PD-AAN-555

ISN: 32600

KENYA

RURAL PRIVATE ENTERPRISE

615-0220

PROJECT PAPER

August 11, 1983

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: ____ — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: KENYA

3. PROJECT NUMBER: 615-0220

4. BUREAU/OFFICE: AFR — 06

5. PROJECT TITLE (maximum 40 characters): RURAL PRIVATE ENTERPRISE

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 03, DD 31, YY 89

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 83 — B. Quarter 4 — C. Final FY 84

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 83 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	7,030	7,570	14,600	17,200	18,800	36,000
(Grant)	(1,230)	(1,770)	(3,000)	(5,200)	(6,800)	(12,000)
(Loan)	(5,800)	(5,800)	(11,600)	(12,000)	(12,000)	(24,000)
Other U.S. 1.						
Other U.S. 2.						
Host Country	-	12,100	12,100	-	26,000	26,000
Other Donor(s)						
TOTALS		19,670	26,700	17,200	44,800	62,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPRO-PRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) FN	260B	111	150	-	-	3,000	11,600	12,000	24,000
(2)									
(3)									
(4)									
TOTALS									

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 840, 819

11. SECONDARY PURPOSE CODE: 270, 730

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BL	PVOU	PVON				
B. Amount	36,000	6,500	4,500				

13. PROJECT PURPOSE (maximum 480 characters)

To establish and expand rural private enterprise in Kenya.

14. SCHEDULED EVALUATIONS
Interim: MM 06, YY 86 — MM __, YY __ — Final: MM 07, YY 88

15. SOURCE/ORIGIN OF GOODS AND SERVICES
☐ 000 ☐ 941 ☐ Local ☒ Other (Specify) 935

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY
Signature: M. Peter McPherson
Title: Administrator
Frank B. Kimbell (for McPherson)
Date Signed: MM 8, DD 11, YY 83

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM __ DD __ YY __

AID 1330-4 (8-79)

RURAL PRIVATE ENTERPRISE
(615-0220)
PROJECT PAPER

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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

PROJECT AUTHORIZATION

Name of Country/Entity:	Republic of Kenya
Name of Project:	Rural Private Enterprise
Number of Project:	615-0220
Number of Loan:	615-T-020
Number of Grant:	615-0220

1. Pursuant to Section 103 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Rural Private Enterprise Project for the Republic of Kenya (the "Cooperating Country") involving planned obligations of not to exceed $24,000,000 in loan funds and $12,000,000 in grant funds over a two year period from the date of authorization subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is 5 years and 8 months from the date of initial obligation.

2. The project provides: loan funds to intermediate credit institutions for lending to rural private enterprises; grant funds for technical and management assistance and training to rural entrepreneurs; grant funds to private voluntary organizations for financial management, technical and training assistance to small scale enterprises and enterprise groups; grant funds for project monitoring and evaluation.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

4. (a) Interest Rate and Terms of Repayment:

The Cooperating Country shall repay the loan to A.I.D. in U.S. Dollars within forty (40) years from the date of first disbursement of the loan, including a grace period of not to exceed ten (10) years. The Cooperating Country shall pay to A.I.D. in U.S. Dollars interest from the date of first disbursement of the loan at the rate of (a) two percent (2%) per annum during the first ten (10) years, and (b) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the loan and on any due on unpaid interest accrued thereon.

(b) Source and Origin of Commodities, Nationality of Services:

Commodities financed under the loan shall have their source and origin in Kenya or in countries included in A.I.D. Geographic Code 941 except as A.I.D. may otherwise agree in writing. Commodities financed under the grant shall have their source and origin in Kenya or the United States except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of loan-financed commodities or services shall have Kenya or countries included in A.I.D. Geographic Code 941 as their place of nationality, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, suppliers of grant-financed commodities or services shall have Kenya or the United States as their place of nationality except as A.I.D. may otherwise agree in writing.

Ocean shipping financed by A.I.D. under the project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States for grant-financed commodities or of Kenya or countries included in A.I.D. Geographic Code 941 for loan-financed commodities.

(c) Conditions Precedent to Disbursement:

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement, the Cooperating Country shall, except as A.I.D. may agree otherwise in writing:

1. Establish a Special Account at the Central Bank of Kenya into which bank repayments will be made;

2. Identify the officer in the Central Bank of Kenya who will be responsible for administering the Special Account.

(d) Condition Precedent to Additional Disbursement:

Prior to any disbursement or the issuance of documents under the Project Agreement to finance any subloans to banks, the Cooperating Country shall furnish in form and substance satisfactory to A.I.D. a copy of the subloan agreement with said bank, together with all supporting documentation leading to selection and financing of said banks.

(e) Covenants

The Cooperating Country shall covenant in substance; that it will:

1. Process expeditiously all project-related import and foreign exchange approvals;

2. Provide all necessary personnel to ensure the effective management of the Special Account at the Central Bank of Kenya.

3. Include in subloan agreements to banks, a covenant which requires such banks to ensure compliance with Cooperating Country Environmental rules with respect to any projects financed by such bank.

4. Require all repayments made to it by the recipient banks, less the payments necessary to service the A.I.D. loan, be relent to banks for additional subloans for the same project purposes.

(f) Waivers

The following waivers to A.I.D. regulations are hereby approved:

1. A waiver of A.I.D. source and origin requirements for up to $12 million of loan-financed commodities and commodity-related services from A.I.D. Geographic Code 941 and the Cooperating Country to A.I.D. Geographic Code 935 and the Cooperating Country.

   I hereby certify that exclusion of procurement from free world countries other than the cooperating country and countries included in Code 941 would seriously impede attainment of U.S. foreign policy objectives and objectives of the foreign assistance program.

2. A waiver to expand the flag eligibility requirements to allow financing of transportation costs of vessels under Code 935 flag registry for procurements made from Code 935 countries other than the U.S. I hereby certify that the interests of the United States are best served by permitting financing of transportation services on ocean vessels under flag registry of free world countries other than the Cooperating Country and countries included in Code 941.

Frank B. Kimball
M. Peter ~~McPherson~~ for

Date Aug 1, 1983

Clearances:
GC/AFR: TBork for John R. Clyne
GC: RDerham
AFR/PD: LHausman (Draft)
DAA/AFR: GPatterson
M/SER/COM: PHagan (Draft)
A/AA/PPC: RDerham
A/AA: ARLove

I. SUMMARY:

The purpose of the 5-year $36 million Rural Private Enterprise Project (615-0220) is to establish and expand rural private enterprises[1/] in Kenya. Achievement of this purpose will directly contribute to fulfillment of the Government of Kenya and USAID top goal of increased rural production, employment and income. Project objectives will be attained through the provision of credit and technical assistance to commercial banks[2/] active in Kenya who will in turn make loans and provide business advice to entrepreneurs. The project will also provide grants to PVO's who will provide business management advice and extend loans to small-scale entrepreneurs.

Per capita availability of good agricultural land in Kenya is currently estimated to be 0.6 hectares. In heavily populated areas it is less than 0.4 hectares. Kenya falls somewhere between India and China in terms of cropped land per capita. Given the relatively constrained agricultural land base, small holders currently earn more than 40% of their income from off-farm activities. With a population growth rate of approximately 4% and a labor force which is projected to increase from 7.3 to 15.7 million by the end of the century, it is imperative that Kenya expand off-farm employment and income-generating opportunities dramatically over the next 20 years. It is the strategy of this project to help expand those opportunities through accelerated development of private enterprises located in rural areas and other businesses with strong backward and forward linkages to agriculture.

The proposal for the Rural Private Enterprises project results from the convergence of several complementary trends. First, a growing and accelerating awareness on the part of the Kenya Government and USAID that the private sector is the best means to attain many development objectives has led to an increasing emphasis on the need to use private sector entities as development agents. Second, AID's private sector policy initiative has brought increased attention and expertise to bear on the potential ways and means to use the private sector to attain development objective. In the case of Kenya the local

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1/ Defined for purposes of this project as businesses with strong backward or forward linkages to agriculture, wherever located, and other business located outside Nairobi and Mombasa.

2/ Or finance companies which are part of a commercial bank group.

manifestation of this initiative was development of the PRE Kenya Commercial Bank (KCB) project which in many ways has served as the prototype for this project. Finally, USAID has gained substantial experience with the smallest rural entrepreneurs over the last few years through grants to private voluntary organizations. This experience has demonstrated the need to provide business and management advice as well as credit to small-scale businesses if they are to flourish and become self-sustaining contributors to rural private sector development.

Project costs are estimated as follows:

SUMMARY PROJECT COST ($ 000)
(L-Loan Funds, G-Grant Funds)

	AID	Commercial Banks	Private Sector	PVO	Total
1. Loans to subborrowers	24,000(L)	24,000			48,000
2. Business Advisory Services	400(G)	200			600
3. Management & Technical Assistance	2,866(G)		464		3,330
4. PVO Management & Loan funds	6,468(G)		87	1,085	7,640
5. Monitoring, Evaluation & Special studies	1,150(G)				1,150
6. Contingencies (10%) Grant funds only	1,116(G)	20	55	89	1,280
Total:	24,000(L)	24,000			48,000
	12,000(G)	220	606	1,174	14,000
Grand Total	36,000	24,220	606	1,174	62,000
	58%	40%	1%	1%	

II. PROJECT RATIONALE AND DESCRIPTION:

A. Rationale:

1. Description of the Problem and Alternatives:

The principal problem to be addressed by the project is the need to expand employment and income-generating opportunities in rural areas. The traditional approach to resolution of this problem has been to try to increase agricultural production (and thus rural production, employment and income) through various government to government projects directed to research, extension, rural roads and long-term training.

Kenya's high ratio of population to arable land now mandates increased off-farm employment and expansion of private enterprise as essential steps toward an improved standard of living for the four-fifths of Kenyan's population that lives in rural areas. Consequently this project will emphasize off-farm and non-governmental activities. The project will also address in part the needs for increased markets for agricultural production, for better agricultural input and marketing services in rural areas, and for stimulation of investment in the export sector in order to redress Kenya's current balance of payments deficit and lay the groundwork for self-sustaining economic growth. Alternative approaches are three: rural versus urban, farm versus off-farm, and public versus private sector. The reasons for the emphasis on rural, off-farm, private sector activities are discussed briefly below.

Although numerous employment generating investment opportunities exist in urban areas, USAID's overall country development strategy focuses on rural areas as the key to equitable, long-term, self-sustaining growth. In accordance with this strategy, this project also focuses on rural areas, with the exception that agribusinesses (defined as businesses having strong backward or forward linkages with agriculture) are included in the target group even if they are located in urban areas because of the multiplier effect of investment in agribusinesses on agricultural production.

The limitation of project activities to the off-farm sector is based first on the substantial current and planned U.S. and other donor involvement with on-farm production activities, second on the fact that implementation intermediaries appropriate for on-farm activities are different from those directed toward off-farm production, and third on the fact that ample agricultural credit is available through the Agricultural Finance Corporation.

The case for choosing a private sector approach is influenced by the fact that Kenya's long history of public investment has most often been unprofitable. Although such investments can provide employment, the cost is high since productivity tends to be low and Government subsidies are often required.

2. Host Country Priorities:

Kenya's 1979-83 Development Plan, now coming to a close, has emphasized measures to promote economic growth and smallholder agricultural production, with particular attention to equitable income distribution. Problems of income distribution and poverty were to be addressed primarily through efforts to increase opportunities for productive employment and broaden access to basic social services. It is becoming clear that the

Kenyan strategy being formulated for the 1983/84 - 1987/88 planning period recognizes both the serious resource constraints of the public sector and the comparative advantage of the private sector in managing and mobilizing capital. This approach, emphasizing use of private sector resources to further national development goals, also addresses directly two of the most severe constraints to current government development efforts: the growing burden of recurrent expenditure and the strained capacity to implement programs effectively.

Major policy decisions contained in Sessional Paper No. 4 of 1982 reflect a planned reduction in Government expenditures as a percent of GDP, and an overall reduction in the Government deficit. The budget deficit was reduced from 9.5 percent GDP in 1980/81 to less than 5 percent in 1982/83. Such a sharp reduction was attained by cutting the Development Budget while allowing the Recurrent Budget for a time to grow more rapidly than expenditures overall.

The reduction in Government's share of GDP and the restrictions on expenditures for new projects in the Development Budget reflect a shift in priorities toward private sector activities that fully supports the basic approach adopted in AID's proposed Rural Private Enterprise project. To quote from the summary of Sessional Paper No. 4:

> "The need to contain Government expenditure in the years immediately ahead inevitably means that public sector employment opportunities will grow more slowly than in the recent past. But this is not the whole picture. As Government's requirements for domestic credit diminish, more credit can be made available to the private sector. Private sector activity should increase more rapidly than it otherwise could and employment opportunities in the private sector should also expand".

Government policies contained in Sessional Paper No. 4 of 1982 are expected to be implemented soon. USAID dialogue with Government indicates that the major themes of the Sessional Paper will be fully reflected in the more comprehensive Five Year Plan for 1983/84 - 1987/88. The proposed Rural Private Enterprise Development project which is designed to provide loan funds and business advisory services to private borrowers through the commercial banks and PVO's is timed to demonstrate rapid and flexible U.S. response to the Kenya Government's increasing commitment to private sector initiatives and market-oriented solutions to difficult development problems.

3. Other Donor Activities:

The Government of Kenya with the assistance of other donors has established a network of institutions to promote industrial development and employment. Each of the major institutions concentrates on special market segments. Two institutions, the Industrial Development Bank (IDB) and the Industrial and Commercial Development Corporation (ICDC), deal almost exclusively with larger scale enterprises. Average loan sizes in 1981 were 700,000 U.S. dollars or more. The Development Finance Corporation of Kenya (DFCK) which often deals with somewhat smaller firms, had an average 1981 loan size of 250,000 U.S. dollars. The programs of Kenya Industrial Estates (KIE) have focused on the smallest entrepreneurs and have provided the highest level of technical assistance as well as a significant level of operating subsidies. Although KIE's programs have focused on the smallest entrepreneurs as a matter of highest priority, KIE's average loan size was more than 55,000 U.S. dollars in 1981, and more than 115,000 U.S. dollars in 1980. The USAID strategy of expanding the capability and outreach of the commercial banking system to assist rural enterprises has been previously exploited only by the International Finance Corporation under two agreements with the Kenya Commercial Bank (KCB). A successful pilot project between the IFC and KCB during 1977/78 totaling 2 million U.S. dollars led to a follow-on project signed in 1981 totaling 8 million U.S. dollars. This second project is now also under successful implementation.

As of December 31, 1981, thirteen other major bilateral and multilateral donors had commitments outstanding of 132 million U.S. dollars for 24 on-going projects to assist industrial development in Kenya (See Table II.A.1). Four donors were providing assistance of nearly 70 million dollars under five projects with the Industrial Development Bank (mostly for on-lending to medium and large scale industries). There was one on-going project for 2 million U.S. dollars between the Netherlands and the DFCK to enable the latter to operate a low-interest credit scheme for small scale entrepreneurs. Also at the small end of the scale, five donors had outstanding commitments of 44 million dollars to Kenya Industrial Estates under seven on-going projects, some dating from the Mid-1960's.

TABLE II.A.1

KENYA: OTHER DONOR COMMITMENTS FOR INDUSTRIAL DEVELOPMENT OUTSTANDING, AS OF DECEMBER 31, 1981

Country	Number of Projects	Commitment Outstanding (1000 U.S. Dollars)
Bilateral:		
Austria	1	918
Germany	4	27,667
Netherlands	2	3,423
India	1	13,559
Norway	2	3,774
Sweden	1	4,650
Multilateral:		
ADB	1	5,800
EEC	1	885
IBRD	3	60,000
OPEC	1	5,300
UNDP	5	6,133
UNIDO	2	65
TOTAL	24	132,194

Source: UNDP, Compendium on Development Assistance to Kenya as at 31 December, 1981.

Although large scale projects in Kenya can in all probability absorb significant additional resources, project identification and project economic analysis must be improved significantly if such resources are to provide an adequate return and expand employment opportunities. Donor resources available to assist the smallest scale entrepreneurs through government-run programs appear to exceed present absorptive capability as indicated by the poor results achieved. The amount of donor assistance flowing through KIE, for example already exceeds KIE's ability to absorb resources. As of August 31, 1982, 65 percent of KIE loans were in arrears and arrearages were equivalent to more than one-fifth of the value of loans outstanding. The level of donor assistance already flowing toward the smallest scale entrepreneurs, and the degree of success achieved so far, suggest the need for the introduction of innovative approaches and new mechanisms to increase outreach to small and medium scale entrepreneurs especially in rural areas.

The United States is a relatively late comer to the field of rural private enterprise development in Kenya as compared to some other donors. Design of U.S. programs can profit from evaluation of the efforts of others and avoidance of duplication. One lesson learned is that government loans in Kenya are often perceived as gifts. Another is that continuing government subsidies can become a crutch to those who will never in fact be successful entrepreneurs, but will continue to drain resources away from those who have real potential. A third lesson is that the entrepreneur must have substantial personal and financial commitment to the success of his enterprise. Finally, there must be an apolitical, on-the-spot institution capable of assessing such commitment and determining overall risk. Each of these lessons has been applied in the design of the Rural Private Enterprise project.

4. Relation to the CDSS:

The USAID/Kenya Country Development Strategy Statement for the period 1983/87 is structured around three development objectives: (1) increased rural production, employment and income; (2) reduced population growth; (3) efficient delivery of basic social services. USAID emphasis on increased rural production (farm and off-farm) is based both on equity considerations and on the realization that full employment of Kenya's rapidly growing labor force, and intensive utilization of Kenya's limited amount of good agricultural land, call for an integrated program of investment in a wide variety of agricultural, forestry, processing, manufacturing, and service activities in rural areas. The proposed Rural Private Enterprise project is designed to contribute to the goal of increased rural production by providing rural entrpreneurs of various sizes with a package of medium and short-term credit, business advisory services, and technical assistance provided by banking institutions with extensive rural branch networks and by PVO's.

Kenya's estimated 1981 population of 17.5 million is growing at an annual rate of more than 4 percent. The country's labor force is expected to rise from 6.1 million persons in 1978 to 15.7 million by the end of this century. Only 18 percent of Kenya's land is classified as having high or medium potential for agriculture while more than four-fifths of the country's land is classified as arid and semi-arid. Availability of high and medium potential land per capita has fallen from .9 hectares in 1969 to .6 hectares in 1979, and will fall to .4 hectares by 1989. Given such an analysis, the current CDSS focuses specifically on assisting small farmers with low incomes and on the rural landless.

The small farm is the dominant mode of agricultural production in Kenya accounting for 49 percent of recorded farmland, 52 percent of marketed production, 70 percent of value-added in agriculture, and 80 percent of agricultural employment. A major portion of planned USAID development expenditure is directed at providing the smallholder with access to the inputs, technology and marketing opportunities that are necessary for economic viability. Nevertheless an increasing number of rural residents, although nominally classified as small farmers, already receive a significant proportion of their total income from off-farm sources. Off-farm income on average accounted for 43 percent of small farm incomes recorded in the 1974/75 Integrated Rural Survey. Subsequent studies have shown that a significant connection exists between the availability of cash income (important for access to credit and for purchases of inputs) and increases in agricultural innovation and productivity among smallholders. Cash sales to rural markets, co-operatives, and processors, together with off-farm employment, have thus become integral aspects of "progressive" smallholder production in Kenya. Such trends will become increasingly important as the per capita availability of good agricultural land continues its rapid decline. Moreover, Integrated Rural Survey data for 1976/77 indicate that some 14 percent of households surveyed did not own land within the areas in which they were enumerated. Although some of these families might have had landholdings in other areas, it is likely that the majority were landless. The landless poor represent a particularly difficult sub-group to reach without a general increase in economic activity and employment in rural areas of the type which the proposed Rural Private Enterprise Project is designed to produce.

5. Relevant Experience with Similar Projects:

(a) Private Enterprise Bureau (PRE) Project:

In January, 1983, AID and the Kenya Commercial Bank/Kenya Commercial Finance Company signed a $2,500,000 loan and $250,000 grant agreement to finance the development of rural private enterprises. Conditions precedent to first disbursement were met in April 1983 and the first four loans were approved in June. PRE is now establishing a Letter of Commitment of U.S.bank to permit disbursement of the first tranche of funds for those four loans. The approved loans are:

Applicant	Location	Project	KSh
Arkay Industries Ltd	Eldoret	Edible Oil Manufacturers	1,500,000
Ima Hauliers Ltd	Kisumu	Sugar Cane Transporters	1,000,000
Macithi Trout Farm Ltd	Nyeri	Trout Farming	1,735,000
Kenby Cables, Ltd.	Kisumu	Cable Manufacturers	1,500,000
			5,735,000

Several points may be noted concerning those first loans. First, although the maximum loan size permitted under the project is KSh 6,500,000, the largest approved loan is less than one-third that amount. Second, three of the four loans are in the poorer, Western regions of Kenya and none are in Nairobi or Mombasa, even though agribusiness investment is allowed in those cities under the terms of the agreement. Although those four projects cannot be taken as a true sample of what may occur under the proposed Rural Private Enteprise Project, they do demonstrate that commercial bank lending does not necessarily take place at the maximum leading limit in the metropolitan centers.

(b) Private Voluntary Organization Assistance to Small-Scale Enterprises:

USAID's principal previous experience in the rural private enterprise sector is grant assistance to PVOs in Kenya providing management assistance and loans to small-scale entrepreneurs. This assistance consists of the following elements:

(1) The Self-Help Enterprise Development (Project 615-0208) is a $500,000 activity designed to create and strengthen enterprises - mainly among group ranches, cooperative savings groups and private voluntary organizations, through provision of technical and managerial assistance.

(2) Maseno South Enterprise Development (Project 615-0226) is a $500,000 church-based grant which is designed to provide management assistance, training and credit for self-sustaining small group development activities in Nyanza Province, Western Kenya.

(3) Partnership for Productivity (PFP) has received USAID assistance in the past to develop a Rural Enterprise Extension Service (REES) for small-scale entrepreneurs in Western Kenya. Currently PFP is broadening the scope of its Rural Enterprise Extension Program and has two small grants from AID: $125,000 for a Women in Development activity (Project 698.0388.15) and $150,000 for a Law in Development activity (Project 615-0209). Both of these grants are being used by PFP to improve the legal basis for both individual and group entrepreneural activity, particularly among women.

(4) The Small-Scale Enterprise grant (Project 698-0410.32), of $275,000 supports the National Christian Council of Kenya which is primarily an urban-based activity. The purpose of the grant is to strengthen and expand the capability of the NCCK to provide technical assistance and credit facilities to selected incipient (Small Scale) business persons through its urban community improvement program in the secondary cities.

(5) A number of centrally funded activities promote business activity among small groups and small scale entrepreneurs in Kenya. The Institute for International Development for example is providing technical assistance and credit funds to a predominantly church-based business service in Central Kenya (with an office in Nakuru) and World Education Incorporated is providing assistance to income-generating women's groups in the Kenya Coast area.

