.

MFIs have higher administrative costs than formal commercial banks and hence charge higher interests on loans. Although an efficient MFIs can easily cover such costs, existence of high loan delinquency can lead to faster loss of equity due to loss of interest income meant to cover such costs. On the other hand, insistence on tangible securities may eliminate potential clients that MFIs aim at serving.

2.3 Definition and Objectives of Financial Regulation

Vogel (1997) defines financial regulations as a body of principles, rules, standards, and compliance procedures that apply to financial institutions. Financial supervision involves examination and monitoring of the organization for compliance with financial regulations. Prudent regulation helps to avoid a banking crisis and maintain the integrity of the payment system, protect depositors, encourage financial sector competition and efficiency.

Drake and Atero (1992) state that the objective of financial regulations include the achievement of external balances that affect economic activity, the allocation of financial resources to priority areas, the preservation of the safety and soundness of each financial institution and the maintenance of public confidence and smooth functioning and integrity of the financial market. The regulatory framework, like the above, is however, often developed for the formal financial sector and thus does not recognize the peculiar circumstances and methodologies required by the micro-finance sector. While regulations are important in ensuring that the players maintain acceptable standards, the current regulatory framework in Kenya limits access to financial services as most micro-finance organizations are unable to offer savings services, which could provide them with a cheaper source of finance for their lending operations.

A report of the Task Force on Supportive Policy and Regulatory Framework for Micro-finance, published by the India National Bank for Agriculture and Rural Development (NABARD) in 1999, note that, regulation could be provided for the main purpose of protecting the interest of small savers, ensuring proper terms of credit and financial discipline, instituting a proper reporting system and achieving orderly development.

CGAP Occasional Paper No. 4 (2000) states that although formal credit and savings for the poor are not recent innovations, the past two decades have seen the emergence of powerful technologies for developing micro-finance services. Much of this innovation has been pioneered by NGOs, who typically do not have a legal charter authorising them to engage in financial intermediation.

Many participants involved in these discussions are however, motivated by different objectives that include: looking for ways to fund themselves, using regulation as a means to promote their business and improve their operations, means to expand savings services to the poor, speed up emergence of sustainable MFIs, protect depositors, protect borrowers from high interest rates charged by MFIs, to improve coordination and supervision of MFIs, means of clamping down on bothersome foreign funded NGOs and to set up a legal structure for provision of loans to the poor. Yet, according to the author, "experimentation with micro-finance supervision is so recent that we cannot rely much on historical results to guide us".

Wright (2000) argues that donors, defensive and risk averse by nature, would hate to be associated with poor people loosing their savings, and therefore seek the most conservative approach which is usually some form of government deposit guarantee which in turn "necessitates" Central Bank regulation and supervision.

2.4 Approaches to Regulation

Ledgerwood (1998) gives the three approaches to the regulation of MFIs as self regulation, where the industry develops its own supervisory body; full regulation under existing laws or establishment of specific laws applicable to MFIs, and lastly, regulating MFIs by regulatory authorities while contracting a third party to perform supervisory functions.

Berenbach & Churchill (1997) note that a great diversity of MFIs in institutional type, scale of operations, and level of professionalism complicates the regulation of MFIs. They recommend five approaches to regulation. These are no regulation; pure self regulation; the hybrid approach (where a third party is contracted to perform some or all of the supervisory functions); regulation within the existing laws and establishment of a specialized law specific to MFIs. They indicate that many techniques and practices used by MFIs are still in the experimental stages hence the need for flexibility in the regulatory approach.

The Indian Task Force on supportive policy and regulatory framework for MFIs states that the regulation of MFIs may cover registration of an Act as MFI, reserve requirements, compliance with prudential accounting norms, and directions in respect to operations and reporting systems, while supervision may comprise on-site inspection and off-site supervision.

Ledgerwood (1998) argue that at a minimum, five issues need to be considered when regulating and supervising MFIs. These include: minimum capital requirement; capital adequacy; liquidity requirement; asset quality and portfolio diversification.

The current model of regulation and supervision of financial institutions (according to Vogel) is the CAMEL approach. Vogel (1997) notes that while capital adequacy, asset quality, earnings and liquidity can be measured easily, management can be quite elusive; and hence difficult to measure. Ironically however, management is at the heart of micro-lending. Consequently, approaches to audit, regulation and supervision have to focus on systems --- the availability of information on loans on a day-to-day basis, sound procedures for dealing with bad loans, or erring loan officers.

Contributors in CGAP (2000) argues that small community based intermediaries, for example, small financial cooperatives should not be prohibited from taking deposits simply because they are either too small or too remote to be supervised effectively.

Rosengard, Rai, Dondo & Okech (1999) while illustrating K-REP's experience, indicate that CBK should examine its licensing standards for the establishment of micro-finance banks in Kenya and in addition consider positive incentives to conform with CAMEL bank soundness requirements by the active dissemination of transparent CAMEL criteria and standards of micro-finance banks.

Vogel (1997) argues that everyone would agree that micro-enterprise finance intermediaries are significantly different from commercial banks. However, they would not necessarily agree whether this implies more strict, lenient (including no regulation at all) or identical regulation due to the overriding concern of creating "a level playing field".

While a number of authors (CGAP, 2000) believe that the future of micro-finance lies in a licensed setting, which is the only setting that will permit massive, sustainable delivery of financial services to the poor, the issue of who should be regulated remains a contentious issue as people seem to be coming up with different answers in different countries.

Kirkpatrick & Maimbo (2001) argue that, five years after the notable paper by Berenbach and Churchil (1997) on micro-finance regulation and supervision, the appropriate level of government supplied regulation in the industry remains unclear. Although subsequent literature has successfully identified the basic options available to regulators, literature is yet to establish a clear core principles which national regulators can translate into specific performance benchmarks, guidelines, rules and regulations.

Kirkpatrick & Maimbo (2001) advocate for a regulatory and supervisory framework that reflects the evolving micro-finance agenda. They argue that, while there is a long standing consensus that access to financial markets is important for poor people, there exists an on-going debate on the most appropriate type of institution and the method of delivering financial markets to the poor.

2.5 Risk Profile of Micro-finance Institutions

An appropriate regulatory approach would be based on an understanding of the risk profile of MFIs and the legal and institutional framework of a given country (Berenbach & Churchill, 1997). In some circumstances, it may be necessary for the regulator to assist the MFIs to manage their risk profiles effectively. According to Ledgerwood (1998), although MFIs hold many risk features similar to those of commercial banks e.g. liquidity problems arising from a mismatch of maturities, term structures and currencies, the risk features of MFIs differ significantly from those of commercial banks. This is due primarily to MFIs client base (low income and asset less clients requiring small loans), lending models (small unsecured loans for short term based on character or group guarantees), and their ownership structure which is capitalized by donors rather than commercial investors/owners.

While regulation is intended to ensure safety of depositors' funds; maintenance of public confidence in the system; broadening of the funding base of MFIs and allowance of integration of MFIs into the financial system, supervision of MFIs is expensive and requires specialized expertise different from that of commercial banks. MFIs may be required to share the supervision costs and their supervisory staff will need specialized training in MFI operations. In addition, deposit taking involves potential risk of loss hence MFIs intending to take deposits must be regulated and supervised.

Kirkpatrick & Maimbo (2001) quoting Matin et al (1999:9) argue that the micro-finance agenda has gone through three eras. These are, the Subsidised Agricultural Credit era (1950s to 1970s), the Micro-enterprise era (1980 to 1996) and the Micro-financial Services era (from late 1990s).

During the period of the Subsidized Agricultural era, the donors through the public sector and NGOs, took the lead in providing financial services to the poor that is, the "small and marginalized farmers, usually men, whose poverty could be overcome using credit with relaxed collateral requirements and subsidised interest rates. At the time, according to Matin et al (1999), private sector institutions avoided this sector due to high risks associated with lending to the poor. However, the high default rate among farmers, widespread politicisation of the lending process, low interest revenues, high cost structures and overall poor institutional design, prevented the participating organizations from becoming financially viable thus most were abandoned after years of public financial support.

