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The Kenya Rural Enterprise Program:

Directing Credit to Low-Income Groups

The lack of credit facilities in Kenya's rural areas is a significant obstacle to building a sustainable rural financial market. A recent estimate placed the gap between the level of credit supplied and the effective demand for credit at some Ksh. 57 billion. The Government of Kenya has , since the early 1990s, shown an interest in the development of small-scale and micro-enterprises. It has been aided in this effort by assistance from donors such as the World Bank, UNDP, ODA, USAID, the European Union, Ford Foundation and CIDA. Further, Kenya's own commercial banking sector has started focusing on micro-enterprises and two of the major banks, the Kenya Commercial Bank and Barclays Bank have developed credit schemes in this regard.

The Kenya Rural Enterprise Program (K-REP) was established in 1984 as an intermediary NGO, providing credit for on-lending and technical assistance to other NGOs. To promote growth and generate employment in the micro-enterprise sector, K-REP lends to clients who would otherwise find it extremely difficult to access credit from commercial banks and other formal financial institutions. Its operations are currently concentrated in Nairobi, Nyeri, Eldoret and Embu. *Kenya Rural Enterprise Program: Case Study of a Micro-Finance Scheme* documents K-REP's innovations and performance, and provides some insight on how to improve micro-finance programs.

Access and Outreach

After beginning operations in 1984, K-REP experienced limited success using an integrated model of credit delivery. By 1989, the K-REP Board of Directors reduced the number of

NGOs under assistance and promoted a minimalist lending program which focused on providing credit without training and technical assistance. However, K-REP has maintained most of its original activities--namely, support to NGOs, research, evaluation, innovation, information dissemination and consultancies--and has added a direct lending program. Increasingly, K-REP focuses on efficient credit delivery and overall sustainability.

Currently, K-REP offers credit directly through group lending and indirectly through other NGOs. Its Juhudi Scheme, initiated in 1989, provides individual loans based on a modification of the group lending methodology used by the Grameen Bank in Bangladesh. K-REP facilitates the formation of five-member groups called watanos. Up to six watanos confederate into a kiwa, which is registered by the Ministry of Culture and Social Services as a self-help group. The Chikola Scheme, initiated in 1991, provides credit to individual entrepreneurs through existing rotating savings and credit associations (ROSCAs). Under the Chikola Scheme, K-REP provides a single loan to an established group (average membership of 20 persons) that retails the loan to its individual members. After a Juhudi group has been in existence for some time, it may seek approval to transform into a Chikola group. Additionally, K-REP maintains a wholesale credit facility for selected NGOs, which on-lend to their clients using the Juhudi methodology. However, K-REP has also combined the Juhudi and Chikola schemes at the area field office levels and separated the administration of sustainable (micro-enterprise lending) and non-financial services.

With the exception of the Nairobi city offices, all area offices serve rural and urban clientele. The operating target for an Area Credit Office is 1,800 clients. Direct individual borrowers have grown in number, climbing from 1377 in 1991 to 15,014 in 1995. Overall, micro-enterprise finance serves primarily commerce, trade, manufacturing and service sectors.

Member savings increased from Ksh 2.4 million in 1991 to Ksh 55.3 million in 1995. The number of active savers went from 2,337 in 1991, to 5,429 in 1993 and 15,014 in 1995, growing most rapidly over the period 1993-1994 when the Chikola Credit Scheme was expanded. Member savings are required in order to borrow from K-REP, and before becoming eligible to borrow, clients are required to save a minimum of 10% of the loan. This has helped to raise the volume of savings deposits as the number of borrowers and loan volume increase.

The K-REP methodology benefits client groups in several ways. Clients expand their businesses and employ more people. Clients are also introduced to the banking system and their productive activity is integrated into the formal financial system. Further, K-REP involves clients in making major decisions, such as loan approvals, and in improving the schemes.

Financial Performance

K-REP has depended on donor funding for on-lending and institutional support. During the period 1991-1995, K-REP received Ksh 352 million in grants. Total assets increased from Ksh 66 million to Ksh 377 million.

Lending as a proportion of total assets has also increased, from about 50% of total assets in

1991 to 67% in 1995. This reflects greater direct lending to members of the Chikola Scheme. The volume of outstanding direct loans has climbed from Ksh 32.5 million in 1991 to Ksh 294 million in 1995. Growth can be attributed to several sources, including: more branch offices, greater efficiency in credit delivery and additional staff trained in group-lending methods.

Arrears and defaults on loans have generally been maintained at a low level until recently. In the Juhudi Scheme, arrears and defaults stood at about Ksh 4.4 million in 1993 and at Ksh 23.6 million in 1995. The Juhudi Scheme has recorded an average repayment rate between 96% to 99% during 1991-1993. In 1995 the Juhudi repayment rate was reported to be 97%. The Chikola Scheme experienced a repayment rate of 99% in 1991. During 1994 and 1995 the repayment rate for Chikola loans fell to about 90%, due primarily to problems at one branch.

