THE NEED FOR REGULATION OF MICRO FINANCE INSTITUTIONS IN KENYA.

(A Case Study of Micro Finance Institutions in Nairobi)

By

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D53/OL/1040/02

A Project Submitted in partial fulfillment of requirements for the award of Masters of Business Administration (Finance) of Kenyatta University.

May 2006
DECLARATION

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

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SIGNATURE
DATE 18-5-2006

DR. E.W. KHAKAME
DEDICATION

To my family (Loving wife-Alison Maitha, Sons Kevin Murithi and Davies Gitonga)

To my parents (Franklin Nkari Rweria and Siliaka Kanyamu)

To my late father-in-law- Eustace Burini and my mother-in-law Joyce Mumu Burini
ACKNOWLEDGEMENT

I would like to thank all the people who in one way or another played a role in making this project and my study of MBA a reality. Special thanks to my supervisor Mr. Dominic Ngaba for his guidance.

Thanks to my colleagues at the Central Bank of Kenya for the constant encouragement and support. I would not forget to mention the Central Bank of Kenya Library staff who ensured constant supply of reading materials for this and other courses.

Special thanks go to my brother, Erastus Rweria and my sisters Lucy Kime, Helen Rweria, Jeddidah Rweria and Alison Kageni for taking care of my ailing parents while I was busy with my studies.

Finally, to all my friends for their patience and understanding during my long withdrawn period while working on this course.
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<td>KWFT</td>
<td>Kenya Women Finance Trust</td>
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<tr>
<td>K- REP</td>
<td>Kenya Rural Enterprise Programme</td>
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<tr>
<td>PRIDE</td>
<td>Promotion of Rural Initiative and Development</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>ODA</td>
<td>Overseas Development Agency</td>
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<td>KGCT</td>
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<td>BSF</td>
<td>Belgium Survival Fund</td>
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<td>FF</td>
<td>Ford Foundation</td>
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<td>IFAD</td>
<td>International Fund for Agriculture Development</td>
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<td>UNDP</td>
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<td>UN</td>
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<td>CBK</td>
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<td>NGOs</td>
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<td>MFIs</td>
<td>Micro Finance Institutions</td>
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<td>SSEs</td>
<td>Small Scale Enterprise</td>
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<td>MEs</td>
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<td>SMEs</td>
<td>Small and Micro Enterprises</td>
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<td>ILO</td>
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<td>NBFI</td>
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DEFINITION OF TERMS

Lending: to allow someone to use a sum money on the understanding that it will be repaid and earn interest.

Loan: to lend especially money, the act of lending on condition that the thing lent will be returned.

MFIs: these are financial institutions that lend small amount of money to the borrowers and also consultative group to assist the poor.

Entrepreneur: refer to a person who is able to identify business opportunities, mobilize the necessary resources (e.g. money, time etc) and he/she initiates a business activity hoping that it will be successful.

Financial Institution: an institution that acts as an agent that provides financial services for its clients.

Regulation: refers to a set of enforceable rules that restrict or direct the actions of the market participants, altering, as a result, the outcomes of those actions.

Supervision: the process of enforcing compliance with regulation rules.
The purpose of the proposed study was to study the need for the regulation of Micro Finance Institutions (MFIs) in Kenya, where some selected MFIs were studied as a sample. The study also pointed out areas, which should be addressed to ensure that these MFIs are regulated under the laws of Kenya so as to protect depositors.

The research was carried out specifically in Nairobi, which is the Capital City of Kenya and a home to majority of the MFIs. Literature was reviewed from books, magazines, journals and references from previous research work conducted by earlier students and researchers on this area. Primary data was collected by the use of a questionnaire, which consisted of open and closed ended questions.

The research adopted both the exploratory and descriptive research design. The sample from this study was drawn by the use of systematic sampling. The population for this study was two managers of every MFI that was selected for the study. Data was analyzed using qualitative and quantitative data analysis techniques with the aid of SPSS.

The findings indicate that there is urgent need for the supervision of micro-finance institutions since majority of them engage in deposit taking-related business. The study found out that the rules restricting lending to the public need to be relaxed to enable micro-finance institutions to lend legally and use legal machinery to recover from defaulters.
It was found that the law as it is hampers the development of the sub-sector as it requires the institutions to be extra cautious when lending.

The government should treat micro-finance institutions different from commercial banks since they do not perform core banking business. These institutions come in to fill the gap left by mainstream banks, i.e. banking for the neglected poor in the society whose savings are small compared to mainstream banks. They therefore should be allowed a lower capital base and less license fees.

There is need for the creation of a regulatory authority for the micro-finance institutions, or delegating such authority to Central Bank of Kenya who have the capacity to do so.

Areas to be closely supervised include minimum capital maintenance, maintenance of proper books of accounts, adherence to accounting standards, and control in lending to customers so that the sub-sector can remain stable.

The government should move with speed to enact the micro-finance bill to weed out unscrupulous shylocks operating as micro-finance institutions who are out to steal from the public. Such institutions give the sub-sector a bad name and depositors shy away from genuine institutions.
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CHAPTER ONE
INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Microfinance, the provision of financial services to poor people, holds enormous potential to support their economic activities and thus contribute to the alleviation of poverty. Widespread experiences and research have particularly shown the importance of savings facilities for the poor. In the framework of financial system approach, adequate regulation and supervision of the microfinance industry increasingly move into the center of attention to ensure the safety of the poor’s deposits, yet microfinance regulation and supervision are still in an embryonic stage, so no standardized approaches are presently available (Brownbridge, 1997).

The lack of an appropriate legal and regulatory framework is a problem existing in a number of developing countries in Asia, Africa and Latin America. A number of countries are considering how to regulate microfinance institutions.

In Africa, only a few countries like Ghana and Ethiopia have enacted laws and regulations that are supportive of the rural banking and MFI’s. In East Africa, Tanzania and Uganda have developed policies on regulation and supervision of MFI’s. In Uganda, micro-deposits institutions regulation has been enacted. There is a need to develop regulatory and supervisory frameworks as well as developing operational parameters and best practices that will be observed by MFI’s. The financial system is regulated to ensure safety of the depositor’s funds and thus maintain the public confidence in the system (Brownbridge, 1997).

In Kenya the idea of microcredit can be traced back to before independence. The colonial government did not provide credit facilities to the African people, and hence informal credit groups such as merry go-rounds were formed within the societies in rural areas and clan levels. During the
1970s, government agencies were set up and their main responsibility was focused to provide credit to those who had no previous access to credit facilities (Henry et al, 1991).

The government and donor community assumed the poor required cheap credit, and as a result credit unions were set up in an effort to mobilize savings amongst poor people. The favorable attitudes and policies towards micro - enterprise both worldwide and locally, owe much to the 1972 ILO mission to Kenya. The report highlighted the limitations of the previous industrial development policies in Kenya and by a large extent, much of the development world (Henry et al, 1991).