In general, USAID has been pleased with the progress made in developing the capabilities of small-scale entrepreneurs through the above-described activities. Two concerns arise, however. First, although the PVOs as a group seem able to provide needed technical assistance at unit costs well below those of large scale government programs, the costs per loan are still high in percentage terms. The second concern is that the PVOs are approaching their management limits. To channel dramatically increased funding through these organizations at this time could overtax their administrative capacity at the expense of the quality of their work. USAID's conclusion is, however, that this group of PVOs could be supported at somewhat higher levels since they have demonstrated the ability to reach entrepreneurs in which AID is particularly interested, but that program expansion should be gradual. An evaluation of PVO performance under the grants described above was undertaken during project development to gain a better understanding of the costs of delivering assistance through the PVO mechanism and of their respective absorptive capacities. The principal conclusions of this evaluation were as follows:

- the PVOs studied were rated vey highly from a social perspective. They reach and assist the self-employed poor who lack access to conventional support mechanisms. They are especially effective in reaching women. At the same time, these programs seek to integrate social and economic inputs (e.g. through group formation) so that income-generation is based on local participation and organizational development;

- the outreach of these organizations through decentralized service delivery structures was found to be impressive from a cost standpoint. Roughly 6,000 clients are served by the four indigenous programs examined at a cost per client of approximately $58 per year. In addition, Technoserve indirectly reaches a great number of clients through the upgrading of larger-scale organizations. Grouping of clients is the key to this relative cost efficiency;

- the PVOs were found to be delivering primarily non-financial assistance, with an emphasis on bookkeeping, management, marketing, and advocacy. Little hard data is available on either the intensity of inputs or of impact. That which does exist, however, indicates increased incomes and enterprise stabilization;

- PVO lending was found to be severely limited in scope. Only two programs have institutionalized lending programs and less than 200 loans have been made. Repayment problems exist in both programs, with greater problems in the program dealing with wealthier clients. Repayment problems appeared to be related to problems in loan administration and follow-up -- not to the level of poverty among the clients;

- the team recommended PVO upgrading in the following areas:

  (i) administration and management -- especially of loan programs;

(ii) delivery of managerial assistance to clients;

(iii) analysis of client credit needs;

(iv) inter-organizational communication and coordination;

(v) streamlining of relationships with donors.

A further description of the findings of this evaluation can be found in Supplementary Annex D, "PVO Evaluation and Social Soundness Analysis", available from AFR/PD/EAP.

B. Objectives:

The project goal, USAID's top development priority, is to increase rural production, employment and income. The strategy chosen to achieve this goal is to establish and expand rural private enterprises in Kenya (project purpose). By promoting rural private enterprises the project will directly contribute to attainment of the project goal through both profits and increased employment. USAID has selected this strategy because it: (1) is private sector oriented and therefore not directly constrained by lack of government administrtative and financial capacity; and (2) provides a means of generating rural employment off the farm where a significant portion of the needed 8 million new jobs by the end of the century must be found. The strategy will also indirectly contribute to the goal through increased provision of agricultural input supply and marketing services.

In order to meet objectives, the United States will provide inputs of credit funds and technical assistance to both financial intermediaries and businesses. These inputs will be supplemented by locally generated credit funds and business advisory personnel provided by financial intermediaries. Anticipated project outputs are increased capital flows to rural private enterprises, increased capacity and interest of financial intermediaries to make loans to rural private enterprises, and utilization of business advisory services by borrowers.

Successful project implementation will lead to the following conditions:

(1) 7,000 new jobs directly and 12,000 jobs indirectly created in project-assisted and project-related enterprises;

(2) increased value added in project-assisted and project-related businesses.

Attainment of these objectives will be measured in the first instance by review of the regular reports of financial intermediaries, secondly through examination of the books and records of financial intermediaries, through regular monitoring of project loans and finally via an in-depth evaluation of assisted businesses in the third year of the project.

A logical framework is included as Annex B.

II. C. Description:

The principal project activity will be the provision of credit funds and business management assistance to rural private enterprises. Formal sector enterprises will be assisted through a commercial bank lending program linked to a management and technical assistance contract. Informal sector enterprises and very small-scale formal sector firms will receive assistance through a variety of private voluntary organization (PVO) programs supported by an independent intermediary which will provide financial, managerial and technical support to PVOs and their clients. The use of two such intermediary mechanisms was selected because it is expected that together they can reach a range of businesses from micro enterprises to medium and large scale firms and because among the alternative institutions available in Kenya they have been shown to be the most administratively and financially sound. A summary of the analyses which led to their choice is included in Section VI.C. "Administrative Analysis".

1. Commercial Bank Lending:

The principal project intervention will be the sub-loan transactions between banks and private enterpreneurs. The Project will provide $24 million (to be matched by banks) for this purpose. To the maximum extent possible the procedures and criteria for reviewing and approving these sub-loans will be those already in use by the banks, within the parameters to be set by the loan agreement. To graft substantially different procedures onto routine bank systems would be not only costly and inefficient, but also non-sustainable following the end of project assistance. However, in order to ensure achievement of project objectives and contribute to achievement of the goal of increased rural production, employment and income, certain basic criteria will be established for approval of project funding for sub-loans. These criteria are summarised below:

(a) Type of Enterprise: To be eligible for project financing the assisted enterprise must be at least 50% owned by Kenyan citizens or by a firm which is an integral part of the Kenyan economy1/ and management control must be in private hands. All project-assisted enterprises (including cooperatives) must be for profit. There will be no limit for total fixed assets of the enterprise since the level of fixed assets is not necessarily related to achievement of project objectives. The enterprise must be located in a rural or non-metropolitan urban area (i.e. outside of Nairobi and Mombasa, except for agribusinesses in these two cities which may be financed after AID review to ensure very strong links to rural areas), and must not be involved in commodity trading, real estate development, finance, insurance, or speculation. On-farm production activities are also excluded unless they are part of a vertically integrated processing or manufacturing enterprise.

(b) Loan Criteria: In addition to the economic and administrative feasibility requirements normally applied to loan applications by banks, the investments to be assisted by the project must meet one of the following development impact criteria to be eligible for financing:

- it is labor intensive2/;
- it has the potential to increase net foreign exchange availability;
- it will provide increased markets, inputs, or services for agricultural production or other rural production based on locally available inputs.

1/ An established firm is an integral part of the local economy if it has done business in Kenya on a continuing basis for not less than three years; it is incorporated locally; its principal place of business is Kenya; most of its operating equipment and physical plant are in Kenya; and most of its senior staff and operating personnel are resident in Kenya.

2/ A labor-intensive investment for purposes of this project is one that requires no more than $5,000 for creation of each new job. This is well below the average estimated asset size per employee of large firms in Kenya(i.e. those employing 50 or more persons, See 82 Nairobi 30756). It is also below the estimated $8,000 investment per new employee found to be required in a screened sample of agribusinesses in Kenya in an independent study financed by USAID/Kenya(See Supplementary Annex B). USAID will retain the option to approve loans which are more capital-intensive if they rely on highly labor-intensive inputs.

(c) Loan Terms: Loans will be made on commercial terms. Interest rates will not exceed the highest allowable by Kenyan law (currently 16%) or the competitive commercial rate, whichever is lower. The AID-financed portion of project loans will be medium-term (at least 3 years). At least a portion of bank financing may be for working capital. The entire credit risk will be borne by the banks.

(d) Loan Size: The maximum AID contribution to routine loans will be $750,000. Although some potential loans of this magnitude would be of a capital intensive nature, USAID has concluded that if a large loan meets the employment generation, export, or increased rural production target it can be financed since it will directly contribute to meeting project objectives. USAID will retain the option to approve AID financing larger than $750,000 on an exceptional basis if sufficient development impact can be demonstrated. No minimum loan size has been established since USAID is interested in reaching small-scale entrepreneurs and even a very small loan can contribute to project objectives. To ensure that a reasonable portion of loans go to small and medium-scale enterprises, banks will receive incentive payments for loans under $75,000.

(e) Loan Uses: Loans financed by the project must be for new investment, either business establishment or expansion. Refinancing of existing debt is excluded. Loan funds may only be used to acquire fixed assets (e.g. land, buildings, machinery) and related services (e.g. equipment installation).

As noted earlier in the description of the problem, rural private enterprises in Kenya face management and technical as well as financial constraints. To address these constraints the project will provide management and technical assistance through participating banks and through an independent contractor.

Bank assistance will be modeled on the business advisory service of the Kenya Commercial Bank which conducts feasibility studies of proposed loans on a cost-sharing basis with potential clients. These feasibility studies include cash-flow analysis which provides credit managers with an alternative to collateral as a means to assess a client's credit worthiness. Kenya Commercial Bank will continue the business advisory service under the project. Other commercial banks which participate in the project will establish an internal capability to provide such services to potential borrowers with technical assistance and training to be financed by the project.

Although the existence of a business advisory capacity within banks is an important element in changing the way banks consider term loans, and although such units provide critical services to borrowers in the small and medium-scale range, such business advisory services are ultimately limited in the magnitude and range of services they can provide. Therefore in order to expand the supply of potential smaller-scale investments, and to increase the viability of such investments, the project will finance an independent contract to provide technical and managerial assistance (on a cost-sharing basis) to potential project borrowers. The contract will have three main functions:

- to provide assistance in analyzing the overall feasibility of proposed investments (including cost/benefit analysis, market analysis, technical production requirements, and procurement needs);

- to provide ongoing management assistance, as needed, to project borrowers in bookkeeping, balance sheet preparation, early problem identification, and trouble shooting; and

- to provide managment and technical training to upgrade entrepreneurial and other specific skills needed within enterprises (e.g. bookkeeping, accounting, production techniques, marketing).

The contract will fund a minimal core staff and will rely on sub-contracts with local or U.S. firms to carry out the majority of studies, management consultancies and training. Other functions to be performed by the management and technical assistance contractor include calculation and disbursement of incentive payments to banks for loans to small businesses, the financing of training for bank personnel, provision of procurement assistance to sub-borrowers, and compiling of commodity origin information on project-financed local procurement.

Given the reliance of the project on market forces to allocate credit resources, within the broad parameters established by the project, it is not possible to state with precision what size or kind of enterprises will be assisted, where they will be located, or what they will be producing. However, a study of current investment opportunities which fit project criteria was carried out during project development. That study, together with the additional provisions the project now includes to channel investment to meet project objectives most efficiently, yield the following profile of likely project investments.

The majority of investments will be for agribusiness with emphasis on processing. Typical subsectors are fruits and vegetables, sisal, fish, edible oils, hides, wood and livestock processing. Also likely are a range of small manufacturing including hand tools, animal and human foods and consumer goods. Among small business loans, bakeries, footware, soap making and wood processing will be common.

Roughly half of investments are likely to be new and half expansions of existing operations. Enterprises range in size from 10-100 or more employees. Investment cost per job will generally range from about $1,000 to $13,000 with an average from $5,000-8,000. Total direct employment created should be about 6,000 jobs with about 12,000 jobs indirectly created, not including farm employment by suppliers to agroprocessing enterprises or employment generated through PVO programs. Many projects will be producing both for the local market and for export. Most of the sample of investments studied met the project objectives, over 80 percent were rural and all were Kenyan owned. The projected breakdown of loans is 175 below KSh 1 million (eligible for incentive payments) at an average loan size of about KSh 700,000, and 95 loans above KSh 1,000,000 at an average loan size of about KSh 5,000,000, (see Section VI.D and Annex I for further details).

USAID will monitor closely the lending profile of the banks, particularly during the first year of the project. Any substantial deviation from the desired lending patterns described above will then be corrected through modified lending criteria or incentives for further credit allotments.

2. <u>Private Voluntary Organization Programs</u>:

As described in section II.A.5 above, USAID has had substantial positive experience over the past few years in providing business assistance to small scale rural enterprises through private voluntary organizations (PVOs). The assessment of PVO programs and capabilities carried out during project development recommended continuation and expansion of assistance in this area, with provision for upgrading of PVO capabilities. In light of these findings and USAID program and project objectives of directly reaching the rural poor through available existing mechanisms, the project will provide $4,155 million for grants to PVOs providing credit and business assistance to small-scale enterprises. An additional $2,313 million will be provided to an intermediary organization to handle sub-granting of funds to upgrade PVO capabilities, and to improve management capabilities of small business.

In contrast with the commercial bank component of the project, assistance through private voluntary organizations (PVOs) to very small-scale income-generating activities will be primarily non-financial, although some credit funds will also be made available. Because of the varied nature of PVO small business programs and the range of skills different PVOs can bring to bear on the problem of small-scale enterprise development, the make-up of this component of the project is highly diverse. Certain common characteristics of the organizations and programs do appear, however, and will be among the pre-requisites for financing under this component. Organizational requirements are that the recipient entity must:

- be private;
- be non-profit;
- be registered in Kenya and with AID;
- be administratively sound, or have demonstrated the capacity to improve readily its management ability;
- demonstrate its involvement with the rural poor; and
- demonstrate substantial prior experience with small enterprise assistance.

The programs to be supported must:

- be targeted toward productive, income generating activities;
- directly assist the poor;
- be cost effective in reaching the poor;
- be for off-farm activities;
- be outside Nairobi and Mombasa; and
- be financed at least 25% from non-AID sources.

Further, priority will be given to programs which support innovative investments and economic activity of women. No restrictions are placed on type of client (individual or group) or nature of the assistance program (financial or non-financial). Within these relatively broad guidelines, PVOs will, to the maximum extent possible, be left to develop and pursue assistance activities in which they have the greatest competence and interest.

Those organizations desiring to continue (three present recipients) or initiate credit programs will be subject to tight supervision and control. This discipline is required because of the mixed PVO performance to date in achieving viable revolving credit funds. Some programs have achieved rather good repayment rates, but overall there is a clear need for improved management of credit programs. As discussed in detail in the assessment of PVO programs (Supplementary Annex D), there are numerous reasons for this record including the current harsh economic climate, intense competition in the informal sector, the very low level of resources many clients have to draw on, and inadequate supervision and follow-up by PVOs.

In spite of these difficulties the project will nevertheless support credit programs since lack of access to credit was almost universally cited as a major constraint to small business expansion. The following measures will serve to ensure that project funded credit programs are well managed:

- technical assistance for implementation of credit programs will be provided by the intermediary organization as a condition for making credit funds available to a PVO for on-lending;

- assistance to credit programs will be suspended if default rates on loans exceed specified limits until acceptable rates are re-established.

The criteria for assistance to PVO programs in general apply equally to loans. Credit terms to borrowers will be negotiated between the PVO and the intermediary organization. Priority in credit allocation will be accorded to PVOs lending on terms approaching those of commercial banks.

The intermediary entity will have three major purposes:

- to assist PVOs in upgrading and expanding their programs;

- to promote the extension of services to small-scale enterprises, both cooperative and individually owned;

- to support and undertake innovative efforts to reach and assist rural populations.

The intermediary will serve as:

- an administrative and financial intermediary between AID and PVOs;

- a communication and coordinating entity among PVOs;

- a source for upgrading of PVO capabilities.

- a provider of technical assistance to both PVOs and client enterprises;

- a provider of credit capital to PVOs;
- a supervisor of PVO credit programs;
- a monitoring and evaluation organization.

Based on the record of the PVO programs currently being assisted by AID, the following statements can be made concerning the likely beneficiaries of this component of the project:

- the programs will reach the poor directly (average monthly income of PVO clients ranges from \$15-\$190, with distribution heavily skewed toward the lower end);
- a large proportion of PVO clients will be women (85% of current clients are women);
- a large proportion of the beneficiaries will be group members;
- a substantial portion of the assistance received will be non-financial;
- employment benefits will primarily redress the problem of underemployment rather than create new jobs;
- benefits will be social as well as economic;
- approximatley 1,350 individuals or group clients will receive loans averaging \$1,200;1/
- approximately 21,500 individuals will benefit either directly or through groups from the project.
- approximately 1,000 new jobs will result from the credit programs;
- the poorer, western region of Kenya is likely to benefit proportionately more than other regions from this component.

Institutions will also benefit from the project through technical and management advice to be provided by the intermediary organization and through increased co-ordination and cooperation with each other.

1/ See Annex H for calculations of beneficiary levels.

3. Special Studies:

The project will also finance four special studies to improve USAID's understanding of options for future private sector initiatives. Studies will be carried out on the feasibility of using cooperatives and finance companies as financial intermediaries, on the potential use of a mechanism to guaranty direct bank lending, and on the indirect impacts of increased formal sector production and employment.

III. COST ESTIMATE AND FINANCIAL PLAN:

A. Budget:

The total project cost is estimated at $62 million of which (a) AID will contribute $24 million in loan funds and $12 million in grant funds; (b) commercial banks will contribute $24 million for loans to businesses and $220,000 for supporting business advisory services; (c) private sector entities will contribute $606,000 (excluding investment in enterprises assisted with AID funds) and (d) Private Voluntary Organization will raise not less than $1,174,000 from sources other than AID. The table below indicates the estimated project costs:

Table III-A-1: SUMMARY PROJECT COST ($ 000)
(L-Loan Funds, G-Grant Funds)

	AID	Commercial Banks	Private Sector	PVO	Total
1. Loans to subborrowers	24,000(L)	24,000			48,000
2. Business Advisory Services	400(G)	200			600
3. Management & Technical Assistance	2,866(G)		464		3,330
4. PVO Management & Loan funds	6,468(G)		87	1,085	7,640
5. Monitoring, Evaluation & Special Studies	1,150(G)				1,150
6. Contingencies (10%) Grant funds only	1,116(G)	20	55	89	1,280
Total:	24,000(L)	24,000			48,000
	12,000(G)	220	606	1,174	14,000
Grand Total	36,000	24,220	606	1,174	62,000
	58%	40%	1%	1%	

To arrive at the above costs for all items (except Item No. 1, Loans to sub-borrowers), annual inflation rates of 7.5 percent for foreign exchange costs and 15 percent for local currency costs have been included

The AID contribution is further broken down into foreign exchange and local currency costs as follows:

Table III-A-2:

AID Contribution:
(Foreign Exchange and Local Currency Costs)

		FX	LC	Total
1. Loans to sub-borrowers (L)		12,000,000	12,000,000	24,000,000
2. Business Advisory Services	(G)	400,000		400,000
3. Management & Technical Assistance	(G)	2,333,000	533,000	2,866,000
4. PVO Management & Loan funds	(G)	1,590,000	4,878,000	6,468,000
5. Monitoring, Evaluation & Special Duties	(G)	400,000	750,000	1,150,000
6. Contingencies 10% of Grant funds	(G)	477,000	639,000	1,116,000
Total Loan		12,000,000	12,000,000	24,000,000
Grant		5,200,000	6,800,000	12,000,000
Grand Total		17,200,000	18,800,000	36,000,000
		48%	52%	

The AID contribution will be disbursed as noted below, assuming that the project is authorized in late FY 83.

Table III-A-3:

Disbursement of AID Funds ($ 000)

		FY 84	FY 85	FY 86	FY 87	FY 88	FY 89	Total
1. Loans to sub-borrowers	(L)	2,400	4,800	4,800	4,800	4,800	2,400	24,000
2. Business Advisory services	(G)	100	200	100				400
3. Management & Technical Assistance	(G)	300	550	600	600	550	266	2,866
4. PVO Management and Loan funds	(G)	800	1,246	1,316	1,363	1,400	343	6,468
5. Monitoring, Evaluation & Special Studies	(G)	200	200	275	150	150	175	1,150
6. Contingencies	(G)	100	304	209	187	200	116	1,116
Total Loan:		2,400	4,800	4,800	4,800	4,800	2,400	24,000
Grant:		1,500	2,500	2,500	2,300	2,300	900	12,000

B. Financing Arrangements:

1. Loans to Enterprises through Commercial Banks:

AID proposes to provide a loan of $24 million to the Government of Kenya at AID's most concessionary terms, that is, principal repayment in 40 years with a ten-year grace period, with interest at two percent per annum during the grace period and three percent during the repayment period. The Government will lend the funds to commercial banks at an interest rate to be negotiated (between 10 percent to 13 percent) depending upon banks' cost for providing business advisory services and promoting projects in rural areas. The Kenya Government loan (attributable to AID) to banks will have a grace period of two years and principal repayment in ten years. The banks will lend funds to private businesses (sub-borrowers) at prevailing commercial rates or at the maximum interest rate fixed by the Government, (currently 16 percent), whichever is less. The banks will provide funds from their own resources to match AID funds (at least one for one) or arrange for such matching through syndication of third party funds. The total loan to a business firm will have a grace period of two years and the principal repayment in not more than eight nor less than three years (medium term). It is estimated that not more than 50 percent of AID funds will be utilized for foreign exchange costs of equipment and spares and the balance for local currency costs of construction and equipment. Banks will be encouraged to supply full working capital requirements of sub-borrowers. However, bank working capital financing may not account for more than 50% of bank matching funding.

Upon completion and approval by AID of a loan agreement between the Government and a commercial bank, the bank will request AID to establish a Letter of Commitment in the entire amount of that agreement at a U.S. bank with representation in Kenya. For local currency expenditures, the borrowing bank will then draw down funds against the Letter of Commitment based on its estimate of local currency disbursement requirements in the next ninety days for approved subloans. The funds will be disbursed directly by the U.S. bank to the local commercial bank. Normal commercial bank practice will then be used for disbursement to the sub-borrower. For foreign exchange disbursements, the borrowing bank will request the U.S. bank holding the Letter of Commitment to establish a Letter of Credit in favor of the intended supplier. (The request to establish a letter of credit can only be made following Government approval of the use of foreign exchange). Payment will then be made in accordance with normal Letter of Credit procedures.

Repayments from commercial banks to the Kenya Government(less any fee charged by the Government for assuming the foreign exchange risk) will be deposited in a Special Account at the Central Bank to be used to finance further medium-term lending by the commercial banks. Funds from this account may be withdrawn by the Government, as needed, to make payments to AID (at the rate of exchange in effect when the overall agreement is signed). Residual funds (which will be substantial) will be used for further medium-term lending to rural private enterprises for business expansion or new enterprises. The fund will operate on a discount facility basis at 0.5% above the minimum savings rate. The same maximum level of any single loan will apply as for the project generally. See Annex G "Financial Analysis" for the financial projections of this account.

2. <u>Business Advisory Services</u>:

Grant funds totalling $400,000 will be provided to two banks to engage one business advisor each for a period of two years to train bank staff and monitor the loan portfolio. The AID contribution will be limited to foreign exchange costs only and will be disbursed by AID directly to technical assistance personnel in dollars upon submission by banks of invoices for services rendered. All local currency costs will be contributed by banks.

The summary of the AID and bank contributions is as follows:

Table III-B-1.

($ in Thousands)

		AID contribution FX	AID contribution LC	AID contribution Total	Bank Contributions LC
Loans to sub-borrowers	(L)	12,000	12,000	24,000	24,000
Business Advisory Personnel	(G)	400	-	400	200

3. Management and Technical Assistance:

AID proposes to provide $2,866,000 in grant funds for foreign exchange and local currency costs of a Management Technical Assistance Contractor. The contract will include funds for the following:

(a) One U.S. and one Kenyan professional, a secretary, office and travel costs;

(b) One-half of the feasibility study costs for one-half of proposed lending; feasibility study costs not to exceed 2% of proposed investment;

(c) Six Workshops/seminars per year to upgrade entrepreneurial skills or specific skills needs within the enterprise;

(d) Short-term training in the U.S. for bank staff (3 persons/year);

(e) Visits by potential entrepreneurs to the U.S.;

(f) Incentive payments to banks for each loan under $75,000 at the rate of 10 percent of the loan amount or $2,700 whichever is less; up to a maximum of 2% of funds provided to each bank 1/.