Semi-formal institutions became prominent between 1980-1998 when the poor were seen as mostly female micro-entrepreneurs with no assets to pledge. A new lending approach, referred to collectively as micro-finance, was developed by registered NGOs or banks with special charters to lend small amounts to individuals and groups, using basic loan appraisal techniques and a variety of techniques to motivate repayments, recognizing that, despite lack of collateral, the poor could repay their loans if provided with the right incentives e.g. access to additional loans.

The Micro-financial services era emerged towards the end of 1990s when there were increasing volumes of literature critical of MF practises particularly due to the failure to meet the needs of the poorest of the poor. In Kenya for example, less than 700,000 out of an estimated 9-10 million poor people have access to finance. Critics contend that current MF models that rely on pre-determined group sizes and graduating loan amounts at pre agreed rates and repayment dates obstruct the development of a full range of services and products that the poor people want. Namely, flexible savings and deposit facilities, loans for education and health, micro-insurance and lines of credit (Wright, 2000). Wright and others argue that, the traditional Grameen style must move away from the micro-enterprise era to micro-financial services era, where emphasis is not simply on providing credit on flexible terms, but rather on providing savings as well as insurance facilities.

Wright (2000: 103) proposes a more flexible approach to MF activities and growth that is effective but not restrictive regulatory systems e.g. the establishment of a Deposit Protection Scheme like one of Guatemala Credit Union Rating Agency that encourages disclosure which allows the public to weed out poor performers, a Savings Guarantee Foundation that ensures that MFI deposit monies are kept in identifiable banks and a Market Driven Deposit Insurance that allows banks to indemnify deposits and the state to monitor the suitability and acceptability of contracts between banks and MFIs. The above approaches, though innovative, are said to suffer from information asymmetry, adverse selection and moral hazard problems that will require further research.

2.6 Regulatory Framework

The Oxford Advanced Learner's Dictionary defines Framework as a structure giving shape and support, a social order or system, a set of principles or ideas used as a basis for one's judgement and decisions. All the cases can be considered within the framework of existing rules.

Gallardo (1998) argues that a good framework for secured transactions can permit banks, capital market institutions and unrelated investors to re-finance loans that have been made by small-sized micro-finance institutions. Without a workable framework for secured transactions, formal and informal MFIs cannot "bundle" accounts receivables with a chattel paper to serve as acceptable collateral for loans to MFIs from commercial banks, capital market institutions and investors. Drake & Otero, 1992 states that a financial system operates within a regulatory framework that supervises bank operations and establishes prudential rules.

2.7 Practical Examples

The summarised examples below (except the Kenyan one) have all been extracted from the CGAP Occasional Paper No.4 of April 2000.

i) Rural Banks in the Philippines

As of September 1997, 824 Rural Banks were serving half a million relatively poor clients. These banks had only 2% of the banking system's assets and deposits but, made-up 83% of the institutions that the Central Bank had to supervise. Supervision of Rural Banks has tied up 50% of the Central Bank's supervision staff and at times, budgetary resources. In the 1990s one in every Rural Bank had to be shut down, merged or restructured to reduce supervision costs.

ii) In February 1996 the Colombian Bank Superintendency issued a capital call, requiring the Finansol, a licensed MFI's owners to re-capitalize it within 60 days due to escalating loan problems. Donor agencies proved either unwilling or unable to help with the re-capitalization. This uncertainty scared private investors away. Ultimately, Finansol could only be saved because, the government, Finansol's principal creditor was forced to surrender most of its debt in return for shares of equity in the bank.

iii) In Uganda, the Cooperative Bank had a small micro-finance portfolio lodged in several stand-alone agencies. Centenary Rural Development Bank (CERUDEB), a specialized micro-finance bank, was willing to acquire some of these agencies, when the Co-operative Bank collapsed, but as the process stretched out for others, their portfolios started to unravel and CERUDEB was no longer willing to pick them up.

iv) In 1992, the Indonesian Banking Act authorised two different bank types: commercial banks (Bank Umum) and peoples' credit banks (Bank Perkreditan Rakyat-BPR). By December 1998, 420 BPRs had 4 million clients. Regulation, supervision and reporting for BPRs are basically similar to those of primary banks, raising the question of whether the regime is appropriate for very small banks.

v) Bolivian's "private financial funds" (FFP) are often held up as a model for regulation of micro-finance. What is often overlooked is that, this step was taken only after several competent financial NGOs obtained outstanding results over several years and after the superintendency had gained experience by supervising BancoSol, a commercial bank that needed no special license.

vi) In Kenya, the memories of the collapsed banks of 1980s are very clear. Among these was the Rural Urban Credit & Finance Ltd, closed in December 1984 that provided small loans to the low income groups. Recently, Trust Bank and Bullion Bank have joined the list. Many Kenyans may question CBK's ability to regulate the proposed MFIs given the problems it has faced over the years in regulating the traditional commercial banks.

2.8 Constraints to Micro-finance Provision in Kenya

According to CBK Report on MF regulation, major impediments to the development of micro-finance business in Kenya include the lack of specific legislation to guide the operations of the micro-finance sector. This has attributed to a number of the constraints faced by the sector. For example:

i) A diversity in institutional form: As already indicated in Section 1.1, micro-finance institutions in Kenya currently operate under 8 different Acts of Parliament. Some legal set up do not address issues regarding ownership, governance and accountability.

ii) Inadequate governance and management: Any individual can set up a micro-finance institution. This leaves the burden of diligence on those who fund such institutions who may, themselves, lack relevant capacity to oversee their operations. This has resulted in wastage of resources, unclear governance structure and even failure.

iii) Limited outreach: In 1999/2000 major micro-finance institutions in Kenya reached out to only 105,045 loan clients with a portfolio of Kshs. 1.9 billion (CBK report, Jan. 2001). Sixty percent of Kenya's population are poor and mostly out of the scope of modern banking services. Yet, although MFIs have been recognized as the most important tool of poverty alleviation, only 10.4% of the eligible micro and small enterprises receive credit and other financial services.

iv) Limited access to funds: Donor support is still the major source of funds for MFIs. Although few MFIs have managed to lend the deposits collected from their clients, the law prohibits institutions from taking deposits unless they are appropriately licensed under the Banking Act.

3.0 RESEARCH METHODOLOGY

The section below covers the population of the study, the data collection method, the procedures and the data analysis techniques.

3.1 Population

The population in the research study comprised 100 micro-finance institutions in Kenya. Both Mullei & Bokea (1999) and Dondo (2000) indicate that, the number of MFIs in Kenya are over 100 though no literature is available to confirm the exact number. This number represents the number of institutions registered with the NGO Co-ordination Bureau as at December 31, 1999 which had indicated in their Memorandum and Articles of Association that they will be providing micro-finance services.

3.2 Sampling Process

A total sample of 50 micro-finance institutions were selected using both the May 31, 2001 CBK list and 1997 K-REP Dictionary of MFIs in Kenya.

i) The CBK list had 17 institutions out of which, 11 (including Post Office Savings Bank) are members of the Association of Micro-finance Institutions of Kenya. The POSB was however excluded from the study as it currently only offers savings services.

ii) The K-REP Dictionary had names of 60 institutions. Some institutions appear in both lists.

Out of the total sample of 50 respondents, 30 respondents (60%) completed the questionnaires. Twenty institutions did not participate for various reasons that include discontinued credit activities due to lack of funding (3 institutions), poor loan repayments (2 institutions), transferred credit activities to a specialized institution (4 institutions) and specializes only in provision of technical support to MFIs and/or grant/loan provisions to them (4 institutions). Two banks and one development finance institution did not find the questionnaire relevant while four other institutions refused to participate in the study.

To reduce the data collection costs, all the institutions selected (except two institutions that have made major contribution to the sector but currently based in Meru and Kisumu respectively) had to either be operating or had their head offices in Nairobi.

3.3 Data Collection Method

The study used both primary and secondary data collected from heads of the MFIs or their representatives. These managers, who are among the policy makers in these organizations, were better placed to know the possible future direction of the organization and hence whether an institution should be regulated or not.

The data was collected using a structured questionnaire. A sample questionnaire developed was pre tested with two institutions before circulation to the other respondents. All the questionnaires were administered using the drop and pick method except questionnaires for the two organizations operating outside Nairobi which were sent by courier to the respective institutions.