Micro credit arose in the 1980’s as a result of research recommendations about government delivery of subsidized credit to poor people. Micro finance projects were set up by international aid organizations and local institutions, such as Micro Finance Institutions in Poland with a sole purpose of promoting small business enterprises. In the developing world the aim of micro finance is that of helping others help themselves (Hulme et al, 1997).

However despite a steady growth of MFIs in Kenya during the 1990 there is still lack of an appropriate legal and regulatory framework that has greatly contributed to the reduced sustainability, reduced outreach, weak management and declining donor support for MFIs particularly NGO’s.

Because of lack of specific laws and regulations in this sector, MFIs are licensed under different Acts of parliament namely, the Non Governmental Organizations Coordination Act, Companies Act, Banking Act, Trusts Societies Act, Co-operative Act, companies limited by guarantee, and Kenya Post Office Savings Bank Act. In many developing countries capital markets are still at a rudimentary stage and commercial banks are reluctant to lend to the poor largely because of the lack of collateral and high transaction costs.
A study by the IFAD 1997, has confirmed that complicated loan procedures and paperwork, combined with a lack of accounting experiences limit poor people’s access to formal sources of credit. The fact is that commercial lenders in rural areas prefer to deal mainly with large scale farmers (Asian Development Bank, 2004).

Micro credit systems have been developed in response to the needs of small-scale farmers and rural entrepreneurs who otherwise do not have access to finance. Without money, it is not possible to purchase inputs that are required to establish business and improve on productivity. Therefore those people who operate with the least amount of surplus income to finance their businesses are in need of this external credit and are considered to be least credit worthy.

The Grameen bank in Bangladesh pioneered micro – credit through lending to members of groups. Group members provided security and due to peer pressure within; group members encouraged each other to ensure prompt payment of the loans (Chambers 2003).

The main objective of MFI’s is mainly to provide financial assistance through establishing saving schemes, offering loan products and insurance products with (SMES). The key function of MFI’s is to provide a way to transfer economic resources through time, across borders and among individuals. MFI’s can take the form of Government institutions and NGO’s (Bodies, 2000),

1.2 STATEMENT OF THE PROBLEM

The government, NGOs and donors advocate for providing MFIs with financial licenses in order to expand savings for the poor and to set up a special regulatory window for micro finance that will speed the emergence of sustainable MFIs. The government also views the high interest rates charged by MFIs as exploitative and wants to protect small borrowers. Some MFIs have also collapsed with depositor’s funds owing to poor coordination and mismanagement. This requires
urgent action to clean up this situation that is hurting the development of micro finance in the
country (Habibia, 2004)

The regulation and licensing of MFIs is complicated by the fact that there are several different
legislations under which micro-finance institutions are licensed, and therefore their supervision is
disjointed. There is need for legal protection of depositors from institutions circumventing the
Banking Act by soliciting deposits from the public but remained unregulated by the authorities.
Some institutions are operating under the disguise of MFI’s to defraud the public by taking
advantage of desperate Kenyans who lack access to financial services and are exploiting them for
their own gain.

The exploitation of Kenyans by unscrupulous micro-finance institutions indicates that an
appropriate regulatory framework for micro-finance institutions does not exist. This threatens the
existence and success of legitimate institutions. This study therefore aimed at establishing the need
for regulation of micro finance institutions in Kenya

1.3 OBJECTIVES OF THE STUDY

1.3.1 BROAD OBJECTIVE
To examine the need for regulation of micro finance institutions in Kenya, with special emphasis to
the MFIs operating in Nairobi.

1.3.2 SPECIFIC OBJECTIVES
1. To investigate the regulatory and legal framework under which MFIs operate in Kenya
presents.
2. To determine the level of savings deposits held by micro finance institutions in Kenya.
3. To determine the sources of funding of MFIs in Kenya and to establish the level of lending
by MFIs in Kenya.
4. To find out the emerging issues in the industry.
1.4 RESEARCH QUESTIONS

1) Is there need to regulate micro finance institutions?

2) What is the regulatory and legal framework that MFIs operate in Kenya presently?

3) What is the level of savings deposits held by MFIs?

4) What are the emerging issues in the industry?

1.5 SIGNIFICANCE OF THE STUDY

This proposed study will be of significance to the following:

a) The Central Bank of Kenya

The findings of this study will assist the CBK as a regulatory authority to assess the current and future expectations of industry players in micro finance. This will help incorporate such feelings and views when it comes to regulation and supervision of the industry.

b) The micro finance industry

This study will help in highlighting different views from the players in the micro finance industry.

c) The government

The government as the licensing authority of financial institutions in Kenya will be interested in the findings of this study, as it will highlight the problems the players are likely to face due to regulation and also take into consideration the views of the players while enacting requisite legislation.

d) Future researchers

The study will be a reference material for future researchers and scholars who would wish to venture into this area of study.

e) The general public

Since most MFIs mobilize funds from the public, it is necessary for the public to understand how these MFIs operate and how they conduct their activities so as to have confidence in these MFIs.
f) Donors

These being the providers of funds to MFIs, they will be able to get an in-depth analysis of the 

need for the regulation of MFIs.

1.6 SCOPE OF THE STUDY

This study was conducted within Nairobi. The location was appropriate because it is metropolitan 

and representative of the whole country thus findings can be generalized. There is a good number 

of micro finance institutions with their head offices situated in Nairobi and this would be quite 

significant for the study and the findings and conclusions drawn would be quite reliable.
2.01 Bank Failures in Kenya

The financial sector at independence in Kenya in 1963 consisted of nine banks and several NBFI’s. The 1970s saw a rapid growth of NBIF’s, stimulated by differences in the regulatory treatment of banks and NBFI’s. There was an accelerated growth of financial institutions during the 1980s when the Kenyan economy was booming. It is during the mid-1980s, that the Kenyan financial system suffered its first financial crisis when several locally owned financial institutions were closed. The sector was to be hit by yet another crisis in the 1990s when six banks and eleven NBFI’s were put under liquidation (Brownbridge, 1997).

These bank failures exposed the deficiency in the system of prudential supervision and regulation of the commercial banks and NBFI’s. Both the legal framework and the CBK supervisory capacity had evolved to regulate a banking system confined to subsidiaries of multinational banks. These had well qualified staff and strong internal controls and therefore required only the minimum of supervision. The emergence of the local financial institutions radically changed the nature of the demands placed on bank supervisors. Not only was there a proliferation of new financial institutions but many were inadequately capitalized and were incompetently or fraudulently managed. Brownbridge notes that the prudential system proved deficient in three important respects: the banking laws were not strict enough, the CBK did not have adequate supervisory capacities, and some of the financial institutions were able to use political connections to flout the banking laws (Rosenberg, 2002).

It is with the realization of the above shortcoming that the CBK Act (Cap 491) has seen four amendments in order to give the Central Bank more authority over the management, regulation and supervision of financial institutions (CBK, 2000).
However, the CBK still lacks adequate capacity to oversee and regulate the financial sector to ensure a stable market. This is evidenced by the continued existence of weak banks and financial institutions some of which are under statutory management after failing to meet the liquidity requirement. The CBK Act is still lacking in that it is the minister for Finance who can propose amendments to the act and even present the amendments in parliament (CBK Act Cap 491).