The contractor will present invoices to USAID for all services rendered, and AID will disburse directly to the contractor's account. The AID and the private sector contributions for the above services are detailed in the following Table III-B-2. (See Annex G for details):

Table III-B-2.

Management and Technical Assistance Contractor
($ in thousands)

	AID contribution FX	LC	Total	Private Sector LC
(a) Advisors	967	330	1,297	
(b) Feasibility studies	100	140	240	240
(c) Workshops and seminars	441	63	504	149
(d) Bank staff training	225		225	50
(e) Visits by entrepreneurs	120		120	25
(f) Incentive payments	480		480	
	2,333	533	2,866	464

4. Private Voluntary Organization Management Grantee (Cooperative Agreement):

AID proposes to provide grant funds amounting to $6,468,000 to assist Private Voluntary Organizations (PVOs) in promoting the expansion of small businesses. AID proposes to sign a cooperative agreement with a U.S. registered PVO to facilitate implementation of this component of the project. The cooperative agreement will include funds for the following:

(a) Two U.S. advisors each for a five year period including support costs;

1/ This formula will result in differential interest rates to banks on a sliding scale of from approximately 1% (at $75,000) to about 3% (at $27,000). The base figure of $2,700 was derived by comparing the present value of administrative costs to KCB under two loan schemes (small and medium scale). $2,700 represents one-half the estimated cost difference. See Annex G for calculation details.

(b) Six workshops or seminars per year for training of small businesses;

(c) Four Kenyan professional one, ecretary and two support staff each for five years;

(d) Funds for PVOs to provide technical assistance and loans to small businesses. Interest charged by PVOs will average 10 percent. The estimates are based upon recent data on four PVOs active in providing extension services to businesses in Kenya at present and projections of the demand for the next five years.

The cooperating PVO will receive advances for estimated expenditure in the following 90 days and will receive subsequent advances after justifying expenditures made.

Table III-B-3 estimates the total cost of this component (See Annex G for details):

Table III-B-3.

PVO Management Grantee (Cooperative Agreement):
($ in thousands)

	AID contribution			PVO/Private Contribution
	FX	LC	Total	LC
(a) Management services	1,369	672	2,041	
(b) Workshops/seminars	221	51	272	87
(c) PVO Technical Assistance		3,257	3,257	1,085
(d) PVO Loans		898	898	
Total:	1,590	4,878	6,468	1,172

5. Monitoring, Evaluation, and Special Studies:

AID proposes to provide grant funds in the amount of $750,000 to monitor the project ($150,000 per year average) and $250,000 for mid-term and final evaluations. $25,000 is budgeted for each of the three studies related to potential mechanisms for future private sector programming (cooperatives, finance companies, and bank guaranties). $75,000 has been reserved to study the indirect impacts of increased formal sector production and employment.

IV. IMPLEMENTATION PLAN:

A. Implementation Arrangements:

Arrangements for implementation of the project are described below for the Government, financial and technical assistance intermediaries and the participating enterprises. The section concludes with a description of special procurement and training arrangements.

1. The Government of Kenya:

USAID/Kenya will sign a project agreement with the Government of Kenya covering all elements of the project and obligating all funds. The Ministry of Finance will sign the agreement on behalf of the Government and will serve as USAID's principal point of contact for project implementation. Government's implementation role as described below will, however, be highly circumscribed, which is appropriate given the private sector orientation of the project and the heavy demands already placed on the Government by numerous other investment activities. The Investment Advisory Center, created by President Moi in 1982 to promote private sector development, was consulted during project design and will continue to provide advice, as necessary, during project implementation. A discussion of the reasons for the decision to sign the principal agreement with the Government is provided in Section VI.C. "Administrative Analysis".

2. Intermediary Organizations:

Four types of intermediary organization will be involved in project implementation: commercial banks, a management and technical assistance contractor, a project monitoring contractor, and a PVO intermediary and PVOs themselves. The role and function of each type of organization was described in Section II.C. "Project Description". The arrangements made for involving each of these organizations in project implementation are described below:

a) Commercial Banks:

Following signature of the overall project agreement the Ministry of Finance and USAID/Kenya will prepare terms of reference and invite proposals for participation of commercial banks in the project. The terms will include: a description of the project and its objectives; a description of the sub-loan (to businesses) criteria; the terms of lending from Government to banks; reporting requirements; and a description of the procedural requirements for bank participation. All established commercial banks in Kenya will be eligible to submit proposals. However, the requirements for bank selection will include demonstration of the bank's financial and administrative soundness; the ability to lend to rural borrowers (presumably through a branch network) the ability (or willingness and capacity to develop the ability) to provide business advisory services to project sub-loan recipients; and independent (of Government) management. At present only three commercial banks (Barclays, Standard and Kenya Commercial Bank) would appear able to meet these requirements. Bank submissions will include: responses to the above requirements; a justification for any needed technical assistance (particularly with regard to development of a business advisory capacity); and a statement of funds required for the first two years of the project and an estimated quarterly disbursement schedule.

The proposals submitted will be evaluated by a committee consisting of two Government, one Investment Advisory Center and three USAID/Kenya representatives. If funds requested by qualifying banks exceed funds available, credit allocations will be made on a prorated basis. After selection of banks, USAID and Government will prepare and Government will sign a subloan agreement with each bank selected. Any technical assistance needed and agreed as part of the loan agreement between Government and a commercial bank will be procured directly by the bank, with AID guidance on precedures and contract approval. The bank will pay all local costs for any such technical assistance and will pay all other personnel and administrative costs associated with establishment of a business advisory capacity. Disbursement procedures will be as described in Section III.B. above, "Financing Arrangements."

b) Management and Technical Assistance Contractor:

Following signature of the overall project agreement with the Government, USAID will prepare a Project Implementation Order/Technical (PIO/T) setting forth in detail the scope of work and respective conditions and responsibilites of the Government, USAID/Kenya and the Management and Technical Assistance Contractor. After the Government and USAID have signed the PIO/T, the REDSO Regional Contracting Officer (RCO) will be requested to invite proposals from qualified U.S. and Kenyan firms and non-profit organizations. Criteria for selection of the firm cr non-profit organization will include demonstration of: previous experience providing technical and management assistance to small and medium-sized firms; knowledge and experience with commercial banking practices; established contacts with potential U.S. providers of specialized technical and management expertise; and some experience in Africa, preferably in Kenya.

Following receipt of proposals from interested organization, a committee of USAID, Kenya Government and Investment Advisory Center personnel will select the contractor and request the Regional Contracting Officer to negotiate and sign a direct AID contract with the organization selected.

c) Project Monitoring Contractor:

The procedures planned for selecting and engaging a project monitoring contractor are the same as those described above for the Management and Technical Assistance Contractor. Criteria for selection of the firm will be different, however, with emphasis on auditing experience and in-depth knowledge of Kenyan business being the primary factors for selection. A local management and consulting firm is the most likely contractor for this component. A description of the functions and responsibilities of the Project Monitoring Contractor is included in Section V. "Monitoring Plan", below.

d) Private Voluntary Organization (PVO) Intermediaries:

This section will discuss two levels of PVO intermediary: 1) the organization facilitating management and technial assistance to participating PVOs; and 2) the PVOs themselves.

Following signature of the overall project agreement, USAID will prepare a Project Implementation Order/Technical (PIO/T) for obtaining the services of a PVO intermediary which will manage assistance to very small-scale enterprises through registered PVOs established in Kenya. The PIO/T, signed by the Government Ministry of Finance will authorize the Regional Contracting Officer (RCO) to invite applications from registered U.S. PVOs to undertake this portion of the project. Criteria for selection of the U.S. PVO will include: experience in assisting small individual and group enterprises; experience in credit management, monitoring and evaluation; and experience in Africa, preferably in Kenya.

Upon receipt of applications from eligible organizations, a committee representing USAID and the Government will select an organization and authorize the Regional Contracting Officer to negotiate and enter into a Cooperative Agreement with the organization selected.

The specific procedures to be followed in making sub-grants to PVO's involved in small-scale enterprise promotion will be developed as part of the intermediary PVO's submission to the Government and AID. Those procedures will include provision for public solicitation of proposals at the beginning of the project. The criteria to be used in selecting sub-grantees and programs are described in section II.C.2., "Project Description, Private Voluntary Organization Assistance". The intermediary organization will consult regularly with USAID/Kenya concerning ongoing and proposed programs and will not make sub-grants if USAID/Kenya objects. There will also be formal USAID/Kenya review and approval for all grants over $100,000. No more than 25% of sub-grant funds will be allotted to a single organization. All financial transactions will be between USAID/Kenya and the PVO intermediary on the one hand and between the intermediary and participating PVOs, on the other. No funds will pass directly from USAID/Kenya to participating PVOs. The same relationship in reverse will apply to reporting.

3. Participating Enterprises:

Contact with and initiation of project activities with participating enterprises will be done primarily through existing systems. Commercial banks can be expected to advertise the new lending facility in the media (Kenya Commercial Bank is currently making arrangements to do so under the PRE/KCB project), but most information concerning the project will pass through existing bank clients by word of mouth to potential customers. PVOs as a group have an impressive network of contacts in the informal sector which they will utilize to disseminate information on their programs.

Private entrepreneurs who think they may be eligible for project financing under the project will then present themselves to a participating bank or PVO. Loan review and approval procedures will follow routine processes, with some modifications in the case of commercial banks to improve the quality of the portfolio and to promote lending at the smaller end of the scale.

The normal bank scenario will be roughly as follows. The credit manager reviews the loan applications against both bank and project criteria. If the credit manager concludes that the loan may satisfy both, and if the project has import requirements, the credit manager informs the Management and Technical Assistance Contractor who will assist the potential borrower in identifying appropriate U.S. equipment. If the loan is immediately determined to be viable, the credit manager processes it according to normal procedures and the bank arranges financing according to the procedures outlined in Section III.B. "Financing Arrangement," above.

In the event that the credit manager determines that the loan needs additional feasibility or technical work, the borrower is referred to the bank's business advisory service which will either conduct the needed feasibility work directly or refer the client to the Management and Technical Assistance Contractor, as appropriate. At this point the Contractor will have the option to turn down a request for assistance if he feels the kind of assistance requested is not available at reasonable cost (normally no more than 2% of the proposed investment) or if he feels the investment is not viable. Normally, however, the presumption will be in favor of doing the study, if the entrepreneur or bank is willing to put up its share of the financing (see below). For those studies referred and agreed to by the Management and Technical Assistance Contractor, the Contractor will arrange for the study to be carried out by an appropriate individual or institution (either U.S. or Kenyan). It is anticipated that the Management and Technical Assistance Contractor will choose to enter into several long-term sub-contracts in order to facilitate this process. The client firm must provide its portion of the study financing "up-front" in order to ensure the client's commitment to the investment. In many cases this "up-front" financing will be provided by the bank as the first portion of the loan to the business. Once the study is completed the bank will again review the loan application, and make its decision in light of the new information. Any proposed loans requiring AID approval (in excess of $750,000 AID contribution, or intended for an agribusiness in Nairobi or Mombasa) will be referred to AID, by letter, for concurrence prior to bank approval of the loan. Once a loan has been made with project funds, verification will be the responsibility of the Monitoring Contractor (see Section V. below). To the extent that problem projects are uncovered by the Monitoring Contractor, this will be reported to the appropriate commercial bank and to the Management and Technical Assistance Contractor for remedial action. Such action could be taken through consultation between the bank and the client, or it could be a special study, management consultancy or training session arranged by the Management and Technical Assistance Contractor.

All of the management and technical assistance services described above as available to bank clients are also available to PVO clients, although it is anticipated that in most cases those services will be provided either by the PVO itself or the PVO intermediary.

4. Special Commodity Procurement Arrangements:

The following commodity procurement provisions have been made in order to ensure the maximum opportunity for U.S. exporters to supply project-financed commodities and to ensure compliance with U.S. procurement regulations:

- A description of the project, the commodities likely to be imported, and the contact point in Kenya (Management and Technical Assistance Contractor) will be published in the Commerce Business Daily early in project implementation;

- Sub-loan agreements will include an instruction that preference be given to U.S. and developing country (Code 941) procurement, where feasible;

- All sub-loan commodity import requirements will be referred to the Management and Technical Assistance Contractor who will provide assistance in identifying appropriate U.S. equipment for sub-borrowers through technical publications, reference to the REDSO library, and by undertaking inquiries to the REDSO/ESA Supply Management officer, SER/COM in Washington, and or U.S. suppliers, as appropriate.

- Sub-borrowers will certify that no commodity will be procured under the loan from a country not covered by Code 935 (Free World);

- Local suppliers will submit a form (to be prepared by USAID and REDSO staff) which identifies the origin of the commodity procured. Copies of these forms will be supplied to the Management and Technical Assistance Contractor who will keep a running total of locally procured Code 935 and Code 941 origin commodities and who will verify that no non-Code 935 origin items have been procured with project funds;

- Foreign suppliers will affix AID handclasp emblems to project financed commodities and containers and will submit form 1450-4 (Invoice and Contract Abstract) to the bank holding the Letter of Credit for payment. The form 1450-4 will identify the source and origin of the commodity and the name and registry of the ship transporting the commodity to Kenya. The bank holding the Letter of Credit will submit this form to the bank holding the Letter of Commitment which will be responsible for keeping a running total of commodity source/origin and flag of transporting vessel. These running totals will be supplied regularly to SER/COM which will be responsible for monitoring overall compliance with source and origin and maritime regulations.

Because private sector entities will be procuring project commodities, it has been assumed that good commercial practice will be followed concerning competition among potential suppliers. For reasons outlined in Section VI.C. "Administrative Analysis", and in Annex F a waiver of the source/origin regulations is requested as part of the project authorization. Further, since there is no regular U.S. flag liner service from ports outside the United States to Kenya or from non-Gulf and East Coast ports, a determination of non-availability of U.S. carriers from these sources to Kenya is being requested on a blanket basis (See Annex F). To try to make such a determinations on a case-by-case basis for the two to three hundred loans expected under the project (each of which will have several procurement actions) would cause inordinate delays in project procurement and would seriously jeopardize USAID's ability to manage the project. Assuming approval of the blanket determination of non-availability, the instructions to the U.S. bank holding the Letter of Commitment will include a provision that Letter of Credit issued to suppliers require the following:

- For suppliers shipping from the Gulf and East Coast, that all goods be shipped on U.S. flag carriers, except as may be determined in writing from A.I.D. (SER/COM) on the basis of non-availability of U.S. carriers;

- For other suppliers, that all goods be shipped on Code 941 flag carriers, except as may be determined in writing by A.I.D. (SER/COM), on the basis of non-availability of Code 941 flag carriers.

As noted above, SER/COM will be responsible for monitoring compliance with these conditions through its computerized monitoring system.

5. Training:

Most training that will take place under the project will come about through PVOs working with their business clients, the PVO intermediary working with PVOs, bank technical assistance personnel working with bank staff, and management consultancies arranged by the Management and Technical Assistance Contractor. Some more formal training will also be provided for bank, business and PVO personnel. Identification of specific training needs will come from all participants in the project: banks, PVOs, business people, and the Management and Technical Assistance Contractor. All such training needs will be referred to the Management and Technical Assistance Contractor who will arrange for: formal couses (primarily for bank personnel); visits to appropriate institutions in Kenya, other Code 941 countries or the United States; and workshops/seminars in areas of frequent need such as financial management, bookkeeping, marketing amd exports. Such workshops/seminars will be initiated once a critical mass of project participants has been identified. They will also be open on a limited basis (no more than 25%) to non-project related personnel. Typically the Management and Technical Assistance Contractor will finance resource people and participants will pay for other costs.

6. Special Studies and Evaluation:

Special studies of alternative kinds of financial intermediaries (coopertives and finance companies) and mechanisms (e.g. guaranty program) as well as of the indirect impacts of increased formal sector production and employment and the project evaluations will be contracted directly by USAID/Kenya.

B. Implementation Schedule:

Signature of the Project Agreement with the Government is currently planned for July, 1983. All initial loan agreements with commercial banks, the contract with the Management and Techncial Assistance Contractors, and the Cooperative Agreement with the PVC Intermediary are planned to be completed by the end of calendar year 1983. Contracts with the Monitoring and Evaluation Contractors will be executed early in CY 1984. Compliance with this schedule would allow start-up activities by the various intermediary organizations during the first quarter of calendar year 1984, with the first sub-grants and loans being made in the second quarter of calendar year 1984. Project monitoring will begin concurrently with sub-loan and sub-grant activities. A mid-term evaluation is scheduled for mid-1986 after two full years of sub-loan and sub-grant activity. A detailed implementation schedule is included as Annex J.

V. MONITORING PLAN:

For both the commercial bank and PVO components of the project, close monitoring of project progress, and modification as necessary, will be critical to project success.

Monitoring of individual PVO programs will be one of the responsibilities of the PVO intermediary entity. The first step in effectively monitoring PVO programs and their impact will be to help PVOs set up and utilize monitoring systems. The PVO assessment carried out as part of project development demonstrated how little is currently known regarding what specific inputs, in what order, range and intensity have the greatest positive impact on informal sector enterprises. The first function of monitoring systems set up under the project would then be to feed back to PVOs themselves information as to which interventions are effective and which are not. The second function of the monitoring systems would be to provide the intermediary and AID with information on program effectiveness and impact, and on PVO financial and administrative performance. The PVO internal monitoring will be checked periodically by the project's Monitoring Contractor.

The first step in monitoring the commercial bank lending programs will be to obtain, in timely fashion, reports from participating banks concerning their lending activities. Banks will provide detailed information on sub-borrowers, total credit provided to sub-borrowers, and the financial status of the overall program on a quarterly basis. Annual reports will summarize progress to date and provide an overall statistical review of each bank's lending activities under the project. Specific reporting requirments are provided in Annex E.

An independent local consulting firm will be engaged to monitor and analyze the commercial bank loan program. The principal functions of the monitoring contractor will be as follows:

- to verify that loans reported by banks have actually been made;
- to verify that loans made have been used for the intended purposes;
- to report problem projects to the appropriate commercial bank and the Management and Technical Assistance Contractor as they surface to allow early remedial action to be taken;
- to verify bank and sub-client compliance with procurement procedures and requirements;
- to analyze the loan portfolio of each bank to verify compliance with loan criteria (size, location, type of business, development indicators);

- to analyze the resulting composite portfolio, compare it with USAID Project Paper projections, and recommend changes, as necessary, in order to maintain lending in line with Project Paper objectives or to modify those objectives, as appropriate;

- to analyze loan drawdowns vis a vis disbursements by banks;

- to spot check monitoring results of PVO monitoring programs;

- to report to USAID quarterly on the above.

Completion of the above tasks by a contractor will serve to extend the ability of the AID project manager to monitor these elements of project implementation. The AID project manager will then spot check the contractor's results and focus on problem areas and solutions.

VI. A. Economic Analysis

1. Macroeconomic Overview:

Despite a long record of growth that is above average among sub-Saharan African countries, the Kenyan economy has performed poorly throughout most of the period covered by the current Five-Year Development Plan (1978/79 - 1982/83). Delay in implementing key policy changes and adverse external circumstances have combined to slow many of the structural adjustments of the Kenyan economy which were correctly identified as being necessary in Plan documents. Per capita GDP at market prices stood at $396 in 1981. Per capita GDP in 1982 stood at $354, in part due to recent strength of the U.S. dollar and to the 17.6 percent devaluation of the shilling in December 1981.

It is now apparent that Kenya will be unable to meet the original economic targets of the five-year Plan. According to recent Government estimates, growth rates (which were to have averaged 6.3 percent per year over the five-year period) have been revised downward to an average 3.9 percent. Moreover, even if the country's terms of trade halt their recent decline, the growth rate of real resources over the period will average only 2.0 percent annually, well below the 4 percent rate of population increase. On average, people will be less well off in Kenya in 1983 than in 1978. (See Table VI-A-1). Under a consistently applied program of structural adjustment, however, the growth record is expected to improve, averaging 4.2 percent during 1981-86, and accelerating to 5.2 percent annually during 1986-91. Demand for loans financed by the project is expected to increase, and the profitability of sub-loans to benefit, substantially from the improved macroeconomic environment projected through the end of the decade.

Table VI-A-1:

KENYA: ANNUAL RATES OF GROWTH OF GDP (at Factor Cost) 1979-83

	1979	1980	1981	1982	1983	1979-83 Average
Development Plan	4.5	7.0	6.5	6.7	6.9	6.3
Sessional Paper No. 4 of 1981	3.5	5.8	5.9	5.9	6.0	5.4
Recent GOK Estimates	4.2	3.3	5.5	3.3	3.0	3.9
Per Capita GDP Growth	0.2	-0.7	1.5	-0.7	-1.0	-0.1
(Adjusted for Terms of Trade)	(-2.4)	(-3.2)	(-1.8)	(-1.6)	(-1.0)	(-2.0)

2. The Manufacturing Sector:

The manufacturing sector in Kenya has performed consistently better than the economy as a whole, growing at an average rate of 8.4 percent per year in the first decade of independence and at a slower but still impressive rate of 5.9 percent since 1974. However, despite its rapid growth the manufacturing sector remains relatively small in Kenya, accounting for 12 percent of wage employment and 13.3 percent of GDP in 1982. Under the structural adjustment program, the growth of manufacturing would average 4.6 percent annually during the period 1981-86 (as consolidations and restructuring occur in some industries) with more rapid expansion occurring in newer industries more closely attuned to market prices. Beyond 1986, a restructured manufacturing sector is expected to grow at 6 percent per year. During the early stages of the restructuring process, the Rural Private Enterprise Project will act in part to offset remaining distortions in some existing price signals by assuring the availability of credit to rural industries which are labor-intensive, export-oriented, or strongly linked to agriculture[1].

In the past, the growth of the manufacturing sector has been fostered primarily by means of a policy of import substitution based on quantitative trade controls and foreign exchange restrictions. Relatively capital-intensive manufacturing has been encouraged and protected. Industry operates with heavy dependence on imported inputs and is therefore vulnerable to limitations on availability of foreign exchange. Most of the easy investments of the import-substitution variety have already been made. High levels of protection have in the past resulted in an anti-export bias reducing the availability of foreign exchange. At the same time, the net contribution to foreign exchange savings of many past investments is open to question. The capital-intensive nature of many import-substitution industries has contributed to the relatively slow growth of industrial employment while the poor quality and high prices of many manufactured goods represent an implicit tax on the agricultural sector.

1/ For an in-depth analysis of the appropriateness of these criteria in the Kenyan context, see Spplementary Annex E: Small Scale Industry in Kenya by Peter Kilby, Working Paper No.20, Michigan State Development Series, 1982. (Office of Rural Development and Development Administration, Development Support Bureau, AID/ta-CA2). Kilby emphasizes the growing importance of non traditional small industry in Kenya with firms employing 10-100 employees. Labor intensive production is found to be concentrated in wood and cork products, transport equipment, sugar and confectionaries, textiles, furniture and fixtures, clothing industry, plastic products, meat and dairy products, non electrical machinery, leather products and footwear, and bakery products. Kilby demonstrates that these labor intensive industries exhibit a higher incidences of domestic-based raw materials, e.g. timber, sugar, cotton, wheat, hides, etc; thus providing a strong analytical basis for a strategy emphazing rural-based production.