Part one of the questionnaire elicited data on organizational demographics including their legal status, size, lending terms and average annual lending budget.

Part two of the questionnaire asked the respondents to indicate whether or not the listed characteristics were applicable to them and if not to indicate their own specific characteristics; the distribution of the organization's portfolio and any possible restrictions in this distribution. The respondents were also to indicate whether or not MFIs should be structured differently from traditional financial institutions operating under the Banking Act.

Part three of the questionnaire tested for any significant differences in the five financial performance indicators among the players using the CAMEL tool. The section also tested the respondents' knowledge of the regulatory process and the role of the Association of Micro-finance Institutions in Kenya.

Secondary data was sourced from a number of literature materials available on previous research work on MFIs, published annual financial statements of the organizations under study and, the Central Bank's Draft Micro-finance Bill and Policy Statement.

3.4 Data Analysis

An SPSS Statistical Programme was used in the data analysis. The data has been presented using percentages, frequency tables and descriptive statistics. The frequency tables and percentages are used to present the ratings of various items by the respondents as well as their opinions. A correlation analysis has been done to establish whether there are strong associations between the characteristics of MFIs and the appropriate regulatory mechanisms. An analysis intended to ascertain whether there are significant differences in the five financial performance indicators among the players using the CAMEL tool, could not be done due to inability of the respondents to provide the necessary data.

4.0 FINDINGS AND OBSERVATIONS

4.1 Laws and regulations affecting Micro-finance Institutions

As stated previously, the existing MFIs in Kenya are operating under eight different Acts of Parliament (CBK Report, 2000). These include Companies Act, Banking Act, Societies Act, NGO Co-ordination Act, Post Office Savings Bank Act, Trustees Act, Building Societies Act, and the Co-operative Societies Act. Table 1 below indicates the legal position of the respondents.

Table 1: Distribution of Organizations by Institutional Form

	Institutional form	Frequency	Percentage (%)
1.	NGO Co-ordination Act	13	43
2.	Banking Act	2	7
3.	Church Based	2	7
4.	Co-operative Society Act	1	3
5.	Companies Act	11	37
6.	Government Initiative	1	3
	Total	**30**	**100**

Table 1 indicates that most of the micro-finance organizations are registered under the NGOs Co-ordination Act followed by the Companies Act.

i) Companies Act

This deals with private companies formed for profit and registered as limited liability companies, limited by shares or by guarantees. None of the existing MFIs have converted to a public company. Only registered companies can raise loans by the use of debentures. The CBK will not register a company as a bank or a financial institution unless it is registered as a limited liability company with identifiable shareholders. K-REP Bank is the only MFI registered as a bank though a number of banks like Co-operative Bank and the Kenya Commercial Bank are also offering micro-finance services.

ii) Trustees Incorporation Act

This covers registration of bodies formed by trustees for religious, educational, literacy, artistic, scientific or public charitable purposes. A Trust has legal personality to hold, acquire, convey, assign, transfer and deal with any property or interest belonging to or held in trust. Jitegemee Trust is registered under this Act.

iii) Co-operative Societies Act

A co-operative society registered by the Registrar of Co-operatives is a body corporate with powers to hold property, enter into contracts, institute and defend suits. A co-operative must have at least 10 members to be registered and no one member may hold more than 20% of the society's share capital. Voting is by one member one vote and not proportionate to shareholding as done in companies. Members' share capital is not liable to attachment or sale. Lending is limited to the membership. A co-operative must retain at least 25% of net profit in the reserve fund. They do not take deposits from the public.

The Co-operative Act provides for the registration and regulation, by the Registrar and Commissioner of Co-operatives respectively. Kenya Union of Savings and Credit Co-operative Society (KUSCCO) is the union of savings and credit societies in Kenya. KUSCCO is a financing co-operative and offers loans, training and other services to the co-operative societies. There are currently over 5,200 co-operative societies in Kenya. A number of SACCOS recently opened up "Front Office Services". These offices offer some form of banking services like saving, deposits, and loan facilities to the members.

iv) NGO Co-ordination Act

The operation of NGOs in Kenya is governed by the NGO Co-ordination Act, 1992 (originally 1990). The Act defines an NGO as a private voluntary grouping of individuals or associations, not operated for profit or for other commercial purposes but which have organized themselves nationally or internationally for the promotion of social welfare, development, charity, or research through mobilization of resources. The registration is done by the NGO Registration Bureau.

An NGO is a body corporate and can raise, mobilize and disburse funds and other resources for the promotion of the organization's objects. It can also acquire moveable and immovable property, sell, dispose off, lease or otherwise deal with all or part of the property or rights of the organization. All property owned by the NGO is normally held in trust by appointed trustees and cannot be sold without the board's approval. Upon dissolution, the NGO's remaining assets have to be distributed to other organization(s) with similar objectives.

v) Societies Act

Community Based organizations (CBOs) are grassroot groups whose broad goals are self development. Their strength lies in their ability to mobilize members cohesively, tackle local problems, and seek common solutions. CBOs that wish to be registered can do so at the Department of Culture and Social Services. Unlike NGOs, they are not allowed to work across provincial and district boundaries that is, their operations are restricted to divisional and district boundaries. There is no Act or guideline for the operation of CBOs.

The Department of Culture and Social Services simply expects them to adhere strictly to their internal constitution as approved by members.

vi) The Banking Act

The Central Bank of Kenya (CBK) supervises the operation of commercial banks, financial institutions, mortgage finance institutions, and building societies operating under the Banking and Building Societies Acts. It is responsible for ensuring monetary stability, maintaining sound financial system, managing foreign exchange, acting as a lender of the last resort and advising the government on monetary issues. It is also responsible for licensing of banks and non-bank financial institutions. CBK's regulatory measures are designed to achieve diverse objectives, namely, macro economic stability.

Like bank and non bank financial institutions, MFIs registered under the Banking Act have to adhere to prudential and other regulatory measures set by the CBK, including, financial capability of organizers and investors, technical capability of directors and executive officers, adequacy of internal controls, and the management information systems.

vii) Building Societies Act

There have been recent trends to harmonize the operations of banks with those of the Building Societies. As a result, a number of banks that formerly had subsidiary building societies have re-merged their activities. Notable building societies that have actively entered the micro-finance market are Equity and Family Finance Building Societies.

viii) Kenya Post Office Savings Bank Act

The Kenya Post Office Savings Bank offers only saving services. The micro finance advocates in Kenya are proposing that the POSB be a micro-finance bank to allow it to not only accept savings, but also to extend loans to low income beneficiaries who comprise over 80% of its clients. The organization is therefore, actively considering diversifying into the provision of loan facilities to its customers in an attempt to strengthen itself and to also mobilize more savings.

ix) Proposed Micro-finance Bill

In the proposed Micro-finance Bill, there is a preposition that the regulated institutions shall not grant loan or credit facility to any end user, single borrower which is in the aggregate exceeding 1% of its core total capital. In case of community based micro-finance institutions the initial loan to an individual shall not exceed Kshs. 0.5 million.

The Bill further proposes that licensed institutions shall not grant loan or credit facility without acceptable security and insurance and shall not grant loan or credit to its associates, directors, staff members or their associates in excess of the limits set above and the aggregate awarded shall not exceed 25% of the core capital of the institution. Ownership by single individual will be limited to 33% of shares of the institution. Every MFI registered under the Bill will also be required to contribute to the Deposit Protection Fund.

4.2 Characteristics of Local Micro-finance institutions

One of the main objectives of this study was to identify the characteristics of MFIs that may support or hinder the MF regulatory process. Using the characteristics provided by Drake & Otero (1992), Christen (1997) and others, the respondents were asked to indicate (by ticking Yes or No) whether their organizations had any of the listed characteristics. Table 2 below summarises the respondents' responses.