The minister, being a political figure may be far from political influence and may have to rely on political consideration when making his decision on some banks. The Act gives the minister the authority to license banks while the role of Central Bank is to regulate (CBK, 2000).

2.02 Evolution of micro finance in Kenya.

The micro industry in Kenya can be traced back to the colonial era. The colonial administration did not have in place credit schemes available for Africans to benefit from. As a result of this, informal organizations such as Merry go rounds were formed to mobilize savings among the community members. It was not until after independence that the first savings and credit co-operatives societies (SACCOs) were registered (Alila et al, 1990).

In the 1970s, the International Labour Organization carried out worldwide studies with particular interest in Kenya. The report pointed out the limitations of the industrial development policies and also identified the characteristics of micro – enterprises that had relevance to the problems of rising unemployment and poverty (Henry et al, 1991).

The appropriate and carefully developed regulation and supervision of the micro finance sector in Kenya would facilitate quality growth, broaden funding base and integrate micro – finance operations with the formal financial system. However micro credit is not a panacea, it is an area open to exploitation. Micro – finance has expanded enormously in the 1990. Policy makers, donors, practitioners and academics around the world now underline the role of micro- finance as
powerful tool for poverty alleviation. Moreover, the current growing interest in micro finance reflects a new conception of financial sector development (Henry et al 1991).

While conventional development theory had suggested the transfer of capital to specific economic sectors, the new approach emphasizes the importance of a sound financial system for economic development. It is argued in the new approach that micro finance services can be provided in a sustainable manner. Correspondingly, building viable and sustainable micro-finance institutions is becoming recognized as a major challenge for financial system development. The mission and vision of MFIs is to advance and promote direct access of economically active entrepreneurs to sustainable financial and non financial services in order to help them improve their economic, social and political status (Henry et al 1991).

2.03 Sources of finances for MFI’s

The history of MFIs and the source of finance for MFIs start with the origin of the Grameen Bank. The origin can be traced back to 1976 when Professor Muhammed Yunus launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor in Bangladesh. The Grammen Bank Project came into operation with the following objectives:

A) Extend banking facilities to poor men and women;
B) Eliminate the exploitation of the poor by money lender;
C) Create opportunities for self-employment for the vast multitude of employed people in rural Bangladesh;
D) Reverse the old-age vicious circle of “low income, low savings and low investment” into vicious circle of “low income, injection of credit, investment, more income, more savings, more investment, more income”;

Today, Grameen Bank is owned by the rural poor whom it serves. Borrowers of the bank own 90% of its shares, while the remaining, 10% is owned by the government.
Since the establishment of Grameen Bank as a financial institution by the government ordinance in 1983, it has financed its activities with funds obtained at concessionary rates from external and domestic sources including the Central Bank of Bangladesh. The author notes that these funds were grants and low interest loans provided by donors. Grameen Bank has reversed conventional banking practice by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity. It provides credit to the poorest of the poor in rural Bangladesh, without any collateral. At Grameen Bank, credit is a cost effective weapon to fight poverty and it serves as a catalyst in the over all development of socio-economic conditions of the poor who have been kept outside the banking orbit on the ground that they are poor and hence not bankable. Professor Muhammad Yunus, the founder of "Grameen Bank" and its Managing Director, reasoned that if financial resources can be made available to the poor people on terms and conditions that are appropriate and reasonable, "these millions of small people with their millions of small pursuits can add up to create the biggest development wonder." In 1995, Grameen Bank decided not to receive any more donor funds and it has not requested any fresh funds from donors. The bank does not need to take any donor money or even take loans from local or external sources in the future.

In Kenya, however, MFIs were highly motivated by donor funding. (Khandker, 1995). They were highly subsidized and relied mainly on donor funding and used the integrated approach to assist micro enterprises. Majority of these MFI’s have gone under due to lack of funding brought about by the donor’s withdrawals and calls for self-reliance of these institutions (Dondo, 2000).

The major sources of finance to MFI’s comprise of the government, donors, commercial banks and co-operative societies. Some commercial banks have gone a step ahead to have sections specifically catering for micro – finance. These sections get their finances mainly from their mainstream bank (CBK, 2000)
2.04 The regulatory framework: -

Regulations are fundamental rules of behaviour. Financial regulations are rules that govern commercial behaviour in the financial system. Financial regulation also refers to the body of principles, rules, standards, and compliance procedures that apply to financial institutions. Financial supervision involves the examination and monitoring of organizations for compliance with financial regulation. Prudent regulation and supervision are designed to avoid a banking crisis and maintain the integrity of the payment system, protect depositors and encourage financial sector competition and efficiency (Chavex et al, 1995).

Hewing et al, 1999, identifies four broad rationale for financial regulation, safe-guarding the system against systemic risk, protecting consumers against opportunistic behaviour by suppliers of financial services, enhancing the efficiency of the financial system and achieving a range of social objectives such as increasing home ownership or channeling resources to particular sectors of the economy or population.

One of the most important issues facing micro finance is the regulation and supervision of MFIs to create an environment that is conducive to the financial repression. Examples of financial repression are imposed interest rate ceiling, subsidized credit, and tax structures that discourage investment in micro finance. Government must ensure that supervisory bodies have the authority and capacity to implement the regulatory standards (Charex et al 1994).

2.05 Risk factors of MFIs.

Both MFIs and commercial Banks are vulnerable to liquidity problems brought on by a mismatch of maturities, term structure, and currencies. The risk features of MFIs differ significantly from those of commercial banks. MFIs for example have a client base characterized by low income, less assets, and clients requiring small loans. On the other hand, their lending models for the unsecured
loans are based on character or group guarantees and have an ownership structure that is capitalized by donors rather than commercial investors or owners (Ledgerwood, 1998).

The regulations designed for commercial banks are usually not suitable for MFIs because MFIs have a different risk profile. An appropriate approach to regulating MFIs must be based on an understanding of the different risks and a country’s legal and institution framework. (Ledgerwood, 1998).

2.06 The role of regulation and supervision in micro finance

Banks are regulated to protect their depositors and prevent risks to the financial system. Credit MFIs do not take deposits from the public and are too small to pose much risk for the financial system. Regulation by the financial authorities is needed for MFI’s that do take deposits for instance, savings based financial co-operative is credit based MFIs that take deposits to finance their growth (Ledgerwood, 1998).

2.07 The way forward for supervision and regulation of MFIs in Kenya.

In Kenya, as in many other countries, approaches to the regulation of MFIs are complicated by the fact that many institutions are involved in providing micro finance services. Various acts of parliament already regulate some of the organizations like banking institutions, savings and credit cooperative societies and the Kenya Post Office Savings Bank. Micro finance NGOs and merry go round organizations in Kenya lack regulatory and supervisory oversight (Ledgerwood, 1998).