The objective of donors and K-REP management is to achieve increased sustainability. But, since financial and nonfinancial services have not been administratively separate until recently, K-REP's full progress has not been easy to measure since each type of service varies in costs, revenues and sustainability. Nevertheless, while total income (excluding grants) covered only 59% of total operating expenses in 1991, this increased to 88% in 1994 and 98% in 1995. Overall, revenues generated through lending and investing activities are beginning to approach levels that could eventually make K-REP self-sustainable.

The Subsidy Dependence Index (SDI) for combined operations of K-REP, which measures the relationship between net subsidies received and earnings on the loan portfolio, fell significantly from 1105 in 1992, to 420 in 1994 and 74 in 1995 (using the rate of inflation plus 2% as the market cost of funds). This improvement comes in part from an increase in the average yield on earning assets, reduced inflation and improvements in expense control.

Innovations and Lessons Learned

Increasingly, K-REP takes the approach that it must charge interest rates sufficient to cover operating and financial costs. Therefore, it has begun to transform its financial services into a bank that will provide access to deposit funds available in the areas it serves. Grants and subsidized loans may be justified to start and strengthen operations, but the strategy is to decrease dependence on them over time.

The K-REP methodology has been affected by declining repayment rates in the Juhudi Scheme at Kibera and the Chikola Scheme at Nyeri. In each instance, management has sought to give more direction to the formation and administration of groups.

The Chikola Scheme offered the advantage of tapping into existing groups of entrepreneurs with existing businesses, who needed additional access to credit. Since those groups and their businesses already existed, K-REP could minimize the transaction costs of delivering credit, sidestep the problems and costs of forming cohesive groups and increase outreach through group-based lending.

However, in 1995 when several groups in the Nyeri Branch did not exhibit the required solidarity and repayment rates declined unacceptably, K-REP understood that the Chikola groups required a longer gestation period and needed to pass the same tests of cohesiveness applied to the Juhudi groups. Now, the credit officer evaluates the cohesiveness and stability of the group prior to extending credit and may extend loans on a different sequence, with faster or slower disbursement.

In order to properly address the default issue, K-REP management studied the underlying causes of non-repayment. Some institutional practices were found to contribute to default such as subsidized interest rates and credit programs associated with other social welfare services. Additionally, delegating credit assessment to the groups yields poor results since group members are not objective regarding their colleagues. Bad screening of potential borrowers by the credit officer and bad appraisal of the investment also increase the default rate. The use of group member savings as collateral may also cause default as borrowers do not like to forfeit their savings on account of their peers. Other major factors that may cause default are theft or destruction of business assets, mismatch between loan size and expected income flow, diversion of loan purpose, fraud and death or sickness.

Client input is necessary to assess performance and to formulate institutional policy. Through client interaction and internal research and evaluation, K-REP has pursued innovations to provide greater access and outreach, lower intermediation costs and better prospects of sustainability. Some of the more promising innovations that K-REP has adopted, such as more flexible loan size and increased group meeting frequency, surfaced initially through interactions with Juhudi borrowers.

K-REP has also implemented a monitoring system that identifies appropriate operating and financial performance indicators and feeds the resulting information back into its operations.

To achieve sustainable growth and increased client outreach, K-REP will need to focus on the following.

- Improve its Management Information System.
- Develop simple but comprehensive processes and instruments to guide its lending operations.
- Identify alternative forms of collateral and ways to incorporate that collateral into its lending schemes.
- Further refine the Juhudi and Chikola schemes on the basis of client inputs.
- Develop different methodologies and varied loan terms to deal with the larger loans needed by micro-enterprises that need such loans
- Devise ways to access funds from the financial markets, rather than relying on donor funds.
- Further develop its intermediary role so that it can provide a more complete set of financial services to micro-enterprises.

There is a general consensus among clients, especially the smaller businesses, that credit from K-REP has resulted in improved incomes, increased output and growth in their businesses. However, the estimated number of micro-enterprises in Kenya is approximately 900,000, of which K-REP reaches some 1.5%. Given that K-REP is the country's largest single microfinancing institution, the potential for growth is considerable.

Note : Since the value of the Kenyan shilling to the US dollar varied considerably over the years referred to in this article, an indicative figure of Ksh 50 to 1 US$ could be used.

Glenn D. Pederson and Washington K. Kiiru. 1996. *Kenya Rural Enterprise Program: Case Study of a Micro-Finance Scheme*. Micro-Finance Series, AFTE1, Africa Region, Washington, D.C.: World Bank.. For further information, please contact Ms. Shimwaayi Muntemba, Rm. J3-101, World Bank, 1818 H Street NW, Washington, D.C. 20433. Tel. no. : (202) 458-7370. On the Internet, contact pmohan@worldbank.org

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