Table 2: Analysis of the Characteristics of Local MFIs

		Respondent response in (%)			
	Characteristics	Yes (%)	No (%)	Not Sure (%)	Total (%)
1	Provide small loans to poor and MSEs	90	7	3	100
2	Target low income asset-less clients	87	3	10	100
3	Extends unsecured loans on character grantees	60	17	23	100
4	Extends unsecured loans on group grantees	86	7	7	100
5	Capitalized by donors	77	23	0	100
6	Board composed of local volunteers	64	23	13	100
7	Board beneficiaries to the loan program	13	77	10	100
8	Uses *minimalist* approach in its lending	60	17	23	100
9	Charges high interest rates than banks	23	60	17	100
10	Charges lower interest rates than banks	67	15	18	100
11	Have self-sufficiency difficulties	30	50	20	100
12	Have a clear vision	97	3	0	100
13	Have a standardized product	60	33	7	100
14	Applies CAMEL based tools	30	27	43	100

Source: Research Data

Table 2 indicates the common characteristic of MFIs in Kenya. The dominant characteristics include provision of small loans to the poor and MSEs, targeting of low income asset less clients, extension of unsecured loans based on group guarantees and capitalization by donors.

b) Other characteristics

The results of the study shows that the average loan size of a MFI is Kshs. 20,000. This amount is lent out over an average period of 12 months, at 2-3% interest per month. MFIs target mainly disadvantaged groups that include salaried workers, 1998 bomb blast victims, self help groups, women, children, the poor and marginalized and micro and medium enterprises. Their main business activity is credit provision, though others undertake related activities like capacity building, banking, provision of house improvement loans, advisory and consultancy services, community health awareness and management of hostel facilities. Most MFIs target specific groups/areas for example, Improve Your Business Kenya working with commercial sex workers in Kariobangi area in Nairobi, hence restricting portfolio distribution. 46% of the respondents confirmed that their portfolio distribution were restricted. The main reasons given for the restrictions included donor conditions, membership, limitation in funding and scope of business.

c) Micro-finance Characteristics that Hinder Regulation

Regulation is only possible where there are rules and standards that can be followed by those being regulated. Supervision will involve monitoring organizations for compliance with regulations already set. Regulation can involve registration of an Act, reserve requirement, compliance with prudential accounting norms and direction with respect of operations and reporting systems. The objectives of regulation can be many, however, in the Kenyan case the following are considered as key objectives: instituting a proper reporting system and achieving orderly development; looking for ways to fund MFIs; establishing a means of expanding saving services to the poor; protecting depositors; and improving co-ordination and supervision. Table 3 lists the MF characteristics that are considered as hindrance to the regulatory process.

Table 3: Characteristics that Hinder Regulation

	Characteristics	The No. of respondents with the characteristics
1	Provide small loans to poor/MSEs	27
2	Target low income assetless clients	26
3	Extends unsecured loans on character guarantee	18
4	Extends unsecured loans on group Guarantee	26
5	Capitalized by donors	23
6	Board composed of local volunteers	19
7	Board beneficiary of loan programme	4
8	**Do not** use minimalist approach in its lending	5
9	Charges lower interest rates than commercial banks	20
10	Have self-sufficiency difficulties and high operating costs	15
11	**Lack** clear vision	1
12	**Lack** standardised products	10
13	**Do not** apply CAMEL tools in assessing performance	24

Source: Research Data

Table 3 indicates the characteristics that hinder the regulation of MFIs. The dominant characteristics are: targeting low-income assetless clients/MSEs, extending unsecured loans based on group guarantees and capitalization by donors.

The above characteristics though common in infant MFIs, can be widely found among Credit only MFIs intending to be regulated by AMFI. The biggest handicap to regulation being donor dependency and lack of unified law to govern the operation of MFIs in Kenya. Nearly all MFIs are donor based, supported, or sponsored (Dondo, 1999). Performance of these institutions are therefore mixed particularly since many NGO operated MFIs were not established to support businesses but have grown from the social welfare backgrounds. NGOs established with the sole purpose of lending to MSEs on a minimalist approach like K-REP, PRIDE, KWFT and others recording an average loan recovery of 96% would be much easier to regulate (Dondo, 1997). Lack of capacity to manage credit programmes is a big hindrance among NGOs. Many start without proper management information systems or qualified personnel. Welfare oriented NGOs pay less salaries than the private sector, limiting their ability to hire qualified staff.

d) Micro-finance Characteristics that Supports Regulation

Christen (1997) advises that the NGOs wishing to be regulated should transform from living on donor funds to living on borrowed funds. That an institution with supportive characteristics will be able to achieve a sustainable performance and hence easier to regulate. ". The author lists down supportive characteristics to regulation as: a clear vision; access to funds through demonstrated viability and sustainability; quality performance; high quality standardized product that can be sold to the banking community; ability to apply the CAMEL based tool; good information, auditing and control systems. The CAMEL tool, used in the ACCION Network has proven to be a powerful impetus to the improvement of the overall performance of MFIs.

The study was able to identify only some of these characteristics. For example, 97% of the institutions indicated that they had a clear vision; 60% had a standardised product and 70% with computerised finance systems. 43% of the respondents were however, not familiar with the CAMEL tool. Additional research will therefore be required to ascertain the existence of institutions with demonstrated viability and sustainability, quality performance, auditing and control systems, which is outside the scope of this study.

Again, the supportive characteristics listed by Christen may be targeting institutions that wish to mobilize public finance and hence be regulated by the CBK. A different set of supportive characteristics may be drawn for institutions that only wish to exercise self-regulation or be regulated by a third party licensed by CBK.

4.3 Regulation and Supervision Process

The proposed Policy Framework on regulation and supervision of MFIs has proposed 3 groupings for MFIs i.e. informally constituted MFIs, formally constituted credit only and formally constituted deposit taking MFIs. The respondents selected their regulatory groups and preferred regulatory form as illustrated in Table 4 and 5 below.

Table 4: Regulatory Grouping

	Regulatory groupings	Frequency	Percentage
1.	Informal	5	17
2.	Formal Credit	16	53
3.	Formal Deposit	2	7
4.	Formal Deposit & Credit	3	10
5.	Others (not sure)	4	13
	Total	**30**	**100**

Source: Research Data

Table 4 indicates that most of the local MFIs fall under formally registered credit only group.

Table 5: Forms of Regulation

	Forms of Regulation	Frequency	Percentage
1.	Self Regulation	8	27
2.	Regulation by AMFI/Third Party	14	46
3.	Regulation within Banking Act	2	7
4.	Establishment of specific MF Act	2	7
5.	Others (not sure)	4	13
	Total	**30**	**100**

Source: Research Data

Table 5 indicates that the preferred regulatory mode is AMFIs or a third party approved the CBK followed by self-regulation.

Eighty three percent (83%) of the respondents indicated that MFIs should not be regulated within the same standards as traditional financial institutions. The main reasons cited for this include differences in levels and type of operations, objectives and target group; risk profiles and characteristics, capital requirements and liquidity levels.

Ninety one percent (91%) of the respondents indicated that they would prefer the enforcement of micro-finance regulation to be done through AMFI. At the time of the study 50% of the respondents were members of AMFI. Those who are members consider AMFI's role as helping to develop a regulatory framework for the sector and undertaking advocacy services on behalf of its members among other functions. They identified the main problem which hinges on lack of proper legal framework as limited outreach, financing difficulties and lack of healthy competition among the players. Flexibility in performance and innovation were considered as the main advantages of the current legal arrangement.

Existing banking regulation though popular with deposit taking MFIs, can be costly as compliance with banking regulation requires changes in organization structure and additional bank reporting. Self regulation on the other hand is good if the industry is at an infancy stage and where the regulators have no experience in dealing with MFIs. Special regulation allows MFIs to maintain their distinctive characteristics, provide reduced range of financial services without becoming a bank, in exchange for a lower capital requirement.

Christen (1997) advises that those wishing to be regulated must meet conditions related to minimum capital requirement, capital adequacy, liquidity requirement, asset quality, portfolio diversification, availability of information on loans on day to day basis, sound procedures for dealing with bad loans, and erring loan officers. Table 6 provides some guidelines on who should be regulated and the agency to carry out the supervision.