This has enabled them to emerge with different techniques of providing micro finance services but has been detrimental to their growth and expansion.

The following approaches are being considered in the on – going discussions between MFIs and Central Bank of Kenya. Regulation by a body created by law: a separate act of parliament is to be
enacted to give the Central Bank of Kenya authority to regulate, pure self-regulation where the MFI industry may establish its own supervisory and governance body. Hybrid approach: where the regulatory authority (Central Bank of Kenya) may contract third parties with expertise in microfinance, e.g. accounting firms to perform some or all of the supervisory functions (Ledgerwood, 1998).

2.08 Regulation of MFIs within existing laws:

This is where MFIs are regulated within the existing legal and regulatory framework for formal financial institutions but adopt different required ratios and supervisory practices to address their risk profiles (Ledgerwood, 1998).

At the moment, MFIs intending to take deposits from the public are required to seek license to operate under the Banking Act as non-bank financial institution or as bank. One NGO that is K-Rep has been licensed as a bank. However, the Kshs. 500 million minimum capital requirements to start a bank are considered too high for majority of MFIs. There are discussions as to whether the Banking act should be amended to allow for licensing of financial institutions with lower paid up capital requirement to cater for MFIs, and enactment of specialized laws and regulations for MFIs. (Ledgerwood, 1998). Already, a micro-finance regulatory bill is being drafted for presentation in parliament (Daily Nation, 26th June 2004)

2.09 Factors to consider when regulating MFIs.

It is important for regulators to establish minimum standards for MFIs while at the same time remaining flexible and innovative. At a minimum when regulating and supervising MFI’s, five issues need to be considered, the minimum capital requirements, the capital adequacy, liquidity requirements and asset quality and portfolio diversification (Ledgerwood 1998)
2.10 The capital or funding base

Capital refers to the level of funds in an organization that is available to cover its risk. Capital constitutes equity and debt. It also refers to the percentage of assets that is funded by debt. Majority of MFIs fund their activities with owner or government funding through grants or concession loans. However it is becoming evident that donor funding is limited. Ways that MFIs can access new capital include debt accessed through guarantee funds, loans and deposit mobilization, equity investment funds, socially responsible mutual funds, and securitization of the loan portfolio (Sterns, 1993).

Debt funds can be assessed through Guarantee funds, which are financial mechanisms that reduce the risk to a financial institution by ensuring repayment of some portion of the loan. Guaranteed funds are needed to encourage the formal sector bank lending to the micro enterprise sector. They can be used to guarantee loan made by a commercial bank to an MFI, which then lends funds to its clients or loans from a bank directly to a micro enterprise (Sterns, 1993).

These are three types of guarantee funds that can cover the risks of making loans. These risks related design features are some of the most important of the acceptance and use of a guarantee mechanism by banks. They are guarantee covering a percentage of the loan principle, a percentage of the loan principle and the interest lost and a certain amount of the loan (Sterns 1993).

Equity capital can be accessed by selling shares of ownership (equity), of the MFI. For this to be possible the institution must be a formal financial intermediary with shareholders unlike debt instruments. Equity does not have a fixed yield or maturity. Rather equity investor invests in the profitable future of the MFI and expects a share of the returns. Because the micro finance industry has not yet developed to the point where there are many investors who are aware of the potential of MFIs, it may take sometime before equity investors play an important role in the funding mechanism of MFIs (Sterns, 1993).
Equity investment funds provide equity and quasi equity (subordinated debt) to selected organizations. Profits is one such investment fund that was set up for the sole purpose of investing in expanding MFLs in Latin America. Efforts are underway to establish similar funds in Africa and Asia (Chambers 2000).

Socially responsible mutual funds are of two types, screened and shared returned funds, with screened mutual funds, managers screen companies for social criteria. Profits are paid to shareholders that choose to invest in these funds because they want to support socially responsible companies. Shared return funds are mutual funds owned by the member organizations (MFIs). Shareholders agree to donate a percentage to the return to the member organization (Sterns, 1993).

Securitization links MFI institutions to capital markets by issuing corporate debentures backed by the MFIs portfolio. The structure requires the creation of a single purpose corporation, which buys the micro enterprise portfolio and capitalizes itself by issuing debentures in the capital market. The purpose of creating a single purpose corporation is to acquire the micro enterprise portfolio of known entities without taking on other risks. The equity of the single purpose corporation comes from the micro finance organization and its partners (Ledgerwood 1998).

Maintaining adequate capital provides protection to institution against various risks, allows for absorption of loses and therefore instills confidence among investors, lenders, clients and regulators.

2.11 Minimum capital requirements
Capital refers to the amount of money of equity an institution holds. Financial institutions wanting to formalize must have a minimum amount of capital to support their activities stated as a currency amount rather than as a percentage of assets. Since MFIs primarily rely on donor funds for capital
contribution, they may not have sufficient capital to meet these rules, which can limit the formalization of micro finance organizations (Ledgerwood, 1998),

Regulators should be encouraged to set minimum capital requirements in accordance with their objectives of encouraging competition and risk behaviour. It is also important for them to recognize that MFI owners may consider social objectives over profit maximization goals, and that minimum capital requirements may not be as powerful an inducement to sound governance as would generally be the case with standard commercial banking institutions (Ledgerwood, 1998),

2.12 Assets quality

Assets quality represents the risks to earnings derived from loans made by the organization. In other words, this measure the degree of risk that some loan portfolio will not be repaid. Most MFI do not require collateral and instead base their decisions on character, group solidarity and past repayment history. In many countries, bank regulations limit the percentage of the portfolio that may be extended as non-secured loans.

The types of security available from micro entrepreneurs are usually not recognized. Instead of collateral, regulators may consider the best indicators of assets quality to the past performance of the portfolio and the current rate of portfolio at risk, defined as the balance of the outstanding loans which have an amount past due. Bank regulators should accept flexible definitions for loan security that enhance repayment incentives (Ledgerwood 1998).

2.13 Conceptual Framework.

The main variables of this study included forms of MFI, funding, regulatory and legal framework in operation Level of savings deposits held by MFI, source of funding, level of lending, and the emerging issues in the industry. In this study, these variables were considered as independent variables while performance was considered as the dependent variable.
Table I: Conceptual framework

Types or forms of MFIs
The regulatory and legal framework in operation.
Level of savings deposits held by MFIs
Source of funding
Level of lending
Emerging issues in the industry.

Needs for regulation of microfinance institutions.

**Independent Variables**

Source: Researcher, (2005)
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Research design
The study adopted both exploratory and descriptive research designs. The exploratory design was used to obtain primary data. A descriptive survey helped to locate and obtain secondary data for the study and describe issues as they were.

3.2 Study Population
This study targeted all the MFI’s in Nairobi. These were the 42 MFI as per the list of MFIs in the Guide for Kenyan Entrepreneurs (2002) provided in appendix 1. This population would provide a significant representation of the whole country, Kenya.