An overvalued exchange rate has been at the heart of the system of industrial protection. The dialogue between donors and the Government has been continuous on this key issue. Significant progress has been made. The Kenya Shilling was devalued against the SDR in February and September of 1981, and again in December 1982 for a cumulative adjustment of 46 percent (a devaluation of 65 percent against the U.S. dollar during the same 22 month period). Of equal significance is the commitment of the Government, emerging from negotiations with the IMF, that Kenya will adjust the exchange rate periodically, taking into account movement in relative prices in Kenya and in its major trading partners. Such an approach would have important implications for implementation of other policy reforms already agreed to including reduced quantitative restrictions on trade, improved import licensing, and introduction of a more liberal and uniform tariff system. Continuing overall movement of this type could have substantial positive implications for the proposed Rural Private Enterprise project, assisting the project to meet its goals of increasing available financing for labor intensive, rural resource-based, and export-oriented production.

3. The Agricultural Sector:

The reduction in the overall growth of GDP since the early 1970's has been reflected in the agricultural sector as well as in manufacturing. The growth of agricultural output has declined from an average annual rate of 4.7 percent during 1964/73 to 3.9 percent during 1974/82. Depsite a rate of growth since independence below that of the general economy, the agricultural sector still provides Kenya with 34 percent of inputs into manufacturing, 70 percent of non-petroleum exports and approximately 65 percent of total employment. Under the current structural adjustment program, the growth of agricultural production is expected to remain at 4 percent or more despite a rapidly growing labor force and the limited availability of high and medium potential land.

Problems in Kenya's key agricultural sector were outlined in Kenya's National Food Policy Paper published early in 1981. Producer prices in the past have been inadequate (maize, beef and milk prices in particular), credit services inefficient (late disbursements, unsatisfactory collection programs), and provision of input supplies inadequate and untimely. Marketing services have been poor with parastatal bodies and cooperatives taking a significant share of sale proceeds at the expense of the producer.

Achievement of the rural production goals of the Rural Private Enterprise project will be substantially enhanced by continuing and extending the policy reforms already begun under the agricultural portion of Kenya's structural adjustment process. As Sessional Paper No. 4 of 1982 points out "the prices farmers receive are the principle incentive to which farmers respond in producing for market". Kenya has now institutionalized a mechanism to adjust agricultural prices under its Annual Price Review. The Reviews in December 1981 and December 1982 recommended large increases in producer prices. The cumulative increases between December 1981 and February 1983 have been substantial for a number of basic agricultural crops including maize (66 percent), wheat (40 percent), rice (81-115 percent), and milk (30 percent). The prices for rice now approximate world levels, and the prices for maize and wheat exceed world levels. Probably as a result, the overall food supply situation has changed from deficit to surplus.

The Annual Price Review is itself an inflexible mechanism, although it represents a quantum leap forward in the thoroughness with which Government considers the impact of its decisions on the farmer. A complete review of grain marketing with a view to introduce a more flexible pricing system is required, and was agreed as part of the current $135 million World Bank Structural Adjustment Program. However, progress in getting the study underway has been disappointingly slow. With regard to pricing, it should also be kept in mind that the devaluation process described above has had a substantial impact on the incomes of producers of coffee and tea, two of Kenya's most important exports, more than half of which are produced by smallholders.

The overall increases in agricultural output and income resulting from measures already begun will have a substantial positive impact on the proposed Rural Private Enterprise project both from the point of view of providing an expanded rural demand, and by increasing the potential supply of outputs to be processed. Sessional Paper No. 4 also suggests an increased commitment by Government to a number of reforms and approaches that will support achievement of project goals, and which indicate a continuing convergence of USAID and the Kenya Government viewpoints on a number of issues. To quote Sessional Paper (Para 53):

> " The institutional changes which form part of the agricultural structural adjustment programme include renewed emphasis on small farm production, the development of gateway towns which are the conduits for inputs and outputs going to and from rural hinterland and pastoral areas, the rejuvenation and improved

efficiency of cooperatives, a greater role for the private sector, a sharper focus of marketing boards on their public functions of strategic storage and price stabilization, and improvements in credit extension and collection".

Although no one pretends that all of the above changes will be adopted immediately or without cost, the Rural Private Enterprise project has been designed as part of an immediate overall U.S. responses to help implement policy decisions which now favor increased rural production (farm and non-farm) with considerable emphasis on an expanded role for the private sector.

4. Credit Situation:

The credit situation in Kenya over the past few years has been seriously affected both by the balance of payments crisis (with resultant negative effects on foreign reserves), and by sharp fluctuations in Government's requirements for credit to finance the budget deficit. (See Table VI-A-2).

Table VI-A-2

MONETARY INDICATORS, 1978-83
(Million Kenyan Pounds)*

As At End Of	Net Foreign Assests	Domestic Credit			Money Supply***	Commercial Bank Liquidity
		Public**	Private	Total		Ratio in %
Dec. 1978	106.4	168.6	445.0	613.6	705.9	23
Dec. 1979	179.4	203.0	488.7	691.7	819.8	18
Dec. 1980	113.2	192.0	587.9	779.9	810.4	21
June 1981	68.0	244.8	601.3	846.1	823.9	20
Dec. 1981	15.0	317.6	651.3	968.9	918.2	21
June 1982	-40.4	377.0	697.3	1074.3	916.2	18
Dec. 1982	-101.0	534.5	717.8	1252.4	1066.2	25
Jan. 1983	-112.0	...	...	1277.0	1063.6	28
Feb. 1983	-126.0	...	...	1263.0	1045.9	28

Source: CBS *Monthly Statistical Bulletin*, July 1982; *Economic Survey 1983*.

Notes: * One Kenya Pound equals approximately 1.54 U.S. Dollars following the devaluations of December 1982.
** Includes parastatal.
*** Money and Quasi-Money.

Total domestic credit, which had grown by 12.8 percent in 1980, and by 24.2 percent in 1981, expanded by 29.3 percent in 1982. Public sector borrowing during 1982 increased by 68.2 percent, and private sector credit expanded by only 10.2 percent. Kenya's total money supply increased by 150 million Kenyan Pounds during 1982. Had it not been for an increase in domestic credit to the public sector of 212 million Kenyan Pounds, the overall money supply would have decreased substantially since net foreign assets also declined by 116 million Pounds (and were substantially negative at year's end). Declining foreign assets partially offset the growth of domestic credit so that expansion in the money supply was held to 16 percent in 1982, a decline of 6 percent in real terms.

Total commercial bank credit in 1982 rose by some 15 percent. More than a third of this increase was accounted for by additional lending to Government in the form of Treasury bill purchases. The liquid assets of the commercial banking system increased by 55 percent in 1982. Just over half of this increase, however was due to increased holdings of Treasury bills. The liquidity ratio of the commercial banks began to rise in August during a period of large scale Government borrowings from the banking system. By February 1983, the liquidity ratio was as high as 28 percent. This was well above the new legal minimum of 20 percent set the same month (but artificially inflated by Treasury bill holdings).

The Government of Kenya has now committed itself to reversing this recent pattern, and to increasing the availability of credit to the private sector. Government's letter of intent in connection with the March 1983 IMF Stand-By, includes a ceiling on the expansion of total domestic credit during FY 1982/83 of 15 percent, with no more than 25 percent of the total in credit expansion to be available to Government. Government has successfully met the target for total domestic credit set for March 1983. It now appears that the ceiling established for June will be met as well. The ceiling on domestic bank credit to Government was also successfully met in March. The final outcome for June is less certain given severe reveneue shortfalls in the last six months of CY 1982.

USAID and the IMF are in basic agreement on the need for continuing this approach. USAID expects to take advantage of the likely overall increase in commercial bank credit to the private sector by employing a matching funds approach under the Rural Private Enterprise project to leverage a substantially increased flow of resources toward rural private enterprises.

In addition to sources of project financing available from the commercial banking system, and from donor-supported development institutions discussed above, Kenya's credit markets have been characterized in recent years by a rapid expansion in non-bank financial institutions. Between 1978 and 1982, domestic credit of the commercial banking system more than doubled, while in the same period non-bank institutions tripled their lending. As a result the overall rate of credit expansion has been significantly faster than recorded by normal banking statistics. By the end of 1982, non-bank credit is estimated to have made up nearly one-third of total credit of the financial system. Non-bank institutions are still not as effectively under the supervision of the Central Bank as commercial banks. Their expansion represents a substantial increase in the level and nature of competition in the financial sector. The lesser degree of Central Bank control over these institutions has enabled them to offer substantially higher returns, and to charge substantially higher rates, than more closely scrutinized institutions.

Current Government policy is to use interest rates more flexibly to encourage domestic savings and capital formation. Bank deposit rates were raised in several stages from 5 percent to 10 percent between June 1980 and September 1981, and lending rates from 10 percent to 14 percent. Nevertheless, due to higher rates of inflation, real interest rates remained negative for savers during most of this period (depending on the exact type of price deflator applied), while borrowers normally paid only small positive rates of interests if any. (See Table VI-A-3). On December 10, 1982, the Government of Kenya again adjusted deposit and lending rates upward by 2.5 and 2 percentage points respectively indicating a continuing commitment to the adjustement process. In its letter of intent to the IMF under the current Stand-By Arrangement Government indicated that it intends to keep interest rates under continuing review to ensure that time deposit rates are kept positive in real terms. Success in reducing the budget deficit, and restraint in growth of the money supply, will contribute directly to reduced inlfation and assist in achievement of this objective. To judge from the continued buoyant demand for loans from non-bank financial institutions which charge substantially higher rates than banks, interest rates in Kenya have not yet reached a level where they seriously threaten to curtail investment.

Table VI-A-3.

KENYA: TRENDS IN SELECTED INTEREST RATES, 1978-1983

	Year	Nominal Interest	Nairobi Consumer Price Index	GDP Deflator	Real Interest (CPI Deflator)	Real Interest (GDP Deflator)
1. Commercial bank savings deposit	1978	5.0	12.6	3.3	-7.6	1.7
	1979	5.0	8.4	6.3	-3.4	-1.3
	1980	6.0	12.8	10.9	-6.8	-4.9
	1981	10.0	12.6	9.7	-2.6	0.3
	1982	12.5	22.3	14.4	-9.8	-1.9
	Mar.82-83	12.5	16.2	...	-3.7	...
2. Commercial bank loans and advances (max)	1978	10.0	12.6	3.3	-2.6	6.7
	1979	10.0	8.4	6.3	1.6	3.7
	1980	11.0	12.8	10.9	-1.8	0.1
	1981	14.0	12.6	9.7	1.4	4.3
	1982	16.0	22.3	14.4	-6.3	1.6
	Mar.82-83	16.0	16.2	...	-0.2	...
3. Post Office savings deposits	1978	5.0	12.6	3.3	-7.6	1.7
	1979	5.0	8.4	6.3	-3.4	-1.3
	1980	6.0	12.8	10.9	-6.8	-4.9
	1981	10.0	12.6	9.7	-2.6	0.3
	1982	10.0	22.3	14.4	-12.3	-1.9
	Mar.82-83	10.0	16.2	...	-6.2	...
4. Building society loans (max)	1978	12.0	12.6	3.3	-0.6	8.7
	1979	12.0	8.4	6.3	3.6	5.7
	1980	14.0	12.8	10.9	-1.2	3.1
	1981	14.0	12.6	9.7	1.4	4.3
	1982	16.0	22.3	14.4	-6.3	1.6
	Mar.82-83	16.0	16.2	...	-0.2	...

Source: Economic Survey, 1983.

The Credit Feasibility Study prepared by management consultants Deloitte Haskins and Sells DHS for USAID/Kenya has investigated the likely level of demand for funds of the type to be made available under the proposed Rural Private Enterprise project. The target enterprises selected by USAID/Kenya for priority consideration consisted essentially of two main groups: agribusiness enterprises wherever located in Kenya with substantial backward and forward linkages to agricultural production; and other rural private enterprises including manufacturing, forestry, construction, transport, communications, and wholesale and retail trade. A categorical breakdown of these types of enterprise was difficult because official statistics are less than ideal. Categorization of smaller firms in rural areas was especially difficult because available statistics were not originally collected for the purposes to which they have now been put.

Table VI-A-4 summarizes results for the two target groups to give some perspective on their overall role in the economy. The Agribusiness components of the table refer mainly to enterprises employing 20 persons or more; thus the table somewhat underestimates the target group likely to be reachable by a broad based rural banking network. Data for other rural private enterprises are necessarily approximate but represent a good estimate of the likely order of magnitude of the variables included.

Table VI-A-4.

TARGET GROUPS - MAIN INDICATORS

	Agribusiness	(Private Sector) Rural Private Enterprise	Total
Employment (Nos.)	76,000	60,000	136,000
Establishments (Nos.)	465	1,100	1,565
GDP (million Kenya Pounds 1981)	188	126	314
Capital Formation (million Kenya Pounds 1981)	54	46	100
Gross Historic Cost Fixed Assets (million Kenya Pounds 1981)	740	*	*

Source: Deloitte Haskins and Sells(DHS), draft Credit Feasibility Study for USAID/Kenya, November, 1982.

* Insufficient information available.

Note: Due to the nature of the data base and to the diverse nature of assumptions required to form the estimates above, a full reading of the DHS study is recommended.

The Credit Feasibility Study estimates that the combined target groups account for 26 percent of private sector wage employment and 14 percent of overall wage employment. The target groups contributed 13 percent of total provisional GDP for 1981. Annual capital formation is estimated at 100 million Kenyan Pounds or approximately 160 million U.S. dollars at the exchange rate prevailing after the devaluations of December 1982. Although the total amount of capital formation which is financed by borrowed funds has not been determined, the gearing of such enterprises in Kenya is normally very high. Assuming a one-to-one matching of AID and commercial bank funds, an average annual injection of credit on the order of 10 million dollars over a period of 5 years is economically and financially feasible given the extensive penetration of the commercial banking system in rural Kenya and the extreme shortage among the target group at the present time of medium-term credit funds which will form the major portion of the lending under the proposed Rural Private Enterprise project.

B. Financial Analysis:

1. Financial Sector in Kenya:

For a country at its stage of development, Kenya has a well-developed financial sector, including 19 commercial banks, 4 development banks, and more than 30 non-bank financial intermediaries. Commercial banks are primarily engaged in providing short-term finance to industry, commerce and agriculture, in that order. Most of the short-term credit is provided via overdraft and is technically payable on demand. In practice, over-draft facilities can be renewed, and are often deployed not as working capital alone, but also as imperfect substitutes for scarce longer term financing.

Traditional development finance is primarily channeled through the Industrial and Commercial Development Corporation (ICDC), the Industrial Development Bank (IDB), the Development Finance Company of Kenya (DFCK), and the East African Development Bank (currently negatively affected by the breakup of the East African Community). The capabilities of the development banks were reviewed at the feasibility stage of this project. The project gives preference to commercial banks for technical, managerial, and financial reasons, as well as for the greater potential outreach of commercial banks in rural Kenya. As suggested in Section II, A.3 above on other donor activities, the current project seeks to complement ongoing activities of the development banks (at the larger end of the industrial scale), and of Kenya Industrial Estates (at the smaller end).

USAID has insufficient information at this time to recommend inclusion in the project of the large number of rapidly growing non-bank financial intermediaries which were discussed briefly in Section IV, A.4 on the credit situation. The proposed IFC study of financial markets, a possible AID Private Enterprise Bureau (PRE) study of capital markets, and a specific study to be funded under this project, will provide required data to assess new developments in this area of growing importance. In the meanwhile, the increased competition offered to commercial banks by non-banking financial intermediaries should act as a stimulus to innovation in defense of traditional commercial bank markets, as well as in the definition of new lending opportunities.

2. The Commercial Banks:

There are 21 licensed banks in Kenya, of which 19 are currently operational. Of the 19 operational banks, 4 are local and the others majority foreign owned. Until recently most of the foreign banks were of European and Asian origin, but American banks arrived in the 1970's and Arab banks in the 1980's, so that today the commercial banking system in Kenya is increasingly competitive and truly international.

Three banks dominate the commercial banking system in Kenya: the Kenya Commercial Bank Group, Barclay's Bank, and Standard Chartered Bank PLC. The two main companies within the Kenya Commercial Bank Group are the Kenya Commercial Bank (KCB) and its subsidiary, the Kenya Commercial Finance Company (KCFC). The Finance Company itself has two wholly owned subsidiariws, one engaged in mortgage finance, and the other primarily a stock brokerage firm. (In this paper, assessment of the KCB Group will be concerned only with KCB and KCFC, since the two other subsidiaries will not be involved in any part of project operations).

In 1970, seven years after independence, the Government of Kenya purchased the long established National and Grindlays' banking operation, creating in KCB the country's first domestically owned bank. Both Barclay's and Standard are foreign-owned, but Barclay's is incorporated locally, has plans for a local stock issue, and is pursuing a program of expansion in rural areas. Standard operates as a branch of Standard Chartered Bank PLC, and its financial records are consolidated with those of the parent company. Information regarding Standard's purely local operations are treated in confidence throughout this paper. It may be estimated, however, that the three banks together account for more than half of the deposits and credits of the commercial banking system in Kenya, with Barclay's accounting for some 18 percent, and the combined deposits of KCB and KCFC also accounting for 18 percent. The three main banks together account for about 90 percent of branch banks in Kenya. KCB alone has some 47 branches, 39 sub-branches, and 114 mobile units.

Barclay's has some 43 branches, 17 representative agencies, and various mobile units covering a further 12 towns. Standard Bank has 38 offices in Kenya. Only three other banks (National Bank, Co-operative Bank, and Bank of Credit and Commerce) have any branches in rural areas, but these branches total less than a dozen.

The three principal commercial banks in Kenya are financially sound despite the current depressed state of the economy and temporary adverse liquidity developments resulting from Government budgetary problems during the past year. At December 31, 1982, Barclay's had equity and retained reserves of 10.6 million Kenyan pounds ($16.3 million), just above the level of 10.5 million Kenyan pounds recorded in 1981. Deposits and cureent account balances amounted to 137 million Kenyan pounds ($211 million), up 8 percent over 1981. Pre-tax profits did fall from 4 million Kenyan pounds in 1981 to 3.2 million in 1982 ($4.9 million), but these profits gave a very satisfactory rate of return on shareholders' funds of 39 percent in 1981 and 30 percent in 1982.

Despite the current recession, the Kenya Commercial Bank, and its Finance Company, reported generally improved positions for 1982. KCB's equity and retained reserves increased slightly from 12.9 million Kenyan pounds in 1981, to 13 million in 1982 ($19.9 million). KCFC equity and reserves have risen from 2.1 million Kenyan pounds in 1981 to 3.1 million in 1982 ($4.7 million). Profits before taxes at KCFC rose from 482 thousand pounds to 685 thousand pounds ($1.1 million), representing a 22 percent return on shareholders' capital. Audited accounts for the KCB Group as a whole during 1982 were prepared at the end of May 1983 and printed copies should be available in July. Separate audited accounts of the Kenyan operations of Standard Chartered Bank PLC cannot be reported on. Profits before tax of the parent company fell from 260 million British pounds in 1981 to 242 million in 1982 ($389.6 million). Share capital and reserves rose from 1.02 billion British pounds in 1981 to 1.14 billion pounds in 1982 ($1.84 billion). Risk to the U.S. Government would be minimal in lending directly or indirectly to any of the three major commercial banks currently operating in Kenya. A more in-depth review of commercial banks operating in Kenya is contained in the Credit Feasibility Study: Supplementary Annex A to this paper (available from AFR/PD/EAP). Audited financial accounts of KCB, KCFC, Barclay's and Standard Bank will be available from the same source as Supplementary Annex F.

3. Financial Soundness:

The project proposes to establish a standard two step loan arrangement with funds being lent by AID to the Government of Kenya, and by the Government of Kenya to selected commercial banks for on-lending to rural private enterprises. The financial feasibility of the project is established by the large available spread between standard A.I.D. concessional rates and commercial lending rates anticipated in Kenya during the project and subsequent payback period. The project divides the available spread between commercial banks (to cover normal profits, costs of necessary advisory services, and the higher costs of medium-term lending to smaller scale, rural enterprises) and Government (to cover foreign exchange risk, to repay the original AID loan, and to establish a permanent fund in the Central Bank as a source of term capital for on-lending by commercial banks to selected rural enterprises).

The AID loan to Government will be at an interest rate of 2 percent per annum during a grace period of 10 years, and at 3 percent per annum thereafter during a period of 30 years, with 61 approximately equal semi-annual payments of principal and interest. A pro forma amortization schedule has been prepared based on a principal sum of $24 million dollars to be drawn down over a period of five years in 20 equal quarterly installments of $1.2 million each (See Table 3, Annex G). The pro forma drawdown schedule is illustrative only and may turn out to be somewhat conservative particularly if macroeconomic conditions improve in Kenya as a result of structural adjustment measures, and if major commercial banks in Kenya elect to participate fully from the initial year of project operation. Given the ten-year grace period at low interest associated with the AID loan to Government, a more rapid drawdown of funds by commercial banks would serve to improve overall financial returns at every level of the project. It is recognized that the opposite also holds true, that the ten year grace period provides a significant opportunity for accumulating reserves in the permanent Central Bank fund, and that every effort should be made to maintain project momentum once an initial drawdown has been made.

The flow of funds out of the permanent Central Bank fund to repay the AID loan (Table 3, Annex G) may be compared with related flows into the fund arising from payments of interest and repayments of principal by commercial banks to Government (Table 4, Annex G). A pro forma amortization schedule consolidating total bank payments and repayments has been prepared, based on an interest rate from Government to banks of 10 percent per annum, a grace period of two years, and an overall loan period of 10 years applicable to each disbursement. A grace period of two years has been selected to be equivalent to that deemed suitable by banks on subloans to ultimate borrowers. A loan period to banks of ten years has been selected as consistent with sub-loans to ultimate borrowers ranging from 3 to 8 years (medium-term). Under these arrangements there is ample time for loan processing and possible extensions, and some revolving of AID-supplied funds can also be achieved. Loans of up to eight years can still be approved in the final year of the proposed five year drawdown period. A ten year loan period has also been selected as being near the upper limit to which commercial banks may be willing to commit themselves at a fixed rate of interest. The simplicity of fixed interest rates and fixed payments has been preferred in the Kenyan context to more flexible but more complex solutions.