Table 6: Suggested Regulatory Guidelines for MFIs in Kenya

Type of MFI	Source of Funds	Activities/characteristics of the MFI	Proposed regulatory form	Regulatory Authority
Type I Informally constituted MFIs	Members' contribution, foreign and local donors	Rotating savings and credit societies, merry go round, and church based groups not formally registered. Extending loans for social objectives. Borrowing limited to amount raised.	Voluntary registration with Department of Culture and Social Services as a CBO. Church based organizations with no separate registration.	No regulation
Type II Basic NGO	Grants and donations from foreign and local donors	Extending loans not in excess of grants awarded. No deposit taking	Registered under NGO Act or as a CBO	Self regulation
Type III NGOs with credit only	Grants and donations, limited deposits taking, concessional commercial borrowing. Forced savings and mandatory deposits.	Donors main source of funds, uses deposits /savings as loan insurance.	Registered under NGO Act, Companies Act or Trust	AMFI or agency appointed by CBK
Type IV Deposit (public) taking MFIs	Foreign and local donors, individuals/institutions as members or shareholders, concessionary and commercial borrowing	Carries out both lending and saving services to the public/MSEs	Registered as a corporate entity. Fulfils CBK Prudential regulation requirements.	Central Bank of Kenya, Bank Supervision Division
Type V Co-operative Societies	Members' savings, concessionary/commercial borrowing	Members have a common interest. Take deposits from members and extend loans to members	Registered by the Registrar of Co-operatives	Commissioner of Co-operatives
Type VI Specialized Commercial/Equity Banks	Individual persons, institutions and donors. Public deposits, savings and commercial loans	Undertake MF services in addition to full banking services. Takes deposits from the public, generates funds through commercial paper or investors	Registered as a private company with the Registrar General and as a bank or financial institution by CBK. Fulfils CBK Prudential regulation requirements.	Central Bank of Kenya, Bank Supervision Division

i) **No Regulation**: Type I MFIs do not require external regulation. According to Kirkpatrick (2001), the advocates of no regulation approach argue that the cost of designing, developing and implementing regulation exceeds the benefits of leaving the industry without a regulatory regime. Others feel that the operation of such institutions is too small to pose a threat to the overall stability of the financial system. While I agree with these sentiments, I would urge the regulators to design incentives (e.g. membership to AMFI, access to training opportunities in micro finance management etc) targeted at this group to facilitate their movement to the next upper group.

ii) **Self-Regulation**: Types II MFIs are useful where the industry is at the infancy stage. Kenya micro-finance industry has indeed moved to the Micro-financial Services Era (Kirkpatrick, 2001) and cannot be considered infant as the practitioners are diversified in form of size, scale of operation and resources. Self-regulation would however still be applicable given the number of the institutions that are still dependent on external donor funding to run their operations, the main source of funding for the 77% of the respondents in this study.

iii) **Regulation by a Third Party or AMFI**: Type III MFIs can be regulated by AMFI or a regulatory agency licensed by CBK. Unfortunately AMFI currently lacks the capacity to regulate any organization and will need the support of CBK to be able to carry out this function.

iv) **Regulation by the Department of Co-operatives**: Type V MFIs are co-operatives and member based organizations. There are currently over 5,200 savings and credit co-operative societies in Kenya currently. Many are satisfied with the legal structure set up by the Department of Co-operatives. However, there are SACCOs that have initiated "Front Office Services" to offer saving and credit services to their members using the micro-finance methodologies. The proposed Micro-finance Bill will allow such institutions to apply for a micro-finance license under the relevant section of the Bill.

v) **Banking Regulation**: Type VI MFIs are those already registered under the Banking Act and are subject to the CBK prudential and other regulation. The registration under the existing banking act has been most convenient approach for institutions wishing to access public deposits in absence of a special regulatory window for MFIs in Kenya. This involves complying with normal prudential regulation involving additional bank reporting and significant changes in the organization's structure which may call for increased operating costs. The option would therefore be more suitable for banking institutions that are already banks and wish to undertake micro-finance lending like Co-operative Bank and National Bank, Barclays Bank and not the existing MFIs that want to convert into a bank.

vi) **Specific Regulation for MFIs:** One option not included in Table 6 above but which is being championed by MF practitioners in Kenya is the creation of a specific regulatory window for MFIs that will allow them to maintain their distinctive characteristics, provide reduced range of financial services and benefit from lower capital requirements. Although it has been argued that there will be no need for such a window where there is no critical mass of licensable MFIs (CGAP, 2000), there is no guideline to indicate the number of MFIs that would form such a critical mass. I believe the approval of the MF Act will bring about some order to this sector, as it will help the regulators to set some minimal standards to guide operations of MFIs as was done with the Co-operative sector. The Government helped the Co-operative sector to set up a Co-operative College to train staff working in the co-operative societies and unions. The CBK will similarly, be able to a develop detailed regulatory and supervisory tools for MFIs that are badly lacking at the moment and equip AMFIs or any other licensed body to carry out the supervision.

The above regulatory options recognize the fact that MFIs are very different from formal banks and will require additional resources to develop an independent regulatory framework. The diversity in institutional form and size of the MF sector makes it impossible to supervise the players. The guiding tool in the selection of the regulatory model is based not only on the MF characteristics but also on their risk, size and number involved. For example, bigger and fewer MFIs would opt for CBK regulation. Smaller MFIs exhibit higher risks related to liquidity, management innovation, ownership and governance (Kirkpatrick quoting Cracknel, 2000). Adopting a purely risky approach, according to the writer, means that the smaller MFIs will need more regulatory time and resources hence higher cost of regulation. It is unlikely that the benefits of such a regulation will outweigh its costs.

vii) **Relationship Analysis**: A correlation analysis was done using the Pearson's model, to establish whether there are any strong association between the characteristics of MFIs and appropriate regulatory mechanisms. The 14 characteristics are the independent variables and the 4 regulatory mechanisms the dependent variables. The results of this analysis are reflected in Table 7.

Table 7: The Characteristic of MFIs Vs the Regulatory Mechanisms

	Characteristics	Frequency per Regulatory Mechanism					Correlation coefficient
		Self	AMFI/ 3rd party	Banking Act	MF Bill	Total	Pearson's R
1	Small loans to poor and MSEs	7	14	2	2	25	0.372
2	Target low income asset-less clients	6	13	2	2	23	0.000
3	Unsecured loans on character grantees	5	10	2	2	19	0.369
4	Unsecured loans on group grantees	6	14	2	2	24	0.255
5	Capitalized by donors	8	14	2	2	26	0.168
6	Board composed of local volunteers	6	12	2	2	22	-0.120
7	Board beneficiaries to the loans	7	12	2	2	23	-0.020
8	Uses *minimalist* approach	6	12	2	2	22	0.138
9	Charges high interest rates than banks	7	11	2	1	21	0.019
10	Charges lower interest rates than banks	8	11	2	2	23	0.171
11	No self-sufficiency difficulties	5	11	2	2	20	0.047
12	Have a clear vision	8	14	2	2	26	0.019
13	Have a standardized product	7	13	2	2	24	0.141
14	Applies CAMEL tools	5	8	1	2	16	0.539

Table 7 indicate that except for three characteristics, there is a general positive relationship between the characteristics of MFIs and the selected regulatory mechanism. The highest relationship is with application of CAMEL tool, provision of small loans to the poor and provision of unsecured loans based on character guarantees (see also Appendix III).

The Pearson's correlation coefficient "r" varies from –1.0 to + 1.0. The negative coefficient indicating an inverse relationship between variables, zero coefficient indicating no relationship and positive coefficient indicating a positive relationship. The conclusion that can be drawn from this data is that 50% of the variance in the regulatory mechanisms is accounted for by the MFI's ability to apply the CAMEL tool in assessing its performance; 37% by the provision of small loans to the poor and 36% by offering unsecured loans based on character guarantees. Charging of higher interest rates on loans results in an inverse relationship.

Although the analysis confirms the importance of the CAMEL tool in the operation of MFIs, the results also indicate that the MF characteristics are not the only factor that determine the regulatory mechanisms selected by an institution.

4.4 Performance Benchmark

Gallardo, (1998) suggests that regulated MFIs should have a higher performance benchmark for capital adequacy ratio (Kenyan bank ratio in 1999 was 8%) and loan classification provisions because MFI have different characteristics from those of formal traditional banks and bank regulators have little experience in regulating them.