3.3 Sampling Strategy
This was a survey and therefore the researcher studied all the MFI’s in Nairobi. However, the researcher choose purposively, one manager from each of these MFIs and obtain a total of 42 managers. This was so because these managers have better knowledge and awareness on the issue at stake and would provide specific information from a management perspective.

3.4 Data Collection
The researcher collected data by the use of a questionnaire, which contained both open-ended and closed-ended questions. It was administered to the managers, who were expected to provide information on the management issues and strategies, provide any other necessary information for the study. The researcher used the drop- and -pick method of administering the questionnaire.

The use of this instrument was advantageous because it requires less manpower and is convenient and cheap. It also enabled the researcher to gather in-depth information on the phenomenon under investigation with a view to achieving the research objectives and in answering the research
questions. However, this method may have a limitation of low response rate. Nevertheless, the method was appropriate because it eliminates any bias or personal opinion on the respondents and also gives them ample time to fill the questionnaires.

3.5 Data Analysis

Data for this study was analyzed using descriptive statistics, that is, the measures of central tendencies and with the application of the SPSS software, the data was presented in tables, cross tabulations, charts and graphs.
INTRODUCTION

This chapter presents the analysis of the collected data and discusses the findings of the study on the need for regulation of microfinance institutions in Kenya, a case study of microfinance institutions in Nairobi.

AN OVERVIEW

The data was collected by administering questionnaires to the management of the MFIs in Nairobi. A total of 42 respondents from such institutions were interviewed. However, 40 of them responded positively. This gives a response rate of 95% which is considered quite representative and valid to draw reliable findings on the issue under investigation.

COMPANY AGE

The respondents were asked to indicate the age of the company and the results are as indicated in table 4.02 and chart 4.02 below.

Table 4.02

<table>
<thead>
<tr>
<th>Company age(years)</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Less than one year</td>
<td>11</td>
<td>27.5</td>
<td>27.5</td>
<td>27.5</td>
</tr>
<tr>
<td>1-5 years</td>
<td>18</td>
<td>45.0</td>
<td>45.0</td>
<td>72.5</td>
</tr>
<tr>
<td>6-9 years</td>
<td>11</td>
<td>27.5</td>
<td>27.5</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Most of the MFIs (45%) were between 1-5 years old, while 27.5% were less than 1 year old and a similar number (27.5%) were between 6-9 years. This result shows that this is an evolving sub-sector.

### 4.03 Years Served

The respondents were asked to indicate the number of years they have served and the result was as shown in table 4.03 and chart 4.03.

**Table 4.03**

<table>
<thead>
<tr>
<th>Number of years served</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0-2 years</td>
<td>9</td>
<td>22.5</td>
<td>22.5</td>
<td>22.5</td>
</tr>
<tr>
<td>2-4 years</td>
<td>15</td>
<td>37.5</td>
<td>37.5</td>
<td>60.0</td>
</tr>
<tr>
<td>4-6 years</td>
<td>8</td>
<td>20.0</td>
<td>20.0</td>
<td>80.0</td>
</tr>
<tr>
<td>Over 6 years</td>
<td>8</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Regarding the number of years served, 22.5\% of the respondents said they had served for between 0-2 years, 37.5\% for between 2-4 years, 20.0\% for between 4-6 years whereas 20.0\% said they had served for over 6 years. The result shows that the employees in these institutions lack the experience required to run them effectively.

### 4.04 Gender

The respondents were asked to state their gender and the result is as shown in table 4.04 and chart 4.04.

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Female</td>
<td>23</td>
<td>57.5</td>
<td>57.5</td>
</tr>
<tr>
<td></td>
<td>Male</td>
<td>17</td>
<td>42.5</td>
<td>42.5</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Whereas 57.5% of the respondents were females, 42.5% of them were males. There is a significant number of female employees in these institutions. This may be a pointer to the composition of customers to be found in these institutions.

### 4.05 Overall performances

The respondents were asked to indicate how the overall performance of their MFI is rated and the result is as shown in table 4.05 and chart 4.05 below.

**Table 4.05**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Good</td>
<td>23</td>
<td>57.5</td>
</tr>
<tr>
<td></td>
<td>Fair</td>
<td>15</td>
<td>37.5</td>
</tr>
<tr>
<td></td>
<td>Poor</td>
<td>2</td>
<td>5.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>40</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Majority of the respondents (57.5%) rated the overall performance of their MFIs as good, whereas 37.5% of them gave their rating as fair. However, 5% of them indicated that theirs is rated poor. This is an indication that the MFI sector is coming up and there is potential for their growth.

4.06 Performance and regulatory framework

The respondents were asked to state if they thought performance is affected by regulatory framework and the result is as shown in table 4.06 and chart 4.06 below.

Table 4.06

<table>
<thead>
<tr>
<th>If performance is affected by regulatory framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Yes</td>
</tr>
<tr>
<td>-----------</td>
</tr>
<tr>
<td>Valid</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
A significant number of the respondents (65.0%) opined that regulatory framework affect the performance of MFIs, the other 35.0% did not. This is important to note especially when enacting new laws so that they do not have adverse effect.

4.07 Extent of effect

The respondents were asked to indicate the extent to which performance is affected by regulatory framework and the outcome was as shown in table 4.07 and chart 4.07 below.

<table>
<thead>
<tr>
<th>The extent to which the regulatory framework affects the performance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valid</strong></td>
</tr>
<tr>
<td>Very great</td>
</tr>
<tr>
<td>Great</td>
</tr>
<tr>
<td>Moderate</td>
</tr>
<tr>
<td>Low extend</td>
</tr>
<tr>
<td>Very low extend</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
The respondents rated the effect of regulatory framework on the performance of MFIs as very great (22.5%), great (37.5%), moderate (20.0%), low extent (12.5%), and very low extent (7.5%).

4.08 The Act that the MFI falls

The respondents were asked to indicate which act their MFI falls under and they indicated as shown in table 4.08 and chart 4.08 below.

Table 4.08

<table>
<thead>
<tr>
<th>The act where the MFI falls</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The SACCO Act</td>
<td>8</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>The banking act</td>
<td>10</td>
<td>25.0</td>
<td>25.0</td>
<td>45.0</td>
</tr>
<tr>
<td>Kenya post office</td>
<td>6</td>
<td>15.0</td>
<td>15.0</td>
<td>60.0</td>
</tr>
<tr>
<td>Savings act</td>
<td>2</td>
<td>5.0</td>
<td>5.0</td>
<td>65.0</td>
</tr>
<tr>
<td>Co-operative act</td>
<td>2</td>
<td>5.0</td>
<td>5.0</td>
<td>70.0</td>
</tr>
<tr>
<td>NGO coordination act</td>
<td>5</td>
<td>12.5</td>
<td>12.5</td>
<td>77.5</td>
</tr>
<tr>
<td>Companies act</td>
<td>6</td>
<td>15.0</td>
<td>15.0</td>
<td>92.5</td>
</tr>
<tr>
<td>Trust act</td>
<td>2</td>
<td>5.0</td>
<td>5.0</td>
<td>97.5</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>2.5</td>
<td>2.5</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
As shown in the table above, MFIs fall under diverse acts, with the Banking Act constituting the biggest number (25.0%). The SACCO Act constitutes 20.0%, Kenya Post Office Savings Act and the Companies Act constitute 15% each. The Cooperative Act and the Trust Act each constitute 5% while the NGO coordination Act constitute 12.5%. The outcome is significant as it shows the many different acts under which the sub-sector is registered. It also shows how difficult it may prove to regulate the sub-sector given the different laws that regulate them. There is need to harmonize the laws that regulate the sub-sector in order to apply the rules uniformly.