Financial flows from Table 3 and 4 which were discussed above, are compared in Table 5, Annex G in order to demonstrate the financial viability of the proposed project. Table 5 suggests that under a broad range of conditions, there will be ample reserves in the permanent Central Bank fund to make all repayments of principal and interest, and to accumulate substantial resources to be further on-lent to commercial banks. A foreign exchange guaranty from the Government of Kenya will be required to protect the value of the permanent fund against possible depreciation of the Kenyan shilling in terms of the U.S. dollar during the period of pay back of the loan to the U.S. Government. Such a guaranty is appropriate since Kenya will benefit from substantial initial inflows of foreign exchange in excess of project requirements for imports. Such inflows immediately reduce the need for borrowing abroad or permit repayment of existing obligations. Moreover Government has substantially within its power the ability to protect the value of the shilling through appropriate fiscal and monetary policies. When such policies cannot be implemented, the value of any permanent fund is unavoidably reduced through an inflation "tax." An additional such "tax" operating through depreciation of the exchange rate would substantially undermine the viability of any continuing fund. As Table 5, Annex G indicates, substantial reserves are accumulated in years 1 through 10 (quarters 2-39) due to the shorter grace period and higher interest rates associated with commercial bank loans (compared to the AID loan to Government). Payments received from banks accelerate reaching a plateau of just over $ 1 million (equivalent) per quarter by period 26 (six and a half-year after the project begins). Beyond the 10th year payments by banks decline as earlier loans are paid off in full.

The fund experiences its first negative cash flow in period 42 when the second repayment of both principal and interest by Government is made at the same time that the fund is facing a decline in payments received from banks. Beyond 15 years, of course, there are no inflows from banks at all, while Government's payments continue through period 160 (40 years). It can be estimated however, that the total value of the fund at the end of the 59th quarter will be a minimum of $26,201,800 (equivalent). This exceeds by some $10.5 million the present value of all future required payments to the U.S. during periods 60-160 (assuming a discount rate of say 13 percent). This minimum estimate of fund size is based on an accumulation of net inflows deposited at zero interest. The project envisages relending available capital to a broad range of rural enterprises, however, as such funds become available. The pattern of such lending cannot be exactly predicted at this time. To give some idea of the effect of compounding on the total fund size, Table 5, Annex G assumes immediate relending of funds each quarter as they become available, at say 13 percent per annum (3 percent higher than lending under the original more restrictive AID program, but approximately 1.5 percentage points below the existing Treasury rate). Under such a regime, an average cash flow of nearly $2 million per quarter is generated by the time the last repayment on the original loan is received by Government from the banks. Although the exact present value of such a flow will be highly dependent on inflation rates during the intervening periods, the objective of institutionalizing a relending facility for term capital in the Central Bank can be successfully achieved in addition to the income, production and employment goals achieved directly.

C. Administrative Analysis:

A number of studies conducted both before and during project development have contributed to the summary administrative analysis presented below. Principal among these were the "Credit Feasibility Study", "Investment Opportunity Study","Agribusiness Policy Study" and "PVO Evaluation/Social Soundness Analysis" which are available from AFR/PD/EAP as Supplementary Annexes A-D. Other inputs into the analysis and its conclusions were two visits by PRE/I staff and a PRE-provided management and training consultancy.

1. Government of Kenya:

An early decision required during project development was to determine what role should be played by the Government in the project and specifically whether the project agreement should be signed with the Government or directly with the various intermediary entities.

Factors to be considered in the choice of an obligating mechanism included:

- the desirability for the Kenya Government to assume the foreign exchange risk;
- the fact that any direct U.S. loans made to private sector banks would have to be guarantied;
- the need for any loans made directly to private sector banks to be exempted from payment of income taxes on interest payments and the need for duty-free status of any project-financed personnel;
- the need for Government to issue foreign exchange and import licenses for most project-financed commodities;
- the already heavy burden on the Government of managing donor-assisted projects and possible project implementation delays which could result from overtaxing the Government;
- the desirability of establishing a means to recirculate bank repayments through the commercial banking system;
- the desirability of achieving some institution-building with commercial banks through a direct relationship between USAID and the banks;
- a possible negative reception from banks having to deal with the Government on project implementation;
- a possible negative attitude toward repayment by sub-borrowers if the project is viewed as a Government project.

USAID concluded from the above that the Government must be involved in the project in a number of critical ways (as it is now with the PRE/KCB project), particularly with regard to foreign exchange risk, allocation of foreign exchange, import licensing, loan guaranties, and tax exemption. Discussions with banks indicated that they were not overly concerned with a formal loan relationship with the Government provided that operationally the program would be independent. In light of the above, USAID/Kenya has opted for a formal agreemenc with the Government to ensure its participation in the areas where it is required, but with important operational procedures (loan approval, disbursement, and procurement, together with the provision of technical assistance) handled directly by AID. This arrangement will also allow development of a long-term fund to support commercial bank medium-term lending while minimally taxing Government administrative capacities.

The Government's role in the project will consist of the following: 1) Signature of the overall agreement with USAID; 2) participation in the preparation and issuance of requests for proposals (applications) and selection of banks, contractors and the PVO intermediary grantee; 3) issuance of import licenses for sub-borrowers wishing to import equipment and raw materials; 4) collection of loan repayments from banks and re-lending the same; and 5) repayment to AID. The Government will have no role in sub-loan or sub-grant decisions and implementation, nor will it be involved in the initial disbursement of funds. With the exception of the issuance of foreign exchange and import licenses, all of the above will be performed by the Ministry of Finance which are capable of undertaking the tasks described. A covenant will be included in the project agreement concerning the issuance of import licenses.

2. <u>Intermediary Organizations</u>:

(a) <u>Selection</u>: Given the broad project objective to establish and expand rural private enterprises, a wide range of intermediary mechanisms suggest themselves as potential vehicles for delivering project assistance. Alternatives considered during project development include: commercial banks, development banks, cooperatives, finance companies, and private voluntary organizations (PVOs). USAID has concluded that more than one intermediary entity would be necessary, considering that enterprises of both formal and informal nature would be assisted.

The only organizations with a proven track record in assisting informal sector enterprises are the PVOs. Given the strong record of PVOs in this area in reaching very small (0-5 employees) enterprises and very poor clients, the decision was made to utilize these organizations to the maximum of their capacities and to expand those capacities, where possible. There are some questions remaining concerning their administrative capacity and the economic feasibility of such assistance. The economic feasibility question stems from the lack of solid data concerning the economic impact of the PVO programs. The PVO Evaluation/Social Soundness Analysis was able to fix a cost per beneficiaryof approximately $58. However very little quantitative information was available on the production and employment impacts of the PVO programs, making a meaningful cost comparison with alternative assistance mechanisms impossible. The PVO Evaluation/Social Soundness Analysis did estimate the capital cost per job among PVO-assisted enterprises to be $2,000 vs. $5,000-$8,000 (Investment Opportunity Study) among commercial bank clients. Against this difference must be weighed the facts that: 1) there is no matching of loan capital in the PVO programs; 2) the indirect impacts of informal sector investments are likely to be lower (retail vs. manufacturing, lower wages); 3) PVO administrative costs are proportionately much higher (16% for the one pure loan program Daraja vs. 2-4% for commercial banks); and 4) PVO credit funds are less likely to be paid back and re-lent. However, the fact remains that they are the only organizations effectively reaching this important portion of the small business community, and USAID plans to continue supporting them for both equity and economic reasons. Provisions have been made in the project (through technical assistance and establishment strict lending performance criteria) to redress the administrative problems.

At the next level (5-20 employees) in the rural private enterprise community, there is a clear gap in the availability of intermediary insititutions. Suggestions were made to utilize the cooperative enterprise sector (PVO Evaluation/Social Soundness Analysis), finance companies (Investment Opportunity Study), and a guaranty program (PVO Evaluation/Social Soundness Analysis) to try to reach this segment of the business community. However, insufficient information exists at present concerning the management and financial soundness of cooperative enterprises and finance companies to allow a definitive judgment in this area. USAID's initial reaction is that in general neither the finance institutions nor the cooperatives are sufficiently strong to serve as intermediate credit institutions under the project at this time. The target market of the finance companies appears to be too urban oriented to meet project needs. Cooperative enterprises are of course eligible to apply for loans at the commercial banks on the same terms as other rural private enterprises, and USAID anticipates that one PVO likely to participate in the program (Technoserve) will devote considerable effort to assisting cooperative enterprises both in managing their enterprises and in obtaining loans from commercial banks. A guaranty program to direct more commercial bank lending to this segment of the business community would be very attractive, if it were allowable under the Foreign Assistance Act, which it currently is not. Funds have been reserved in the project to explore each of these ideas further. Should project monitoring and evaluation indicate the need to re-design some project elements, the needed information will be available.

At the level of formal sector enterprises of 20 or more employees, two alternatives are available: the commercial banks and development banks. The Credit Feasibility Study reviewed the orientations and capacities of both groups with the following conclusions:

(a) Management capacity: Commercial banks were found by a wide margin to be better and more independently run and to have substantially greater capacity for expansion. This is largely due to their larger pool of managerial talent.

(b) Target groups: Commercial banks tend to lend to larger, more experienced businesses. Development banks place much greater emphasis on lending to smaller and less experienced entrepreneurs.

(c) Financial performance: As would be expected from the differences in both management capacity and target groups, the financial performance of commercial banks greatly exceeds that of the development banks. The development banks generally have large arrears and have lost money in recent years.

(d) Outreach and business advisory capacity: Development banks provide much more assistance to businesses in conducting feasibility and engineering studies. The commercial banks, which are lending to experienced businesses, do not need to provide such assistance and therefore have less experience in this area. The exception to this statement is the Kenya Commercial Bank which has an active business advisory service. Branch networks are more highly developed among the commercial banks.

(e) Capital availability and needs: Development banks have generally been successful in attracting donor financing for their activities and demonstrated little additional need for financing. Commercial banks have been successful in generating local capital on a short-term basis. The extreme scarcity of medium-term capital has resulted in a concentration on working capital financing and has contributed to a lack of experience in medium-term lending.

Based on these findings, USAID has opted for commercial banks as implementing agents. Kenya Commercial Bank, Barclays Bank and Standard Chartered PLC appear to be in the best position to compete for the financial intermediary role because of their size, experience and large branch networks. With some assistance, they will be able to implement the project efficiently. Their strong financial and management performance makes them the best choice for efficient project execution and profitable selection of sub-loan recipients, but the project will be open to responsive proposals from other banks as well. Further information and analysis of the financial and administrative capacities of Kenya Commercial Bank, Barclays Bank and Standard Chartered PLC can be found in Supplementary Annexes A and F.

In summary the project will utilize the proven, reliable intermedaries (commercial banks and PVOs) available to reach rural private enterprises with project assistance. The choice of intermediary requires that some special attention be given to enterprises, of 5-20 employees which the project will address by providing incentives to banks to lend at this level, by providing grant funding for required management and technical assistance to sub-borrowers, and by providing funding to PVOs which may assist some enterprises to obtain bank loans. To the extent that these intermediaries need upgrading or re-direction to achieve project objectives better, assistance will be provided to that end.

(b) Upgrading/Redirection:

Insofar as commercial banks are concerned, their administrative and financial capacities are well documented in the Credit Feasibility Study. The principal need as concerns commercial banks is to induce them to be more willing and able to lend to smaller-scale enterprises. To some extent some such lending will be encouraged by the requirements that the loans be rural and that they meet at least one of the project's development criteria. In addition, the project includes several provisions designed to make lending to smaller scale enteprises more attractive to commercial banks. These are as follows:

- the foreign exchange costs of technical assistance to the banks to establish a business advisory capacity similar to that existing now at the Kenya Commercial Bank1/ will be financed by the project;

1/ The Business Advisory Service (BAS) of the Kenya Commercial Bank was established under the initial IFC loan to KCB for the Small and Medium-Scale Enterprise Program. The BAS conducts feasibility studies on potential loans (on a cost-sharing basis with entrepreneurs) which allows Credit Managers to make lending decisions on a cash-flow as well as collateral basis. Such studies can also alert potential investors to problems in their proposed investments. The BAS also provides procurement assistance to potential borrowers and follows-up on loans made. Although the BAS has limitations in the assistance it can provide to smaller borrowers, it has provided an important focal point for such lending to small and medium-scale enterprises.

- the interest spread will be sufficient to cover a portion of the local costs associated with establishment of a business advisory capacity;

- training will be provided to business advisory personnel;

- the Management and Technial Assistance Contractor will help improve the quality of the investment proposals made by smaller scale entrepreneurs;

- incentive payments will be made to banks making loans smaller than $75,000 to offset some of the proportionately greater administrative costs of making smaller loans.

Concerning the Private Voluntary Organizations likely to be involved in the project, the PVO Evaluation/Social Soundness Analysis concluded that all five organizations reviewed were essentially sound in their management, effective in achieving their objectives, and able to manage somewhat larger programs. The study also identified several areas in general need of improvement. The principal needs identified were to:

- upgrade management and administrative systems;

- upgrade or establish credit delivery systems;

- to improve coordination and sharing of information with other PVOs and with donors;

- to improve access to technical assistance and training for both PVOs and their clients in areas such as marketing and enterprise management;

- to establish or improve monitoring and evaluation of PVO programs.

The principal project mechanism to address these needs will be to provide sub-grant and technical assistance through a PVO intermediary. PVOs and PVO clients will also have access to services and training made available under the Management and Technical Assistance Contractor where those are not available directly from the PVO intermediary organization.

(c) <u>Sustainability</u>:

Commercial banks have a long and successful history in Kenya and will of course continue to operate following project completion. The following factors will encourage banks to continue to make medium-term loans: 1) banks will have developed business advisory services able to provide credit managers with cash flow (vs. collateral) criteria for loan approval; 2) banks will have had 5 years of experience making medium-term loans to rural private enterprises; 3) banks will have a continuing source of medium-term capital (the special account, and perhaps a syndicated insurance fund); and 4) economic incentives in the economy as a whole are expected (after structural adjustment) to favor more rural, local resource-based, export-oriented investments. There would therefore seem to be a reasonable prospect that lending similar to that financed by the project will continue following the project's completion.

The permanency of PVO lending and assistance programs is more open to question. By the very nature of PVO clients it cannot reasonably be expected that the PVO programs will become self-financing operations. However, the individual and group enterprises assisted by the PVOs will continue to function and to be an important source of earnings to project beneficiaries. Further, the PVOs assisted by the project will after the project be more effective delivery systems for donor (and possibly Kenya Government) assistance to small-scale informal sector enterprises.

3. Rural Private Enterprises:

The various studies dealing with the project's administrative feasibility from the point of view of rural private enterprises (Credit Feasibility Study, Investment Opportunity Study, the Agribusiness Policy Study) and discussions with commercial banks and the Investment Advisory Center all concluded that there are a sufficient number of viable enterprises and investments available which meet project criteria to justify a program at the proposed level. Those efforts were equally in agreement concerning the need to provide management and technical assistance to improve the quality of the portfolio and its distribution among various enterprise categories. Project elements which will respond to this need for assistance include technical assistance to banks for business advisory services, the Management and Technical Assistance Contract, and the bulk of PVO assistance efforts.

Another administrative factor which emerged from the studies and discussions with probable project participants was the potentially fatal impact of strict application of U.S. procurement regulations on the ability and willingness of rural private enterprises (particularly the smaller ones) to participate in the project. As described in Section IV.A, "Implementation Arrangements", provision has been made in project design concerning most procurment requirements and to provide maximum opportunity for U.S. suppliers to meet the procurement needs of the project. However, the source and origin regulations will need to be waived for the reasons given below:

- Sub-borrowers are likely to be widely dispersed with little access to the procurement information needed to effect U.S. and developing country (Code 941) procurement. Application of source and origin requirements would therefore bias project lending toward larger, urban enterprises.

- Sub-borrowers will be paying commercial rates for their loans and will therefore be unwilling to utilize loan funds to procure more costly Code 941 commodities.

- Code 941 commodities are rarely available off-the shelf in rural areas in Kenya. To require procurement from Code 941 sources would therefore imply major delays in implementing many sub-loans.

- Once procured, Code 941 commodities would be difficult or impossible to maintain and repair in rural areas because the needed maintenance expertise and spare parts are unavailable.

All of these factors indicate that, from the point of view of rural private enterprises, a Code 941 procurement requirement would make the lending program unattractive and/or impossible to utilize. In addition, as is suggested by the recent evaluation of the Entente Fund African Enterprises Program Evaluation[1/], a Code 941 procurement requirement would be extremely difficult to implement, enforce or monitor. An attempt to enforce Code 941 procurement would place enormous burdens on the financial intermediaries (which they are unlikely to accept) and on USAID, with little prospect of satisfactory compliance. These considerations have led USAID to conclude (as did the PID review committee) that the project would not be feasible administratively if Code 941 procurement were required. A waiver request is therefore included as Annex F. Case by case determinations of non-availability of U.S. flag carriers from other than U.S. ports would also be infeasible, thus a blanket determination regarding non-U.S. flag carriers is also included in Annex F.

1/ "Assisting Small Business in Francophone Africa: The Entente Fund Africa Enterprises Program", AID Project Impact Evaluation No.40, December, 1982.

4. A.I.D:

The project is designed in such a way as to reduce to the extent possible AID support requirements. By using financial intermediaries to solicit, appraise, approve and manage project-funded loans, AID can effectively remove itself from many of the day-to-day project implementation requirements. The bulk of AID's project support workload will be in the first two quarters of project implementation. Financial intermediaries, principal contractors and grantees must be selected and agreements negotiated during that period and Letters of Commitment must be established. Once these initial project implementation actions have been completed, however, the AID support workload will consist primarily of reviewing financial intermediary, contractor and PVO reports and making spot visits to loan recipients. Currently planned USAID personnel levels, which include one U.S. Direct Hire employee to manage the project as his/her principal responsibility, are adequate for these tasks. The Management and Technical Assistance Contractor will request Private Enterprise Bureau assistance in conducting feasibility studies and arranging training and REDSO/Supply Management and SER/COM assistance in promoting procurement of U.S. commodities by project sub-borrowers.

VI. D. Business Analysis:

During project design four studies were undertaken to determine the nature of rural enterprise likely to be assisted, the probable level of demand for medium term credit, the type of investments and the likely development impacts. These reviews contain an analysis of constraints and a sample of investment proposals.

The rural enterprise sector contains some 1,500 general enterprises in manufacturing and services along with some 500 agribusiness firms and perhaps 200,000 informal sector businesses.

The major constraints to expansion of the sector have been identified as:

- the lack of medium-term credit resulting from the short-term nature of the deposit base and the lack of liquidity. Demand for this term lending is estimated at between $100-150 million;

- price controls and regulation on licensing, imports and exports;

- the lack of diversity in investment proposals;

- inadequate management and technical capacity particularly among the smaller businesses;

- the shortage of foreign exchange and the resulting lack of spare parts and imported raw materials.

The constraints have an impact, to some degree or another, on all rural private enterprise investment activities, and vary in their effects by particular enterprise and over time. The policy and regulation issues are being addressed by USAID and IBRD in Structural Adjustment Programs. The management questions are to be helped by the improvement of bank advisory services and project-financed technical and management assistance. This project directly addresses the credit problems and will help relieve the current foreign exchange shortage. The size of the unmet credit demand indicates that despite the constraints business opportunities exist.

The rural enterprise sector consists of some 2,000 registered companies in agribusiness, manufacturing and services and some 200,000 informal enterprises. A sample of 28 proposals was reviewed against project criteria and objectives to determine the likely outcomes. The main criteria applied were:

- increased rural production, employment and income;

- private sector, rural location;

- labor intensity, potential foreign exchange savings;

- increased markets, inputs or services for agriculture.

All the projects in the sample met some of the criteria and most met at least three. There was a good distribution between small and larger enterprises. Cost per job ranged from about $1000 to $20,000 plus, with an average of $8000. Estimates of employment are 6000 direct and 12,000 indirect jobs, not counting those supplying agriculture products for processing or jobs to be created through PVO programs. Most enterprises were rural with strong links to agriculture.

As expected agribusiness dominates. Agroprocessing of fruit, vegetables, sisal, oils, hides, fish, livestock and wood make up the majority of enterprises. Small scale manufacturing and service businesses made up the remainder. Most enterprises would produce for both the local and export market. Basic tests of viability showed most projects could be successful.

The projected portfolio of loans is expected to number 270 and range between $7,500 and $750,000 U.S. contribution not including the micro enterprise loans. The actual loans are expected to deviate from the sample by a) including a large percentage of expansions and b) having more non agriculture or input/services firms.

The reviews and experience to date confirm that there is adequate demand for medium-term credit for rural enterprise. It also confirms that the loans can have high development impact and provide services and markets for rural families.

A more detailed Business Analysis is included as Annex I.

VI. E. <u>Social Soundness Analysis</u>:

The Social Soundness Analysis carried out during project design was prepared in two parts. Analysis of the PVO component was included in the appraisal of each PVO program considered. A separate analysis was carried out for the commercial lending component of the project. Both are included in the "PVO Evaluation and Social Soundness Analysis" available from AFR/PD/EAP as Supplementary Annex D. The results of both investigations are summarised below.

1. <u>PVO Programs</u>:

In general the PVO programs reviewed were rated very highly from a social perspective. They reach and assist the self-employed poor who lack access to conventional support mechanisms. These are specially effective in reaching women (more than 85% of their clients are women). At the same time the PVO programs seek to integrate social and economic inputs through group formation so that income generation is based on local participation and organizational development. Outreach was found to be good through decentralized service delivery structures, and the programs were considered to be cost effective per client. In summary, in terms of beneficiaries, participation, feasibility, and social impact the programs were found to be socially sound. Given the anticipated strong positive social impact of this component of the project the project design has included funding for the PVO component up to the estimated maximum absorptive capacity of PVOs doing project-related work.

2. <u>Commercial Bank Lending</u>:

The conclusions of the Social Soundness Analysis regarding the commercial bank lending program differed charply from those concerning PVO programs. The principal conclusions of the analysis were that, given the criteria established in the PID, most loan capital would: flow to large, capital intensive firms located in Nairobi and Mombasa; create few jobs per dollar invested; and not be accessible to the majority of rural Kenyans. Such a lending pattern would not, the analysis argued, respond to the objectives of the project nor to the current socio-economic needs of Kenya. USAID agrees entirely that such a lending pattern would not be consistent with program or project objectives and would be undesirable. However, USAID's own analysis does not support the conclusion that project lending criteria would lead to a loan portfolio of the type described by the Social Soundness Analysis.

The Social Soundness Analysis drew its conclusions by applying IFC and KCFC term lending patterns to the project. However, neither of these portfolios required that sub-loans be labor-intensive, export-oriented or strongly linked to agriculture, as does the project. Nor do they require that lending be rural, as does the project (except for agribusinesses). More generally, term lending by the KCFC is the exception to their normal lending and is only done under the "safest" conditions (given the short-term deposit base and possibility of precipitous withdrawals). Loan capital provided under the project will be more secure (from the banks' point of view) than their normal sources of capital, which should affect their lending behavior. The Social Soundness Analysis calculation also makes at least one arithmetic error with far-reaching implications. It concludes (p.18) that utilization of project credit resources according to the KCFC pattern (in which 13% of loan value is applied to loans of less than Ksh 1 million) would result in only 17 loans of less than KSh 1 million. In fact, 13% percent of the value of loans under the project would total KSh 80 million. At the current average loan size of approximately KSh 240,000 for loans under KSh 1 million more than 300 such loans would result, not 17 as projected by the Social Soundness Analysis.