To take deposits, MFIs are required to satisfy the CAMEL conditions. The research results indicate that 43% of the respondents had never heard of a CAMEL tool and hence could not answer any related questions. Almost all organizations were reluctant to propose any minimal levels for capital adequacy, earnings or liquidity levels.

Minimum capital requirement (MCR) has been a banking license tool in Kenya since 1968. The tool is meant to provide an adequate buffer for deposits and lately, for controlling new entrants into the industry. Table 8 compares the MCR for banks and financial institutions against proposed levels for MFIs.

Table 8: Minimum Capital Requirement

Institutional groups	Minimum capital requirement (Kshs. '000)
Commercial banks (local/foreign)	350,000
Non Bank financial institutions (local/foreign)	300,000
Micro-finance institutions (NGOs)	50,000
Micro-finance institutions (CBOs)	20,000

Source: CBK Reports

Table 8 indicates that the proposed minimum capital requirement for MFIs is very low compared with that of formal banks and financial institutions.

The proposed MF Bill, proposes that the regulated MFIs attain a minimum liquidity ratio initially set at 20%; a core capital of not less than 10% of the total risk adjusted assets plus adjusted balance sheet items as may be determined by CBK; a core capital of not less than 8% of the total deposit liabilities; total capital of not less than 20% of the total risk adjusted assets plus risk adjusted off balance sheet items as may be determined by CBK; a core capital of at least Kshs. 50 million for MFIs and Kshs. 20 million for community based MFIs.

4.5 Management and Institutional Capacity for Regulation

The number of people and form of representation on the boards of the respondents' organizations varied greatly with 50% of the institutions having 5-10 board members. Most of these members were elected/appointed to the board on the basis of their expertise. The respondents did not foresee any change in the board composition when the proposed MF Bill is effected. 60% of the respondents agreed that MFIs should not have standardised organization structure because of the differences in levels of resources, size and client structure.

Sixty five percent (65%) however agreed that there should be a standardised reporting requirement for MFIs as this will facilitate ease in performance comparison and encourage healthy competition. It is not certain how many of the MFIs wishing to take deposits will meet the requirements that may be imposed by the CBK as regards the existence of a qualified staff, financial capacity, strength of investors, shareholders, directors and officers and an effective management information system, risk management and control systems.

However, it should be noted that there has been a lot of transformation of MFIs' activities. For instant, organizations like Tototo have handed over their credit activities to KWFT, a specialized lending agency. Other MFIs are only offering training and capacity building to those that extend credits, for example, MicroPED. Apart from these MFIs, we also have MFIs that specialize in extending loans to MFIs wishing to on-lend such funds to actual beneficiaries. Jitegemee Trust works with Vintage Management under such an arrangement.

Given the limited human, technical and financial resources, the CBK may need to establish which, and how many MFIs it can effectively supervise or those of which they encourage regulation. Although CBK maintains a possible list of 17 MFIs that they could probably work with, it is currently collaborating only with the 11 institutions that are members of the AMFIs.

The need for regulation will call for an additional demand on both the CBK and AMFIs, in developing relevant prudential guidelines to be used by the regulators and the regulated. This will result in additional costs, in terms of staffing and supervision, to ensure the compliance with reporting and supervision procedures. CBK and AMFIs should tap into the experiences of other countries like Indonesia, Bolivia, and Philippines. AMFIs should not only cater for its members but also encourage non-members to join in and adopt internal regulatory guidelines.

Beyond the minimum levels of capitalization and licensing of banks and financial institutions, the CBK carries out a careful review and assessment of the financial capability of the organizers, investors, professional and technical capabilities of directors and executive officers. The adequacy of the internal controls and management systems relative to the scope of financial services to be offered in the areas identified.

Bank license application requires detailed information on financial capacity, professional/technical competencies and services to be offered. In the proposed Micro-finance Bill, the applicant for a license, will need to submit for verification by CBK, an analysis of the domestic economic situation, financial sector environment, legal framework, organization's set up of applicant, equity and ownership, economic and financial analysis, risk analysis and the proposed management detailing professional qualification, skills and relevant experiences in micro and small lending among other conditions.

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

MFIs have been recognized as one of the most important tools for poverty alleviation in Kenya (CBK Report, 2000) as over 100 organizations in Kenya practice some form of micro finance lending. Many of these organizations apply the Grameen Bank method of delivering financial services using informal community based delivery systems to deliver credit and savings, group guarantee mechanisms, credit appraisal based on character assessment and focus lending to small businesses and the poor who cannot access finance from formal banks.

However, the sector has in recent past faced a number of constrains in delivering these financial services that include diversity in institutional form, limited outreach and access to funds. The challenge has been to develop an appropriate legal framework that will guide the operations of MFIs, facilitate growth of the sector and develop a sustainable MF industry that will be less dependent on the supply of donor funding and will rely on local markets for its funding. The existence of an appropriate regulatory framework to govern the operations of MFIs will be ideal, as it will facilitate ease in comparison of performance, and formulation of guiding principles.

This study has two broad objectives, that is, to identify the characteristics of local MFIs that may support or hinder regulatory process and to identify appropriate regulatory approaches that could be suitable for MFIs in Kenya. The study has identified a number of characteristics that hinder the regulatory process and six regulatory approaches that could be adopted. These approaches are more specific than the three *tier* approach being advocated by AMFI identified as informally constituted, formally constituted credit only and formally constituted deposit only. The term informally constituted is also found misleading as many respondents indicated that it implies that an organization lacks registration, yet many MFIs falling under this group are registered as CBOs by the Department of Culture and Social Services or are operated as projects of registered churches.

Under the proposed MF Bill, the deposit taking MFIs will have to meet normal bank standards as regards directors, shareholders, governance structure, clear reporting systems and structures to enable the CBK to supervise them. Minimum capital requirement has been proposed at Kshs 50 million for NGOs and Kshs 20 million for community based MFIs, which is considered affordable by many MFIs.

Credit only MFIs are proposed to be regulated by AMFI under a framework to be set by the AMFI members using standards on the best practices on repayment rate and number of clients. Informally constituted MFIs will comprise organizations still experimenting with small amounts and those using credit as an intervention to support their core activities. They will be guided by the standards set by those giving them funds. These organizations will be free to join AMFI by changing their Articles of Association and meeting the conditions set by AMFI on minimum clients level of 2000 and any other requirements.

The choice of the regulatory form will not only be determined by the characteristics of a MFI but also on other factors including the number of clients served, the sourcing of funds, organization size and portfolio distribution.

5.2 Recommendations

5.2.1 Micro-finance Institutions that can meet the banking regulatory structures, guidelines and procedures like K-REP Bank should be allowed to operate under the existing Banking Act.

5.2.4 There is an urgent need to build the capacity of AMFI if the regulatory process is to take effect.

5.2.5 It is important that all parties should be able to benefit from some form of regulation, hence the need for AMFI/CBK to provide a path that allows each MFI to evolve overtime, into a formal financial institution.

5.2.6 The proposed Micro-finance Policy Statement should establish standard registration requirements that cover establishment and governance structure for both credit only and deposit taking MF categories. The Government in collaboration with AMFI should set up levels of minimum capital, capital adequacy, leveraging and portfolio quality for the two groups.

5.3 Limitations of the Study

The researcher faced the following limitations while undertaking this study

5.3.1 Difficulty in locating institutions. The 1997 KREP Dictionary of Micro-finance Institutions provided physical and telephone addresses, however, some MFIs had changed both locations and telephone addresses making it difficult to locate them.

5.3.2 Although the University of Nairobi provided research authorisation letters, many respondents still needed confirmation from the researcher that the information given will be held in confidence and not availed to the public. A number of MFIs opted to only complete the general questions and leave out all the questions that required specific institution's financial performance data.

5.3.3 It was difficult to get appointments with the heads of some MFIs, yet the next officer on line could only release information with approval of the head of the institution. This made the exercise very slow and time consuming.

5.3.4 Many institutions found the questionnaire too technical and specific, while others were not familiar with the ongoing debate on the regulation of the micro-finance sector. As a result, a few of institutions opted out of the study, while others were openly willing to discuss the details before completing the questionnaire.