4.09 Satisfaction with the act

The respondents were asked to indicate if they are satisfied with the act as it is. The outcome was as shown in table 4.09 and chart 4.09 below.

Table 4.09

<table>
<thead>
<tr>
<th>Whether respondents are satisfied with the act as it is</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frequency</td>
</tr>
<tr>
<td>Valid Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
Whether respondents are satisfied with the act as it is

Whereas 62.5% of the respondents said they were satisfied with the act as it is, 37.5% of them did not. The outcome is significant as majority would like to remain operating under the law they are currently operating in. This shows that there is need to consult the players in the sub-sector before the enactment of any new law to regulate them, otherwise this may be met by resistance from the players.

4.10 Provisions for improvement

The respondents were asked to indicate if there are certain provisions they would want improved. The results were as shown in table 4.10 and chart 4.10 below.

Table 4.10

<table>
<thead>
<tr>
<th>Whether there are provisions that need improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>----------------</td>
</tr>
<tr>
<td>Valid Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
Whereas 47.5% of the respondents said there were certain provisions they would want improved, a significant number (52.5%) of them said they did not. The outcome is important as it shows many institutions are comfortable with the provisions under which they operate currently.

4.11 Groupings of microfinance

The respondents were asked to indicate under which grouping in the micro-finance bill their organizations belong and the outcome is as shown in table 4.11 and chart 4.11 below.

Table 4.11

<table>
<thead>
<tr>
<th>The groupings in the micro finance bill that the organization belong to</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Informal constituted MFIs</td>
<td>10</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td></td>
<td>Formally constituted MFIs</td>
<td>15</td>
<td>37.5</td>
<td>37.5</td>
</tr>
<tr>
<td></td>
<td>Formally constituted MFIs-Deposit taking</td>
<td>15</td>
<td>37.5</td>
<td>37.5</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
While 25.0% of the respondents said their organizations belong to informally constituted MFIs, 37.5% of them each said theirs belong to formally constituted MFIs and formally constituted MFIs – Deposit taking respectively. This outcome is significant in that 37.5 of the MFIs are deposit taking, yet not regulated to safeguard depositors’ interest.

4.12 Regulatory approach

The respondents were asked to indicate which regulatory approach would be suitable to them and the result was as shown in table 4.12 and chart 4.12 below.
Table 4.12

Regulations of MFIs may cover registration of new act, minimum reserve requirement, compliance with accounting standards, directions in respect of operations, reporting systems, and onsite inspections. The suitable regulatory approach

<table>
<thead>
<tr>
<th>Valid</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>No regulation</td>
<td>7</td>
<td>17.5</td>
<td>17.5</td>
<td>17.5</td>
</tr>
<tr>
<td>Self-regulation</td>
<td>8</td>
<td>20.0</td>
<td>20.0</td>
<td>37.5</td>
</tr>
<tr>
<td>Regulation by third party, for example AMFI</td>
<td>7</td>
<td>17.5</td>
<td>17.5</td>
<td>55.0</td>
</tr>
<tr>
<td>Regulation within an existing act</td>
<td>10</td>
<td>25.0</td>
<td>25.0</td>
<td>80.0</td>
</tr>
<tr>
<td>Establishment of an act of parliament</td>
<td>8</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Chart 4.12

Regulations of MFIs may cover registration of new act, minimum reserve requirements and compliance with accounting standards, directions in respect of operations, reporting systems, and onsite inspections. The suitable regulatory approach

The respondents had diverse views with regard to suitability of various regulatory approaches, with 17.5% of them saying regulation was not suitable, 20.0% thought self regulation would be suitable while 17.5% of the respondents said regulation by third party for example AMFI would be suitable. Majority (25.0%) thought regulation within an existing act would be suitable while 20%
4.13 Standards as traditional financial institutions

The respondents were asked to indicate if existing MFI s should be regulated within the same standards as traditional financial institutions and the result was as shown in table 4.13 and chart 4.13.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Yes</td>
<td>21</td>
<td>52.5</td>
<td>52.5</td>
<td>52.5</td>
</tr>
<tr>
<td>No</td>
<td>19</td>
<td>47.5</td>
<td>47.5</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

While majority of the respondents, (52.5%), said existing MFI s should be regulated within the existing standards as traditional financial institutions, only 47.5% of them said otherwise. This shows there is a general agreement for the need for regulation of the MFI s. This therefore shows an existing regulatory authority would appropriately regulate the MFI s.
4.14 Activities under Central Bank

The respondents were asked to indicate if the activities of their organization fall under Central Bank and the result was as shown in table 4.14 and chart 4.14.

Table 4.14

<table>
<thead>
<tr>
<th>Whether the activities of the organization fall under central bank</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Yes</td>
<td>31</td>
<td>77.5</td>
<td>77.5</td>
<td>77.5</td>
</tr>
<tr>
<td>No</td>
<td>9</td>
<td>22.5</td>
<td>22.5</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Chart 4.14

A big majority of the respondents (77.5%) said the activities of their organizations fall under central bank. The other 22.5% said otherwise. The outcome is significant in that a central regulatory authority need to oversee the operations of the MFIs. The Central Bank would be suited in regulating these institutions given that the activities of 77.5% of the MFIs in Nairobi fall under Central Bank.
4.15 Effectiveness & efficiency of MFIs

The respondents were asked if there is regular supervision of their activities to ensure effectiveness and efficiency of MFIs and the outcome was as shown in Table 4.15 and Figure 4.15.

Table 4.15

<table>
<thead>
<tr>
<th>Whether there is regular supervision of the activities to ensure effectiveness and efficiency of MFI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Figure 4.15

A big majority of the respondents (67.5%) said there are regular supervision of the activities to ensure effectiveness and efficiency of MFIs. However, (32.5%) of them did not concur. The number that did not concur may be the ones registered under other acts that do not require
supervision or the act may not provide for such. This may also be an indication that some of the MFIs may be operating business that they are not legally licensed to carry on.

4.16 Supervision of central bank

The respondents were asked to indicate if Supervision by Central Bank is required to monitor the activities of MFIs and they indicated as shown in table 4.16 and figure 4.16 below.