In spite of the above problems with the analysis (most of which arise because of time and data constraints) the concern to ensure that funds will be directed towards smaller scale rural enterprises is valid. As discussed in the Business Analysis, USAID commissioned an Investment Opportunity Study to develop a portfolio of likely investments using project criteria. That portfolio showed 85% of the loans in rural areas at a cost/job of about $8,000. It also showed an average loan size of nearly KSh 11 million - too large. USAID therefore lowered the maximum loan size. The new maximum, when applied to the same portfolio yelded an average loan size of about KSh 3.5 million, at a cost per job of less than $6,000. Additional actions taken to increase participation of smaller, more rural enterprises are: 1) restriction of lending in Nairobi and Mombasa through a requirement that USAID approve any such loans and that such approval will only be given if very strong links to rural production and employment are demonstrated; and 2) introduction of an incentive scheme to make lending to smaller entrepreneurs more attractive.

The Social Soundness Analysis also discusses at considerable length the dichotomy between formal and informal sector enterprises, and concludes that promotion of informal sector enterprises has a greater impact on the rural poor. The issue is of course a debatable one and one for which insufficient data is available in Kenya to resolve. There are certainly, for example, strong backward and forward linkages in formal sector production1/ which are largely undocumented. However, whatever the outcome of such a discussion, it seems clear that both the formal and informal sectors are necessary and interdependent participants in a developing economy. The project provides assistance to both (in the case of the informal sector up to the estimated limits of the capacities of the delivery mechanisms - PVOs), and it will study the possibilites of other potential delivery mechanisms (cooperatives, finance companies, guaranty schemes with commercial banks), to try to develop alternative means of assisting the intermediate group which falls between the formal and informal sectors.

F. Environment:

The Initial Environmental Examination (IEE) approved at the time of PID review concluded that since AID will not have prior knowledge or control over specific sub-loans to be financed by the project, a categorical exclusion to further environmental analysis was appropriate. However, the subloan approval guidelines will include a requirement that each proposed activity comply with the Government environmental regulations.

VII. CONDITIONS, COVENANTS AND NEGOTIATING STATUS:

At the time of PP preparation the project had been discussed with the Investment Advisory Center, the Ministry of Planning and Economic Development, and the Ministry of Finance. Discussions had also been carried out with the Kenya Commercial Bank, Barclays and Standard. More limited discussions had been carried out with Citibank and Commercial Bank of Africa (Bank of America). In general the project has received favorable reactions from all organizations approached, although all are of course awaiting specific procedural, financial and reporting information before making any commitments. A letter of request for the entire project is expected shortly. USAID expects that

1/ The project will conduct a study in this area to try to bring more information to bear on the discussion.

negotiations with Government can be completed in time for a July obligation if the AID/W review and approval process is expeditious. In addition to standard conditions precedent and covenants USAID plans to include conditions and covenants in the agreement with the Kenya Government as follows:

A. Prior to first disbursement by A.I.D. or to the issuance of documentation pursuant to which disbursement will be made, unless A.I.D. otherwise agrees in writing, the Government of Kenya will:

1. Establish a Special Account at the Central Bank of Kenya into which bank repayments will be made;

2. Identify the officer in the Central Bank of Kenya who will be responsible for administering the Special Account.

B. Prior to disbursement under any project sub-loan agreement with commercial banks, the Government of Kenya will furnish to A.I.D., in form and substance satisfactory to A.I.D., a copy of such sub-loan agreement.

C. The Government of Kenya agrees to:

1. process expeditiously all project-related import and foreign exchange approvals;

2. provide all necessary personnel to ensure the effective management of the Special Account at the Central Bank of Kenya.

VIII. EVALUATION PLAN:

A. Evaluation Arrangements:

Monitoring, evaluation and special studies are of particular importance in this project, and provision has been made for close coordination of these elements. The Government of Kenya in its Sessional Paper No. 4 of 1982, and in its draft Five Year Plan for the period 1983/84-1987/88, is placing increased emphasis on the role of the private sector. Moreover, the Rural Private Enterprise Project is the largest single element in USAID/Kenya's strategy of utilizing private sector institutions and mobilizing private sector resources for development purposes. Evaluation results will have implications not only for USAID/Kenya, but for AID programs in general. A total of $1,150,000, therefore, has been budgeted for monitoring, evaluation and studies of this project (3.2 percent of total AID funds in the project).

Evaluation expenditures of $250,000, and related studies totaling $150,000 are not excessive in light of programmatic considerations. Economies in direct evaluation expenditures have been made possible as a result of special reporting procedures required of participating banks (See Annex E), and close monitoring arrangements for bank and PVO operations (discussed in Section III B.5 above). Baseline data, and progress indicators, will be collected as the project proceeds and should be available to the evaluation contractor in readily useable form. A single contractor will be engaged early in the project cycle to perform all required studies, and eventually to carry out both the mid-term and final project evaluations. It is expected that these special studies will require the periodic presence in Kenya of contractor representatives. In addition, it will be the responsibility of the evaluation contractor to establish whatever local representation is required to ensure that baseline and other data necessary for successful evaluation of the project are collected on a continuing basis. Time pressures or lack of acceptable data should be considerably reduced as negative factors in completing mid-term and final evaluations by adopting this approach.

Early in project implementation, USAID will prepare a Project Implementation Order/Technical (PIO/T) providing a detailed scope of work, and defining the respective conditions and responsibilities of USAID/Kenya and the Evaluation and Studies Contractor. After Government and USAID have signed the PIO/T, the REDSO Regional Contracting Officer will be requested to invite proposals from qualified U.S. and Kenyan firms and universities. Criteria for selection of the organizations will include demonstration of: previous experience providing design and evaluation of intermediate credit programs in developing countries (preferably in Africa); knowledge and experience of commercial banking practices; previous experience with co-operative and other small scale lending and management assistance programs; knowledge and experience of inter-industry, social accounting, urban/rural and formal/informal sector relationships in developing countries (preferably in Africa, preferably in Kenya).

Following receipt of proposals from interested firms and universities, USAID will select the contractor and request the Regional Contracting Officer to negotiate and sign a direct AID contract with the organization selected. Immediately after signing of the contract, work should begin on two studies budgeted at $25,000 each: a) to review a possible expanded use by AID of the co-operative system to assist development of rural private enterprises in Kenya; and b) to investigate the legality, commercial acceptability, desireability and procedures associated with establishing a guaranty mechanism to assist rural private enterprises in the country.

Following completion of the proposed IFC study of financial markets in Kenya, and of the possible Private Enterprise Bureau (PRE) study of capital markets, but in no case less than six months before the mid-term evaluation, work should begin on a study budgeted at $25,000 to review possible expanded use by AID of the growing network of finance companies to assist development of rural private enterprises in Kenya. Final analysis and recommendations should be completed before the mid-term evaluation begins in order to permit prompt implementation of any recommendation by the evaluation team to expand project coverage through use of non-bank financial intermediaries.

Two years after the initial drawdown of funds by commercial banks under the project, work should commence on the project's mid-term evaluation with special emphasis on achievement of project inputs, and recommendations on any additional necessary mechanisms or implementation steps required to better achieve project outputs and the project purpose. Following completion of the mid-term evaluation, but in no case less than one year prior to the final evaluation, work should begin on a study budgeted at $75,000 to determine the indirect impacts of increased formal sector production on: formal or informal sector suppliers of inputs or purchasers of outputs; and employees and their families (either through direct flows of income or through remittances). Special attention should be paid to methodological approaches, and to national and regional baseline data and analyses, completed or planned by the Central Bureau of Statistics (CBS), the World Bank, and others. An in-depth project evaluation will be initiated five years after obligation of project funds has occurred, utilizing the logical framework (Annex B) as the evaluation guide. A supplemental discussion of performance characteristics and related evaluation considerations is included in the sections below.

B. Baseline:

1. Socio-Economic Baseline:

Kenya is fortunate in having a number of completed or planned surveys and studies which the Studies and Evaluation Contractor must consult in order to establish a satisfactory baseline of economic and social data, and to develop a satisfactory insight into the Kenyan socio-economic framework. Data from the <u>1982 Census of Industrial Production</u>, carried out by the Central Bureau of Statistics, should be ready in time for the mid-term evaluation. In any case, the data must be reviewed. The Industrial Census will contain a detailed baseline of urban and rural production, factor payments, and employment, by firm size. These data will be supplemented by related CBS data contained in publications such as: The Survey of Industrial Production; Employment and Earnings in the Modern Sector; the Economic Survey; and the Statistical Abstract. At the household level, the Central Bureau of Statistics is carrying out a comprehensive National Sample Survey and Evaluation Programme. Urban and rural household budget data, together with related health, nutrition and other social indicators will be collected during 1982/83. It is expected that analysis of the household budget data will form an essential baseline for the final project evaluation. The Studies and Evaluation Contractor will be responsible for closely reviewing progress on the analysis of this data, and arranging for access to analysis in progress, if necessary, to establish an adequate baseline for the mid-term and final evaluations. A research proposal entitled Support Networks and Survival Strategies of the Urban Poor has been prepared by Mr. Michael Bamberger of the Urban and Regional Economics Division of the World Bank. The Studies and Evaluation Contractor can profit from methodological and analytical work completed and projected with regard to formal/informal and rural/urban relationships in Kenya by reviewing the research proposal, following up regarding its status, and consulting or perhaps collaborating with its originators.

2. Project Specific Baseline:

It is not anticipated that a project of this magnitude will have effects on the national economy that are statistically distinguishable from other causes of growth during the period of project implementation. What will be required of the Studies and Evaluation Contractor is a comparison of project specific data and national data to put project achievements in a national perspective. The requirement is for an assessment of the relations between credit, production, employment, incomes, and welfare in the project against similar relations in the economy as a whole for which adequate data should be available. The contracting organization will review the project-specific baseline data contained in the initial proposals of banks and PVOs, and in the reports of the banks and the monitoring contractor, and propose such additional baseline data to be collected as in the organization's opinion may be necessary to evaluate achievement of the project purpose.

C. Targets:

1. Inputs:

AID inputs into the project are primarily technical, managerial and financial. In general, timely provision of inputs of these types poses relatively little difficulty. In this project in particular, AID will be responding to incremental private sector requests for disbursement of funds and provision of technical assistance. Once initial contracts are signed with banks, contractors and PVOs, as proposed in the implementation plan, and defined in the evaluation arrangements, the measure of project success at the input level will be the project's response time to requests for funds and specific technical assistance requirements. These requests, from a variety of PVOs and banks, cannot realistically be forecast with great accuracy in advance, and given the private sector orientation of the project, a strict schedule should not be imposed. It should be noted that the pro-forma drawdown and amortization schedule contained in the project's financial analysis sections are illustrative of the simplest drawdown and repayment possibilities. It is not expected that economic conditions will necessarily lead to this pattern of disbursement, nor that equal quarterly drawdowns are more desireable than some other pattern which banks may request. The Loan Agreement, reports from financial intermediaries, contract and other project implementation documents, should be used by the Studies and Evaluation Contractor to verify AID's ability to respond flexibly and in a timely fashion in providing required inputs to meet changing private sector requirements.

2. Outputs:

The project will lend $50 million to rural private enterprises by the end of 5 years of project operations, as will be indicated by reports of financial intermediaries and PVOs. Of this total, 2 million will be lent by PVOs themselves, and the rest by banks. Some 1600 loans will be made in total, the great majority by the PVOs. It is estimated that perhaps 250 loans will be made by commercial banks, totalling $48 million dollars. The number of loans is not particularly relevant to achievement of the project purpose if all the funds are fully lent to meet employment, income, and production goals. As an indicator of successful lending, the project seeks to hold bad debt losses to a five-year average of two percent of the value of loans outstanding by commercial banks. It is recognized that macroeconomic conditions may affect performance in any one year. No similar goal has been set for the $2 million of lending by PVOs, given the poor existing data base on which to form an estimate. The PVO Management Grantee will, however, be required to show improvement in this area compared to the prior experience of individual PVOs' participating in the project. Principal and interest in arrears more than six months should be held to 10 percent or less of total lending by banks. PVOs should demonstrate improvement in performance in these areas to levels above those which they experienced before joining the project.

Provision of business advisory services by banks, and of technical assistance by the contractor, is not seen as an end in itself. A primary measure of the success of such services will be the ability of sub-borrowers to repay their loans in a timely fashion and in full so that the project successfully meets its bad debt and arrearage targets. Beyond such indicators, the rates of expansion of investment, employment, production and sales will be important verifiable indicators of successful business and technical advisory services. It may be possible for the Studies and Evaluation Contractor to compare relative success in these areas between assisted and unassisted sub-borrowers, although it is realized that the least viable sub-loans ought to receive the bulk of referrals to the available services. Given the relatively lower level of record-keeping to be expected from PVO providers of management and technical advice, and by their clients, a case study and survey approach will be preferable for evaluating the extent of usage, and the extent of success, of business advice channeled through these sources.

3. Project Purpose Targets:

Financial reports from banks will be utilized to verify that a minimum 6,000 jobs have been directly created in project-assisted enterprises. It has been estimated that at least one additional job in the formal sector and one in the informal sector will be associated with each job created directly. Inter-industry relationsips in the economy as a whole will be investigated by the Studies and Evaluation Contractor to establish a correct order of magnitude for such ratios. Given an estimated average capital/output ratio of four to one, which is plausible for Kenya, it may be hypothesized that when $48 million has been lent, a minimum annual increase in output of $12 million ought to occur in project-assisted businesses. On the basis of financial intermediary reports, this conclusion is to be verified or modified by the Studies and Evaluation Contractor. Since reported estimates of production are likely to be minimums, demonstration of an output/capital ratio of four to one would be substantial evidence of project success. It is recognized, however, that the reverse is not necessarily indicative of failure to meet the project's production goal. Production targets have not been established for the PVO components, given the likelihood that records will not be able to adequately reflect true production increases. A survey or case study approach will provide verification of the success or failure of the PVO approach to providing business and technical advice.

4. Goal Achievement:

The Studies and Evaluation Contractor will compare project purpose targets, described in the previous section, with socio-economic data described in the section on baseline data. The contractor will determine the impact of project income, production, and employment achievements on total non-agricultural income, production and employment in rural areas. The purpose of such a comparison is to provide perspective. There is no assumption that project effects can be statistically segregated from national trends in the economy. Socio-economic baseline data described earlier should provide required input into this estimation process. Case studies, surveys, or both, should be utilized to verify such relationships in representative project-assisted enterprises. Monitoring of records of PVO activities will demonstrate whether the target has been achieved with regard to the estimated 1,000 jobs to be directly created through PVO lending activity. It is recognized that the major contribution of PVO business advice may be in the reduction of underemployment, rather than in the creation of easily identifiable new jobs per se.

Increases in value-added as a result of project lending activities may be difficult to measure given predictable desire on the part of some entrepreneurs to understate production data for sales-tax or income-tax purposes. The Studies and Evaluation Contractor will, however, compare growth rates in relevant sectors of the national economy with project assisted growth rates by comparable sector to determine relative success of project assisted activities.

D. Project Assumptions:

The project assumes continuation of the process of structural adjustment, begun in Kenya before project start-up, as a pre-condition to achievement of projects outputs, purpose and goal, and possibly of some project inputs (loan fund drawdowns). The details of structural adjustment in Kenya are complex. The Studies and Evaluation Contractor will review relevant IMF, World Bank, and USAID documents during the mid-term and final evaluations to determine whether macroeconomic actions or inactions on the part of Government have substantially enhanced or inhibited project achievements. Government's intentions regarding continuation of the structural adjustment are contained in its letters of intent to the IMF, IBRD and USAID. Its long-term intentions are set forth in Sessional Paper No. 4 of 1982 on Development Prospects and Policies and in the 1983/84-1987/88 Five Year Plan, which the contractor will also review. Although many potential disruptions at the macroeconomic level are of concern (the logical framework contained at Annex B lists six), the design team is particularly concerned that project assisted businesses should have continued and reliable access to foreign exchange for import of equipment and inputs; and that there be no abrupt changes in interest rate policies. The overall availability of foreign exchange is being dealt with by the IMF, IBRD and USAID in the context of program assistance activities which will directly complement this project. USAID will in addition negotiate a covenant with Government concerning prompt processing of foreign exchange and import licenses for project-assisted imports. USAID will also continue to discuss with Government the importance of maintaining positive real rates of interest to savers to ensure availability of an adequate deposit base in commercial banks which will be required to provide necessary matching funds. USAID will leave open the possibility of renegotiating project interest rates to banks and to borrowers, reducing the spread to Government if necessary, to maintain project viability if official rates of interest are permitted to fall below expected levels.

ANNEX A

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TAGS:
SUBJECT: ECPR RESULTS: KENYA RURAL PRIVATE ENTERPRISES PID (615-0220)

1. THE SUBJECT PID WAS REVIEWED BY THE ECPR CHAIRED BY DAA PATTERSON ON 16 MARCH. THE PID WAS APPROVED FOR LOP FUNDING OF DOLS. 31 MILLION OVER FIVE YEARS. THE CURRENT OYB LEVEL FY 83 IS DOLS. 3 MILLION GRANT AND DOLS. 6.5 MILLION LOAN.

2. THE ECPR COMMENDS THE MISSION ON THE QUALITY OF THIS INNOVATIVE AND TIMELY PROJECT WHICH IS PARTICULARLY WELL FOCUSED ON THE NEEDS OF PRIVATE ENTERPRISE IN RURAL KENYA. THIS PROJECT WILL PROVIDE USEFUL LESSONS FOR SIMILAR PROJECTS/PROGRAMS IN AFRICA AND ELSEWHERE; FOR THIS REASON AND THE LIMITATIONS OF [illegible] REVISED, THE PP WILL BE AUTHORIZED IN AID/W.

3. ECPR GUIDANCE FOR PP PREPARATION IS AS FOLLOWS:

(A) CREDIT AVAILABILITY: IN ADDITION TO THE [illegible] EXPANSION AND EMPLOYMENT GENERATION OBJECTIVES [illegible] IN THE PID, THE PP SHOULD [illegible] ON THE ANTICIPATED IMPACT OF THE PROJECT ON THE AVAILABILITY [illegible] MECHANISM FOR EXTENDING MEDIUM-TERM CREDIT TO RURAL PRIVATE ENTERPRISES, I.E., CAN [illegible] A SHIFT AWAY FROM OVERDRAFT LENDING TOWARD MORE MEDIUM AND [illegible]-TERM LENDING FROM PARTICIPATING [illegible] AFTER THIS PROJECT.

(B) FINANCING INTERMEDIARIES: THE ECPR CONCLUDED THAT THE KENYA COMMERCIAL BANK IS AN APPROPRIATE INSTITUTION FOR PARTICIPATION IN THE PROJECT BECAUSE OF ITS PROVEN [illegible] AS A [illegible] INSTITUTION AND ITS [illegible] ORGANIZATIONAL CAPABILITY TO [illegible] WITH [illegible] RURAL [illegible] THROUGH ITS EXTENSIVE BRANCH SYSTEM. THE COMMITTEE [illegible], HOWEVER, [illegible] [illegible] TO [illegible] THOROUGHLY [illegible] INVOLVEMENT [illegible] PRIVATE [illegible] [illegible] IN ORDER TO INCREASE COMPETITION AND COVERAGE IN RURAL AREAS. [illegible] PARTICIPATION [illegible]

TOO COMPLEX. SUCH A DEVELOPMENT WOULD HAVE AN IMPACT UPON THE ULTIMATE FEASIBILITY OF THIS PROJECT. THE [illegible] REQUESTS THAT THE PP CLEARLY DESCRIBE THE ADMINISTRATIVE ARRANGEMENTS FOR IMPLEMENTING THE PROJECT INCLUDING THE PROVISION OF TECHNICAL ASSISTANCE TO ICIS AND SUBBORROWERS AND THE ROLE OF USAID KENYA IN APPROVING LOANS AND MONITORING PROJECT ACTIVITIES.

- (C) PROCUREMENT: THE [illegible] REQUESTED GC AND SER/CM TO PROVIDE GUIDANCE TO THE MISSION ON SOURCE/ORIGIN REQUIREMENTS, COMMODITY ELIGIBILITY AND OTHER PROCUREMENT REGULATIONS APPLICABLE TO THIS PROJECT. SECTIONS 1; AND 2, BELOW PROVIDE THAT GUIDANCE AS DEVELOPED TO DATE. WE WOULD APPRECIATE THE MISSION'S RESPONSE TO THIS GUIDANCE AND WILL PROVIDE FURTHER GUIDANCE AND INFORMATION BASED ON THAT RESPONSE. THE [illegible] WAS VERY [illegible] ABOUT THE NEED TO RESOLVE ALL MATTERS RELATED TO PROJECT PROCUREMENT AND RELATED ADMINISTRATIVE REQUIREMENTS DURING PP DESIGN AND IT WAS

AGREED THAT THE VIABILITY OF THIS PROJECT IS DEPENDENT ON HAVING SIMPLE AND WORKABLE PROCUREMENT ARRANGEMENTS [illegible] [illegible] PRIOR TO PROCEEDING WITH PROJECT AUTHORIZATION AND IMPLEMENTATION. PROCUREMENT GUIDANCE IS DIVIDED INTO FOREIGN EXCHANGE PROCUREMENT AND LOCAL CURRENCY PROCUREMENT AS FOLLOWS:

- - (1) FOREIGN EXCHANGE PROCUREMENT: FOR FOREIGN EXCHANGE PROCUREMENT A NUMBER OF AID PROCUREMENT POLICIES APPLY TO PROCUREMENT BY THE INTERMEDIATE CREDIT INSTITUTION (ICI) AS WELL AS THE [illegible] FROM THE ICI. SEE HANDBOOK 1, SUPP. B, CHAPTER 18, SEC. 18A[illegible]. THE MOST DIFFICULT OF THESE POLICIES ARE THE APPLICABLE SOURCE/ORIGIN REQUIREMENTS. IF PROCUREMENT FROM NON-941 COUNTRIES IS ANTICIPATED BY SUBBORROWERS, IT IS SUGGESTED THAT THE PROJECT PAPER INCLUDE A JUSTIFICATION AND REQUEST FOR A [illegible] BLANKET WAIVER OF THE [illegible] SOURCE/ORIGIN REQUIREMENT TO ALLOW PROCUREMENT FROM CODE [illegible] COUNTRIES. SEE HANDBOOK I, SUPP. B, CHAPTER 5, SECTION 5[illegible], A, [illegible], AND C. ANOTHER PROBLEM AREA COULD BE THE CARGO PREFERENCE REQUIREMENTS FOUND IN HANDBOOK 1, SUPP. B, CHAPTER 1[illegible]. AA AFR IN CONSULTATION WITH [illegible] AND GC MAY DETERMINE NOT TO APPLY SAID [illegible] [illegible] TO THIS PROJECT IF OVERALL [illegible] [illegible] COMPLIANCE WITH CARGO PREFERENCE IS DETERMINED TO BE [illegible]. SEE HANDBOOK 1, SUPP. B, CHAPTER 1[illegible], SECTION 1[illegible].

[illegible]

[illegible]

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- - (2) LOCAL CURRENCY PROCUREMENT. THE PROCUREMENT PROBLEM HERE WILL BE SHELF ITEMS IMPORTED FROM CODE 899 COUNTRIES WHERE THE TOTAL PROCUREMENT FOR EACH SUBLOAN EXCEEDS DOLS 250,000 EQUIVALENT. IT APPEARS LIKELY THAT A NUMBER OF SUBLOANS WILL INVOLVE PROCUREMENT OF SHELF ITEMS FROM CODE 899 COUNTRIES IN EXCESS OF DOLS. 250,000 EQUIVALENT. THIS BEING THE CASE IT IS SUGGESTED THAT A PROJECT BLANKET SOURCE ORIGIN WAIVER BE SOUGHT. SEE HANDBOOK 1, SUPP. B, CHAPTER 5, SEC. 5B4A, B, AND C; AND CHAPTER 13, SECTION 13A4B.