5.3.5 Few respondents were familiar with the CAMEL as a performance assessment tool hence were unable to propose any limits of its components. It was not therefore possible to analyse the differences in the five financial performance indicators using the CAMEL tool as was required.

5.4 Suggestions for further Research

A study should be undertaken to:

5.4.1 Establish the number of MFIs that can actually meet the CBK prudential regulation. Only 10% of the respondents indicated their wish to access public deposits although some of these respondents did no appear to have grasped the expectations under the Bill

5.4.2 Assess the criteria that would be used by CBK to regulate the MFIs that will be subject to the supervision of AMFI given AMFIs' existing technical and financial limitations.

5.5 Implications for Policy and Practice

5.5.1 There is an urgent need for the government to provide a forum where MFIs could meet to exchange views about the sector. Institutions that are not members of AMFI feel left out of the ongoing debate, though they believe they have views to offer.

5.5.2 The Government should publicise the MF Policy Document and educate the public on its aims and objectives before the Bill is tabled in Parliament

5.5.3 Although the Government is currently mainly focusing on those MFIs wishing to take deposits from the general public, developing also those that wish to be regulated through AMFI will encourage the development of future licensable MFIs.

5.5.4 Investors and donors wishing to invest in MFIs can only do so to organizations with clear business plans, efficient and realistic client to credit officer ratio, and qualified directors. The Government should assist in setting standards for the operation of MFIs and in determining who will be the custodian of these standards.

5.5.5 AMFI was set up to spearhead the discussions with CBK on the regulation of MFIs, address MF needs, and set standards that are specific to MFIs. AMFI however, still lack internal capacity and needs to be properly equipped to carry out this role.

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APPENDIX I

UNIVERSITY OF NAIROBI
FACULTY OF COMMERCE
MBA PROGRAMME – LOWER KABETE CAMPUS

Telephone: 732160 Ext. 215
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

17th July 2001

TO WHOM IT MAY CONCERN

Dear Sir/Madam

REF: – MARGARET ORIARO – D61/P/8445/98

This is to confirm that the above named person is a Master of Business and Administration student of the University of Nairobi, Faculty of Commerce.

She is required to submit as part of her coursework assessment a research project report on: "***Assessing the suitability of a Regulatory Framework for Operations of MFI's in Kenya***". We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist her by allowing her to collect data in your organization for the research. This is purely for academic purposes only.

Thank you.

M. B. A. OFFICE
P. O. Box 30197,
NAIROBI.
NAIROBI UNIVERSITY COMMERCE FACULTY

DR. MARTIN OGUTU
LECTURER & CO-ORDINATOR, MBA PROGRAMME

Appendix II

QUESTIONNAIRE

MICRO-FINANCE INSTITUTIONS QUESTIONNAIRE

July 2001

Strictly Confidential

Questionnaire No.: ________________________________

Background

This study is part of an MBA research project being undertaken under the supervision of the Department of Commerce, University of Nairobi.

The government, together with the key stakeholders in the micro-finance sector, have initiated efforts aimed at regulating the sector. This study aims at analysing the characteristics of MFIs' operations in Kenya so as to be able to assess the suitability of a regulatory framework and the form it can take. All information generated by the research study will be treated with strict confidentiality, and no reference will be made to specific micro-finance institution.

PART I: General Information

1. Organisation

   i) Name and address:

   ____

   ____

   ii) Contact: Telephone, e-mail, and fax____

   iii) Contact Person and position: ______________________________

2. Legal status and date incorporated: ______________________

3. Location of business: ______________________

4. Main business activities:

____

____

____

---

5. Current number of staff:

   i) Professionals: ______________

   ii) Support: ______________

   iii) Others (please specify): ______________

6. Target clients and number served to date:

____

____

7. Current lending terms:

   i) Average loan size: Kshs.______________

   ii) Loan Period: ______________

   iii) Interest rate: ______________

   iv) Loan security:______________

   v) Others (please specify):

8. What is your organisation's average lending budget per annum?

   Kshs. ______________

Part II: Characteristics

9. Does your organization have any of the following characteristics?

		Yes	No
i)	Provide small loans mainly to the poor and small scale enterprises	☐	☐
ii)	Target low income assetless clients requiring small loans	☐	☐
iii)	Extends unsecured loans for short term based on		

character grantees ☐ ☐

iv) Extends unsecured loans for short term based on group grantees ☐ ☐

v) Capitalized by donors through grants/loans rather than commercial investors/owners ☐ ☐

vi) Board composed of local volunteers ☐ ☐

vii) Board members are beneficiaries to the loan program ☐ ☐

viii) Uses *minimalist* approach in its lending ☐ ☐

ix) Charges higher interest rates than normal commercial banks ☐ ☐

x) Charges lower interest rates than normal commercial banks ☐ ☐

xi) Have self-sufficiency difficulties and high operating costs ☐ ☐

xii) Have a clear vision ☐ ☐

xiii) Have a standardized product ☐ ☐

xiv) Applies CAMEL based tools in assessing its performance ☐ ☐

xv) Other characteristics not indicated above (please specify):____________________________

10 How is your portfolio distributed (i.e. does the organization lend to a particular sector/location)?

11. Are there any restrictions to the portfolio distribution?

i) Yes ☐

ii) No ☐

12. If yes, what are the main constraints?

13. Is the organisation's financial system computerised?

- i) Yes ☐
- ii) No ☐

14. In what way do you think MFIs are structurally different from traditional financial institutions operating under the Banking Act?

____

____

Part III: Regulatory Process

a) General

15. In which of the following groupings proposed in the Micro-finance Bill does your organization belong?

- i) Informally constituted MFIs ☐
- ii) Formally constituted MFIs – Credit only ☐
- iii) Formally constituted MFIs – Deposit taking ☐

(Please tick the relevant group)

16. Regulation of MFIs may cover registration of a new Act, minimum reserve requirements, compliance with prudential accounting norms, and directions in respect of operations and reporting systems. While supervision may comprise on-site inspection and off-site supervision. Which of the following regulatory approach (es) would be suitable to your organisation?

- i) No regulation ☐
- ii) Self regulation ☐
- iii) Regulation by third party (e.g. AMFIs or a private firm) ☐
- iv) Regulation within the existing laws ☐
- v) Establishment of an Act of Parliament ☐
- vi) Other (please specify) ☐

17. Should existing MFIs be regulated within the same standards as traditional financial institutions?

i) Yes ☐

ii) No ☐

18. If no, why do you think the MFIs should be treated differently?

____

____

____

19. How do you think the MFIs' regulations can be enforced?

____

____

____

20. Is the organisation a member of the Association of Micro-finance Institutions?

i) Yes ☐

ii) No ☐

21. If yes, what benefits would your organisation derive from being a member of AMFIs?

i) Help in developing regulatory framework for MFIs ☐

ii) Set up accounting standards for the sector ☐

iii) Carry out advocacy activities for the members ☐

iv) Enable MFIs access deposits ☐

v) Set conditions for organisations wanting to become MFIs ☐

vi) Allow integration of MFIs into the Kenyan finance system ☐

vii) Supervise operations of MFIs ☐

viii) Others (please specify): ______________

22. Does any of the following explain the problems with the current legal status?

i) Inadequate governance ☐

ii) Inadequate management capacity ☐

iii) Limited outreach ☐

iv) Unhealthy competition ☐

v) Limited access to funds ☐

vi) Unfavourable image ☐

vii) Lack of performance standards ☐

viii) Limited growth ☐

ix) No problem ☐

x) Others (please specify):________________________________

23. Does any of the following explain the advantages of the current legal set up?

i) Facilitate access to donor funding ☐

ii) Limited supervision ☐

iii) Better access to the target clients ☐

iv) Allow innovation ☐

v) Flexibility in performance ☐

vi) Others (please specify): ________________________________

b) Capital adequacy

24. What is the organisation financial year? ________________________

25. When were your last accounts audited? ________________________

26. To take deposits, MFIs are required to satisfy the conditions shown below. Please indicate whether each of the CAMEL measures is suitable for use with MFIs:

		Yes	No
i)	Capital adequacy	☐	☐
i)	Asset quality	☐	☐
ii)	Management quality	☐	☐
iii)	Earnings	☐	☐
iv)	Liquidity requirement	☐	☐

27. If the answer is yes for any of the above, please recommend the appropriate levels for each of the following:

i) Minimum capital: ________________________________

v) Asset quality: ________________________________

vi) Earnings: ________________________________

vii) Liquidity requirement: ________________________________

28. What proportion of the organisation's capital is represented by the following?

i) Debt: ________%

ii) Grants:_______%

iii) Shares: _______%

iv) Others (please specify):____%

29. What proportion of your capital is:

i) Equity:____%

ii) Debt:_____%

30. Does donated funds constitute capital?

i) Yes ☐

ii) No ☐

31. Does occasional funds provided by donors constitute debt?

i) Yes ☐

ii) No ☐

32. What was the organisation's leverage ratio as at December 31, 2000 (ratio of total debt/total assets)?:____________%

33. What was the value of your total assets as at December 31, 2000?:

Kshs._______________

34. Should CBK make capital adequacy requirements stringent for MFIs given their relatively faster and larger losses on their capital base?

i) Yes ☐

ii) No ☐

c) Asset Quality

35. What should be the basis for loan provisions?

i) Periodic sampling of assets ☐

ii) Collateral pledges ☐

iii) Historic performance ☐

iv) Others (please specify): ______________________________________

36. Do you write off loans?

i) Yes ☐

ii) No ☐

37. If yes, under what circumstances would the write off be authorised?

____

____

d) Management

38. What is the number of current Board Members: ___________

39. What is the proportion of representation in the board by the following groups?

i) Donors: _________%

ii) Government: _____%

iii) Experts (please specify):________%

iv) Creditors: ________________%

v) Others (please specify) ______________%

40. Does the organisation foresee any change in the board composition if the MFI Regulatory Bill is effected?

i) Yes ☐

ii) No ☐

41. If yes, why do you think there will be a change?

____

____

____

42. Should MFIs have standardised organization structure?

i) Yes ☐

ii) No ☐

43. If no, why not?

____

____

44. Should there be a standardised reporting requirement for MFIs?

i) Yes ☐

ii) No ☐

45. Give reason for your answer to question 44:

____

____

e) **Earning**

46. How do you measure profitability of a MFI (in terms of interest earned, net income from operations etc)?:

____

____

f) **Liquidity**

47. What was the balance of your organization's total cash (and near cash items- e.g. short term investments in financial securities such as Treasury Bills, Bonds etc) as at December 31, 2000?: Kshs.______________________________

48. What was the balance of your organization's total liabilities (short and long term loans) as at December 31, 2000?: Kshs.__________________________

49. What is the proportion of donor funding to total annual funding? ----%

50. What would you recommend as the liquidity ratio to be adopted in regulating MFIs?: ______________________________________

51. What was the average proportion of total administrative overhead to total expenditure in December 31, 2000? ______%

52. Should the liquidity and reserve ratios of MFIs be higher or lower than those of traditional banks?

i) Higher ☐

ii) Lower ☐

53. Please explain the reason for choosing a higher or lower liquidity and reserve ratio:____

____

Correlation Analysis- Characteristics Vs Regulatory Mechanisms

1. Loans to poor * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Loans to poor	YES	7	13	2	1	23
	NO		1		1	2
Total		7	14	2	2	25

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.372	.235	1.924	.067[c]
Ordinal by Ordinal	Spearman Correlation	.297	.172	1.490	.150[c]
N of Valid Cases		25			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

2. Target to Low Earners * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Target to Low Earners	YES	6	12	2	2	22
	NO		1			1
Total		6	13	2	2	23

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.000	.044	.000	1.000[c]
Ordinal by Ordinal	Spearman Correlation	.036	.059	.165	.871[c]
N of Valid Cases		23			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

3. Loans (Character Grantees) * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Loans (Character Grantees)	YES	5	7	1	1	14
	NO		3	1	1	5
Total		5	10	2	2	19

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.369	.198	1.636	.120[c]
Ordinal by Ordinal	Spearman Correlation	.394	.167	1.766	.095[c]
N of Valid Cases		19			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

4. Loans (Group Grantees) * Regulatory Approach

Crosstab

Count

		Regulatory Approach				
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	Total
Loans (Group Grantees)	YES	6	14	1	2	23
	NO			1		1
Total		6	14	2	2	24

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.255	.139	1.239	.228[c]
Ordinal by Ordinal	Spearman Correlation	.306	.150	1.506	.146[c]
N of Valid Cases		24			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

5. Capitalized by Donors * Regulatory Approach

Crosstab

Count

		Regulatory Approach				
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	Total
Capitalized by Donors	YES	8	11	1	2	22
	NO		3	1		4
Total		8	14	2	2	26

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.168	.138	.836	.411[c]
Ordinal by Ordinal	Spearman Correlation	.252	.130	1.275	.214[c]
N of Valid Cases		26			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

6. Board has local Volunteers * Regulatory Approach

Crosstab

Count

		Regulatory Approach				
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	Total
Board has local Volunteers	YES	4	9	1	2	16
	NO	2	3	1		6
Total		6	12	2	2	22

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	-.120	.180	-.539	.596[c]
Ordinal by Ordinal	Spearman Correlation	-.089	.210	-.399	.694[c]
N of Valid Cases		22			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

7. Board is Beneficiary of loans * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Board is Beneficiary of loans	YES	1	1	1		3
	NO	6	11	1	2	20
Total		7	12	2	2	23

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	-.020	.201	-.090	.929[c]
Ordinal by Ordinal	Spearman Correlation	-.043	.232	-.196	.847[c]
N of Valid Cases		23			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

8. Minimalist * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Minimalist	YES	5	10	2	1	18
	NO	1	2		1	4
Total		6	12	2	2	22

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.138	.253	.624	.540[c]
Ordinal by Ordinal	Spearman Correlation	.082	.232	.369	.716[c]
N of Valid Cases		22			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

9. Interest higher than comm. bank * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Interest higher than comm. bank	YES	1	5			6
	NO	6	6	2	1	15
Total		7	11	2	1	21

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.019	.158	.085	.933[c]
Ordinal by Ordinal	Spearman Correlation	-.058	.188	-.252	.804[c]
N of Valid Cases		21			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

10. Interest Lower than Comm. Banks * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Interest Lower than Comm. Banks	YES	7	7	2	1	17
	NO	1	4		1	6
Total		8	11	2	2	23

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.171	.204	.796	.435[c]
Ordinal by Ordinal	Spearman Correlation	.178	.190	.830	.416[c]
N of Valid Cases		23			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

11. Have self-sufficiency problems * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Have self-sufficiency problems	YES	3	3	1	1	8
	NO	2	8	1	1	12
Total		5	11	2	2	20

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.047	.236	.201	.843[c]
Ordinal by Ordinal	Spearman Correlation	.098	.242	.417	.682[c]
N of Valid Cases		20			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

12. Have clear vision * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Have clear vision	YES	8	13	2	2	25
	NO		1			[illegible]
Total		8	14	2	2	26

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.019	.042	.091	.928[c]
Ordinal by Ordinal	Spearman Correlation	.059	.057	.290	.774[c]
N of Valid Cases		26			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

13. Have standardized Product * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Have standardized Product	YES	4	10		1	15
	NO	3	3	2	1	9
Total		7	13	2	2	24

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.141	.216	.667	.512[c]
Ordinal by Ordinal	Spearman Correlation	.110	.226	.519	.609[c]
N of Valid Cases		24			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

14. Uses CAMEL to asses to performance * Regulatory Approach

Crosstab

Count

		Regulatory Approach				Total
		Self Regulation	Regulation by 3rd Party	Regulation within existing laws	Establisheme nt of an act of Parliament	
Uses CAMEL to asses to performance	YES	4	5			9
	NO	1	3	1	2	7
Total		5	8	1	2	16

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	.539	.160	2.393	.031[c]
Ordinal by Ordinal	Spearman Correlation	.505	.192	2.191	.046[c]
N of Valid Cases		16			

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		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
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