Table 4.16

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>28</td>
<td>70.0</td>
<td>70.0</td>
<td>70.0</td>
</tr>
<tr>
<td>No</td>
<td>12</td>
<td>30.0</td>
<td>30.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.16

A significant number of the respondents (70%) were of the opinion that supervision of central bank is required to monitor MFIs activities. The other (30%) however, thought such supervision is not
required. The outcome is significant in that since 70% is under the supervision of the Central Bank, then the other 30% can be brought on board for purposes of regulating them.

4.17 Composition of capital base

The respondents were asked to indicate the current composition of their organization’s capital base and the result was as shown in table 4.17 and chart 4.17 below.

Table 4.17

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Debt------%</td>
<td>15</td>
<td>37.5</td>
<td>37.5</td>
</tr>
<tr>
<td></td>
<td>Grants----%</td>
<td>14</td>
<td>35.0</td>
<td>72.5</td>
</tr>
<tr>
<td></td>
<td>Equity ----%</td>
<td>9</td>
<td>22.5</td>
<td>95.0</td>
</tr>
<tr>
<td></td>
<td>Others ----%</td>
<td>2</td>
<td>5.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Whereas 37.5 % of the respondents said the current composition of their capital base was debts, 35.0 % of them said it was grants while 22.5 % of them said their capital base was equity. A small
number (5.0%) cited others. The result is significant as it shows the sector thrives on borrowed funds that must be repaid. Therefore care must be taken when lending to avoid bad debts which can bring down an institution.

4.18 Extra funds

The respondents were asked if their organization require extra funds and they indicated as shown in table 4.17 figure 4.18 below.

<table>
<thead>
<tr>
<th>Table 4.18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whether the organization require extra funds</td>
</tr>
<tr>
<td>Frequency</td>
</tr>
<tr>
<td>Valid Yes</td>
</tr>
</tbody>
</table>

Figure 4.18

All the respondents admitted that their organization did require extra funds. This is an indication that all the organizations have a need to expand and the vehicle for expansion is more funds.
4.19 Assisting clients

The respondents were asked to indicate if their MFI has the ability to assist its clients achieve its objectives and the result was as shown in table 4.19 and chart 4.19 below.

**Table 4.19**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valid</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>25</td>
<td>62.5</td>
<td>62.5</td>
<td>62.5</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>37.5</td>
<td>37.5</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>40</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

**Chart 4.19**

Whether the MFI has the ability to assist its clients achieve its set objectives

A big majority of the respondents (62.5 %) said their organizations have the ability to assist their clients to achieve their set objectives. However, 37.5 % of them said theirs do not have such ability.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This chapter summarizes the major findings of the study in relation to the regulation and supervision of MFIs in Kenya. The summary is basically in relation to the objectives provided in chapter one. The chapter also discusses the recommendations, limitations of the study and suggestions for further research.

5.2 Summary of findings and conclusions.

From the analysis provided from the financial institutions, the responses highlight the findings relevant to the success of SMEs and MSEs and hence industrial development of our country by the year 2020.

Majority of the respondents were in favour of their physical location being a crucial factor in this kind of business. There are also very few MFIs who have been in existence for longer periods, most of them have not taken even more than five years in business. This suggests that they do not have rigid attitudes towards any policy or work standards. They can easily change their attitude to cope with the newly proposed regulations and supervisory activities by the Central Bank. Both the formal and informal enterprises can easily be regulated so that they become effective in terms of performance to the public. Over the last few years, they have not been doing very well.

These organizations were not having any proper functional areas. A good number don’t know the way forward. This calls for proper regulations, to assist in improving their performance. When asked about supervision, a good number seemed to be ignorant about the need for regulations and supervisions. This is why their performance has been dismal. But with the introduction of supervision, they will grow. Activities of MFIs have not been good enough. Some have been stealing people’s money and go underground for some time.
It is through supervision and regulation of the MFls that the SMEs and MSEs in Kenya would be able to grow.

5.3 Recommendations

a) The supervising authority of micro-finance institutions should be vested on the Central Bank as the study indicates that the activities of micro-finance institutions fall under central bank. The study also shows that majority of the institutions are not supervised at all. This leaves depositors exposed and they could lose their money as a result of mismanagement of these institutions.

b) Those institutions that do not meet the minimum requirements for licensing to operate as micro-finance institutions should be closed or merged to meet the capital requirement. Those that fall by the wayside after licensing should be dealt with by the concerned authority promptly to avoid further loss to depositors, creditors, and other related parties.

c) There is need for close supervision because most micro-finance institutions’ employees were found to lack requisite experience and training necessary for the running and management of micro-finance institutions. Employees in these institutions especially in lower cadre lack basic training in accounting, customer care, and marketing while the managers require such skills as planning, management skill, budgeting and controlling for effective management of these institutions.

d) Any trading entity is expected to keep proper books of accounts. For some that are registered under certain acts such as companies act and the banking act, it is a mandatory requirement to keep proper books of accounts, have in place proper control systems, maintain proper accounting systems and allow audit of their financial statements. These micro-finance institutions should be subjected to the same requirements to allow their books to be scrutinised in order to safeguard their creditors who include depositors.

e) They should be inspected regularly by way of onsite and off site inspection. Compliance with required minimum standards can only be achieved by requiring certain minimum educational
or professional qualifications for holders of certain positions in these institutions. This can be achieved through the sponsorship of employees for further studies, constant training and seminars. This will go a long way in enhancing the employees positive attitude and perceptual ability, hence better performance of micro-finance institutions.

f) Marketing seems to be low. These institutions should try to increase marketing efforts to increase awareness amongst the users, who are the entrepreneurs.

g) The government, through the ministry of finance should urgently enact the micro-finance bill that has been before parliament for several years. This will give legal authority to the supervising body to regulate the operations of the micro-finance institutions. This will ensure some institutions will not be licensed under one act and then operate in contravention of the same act. It will also put to an end the legal battles between institutions and depositors who are unable to access their own deposits.

Regulations should be there but not very stringent to allow good process change.

It is through these regulations that the performance of MSEs and SMEs or even the very informal sector would be at a promising position. The development of a country depends on the success of entrepreneurs and small business managers. Thus without proper care taken on their financial security or risks, they stand to loose and hence poor economic growth and development.

To conclude, no person or groups of individuals who indulge in business will succeed without guidelines or regulations as benchmarks for performance.

5.4 Limitations

The researcher however, notes, there were some difficulties while undertaking this research. These included:
Lack of adequate time - especially in data collection limited the researcher since he is in full time employment. The researcher tried to overcome this difficulty by hiring a research assistant to assist in data collection.

Financial difficulties: - the researcher encountered financial constraints which affected the completion of this project. The researcher however, engaged his own finances in the study.

Lack of cooperation from respondents – The management of MFI's were uncomfortable that some confidential information would be released and they would suffer some disadvantages due to this. However, the researcher assured the respondents that all the information given would be treated with utmost confidentiality.

5.5 Suggestions for Further Research

The researcher would like to suggest that further studies be carried out on this area especially to have a wide scope and include all the MFI's in Kenya. Due to limitations of time and money, the researcher could not cover all the micro-finance institutions in Kenya.