- (D) CONSTRAINTS AND CREDIT DEMAND: THE ECPR REQUESTS THAT PP SUMMARIZE THE MAJOR CONSTRAINTS TO BUSINESS EXPANSION FACED BY THE PROJECT'S TARGET ENTERPRISES AND IDENTIFY POSSIBLE POLICY CHANGES TO BE EXPLORED WITH THE GO . THE ECPR DID NOT REQUIRE A SPECIAL STUDY OR SURVEY IN THIS AREA FOR PP DESIGN, BUT RATHER A GENERAL REVIEW OF THE POLICY AND ADMINISTRATIVE ENVIRONMENT IN WHICH RURAL ENTERPRISES OPERATE WHICH COULD SERVE AS A BASIS FOR FUTURE STUDY DURING PROJECT IMPLEMENTATION. (SEE PARA 4 E) BELOW.) THE ECPR ALSO SUGGESTED THAT THE CHARACTERISTICS OF CREDIT DEMAND SHOULD BE FURTHER DEFINED THROUGH A DESCRIPTION AND ANALYSIS OF INVESTMENT OPPORTUNITIES INCLUDING [illegible] LOAN REQUESTS. THE ECPR NOTED THAT ONE OF THE CRITERIA FOR LOANS [illegible] ALTHOUGH THE GENERATION OF NON-FARM EMPLOYMENT OPPORTUNITIES IS AN IMPORTANT PROJECT OBJECTIVE (AND ONE OF THREE CRITERIA FOR LOANS -- THE OTHER TWO BEING LINKAGE TO AGRICULTURE AND EXPORT PROMOTION), THE FINAL PROJECT DESIGN NEED NOT NECESSARILY INCLUDE REQUIREMENTS FOR SPECIFIC CAPITAL/LABOR RATIOS EITHER FOR INDIVIDUAL SUBLOANS OR FOR A PARTICULAR BANK'S PORTFOLIO. IT WAS NOTED THAT APPLICATION OF CAPITAL/LABOR RATIOS COULD BE TOO RESTRICTIVE AND THUS COMPLICATE BOTH PROCESSING OF LOAN APPLICATIONS AND ACCOUNTING/REPORTING. HOWEVER, CRITERIA SHOULD BE ESTABLISHED AND APPLIED TO ASSURE THAT SUBLOANS ARE MADE FOR PRODUCTIVE ECONOMIC PURPOSES CONSISTENT WITH PROJECT OBJECTIVES AND THAT A REASONABLE PORTION OF LOANS ARE UTILIZED BY SMALL AND MEDIUM SIZED ENTERPRISES.

- (F) OBLIGATING MECHANISM: THE PRESENTATION IN THE PID INDICATED THE MISSION IS FULLY AWARE OF THE ADVANTAGES AND DISADVANTAGES OF SIGNING AN AGREEMENT WITH THE GOB AS A [illegible] TO PROVIDING FUNDS TO ICIS [illegible] SIGNING AGREEMENTS DIRECTLY WITH PARTICIPATING BANKS [illegible]

CONVERTIBILITY, FX ALLOCATIONS TO SUB-BORROWERS, TAX WAIVERS ON-LOAN REPAYMENTS, AND LOAN GUARANTEES WILL BE HANDLED. THE SENSE OF THE ECPR WAS THAT THE ADVANTAGES OF A TWO-STEP ARRANGEMENT IN WHICH FUNDS ARE OBLIGATED THROUGH THE GOK BUT ADMINISTERED AND DISBURSED BY THE ICIS SEEMED TO OUTWEIGH THE ADVANTAGES OF OBLIGATING DIRECTLY WITH THE ICIS. FYI: TO MINIMIZE INVOLVEMENT

OF GOVERNMENTAL MACHINERY, MISSION MIGHT CONSIDER ARRANGEMENT WHEREBY CB COULD ACT AS AGENT OF GOK IN ACTUAL ALLOCATION OF FUNDS TO ICI'S. END FYI. THE ECPR DISCUSSIONS INDICATED THAT QUESTIONS RELATED TO FX RISK/CONVERTIBILITY/ALLOCATION, TAX WAIVERS, AND LOAN GUARANTIES WOULD BE MORE EASILY DEALT WITH IN THE CONTEXT OF A TWO-STEP OBLIGATING MECHANISM.

- (G) THE ECPR SUGGESTED THE PP DESIGN LOOK INTO THE POSSIBILITY OF UTILIZING VARIOUS BUSINESS GROUPS, COOPERATIVES, FARMER ASSOCIATIONS, CREDIT UNIONS, ETC, AS ORGANIZATIONS WHICH COULD COLLECT, REVIEW AND RECOMMEND CERTAIN LOAN APPLICATIONS TO ICIS UNDER THE PROJECT.

- (H) THE ECPR URGES THE PP DESIGN TEAM TO INCLUDE A LIBERAL AMOUNT OF FUNDS IN THE PROJECTS TO CARRY OUT STUDIES AND EVALUATIONS. STUDIES WILL BE REQUIRED TO FURTHER EXAMINE CONSTRAINTS TO BUSINESS EXPANSION DISCUSSED IN PARA 3E(1) ABOVE AND EVALUATIONS OF THIS PROJECT WILL PROVIDE USEFUL INFORMATION FOR FUTURE PROJECTS OF THIS KIND IN KENYA, AFRICA, AND OTHER AREAS.

4. PLEASE ADVISE CURRENT ASSESSMENT OF TIMING FOR PP DEVELOPMENT AND SUBMISSION TO AID/W. DAM

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ANNEX B

RURAL PRIVATE ENTERPRISE
LOGICAL FRAMEWORK

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATIONS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
Program of Sector Goal The broader objective to which this project contributes:	Measures of Goal Achievement:		Assumptions of achieving goal targets:
Increased rural production, employment and income	1. Increased value of output of rural private enterprises 2. Jobs directly and indirect created 3. Increased income of owners and employees of rural private enterprises	Census of Industrial Production; Survey of Industrial Production; Employment and Earnings in the Modern Sector; Other National statistics	Government will pursue fiscal, monetary, pricing, marketing, industrialization, and export policies in accordance with Sessional Paper No. 4 and the Report of the Working Party on Government Expenditure
Project Purpose:	Conditions that will indicate purpose has been achieved: End-of-Project status:		Assumptions for Achieving purpose:
To establish and expand rural private enterprises in Kenya	1. Increased value added in project-assisted and project-related businesses.	1. Financial intermediary reports	1. Relevant GOK ministries will provide and maintain needed infrastructural support services such as water, access to land, electricity, road and rail access.
	2. A minimum of 7,000 jobs directly created and 12,000 jobs indirectly created	2. In-depth evaluation	2. Adequately functioning import and export licensing system
		3. Loan application data and enterprise balance sheets	

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATIONS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
Project Outputs:	Magnitude of Outputs		Assumptions for achieving outputs:
1. Increased capital flows to rural private enterprises	1. A minimum of $50 million cumulative total value of loans	1. Financial intermediary reports	1. Realistic price structure for labor, capital, raw materials and imported inputs
2. Increased capacity and interest of financial intermediaries to make loans to rural private enterprises	2. A minimum of 1600 loans made to rural private enterprises and agribusinesses	2. Monitoring reports	2. Realistic price structure for business outputs
3. Consultation and advisory services being utilized by borrowers	3. Average annual bad debt losses less than 2 percent of loans outstanding. Average value of principal and interest in arrears more than 6 months less than 10 percent		
	4. Project borrowers using advisory services as necessary to assure sufficient profitability to repay loan principal and interest within bad debt and arrears targets set.		
Project Inputs:	Implementation Target (Type & Quantity)		Assumptions for Providing Inputs:
1. USAID credit funds	1. Credit funds disbursed on schedule	1. Loan Agreement	1. Competent and appropriately structured financial intermediaries will want to participate in project
2. Locally generated credit funds	2. Matching credit funds disbursed on schedule	2. Financial intermediary reports	2. GOK will assume foreign exchange risk
3. Management and Technical Assistance to financial intermediaries and businesses	3. Feasibility studies conducted and management assistance provided	3. Implementation documents	3. Sufficient liquidity available to intermediaries to match credit funds
			4. Sufficient interest spead available to banks to make lending matching of funds profitable

ANNEX C

STATUTORY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY: The responses contained in the Structural Adjustment Program Grant (615-0213) Program Assistance Approval Document approved on June 24, 1983, remain valid.

B. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b); Second CR FY 83, Sec. 101(b)(1).

(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project;
(b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?
(c) If the proposed assistance is a new country program or will exceed or cause the total assistance level for the country to exceed assistance amounts provided to such country in FY 82, has a notification been provided to Congress?

(a) This project was included in the FY 84 Congressional Presentation, pages 171 and 173. A Congressional Notification was sent to Congress on 7/15/83 The 15-day waiting expired on 7/29/83 without Congressional objection.

(b) Yes
(c) FY 83 assistance is above FY 1982 levels. Congress has been notified as stated above.

(d) If the proposed assistance is from the $85 million in ESF funds transferred to AID under the Second CR for FY 83 for "economic development assistance projects", has the notification required by Sec. 101(b)(1) of the Second CR for FY 83 been made?

N/A

2. <u>FAA Sec. 611(a)(1).</u> Prior to obligation in excess of $100,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

(a) Yes.

(b) Yes.

3. <u>FAA Sec. 611(a)(2).</u> If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislation is required.

4. <u>FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501.</u> If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973?

N/A

5. <u>FAA Sec. 611(e).</u> If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's

N/A

capability effectively to maintain and utilize the project?

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

No. It is a country-specific activity.

7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

The project is specifically designed to increase the flow of international trade, to foster private initiative and competition, to discourage monopolistic practices and to improve the technical efficiency of industry agriculture and commerce. Some project resources will encourage development and use of cooperatives and credit unions. The project's impact on labor unions is unclear but no negative impact is anticipated.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Grant-funded technical and management assistance will draw on U.S. private sector expertise. Loan funds will permit increased U.S. exports of capital equipment and machinery.

9. FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and othe services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

Local commercial banks will match U.S. loan funding on a one to one basis and local organizations and enterprises will contribute a portion of the local costs of training and technical assistance.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No.

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes.

12. FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

This assistance is not for the production of any specific commodity for export.

13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16? Does the project or program take into consideration the problem of the destruction of tropical forests?

Yes. A negative determination was approved by the Africa Bureau environmental officer.

14.	FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?	N/A
15.	FAA Sec. 128; Second CR FY 83, Sec. 101(b)(2). Has an attempt been made to finance productive facilities, goods, and services which will expeditiously and directly benefit those living in absolute poverty under the standards adopted by the World Bank?	Yes, through provision of technical assistance and credit funds for private voluntary organizations which assist the very poor, and through sub-grant criteria which require lending to be rural and in accordance with specified development criteria.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural	(a) All credit funds will be for investment in small towns or rural areas. Labor intensive production is one of the criteria for sub-loan approval and technical assistance will be provided to to sub-borrowers for selection of appropriate technologies. U.S. private voluntary and private for profit institution will be involved in the provision of technical and management assistance to sub-borrowers.

and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

(b, c, d) The Private voluntary organizations to be involved in project implementation focus heavily on cooperative, self-help organizations, and assistance to women.

(e) Training visits to other developing countries for entrepreneurs will be undertaken as part of the project's training component.

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

Section 103: Project-assisted enterprises are expected to be concentrated in the agricultural input and agriculture processing areas.

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Yes, through private voluntary organization assistance and incentive measures.

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes. It is estimated that host country entities will contribute $26 million (42%) to the project costs.

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e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"?

N/A

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes. The project is specifically targeted toward the development of economic resources and increased productive capacity.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the project people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in government processes essential to self-government.

The principal intermediary organizations involved in the project are Kenyan and the vast majority of project-assisted investments will be by Kenyans. Local training and technical assistance organizations will be utilized to the maximum extent practicable.

2. Development Assistance Project Criteria (Loans only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

The project financial analysis concluded that the Government of Kenya could repay the loan.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan? — N/A

c. ISDCA of 1981, Sec. 724 (c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)? — N/A

d. Second CR FY 83, Sec. 134. If the recipient country has an annual per capita gross national product greater than $795 but less than $1,285, will the loan be repayable within 25 years following the date on which funds are initially made available? If it has an annual per capita GNP greater than or equal to $1,285, within 20 years? — N/A

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102? — N/A

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b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities? — N/A

c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to non-proliferation objectives? — N/A

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? — N/A

e. Second CR FY 83, Sec. 101(b)(1). If ESF funds to be utilized are part of the $85 million transferred to AID under the Second CR for FY 83 for "economic development assistance projects", will such funds be used for such projects and not for non-development activities including balance of payments support, commodity imports, sector loans, and program loans? — N/A

5C(c) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	Grant financed contracts will follow A.I.D. contracting procedures which contain provisions for small business participation.
2. FAA Sec. 604(a). Will all commodity procurement financed be from the United States except as otherwise determined by the President or under delegation from him?	Yes.
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	Kenya does not discriminate against U.S. marine companies.
4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such	Project financing is not for any specific procurement of commodity. Agricultural commodities are unlikely to be procured under the project.

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commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

5.	FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one or these areas?	No.
6.	FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates?	Separate determination made on non-availability
7.	FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the	Yes.

fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable not competitive with private enterprise, and made available without undue interference with domestic programs? — N/A

8. International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U. S. carriers be used to the extent such service is available? — Yes.

9. FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? — Yes.

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services to be used? — N/A

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — Yes.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP)? — N/A

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — Yes.

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A

3. FAA Sec. 620(b). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the communist-bloc countries? — Yes.

4. Will arrangements preclude use of financing:

a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practive abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

(1) Yes.

(2) Yes.

(3) Yes.

(4) Yes.

b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property?

Yes.

c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes.

d. FAA Sec. 662. For CIA activities?

Yes.

e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

Yes.

f. <u>FY 1982 Appropriation Act, Sec. 503.</u> To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?	Yes.
g. <u>FY 1982 Appropriation Act, Sec. 505.</u> To pay U.N. assessments, arrearages for dues?	Yes.
h. <u>FY 1982 Appropriation Act, Sec. 506.</u> To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?	Yes.
i. <u>FY 1982 Appropriation Act, Sec. 510.</u> To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?	Yes.
j. <u>FY 1982 Appropriation Act, Sec. 511.</u> For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?	Yes.
k. <u>FY 1982 Appropriation Act, Sec. 515.</u> To be used for publicity or propaganda purposes within U.S. not authorized by Congress?	Yes.

ANNEX D

REPUBLIC OF KENYA
MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. EA/FA..9/03..
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

1st July........ 19..83

Mrs. Allison B. Herrick,
Director,
USAID Mission to Kenya,
P.O. Box 30261,
NAIROBI.

Dear ~~Mrs. Herrick~~ Allison,

RE: RURAL PRIVATE ENTERPRISE PROJECT

As you are aware one of the major thrusts of Government policies and this year's budget is to reduce government expenditure in order to make more liquidity available for development through the private sector. As part of the overall program to utilize the private sector to achieve development objectives, the Government of Kenya requests the assistance of the United States in financing and implementing a program of lending to rural private enterprises through the commercial banking system.

The Government of Kenya also requests assistance in financing a program of grants to private voluntary organizations which are providing financial, management and technical assistance to very small-scale enterprises. A combination of $24 million in concessional loan funds and $12 million in grant funds is requested to help carry out these programs.

Yours sincerely,

WMayaka

W. P. MAYAKA
for: PERMANENT SECRETARY

Reporting Requirements for Commercial Banks

A. Quarterly: Banks will provide AID with reports on Subborrowers, a cumulative statistical review of the Project's progress, and financial statements of the bank within 45 days of the end of each quarter. Reports on Subborrowers will contain the following information:

(1) (a) New Subborrowers: A brief description of each new Subborrower including the nature and location of business; the purpose and the developmental objectives of the Subloan and anticipated employment to be directly generated; total assets before and after financing and projected increased value added; term loans, overdraft and other facilities provided by the banks; and the component of term loans provided by AID. Details of funds committed but not disbursed and of funds disbursed will also be included. A calculation of incentive payments due.

(b) Statistical Review: Separate cumulative totals of funds and other facilities provided by AID and the bank. An analysis of total funds outstanding, size of firms and location will be provided. The review will also include a summary of funds outstanding, classified by size of Subborrower, separately showing term loans provided by the bank, AID, and overdraft and other facilities provided by the bank on a cumulative basis.

(c) Rating of Existing Subborrowers: A quarterly rating of all individual Subborrowers according to creditworthiness and compliance with debt service obligations.

(2) the amount disbursed under the Loan, and the amount sublent by the bank under the Project, both in toto and for the quarter, and for both the A.I.D.-financed portion and bank-financed portion of the Project;

(3) an estimate of the amount of the Loan to be disbursed in the subsequent quarter;

(4) the amount of principal, interest, standby fees, and prepayment penalties paid to AID, both in toto and for the quarter.

(5) the number of clients using business advisory services during the quarter and the number and value of loans made to such clients.

B. Annually

(1) Statistical Review and Other Reports: The bank will, within 120 days of their financial year end, provide AID with a brief summary of each Subborrower's financial condition, and with a cumulative statistical review providing information as specified in Paragraph A(2) above and an explanation of how the developmental criteria of the Subloan agreement have been met.

(2) Audited Financial Statement: The bank will, within 120 days of their financial year end, provide AID with its annual reports and audited financial statements and with any management letters to the bank prepared by auditors.

SOURCE/ORIGIN WAIVER REQUEST

PROBLEM: Your approval is requested for a waiver of U.S source/origin requirements from A.I.D. Geographic Code 941 to A.I.D. Geographic Code 935 for the procurement of approximately $12,000,000 of capital equipment and spare parts by intermediate credit institution sub-borrowers under the Rural Private Enterprise Project (615-0220).

(a)	Cooperating Country	:	Republic of Kenya
(b)	Nature of Funding	:	Loan
(c)	Description of Goods	:	Capital equipment and spare parts for agribusiness and other rural private enterprises
(d)	Approximate Value	:	Less than $12,000,000
(e)	Origin	:	A.I.D. Geographic Code 935.
(f)	Probable Sources	:	Kenya, Europe, Japan

BACKGROUND: The purpose of the Rural Private Enterprises Project is to establish and expand rural private enterprises in Kenya. Achievement of this purpose will directly contribute to fulfillment of the Government of Kenya and USAID top goal of increased rural production, employment and income. Project objectives will be attained through the provision of credit and technical assistance to commercial banks active in Kenya who will in turn make loans and provide business advice to rural entrepreneurs. The project will also provide grants to PVO's who will provide business management advice and extend loans to small-scale entrepreneurs. $24 million of medium-term loan funds will be provided by A.I.D. through the Kenya Government to commercial banks for on-lending to rural private enterprises at market interest rates. Local resource-based processing and manufacturing, and agriculture service enterprises are most likely to borrow under the project.

Since the project will be implemented through an intermediate credit institution and loan decisions will not be made prior to project authorization, no specific list of required commodities can be established. However, studies carried out during project design do allow broad estimates of the procurement requirements.

USAID estimates that some 270 sub-borrowers will wish to procure approximately $12 million of capital equipment and spare parts of Code 935 but non-Code 941 origin. This procurement will be both off-the-shelf and off-shore. Likely procurement requirements are for items such as food processing machinery, wood and clay-based manufacturing equipment, hides processing equipment and machinery and equipment related to agriculture service industries such as metalworking and bagging. The project sub-borrowers will be rural based and widely dispersed with little access to procurement information on commodities other than those normally available in the vicinity of the enterprise. Likewise, maintance and repair services are available only for equipment normally in use in the area. A large portion of U.S. exports to Kenya (See Attachment I) are items financed in whole or in part by the U.S. Government (PL480, military sales, Commodity Import Program fertilizer, project-financed equipment). Kenyan imports from the U.S., including items financed by military and aid programs, account for less than 6 percent of total Kenyan imports. Other major U.S. exports to Kenya are raw materials for industry, agricultural inputs, and road building equipment. Thus few, if any, of the commodities likely to be imported by sub-borrowers under the project are currently imported by Kenya from the United States. Visits to rural areas by USAID personnel confirm the general non-availability of U.S. equipment, machinery, and spare parts in these areas.

DISCUSSION: Given the likely procurement needs of project sub-borrowers, application of U.S. source and origin requirements to sub-borrowers' procurement would have negative project implementation implications for sub-borrowers, intermediate credit institutions, and A.I.D., with little tangible benefit to U.S. exporters. Application of normal source and origin requirements are likely to reduce significantly the participation of sub-borrowers in the project for the following reasons:

- Needed goods of U.S. and developing country (Code 941) source and origin are not normally available to the rural sub-borrowers either off-the-shelf or from locally known and accepted commercial suppliers. To the extent that appropriate commodities could be made available, substantial additional time and cost would be required to obtain these commodities. Sub-borrowers paying market interest rates are unlikely to be willing to incur these additional costs.

- Maintenance and repair of Code 941 commodities, if not already available and generally used locally, will be difficult, if not impossible, and certainly more costly to the sub-borrower. Even if the sub-borrower is willing to incur additional maintenance and repair costs, the risk of having to shut down operations for an indefinite period of time because of the lack of spare parts may well incline the potential sub-borrower away from the project.

From the point of view of the intermediate credit institutions (commercial banks) application of Code 941 source and origin requirements, and more importantly the administrative burden that such requirements would place on the banks, would make banks far less willing to participate in the project. The administrative cost and burden U.S. procurement requirements place on the implementation agent are usually acceptable to governments who are borrowing at highly concessional rates. In the case of private sector commercial banks which will be borrowing at near commercial rates under the project, however, the additional administrative time and effort which would be required for up to 200 branch managers in rural areas to master and implement A.I.D. source and origin requirements would be a substantial deterrent to their participation.

The following considerations make a Code 941 procurement requirement undesirable from A.I.D's point of view as well:

- Because of the difficulty small, rural borrowers would have in procuring and maintaining Code 941 commodities, a Code 941 requirement would significantly bias the project's lending toward larger, urban-based sub-borrowers, which would be undesirable from both social and economic perspectives.

- Because of the difficulty in repairing and maintaining equipment not routinely available in the vicinity of the investment, project-assisted investments would be less sustainable than would otherwise be the case, thus weakening the potential long-term impact of the project.

- Given the nature of U.S. exports to Kenya, most commodities required by the project would need a waiver in any case. Granting such waivers on a case by case basis would place an enormous and unnecessary burden on sub-borrowers, the intermediate credit institition and AID, without significantly altering the composition of the total import list.

- As was demonstrated by the Impact Evaluation of the Entente Fund African Enterprises Project[1], a Code 941 procurement requirement for lending to rural private enterprises through a number of credit intermediaries is difficult or impossible to monitor and implement in the African context. The referenced project was unable to meet even a 15% Code 941 requirement. The impact evaluation concluded that the Code 941 requirement was an impractical and unworkable condition of the Entente Fund loan and strongly urged that the remaining Code 941 requirements be waived.