Further study need to be undertaken to evaluate the cost of supervision of micro-finance institutions to establish the cost vis-à-vis the benefits that accrue both to the micro-finance institutions and to the government.
REFERENCES


Robert, Chambers. (2003)’ Challenging the professional; frontiers for rural development.


APPENDICES
APPENDIX I

LIST OF MICRO FINANCE INSTITUTIONS IN KENYA
1. Action Aid
2. Adventist Development relief agency
3. BIMAS
4. CARE International in Kenya
5. Charity Development for family
6. Charity Development For family
7. Co-operative Bank of Kenya
8. Council of International Development pride
9. Cross bridge Credit Ltd
10. Dandora Catholic Church
11. Daraja Trust Co. Limited
12. ECLOF
13. Family Finance
14. Faulu Kenya
15. Food for the Hungry International
16. Fridrich Ebert Stiftung
17. Hope Africa
18. Horizon Kenya Co. Ltd
19. Imani Marianists
20. K - MAP: Kenya Management Assistant Programme
21. Kamukunji Sacco
22. Kenya Cats by Trust
23. Kenya Commercial Bank Special loan unit
24. Kenya Rural Enterprise Programme
25. Kenya Small Traders Society
26. Kenya Women Finance Trust
27. Micro – Kenya Ltd
28. Partnership for productivity Kenya
29. PCEA Bahati Community Centre
30. Post Bank
31. Pride Africa Drumnet
32. Pride Ltd
33. Pride Management Services Ltd
34. Pride Management services Ltd
35. Provide International
36. SISDO micro finance
37. Small Micro Enterprise Programme (SMEP)
38. Sun link
39. Undugu society of Kenya
40. Techno Serve International
41. Women enterprise Development
42. Young Women Christian Association

APPENDIX II

LIST OF COMMERCIAL BANKS IN KENYA

1. African Banking Corporation Ltd
2. Akiba Bank Ltd
3. Bank of Baroda (K) Ltd
4. Bank of India
5. Barclays Bank of Kenya Ltd
6. CFC Bank Limited
7. Chase Bank (Kenya) Ltd
8. Charterhouse Bank Ltd
9. Citibank N.A
10. City Finance Bank Ltd
11. Commercial Bank of Africa Ltd
12. Consolidated Bank of Kenya Ltd
13. Co-operative Bank of Kenya Ltd
14. Credit Agricole Indosuez
15. Credit Bank Limited
17. Development Bank of Kenya Ltd
18. Diamond Trust Bank Kenya Ltd
19. Dubai Bank Kenya Limited
20. Equatorial Commercial Bank Ltd
21. Fidelity Commercial Bank Ltd
22. Fina Bank Limited
23. First American Bank of Kenya Ltd
24. Guardian Bank Limited
25. Giro Commercial Bank Limited
26. Habib Bank A.G Zurich
27. Habib Bank Ltd
28. Imperial Bank Ltd
29. Industrial Development Bank Ltd
30. Investments & Mortgages Bank Ltd
31. Kenya Commercial Bank Ltd
32. K – Rep Bank Limited
33. Middle East bank Kenya Ltd
34. National Bank of Kenya Ltd
35. National Industrial Credit Bank Ltd
36. Paramount – Universal Bank Ltd
37. Prime Bank Ltd
38. Southern Credit Banking Corp. Ltd
39. Standard Chartered bank (K) Ltd
40. The Delphis Bank Ltd
41. Trans-National Bank Ltd
42. Victoria Commercial Bank Ltd

LETTER

LAWRENCE K. RWERIA
P.O Box 61205 (00200)
NAIROBI.

Dear Respondent,

REQUEST TO FILL THE QUESTIONNAIRE FOR RESEARCH PURPOSE

This is to request you to kindly fill in the attached questionnaire for research purpose.

The research focuses on the need for regulation of micro finance institutions in Kenya with a special reference to some selected micro finance institutions in Nairobi. The information sought from you will be treated with utmost confidence, and results of this study will be available for your use/reference.

Thank you,

Yours sincerely,

LAWRENCE K. RWERIA
APPENDIX VI

QUESTIONNAIRE

1. Name of organization__________________________________________

2. Company age profile (years). Please tick cross in the box next to the correct answer.
   - [ ] Less than 1 year
   - [X] 1-5 years
   - [ ] 6 – 9 years
   - [ ] More than 10 years

3. No. of years served?
   - [ ] 0 – 2 years
   - [ ] 2 – 4 years
   - [ ] 4 – 6 years
   - [ ] Over 6 years

4. Gender
   - [ ] Female
   - [X] Male

5. How is the overall performance of your MFI rated? Tick one:
   - [ ] Good
   - [ ] Fair
   - [ ] Poor

6. Do you think performance is affected by regulatory framework?
   - [ ] Yes
   - [ ] No

7. If yes, to what extend?
   - [ ] Very great
   - [ ] Great
   - [ ] Moderate
   - [ ] Low extend
   - [ ] Very low extend
8. Which Act does your MFI fall in?
   - The Sacco Act
   - The Banking Act.
   - Kenya Post Office Savings Act
   - Co-operative Act
   - NGO Coordination act
   - Companies’ Act
   - Companies limited by guarantee Act
   - Trust Act
   - Other (Specify)

9. Are you satisfied with the Act as it is?
   - Yes
   - No

10. Are there certain provisions you want improved?
    - Yes
    - No

11. If yes, which provisions do you want to be approved? Please specify.

12. In which of the following groupings in the micro finance bill does your organization belong to?
    - Informally constituted MFIs
    - Formally constituted MFIs
    - Formally constituted MFIs – Deposit taking
      
      *(Please tick the relevant box)*

13. Regulations of MFIs may cover registration of a new Act, minimum reserve requirements and compliance with accounting standards, directions in respect of
operations, reporting systems, and onsite and in-site inspections. Which regulatory approach would be suitable to your organization

- No regulation
- Self-regulation
- Regulation by third party for example AMFI
- Regulation within an existing Act
- Establishment of an act of Parliament
- Others. (Please specify)

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

- Yes
- No

15. If No, why do you think MFI’s should be treated differently

16. Suggest recommendations on a regulatory framework?

17. Do the activities of your organization fall under central bank?

- Yes
- No

18. If yes, is there regular supervision of the activities to ensure effectiveness and efficiency of MFI?

- Yes
- No

19. Do you think supervision of Central Bank is required to monitor MFI activities?

- Yes
- No

20. Suggest and recommend on areas that require supervision
21. What is the current composition of your organization’s capital base?
   - Debt--------%
   - Grants-------%
   - Equity--------%
   - Others--------%

22. What is your organization's financial year?
   Beginning (DDMMYY)______________________________
   End (DDMMYY)______________________________

23. Does your organization require extra funds?
   - Yes
   - No

24. Do you think the MFI has the ability to assist its clients achieve its set objectives?
   - Yes
   - No

25. Is there anything you would like to add on the above topic?
   - Yes
   - No

26. If yes, please specify_________________________________________________________

Thank you for your time.