The conclusion of the PID review committee (See State 103847) and of the AID project design committee following further analysis was that application of a Code 941 source/origin requirement to the Rural Private Enterprises project would make the project unfeasible. It would discourage sub-borrowers from borrowing, it would reduce the long-term impact of the sub-loans, it would dissuade many if not all potential financial intermediaries from participating in the project, it would be difficult or impossible for A.I.D. to monitor in full accordance with its responsibilities, and it would have little positive impact on U.S. exports to Kenya in any case.

USAID does nevertheless recognize the legitimate interests and concerns of U.S. private enterprises which the source and origin requirements were designed to protect. Consequently the following provisions have been included in the project design to permit full and fair U.S. participation in the supply of project-financed commodities where appropriate:

- Early in project implementation, a notice will be published in the Commerce Business Daily describing the project, identifying the kinds of procurement likely to be required under the project, and providing the contact point for project procurement (Management and Technical Assistance Contractor).

  Early in the loan approval process any import requirements of project sub-borrowers will be referred to the Management and Technical Assistance contractor who will assist potential sub-borrowers in the identification and procurement of U.S commodities.

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1. "Assisting Small Business in Francophore Africa". The Entente Fund African Enterprises Program, AID Project Import Evaluation NO.40, December, 1982.

- Sub-loan agreements with sub-borrowers will include a stipulation that preference be given to the procurement of commodities from the United States and other Code 941 countries, in that order, where appropriate.

USAID believes that the above measures will yield a commodity procurement origin mix which closely resembles that which could be expected under more restrictive conditions, without unduly damaging project implementation.

PRIMARY JUSTIFICATION: The criteria relied upon to support the waiver, per Handbook 1, Supplement B, Chapter 5, Section 5B4a, are as follows:

(2) The commodities are not available from the authorized source: Given the extreme difficulty which would be encountered by project sub-borrowers in maintaining and repairing a large proportion of Code 941 origin machinery and spare parts in rural areas of Kenya, such commodities have been considered to be unavailable.

(6) Procurement in Kenya would best promote the objectives of the Foreign Assistance Act: Procurement in Kenya will greatly speed and facilitate the project procurement process for sub-borrowers, rendering the project more feasible from the financial intermediaries' point of view.

(7) Such other circumstances as are determined to be critical to the success of the project: Given the determination that the project would not be feasible from the point of view of sub-borrowers, financial intermediaries or AID if Code 941 source and origin requirements were applied, waiving of such requirements has been considered in the best interests of the project.

RECOMMENDATION: Based on the above justification it is recommended that you determine that exclusion of procurement of goods originating from free world countries other than the cooperating country and the friendly less developed countries included in AID Geographic Code 941 will seriously impede the attainment of U.S. foreign policy objectives and the objectives of the foreign assistance program in Kenya.

KENYA: MAJOR IMPORTS* FROM THE UNITED STATES, 1979-82

Article SITC	Shortened Description	Value (Kshs 1,000,000) 1979	1980	1981	1982
022 429	Non-Fat Milk Purchase	-	15.3	26.9	21.7
041 100	Durham Wheat	-	68.6	8.7	31.9
041 200	Other Wheat	-	20.4	0.1	113.1
042 210	Rice	0.8	4.6	24.1	28.1
044 000	Maize	0.2	137.6	96.7	48.6
045 990	Other Grains	1.6	-	21.0	19.1
233 120	Synthetic Rubber	7.5	6.9	4.0	0.7
333 000	Petroleum Oils	60.4	-	-	-
334 111	Aviation Spirit	27.3	-	-	-
334 211	Jet Fuel	11.1	14.4	-	-
334 302	Gas Oil	-	14.2	-	-
334 511	Lubricating Oil	1.3	15.9	0.4	25.3
411 321	Tallow	2.5	7.5	14.0	28.1
423 202	Soya Bean Oil	3.8	3.8	22.7	12.7
511 110	Ethylene	0.2	0.4	8.9	1.3
511 290	Other Cyclic H.C.	18.5	29.9	16.4	12.4
562 190	Other Fertilizer (N)	-	29.9	-	-
562 223	TSP	-	-	53.2	-
562 223	Other Phospates	-	-	12.7	-
562 920	Fertilizer (N+P)	-	-	17.5	22.3
562 991	Ammonium Phosphate	-	15.0	110.9	-
582 310	Alkyds/Polyesters	0.1	10.5	2.0	0.1
582 901	Other Polyesters	0.5	7.6	1.2	0.1
583 110	Polyestyrene	-	8.5	2.0	-
591 102	Insecticides	22.6	28.8	38.8	28.6
591 200	Fungicides	32.7	47.3	16.2	17.1
598 209	Other Oils	18.9	26.8	15.5	5.5
621 010	Rubber (Plates, Sheets)	5.8	8.5	8.6	5.9
653 140	Tire Cord (cont.)	4.9	-	11.1	0.1
653 540	Tire Cord (non-cont.)	7.1	10.9	22.6	20.4
674 700	Tinned Steel	-	7.6	5.6	-
713 110	Aircraft Engines	0.2	23.0	3.0	0.2
722 400	Wheeled Tractors	0.9	13.1	6.4	4.3
723 300	Road Rollers	24.7	2.7	0.8	0.1
723 410	Bulldozers	9.2	14.8	7.9	0.3
723 420	Mech. Shovels, Excavators	0.5	13.8	1.5	0.5
723 900	Machine Parts	13.6	13.1	16.3	14.5
724 410	Textile Machinery	58.5	31.5	-	-
736 150	Drilling Machinery	-	0.1	8.2	0.1
743 101	Indus. Pumps, Comps.	3.7	7.4	1.3	0.1
745 221	Indus. Machinery	1.2	8.1	-	-
749 200	Auto Parts	-	-	11.2	8.5
764 910	Parts (elec., tel.)	0.9	0.5	9.3	0.8
782 102	Trucks (3t. plus)	17.0	7.4	21.0	0.1
782 109	Other Vehicles	13.3	23.2	-	-
784 900	Auto Parts (spec.)	-	-	10.4	5.6
792 100	Helicopters	-	91.3	132.8	-
792 300	Aircraft (spec.)	-	0.8	18.4	2.3
792 900	Aircraft Parts	22.1	32.4	61.9	18.1
793 820	Floating Docks, Dredges, etc.	-	-	-	196.1
Total from U.S. (m.Kshs)		698.5	1220.0	1273.0	1087.2
Total from U.S. (m.U.S.$)		93.4	163.0	140.7	99.5

Source: Ministry of Finance. Customs and Excise Department.
Special Exercises for USAID/Kenya, November 1982, May 1983.

Note: *Major Imports defined as those exceeding 1 million U.S. dollars for a given 6-digit SITC category in any year 1979-82. Exchange rate: 1 U.S. dollar = Ksh 7.4753 (1979); 7.4202 (1980); 9.0475 (1981); 10.922 (1982).

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ANNEX F.2

DETERMINATION OF NON-AVAILABILITY OF U.S. FLAG CARRIER

PROBLEM: Your approval is requested to determine that U.S. flag carriers are not available for shipments from non-U.S. sources to Kenya under the Rural Private Enterprises Project.

DISCUSSION: The purpose of the Rural Private Enterprises Project is to establish and expand rural private enterprises in Kenya. Achievement of this purpose will directly contribute to fulfillment of the Government of Kenya and USAID top goal of increased rural production, employment and income. Project objectives will be attained through the provision of credit and technical assistance to commercial banks active in Kenya who will in turn make loans and provide business advice to rural entrepreneurs. The project will also provide grants to PVO's who will provide business management advice and extend loans to small-scale entrepreneurs. $24 million of medium-term loan funds will be provided by A.I.D. through the Kenya Government to commercial banks for on-lending to rural private enterprises at market interest rates. Local resource-based processing and manufacturing, and agriculture service enterprises are most likely to borrow under the project.

Since the project will be implemented through an intermediate credit institution and loan decisions will not be made prior to project authorization, no specific list of required commodities can be established. However, studies carried out during project design do allow broad estimates of the procurement requirements. USAID estimates that some 270 sub-borrowers will wish to procure approximately $12 million of capital equipment and spare parts for agribusinesses and other rural private enterprises of Code 935 but non-Code 941 origin. This procurement will be both off-the-shelf and off-shore. However, there is no regular U.S. flag liner service from non-U.S. sources to Kenya. Further, there is no reqular U.S. liner service to Kenya from other than Gulf and East Coast Sources. (See Attachment 1). Therefore you are requested to determine, per Chapter 7, Section 7D5b(3) of Handbook 15 and per Chapter 10, Section 10A4 of Supplement B, Handbook 1, that U.S. flag vessels are not available for intended procurement from non-U.S. Gulf and East Coast Sources, thereby relieving project sub-borrowers of the obligation to ship at least 50 percent of commodities from these sources financed by the project on U.S. flag carriers.

This request is being made on a blanket, rather than a case by case basis because of the large number of individual transactions which will take place under the project. To try to make the determination on a case-by-case basis would impose undue delays in the procurement process which would be unacceptable to private sector sub-borrowers and banks. It would also impose an enormous USAID project management burden.

RECOMMENDATION: That you determine that U.S. flag shipping is not available for the intended procurement from non-U.S. Gulf and East Coast Sources in accordance with your authorities under the cited provision of Chapter 10, Supplement B, Handbook 1.

Attachment: a/s

UNITED STATES GOVERNMENT

memorandum

DATE: July 1, 1983

REPLY TO ATTN OF: David Cowles - RSO

SUBJECT: U.S. Flag Liner Service to Mombasa

TO: Gordon Bertolin

On June 30, 1983, I had a discussion with Mr. Howard Clarke of Mitchell Cotts Kenya Ltd., regarding the availability of U.S. flag shipping to Mombasa. Mitchell Cotts acts as local agent for both Lykes Lines and United States Lines. Mr. Clarke advised that there is liner service available from U.S. east coast and gulf ports to Mombasa. U.S. flag liner vessels do not provide service to Mombasa from other than these points of origin. Therefore, it appears that SER/COM/TS could grant a certificate of non availability of U.S. flag service, in accordance with justification set forth in Section 7D5b(3) of HB 15, for shipments originating at other than U.S. east coast and gulf ports.

The U.S. flag liner service which is available involves transfer of the cargo in a South African port. It is unclear if this is a "transshipment" which would provide grounds for granting a certificate of non availability, in cases where direct foreign flag service is available, or if this would be considered a "relay," in which case a certificate of non availability could not be justified. I will request that SER/COM research this issue and will pass on their finding when received.

OPTIONAL FORM NO. 10
(REV. 7-76)
GSA FPMR (41 CFR) 101-11.6
5010-112

FINANCIAL ANALYSIS ANNEX G

A. DETAILED BUDGET ESTIMATES

Note: Inflation Factor - Foreign Exchange Costs 7.5% per annum; Local currency costs - 15% per annum.

1. Management and Technical Assistance Contract:	A.I.D. Costs ($000)
A. One long term U.S. technician (5 person-years) at Nairobi and office expenses.	
(a) Salary	223.6
(b) Payroll overhead 30% of a)	67.1
(c) General and Administration overhead 90% of a)	201.2
(d) Defence Base Act Insurance 5% of a)	11.2
(e) International travel (Family consisting of 2 adults and 2 children):	
(i) 3.5 tickets x 2 RT (including home leave)	29.1
(ii) Excess baggage people	1.8
(iii) International per diem	2.4
(iv) Mobilization (medical)	1.4
(v) Airfreight (700 lbs)	17.9
(vi) Surface freight (including car)	24.4
(vii) Storage	8.0
(f) Educational allowance	52.0
(g) Temporary quarters and Kenya per diem	3.8

		($000)	(KSh 000)
(h)	Guard services (Ksh 1950/month)		157.8
(i)	Housing (Ksh 13000/month)		1,051.8
(j)	Appliances and furnishings	11.0	
(k)	Kenya travel (one trip/month to Kisumu or Mombasa @ Sh 1000/trip)		80.9
(l)	Kenyan per diem (5 days/month)	15.0	
(m)	Vehicle (1)	10.0	
(n)	Vehicle operation/maintenance @ Sh. 30000/year		202.3
(o)	Office equipment	30.0	70.0
(p)	Office rental (400 sq ft @ Sh. 135 per sq. ft.)		364.0
(q)	Phone, telex, utilities, maintenance (Sh. 4500/month)		364.0
(r)	Office supplies	10.0	20.0
(s)	Home Office visits, one/year	26.6	
(t)	Kenyan administrative assistant (including payroll taxes) Sh. 180000/year		1,213.5
(u)	Secretary (including payroll taxes) @ Sh. 70000 per year		471.9
(v)	Messenger/driver @ Sh. 15000/year		101.1
(w)	Per diem for Kenyan staff (5 days/month		195.0
(x)	U.S. short term T.A. (12 person-months)	200.0	
(y)	Micro-computer and software	20.0	
	Total	966.5	4,292.3[1/]
		330.0	($330.0)
	Total	1,296.5	

1.00 = Sh. 13.00

	A.I.D. ($000)	A.I.D. (KSh 000)	Private Enterprise (KSh 000)
B. Subcontracts for feasibility studies of investment projects at one percent of total investment ($48 million) to be shared equally by A.I.D. and the entrepreneur.	100	1,820 ($140)	3,120 ($240)
C. Workshops and seminars in Kenya. Cost per year. 6 workshops/seminars per year, each of average of one week's duration. Total 6 weeks:			
(a) 2 U.S. Resource persons/ course 12 weeks @ $20,000/ month	60		
(b) Kenyan lecturers. 3 per course @ Sh. 4,000		72	
(c) Travel (U.S. staff 2 trips)	14		
(d) Training materials	2		
(e) Facilities		50	
(f) 20 participants/course, per diem @ Sh. 400			48
(g) Participants salaries @ Sh. 2000/participant/course			24
Subtotal for one year	76	122	288
Total for five years	441	822	1,941
$ Equivalent		($63)	($149)

		A. I. D. ($ 000)	Project ($ 000)
D.	Short term training for Commercial Banks staff		
	3 persons per year @ $15,000/course (AID)	225	
	Banks' share (salaries plus one way airfare)		50
E.	Visits by potential entrepreneurs to the U.S. and other code 941 countries to study processing methods		
	4 visits each of ten days per year @ $6000/trip (AID)	120	
	Entrepreneurs contribution (salary $30000/year)		25
F.	Incentive payments to banks for loans under $75,000. Ceiling of 2% of funds borrowed from AID.		480

SUMMARY OF 1 ($ In Thousands)

		A I D		Private Enterprise
		FX	LC	LC
A.	U.S. advisor	967.0	330.0	
B.	Feasibility studies	100.0	140.0	240.0
C.	Workshops/seminars	441.0	63.0	149.0
D.	Short term training for commercial bank staff	225.0		50.0
E.	Visits by entrepreneurs	120.0		25.0
F.	Incentive payments	480.0		
	Total	2,333.0	533.0	464.0

Total AID contribution = $2,866.0

2. PVO Management Grantee:

		$000	KShs 000
A.	PVO Management Team consisting of one credit advisor and one management advisor.		
(a)	Salary average $40,000 per person/year	464.6	
(b)	Payroll overhead 30% of a)	139.4	
(c)	General and Administration overhead 50% of a)	232.2	
(d)	Defence Base Act Insurance 5% of a)	23.2	
(e)	International travel (2 Families each consisting of 2 adults & 2 children):		
(i)	3.5 tickets/family, 2 families x 2 RT (including home leave)	58.2	
(ii)	Excess baggage people	3.4	
(iii)	International per diem	4.9	
(iv)	Mobilization (medical)	2.8	
(v)	Airfreight (700 lbs)	35.8	
vi)	Surface freight (including) car	48.7	
(vii)	Storage	17.5	
(f)	Educational allowance	130.0	
(g)	Temporary quarters and Kenya per diem	7.6	

		$000	KSh 000
(h)	Guard services (Ksh 1950/ month/family)		315.6
(i)	Housing (Ksh 13000/month/family)		2,103.6
(j)	Appliances and furnishings	22.0	
(k)	Kenya travel and vehicle maintenance		161.8
(l)	Kenyan per diem (20 days/month)	60.0	
(m)	Vehicles (2)	25.0	
(n)	Office equipment	36.9	92.5
(o)	Office rental (600 sq.ft. @ Sh. 135 per sq. ft.)		546.0
(p)	Phone, telex, utilities, maintenance (Sh. 4500/month)		364.0
(q)	Office supplies	10.0	20.0
(r)	Home Office visits, one/year	26.6	
(s)	Kenyan professional (4 @ Sh. 100000/year)		2,697.0
(t)	Secretary @ Sh. 70000/year		471.9
(u)	Messenger/drivers (two @ Sh. 15000/year		202.2
(v)	Per diem for Kenya professional (30 days/month @ $50)		1,170.0
(w)	Per diem for driver/messengers		585.0
(x)	Micro-computer and software	20.0	
	Total	1,368.8	8,729.6
		671.5	($671.5)

Approximate $ Total: 2,049,000

B. Workshops and seminars in Kenya, 6 per year each of average of one week.

	A. I. D. ($000)	A. I. D. (KSh.000)	Private Enterprise
(a) One U.S. resource person 8 weeks @ $15,000/month	30		
(b) Travel of U.S. person	7		
(c) Training materials	1		
(d) Facilities		50	
(e) Kenyan lecturers 2 per course @ Sh. 4,000		48	
(f) 20 participants/course travel and per diem			48
(g) Participants salaries @ Sh. 1,000/participants/course			120
Subtotal for one year	38	98	168
Total for five years	221	661	1,132
$ Equivalent		($ 51)	($ 87)
Approximate AID $ total:	272		

SUMMARY OF 2 ($ In Thousands)

	A.I.D. FX	A.I.D. LC	Private Enterprise LC
A. PVO Management	1,369	672	
B. Workshops/seminars	221.0	51.0	87.0
Total	1,590.0	723.0	87.0

3. <u>Private Voluntary Organizations</u>:

Five PVOs in Kenya who are assisting small businesss were evaluated in May 1983 by Mr. Fred O'Regan in the report titled "PVO Evaluation/Social Soundness Analysis - Rural Private Enterprise Project" Supplementary Annex D. The amounts of loans processed and the total cost to PVOs to process loans and to provide technical assistance in 1982 were as follows:

Table G-1:

P V O s	L O A N S		TECHNICAL ASSISTANCE	
	Amount $	No. of clients	Expenditure $	No. of clients
Daraja	76,000	13	12,000	26
NCCK	20,000	83	45,000	1,507
Partnership for Productivity (PfP)	5,000	19	140,000	3,965
Tototo Home Industries	0	0	65,000	1,070
Technoserve (Basic)	0	0	35,000	N/A
Total:	102,000	115	297,000	6,568

All the above PVOs are receiving some assistance from AID. It is very likely that these PVOs and others providing similar extension services to small businesses will apply to AID for assistance in the very near future. The data developed in the O'Regan report for the absorptive capacity of each PVO is used to project the demand for funds for PVOs. In projecting the demand, the following assumptions are made:

-- AID will supply no more than 75% of grant-financed technical assistance to small enterprise clients;

-- Sound new program applications equal to 50% of the current AID program assistance will be received beginning in the second year of the program;

-- 10% growth for all programs;

-- Interest payments will, on average, offset defaults;

-- Repayments will, on average, be completed within two years;

-- NCCK can immediately double its loan program;

-- PfP can immediately quadruple its loan program.

The resulting demand for funds by PVOs is projected below:

Table G-2

($ in Thousands)

Activity	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Total A.I.D. Contrib.
Technical Assistance	327	698	869	1,088	1,359	4,341	3,257
Loans	(136)	(255)	(320)	(398)	(500)	(1,609)	
Less repayment			(136)	(255)	(320)	(711)	
Net Loans	136	255	184	143	180	898	898
Total:	463	953	1,053	1,231	1,539	5,239	
A.I.D. Contribution	382	779	836	959	1,199		4,155

Detailed calculations leading to the above demand estimates are provided in Annex H.

B. **FINANCIAL TABLES:**

Table G.3.

Rural Private Enterprise Project: Pro-Forma
Amortization Schedule for AID Loan to GOK
(Thousand U.S. Dollars)

Quarter	1	2	3	4	5	6	7	8	9	10	11	
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	
Quarter	12	13	14	15	16	17	18	19	20	21	...	39
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	...	-

Interest at 1.0099505% per semester (1.02% annually)

Quarter	1	2	3	4	5	6	7	8		39
1st Disbursement	-	11.9	-	11.9	-	11.9	-	11.9	...	11.9
2nd Disbursement	-	-	11.9	...	11.9	-	11.9	...	...	11.9
3rd Disbursement	-	-	-	11.9	-	11.9	-	...	...	11.9
...	...	...	...	...	...	...	...	...	...	11.9

Quarter	1	2	3	4	5	6	7	8	9	10	11	
20th Disbursement	11.9	11.9	23.8	23.8	35.8	35.8	47.8	47.8	59.7	59.7		
	12	13	14	15	16	17	18	19	20	21	...	39
	71.6	71.6	83.6	83.6	95.5	95.5	107.4	107.4	119.4	119.4	...	119.4

Interest at 1.0148591% per semester (1.03% annually)

	40	41	...	160
Debt Service (Principal plus Interest)	972.0	972.0	...	972.0

Table G-4.
Rural Private Enterprises Project:
Pro-Forma Amortization Schedule For
Consolidated Loans to Commercial Banks by AID/GOK
(Thousands of U.S. Dollars)

Quarter	1	2	3	4	5	6	7	8	9	10
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200

Quarter	11	12	13	14	15	16	17	18	19	20
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200

Debt Service on
Each Disbursement:

Interest at 4.88088% per semester (10.0% annually)

Quarter	2	4	6	8	10	12	14	16	18	20
Total	58.6	58.6	58.6	105.5	105.5	105.5	105.5	105.5	105.5	105.5
Principal	–	–	–	46.9	49.2	51.7	54.1	56.8	59.5	62.5
Interest	58.6	58.6	58.6	58.6	56.3	53.8	51.4	48.7	46.0	43.0

Quarter	22	24	26	28	30	32	34	36	38	40
Total	105.5	105.5	105.5	105.5	105.5	105.5	105.5	105.5	105.5	105.5
Principal	65.5	68.7	72.0	75.6	79.3	83.1	87.2	91.4	95.9	100.6
Interest	40.0	36.8	33.5	29.9	26.2	22.4	18.3	14.1	9.6	4.9

Consolidated Debt Service On
Outstanding Disbursements:

Quarter	1	2	3	4	5	6	7	8	9	10	11	12
Amount	–	58.6	58.6	117.1	117.1	175.7	175.7	281.2	281.5	386.7	386.7	492.2

Quarter	13	14	15	16	17	18	19	20	21	22	23	24
Amount	492.2	597.7	597.7	703.2	703.2	808.7	808.7	914.2	914.2	961.1	961.1	1008.0

Quarter	25	26	27	28	29	30	31	32	33	34	35	36
Amount	1008.0	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9	1054.9

Quarter	37	38	39	40	41	42	43	44	45	46	47	48
	1054.9	1054,9	1054.9	1054.9	1054.9	949.4	949.4	844.0	844.0	738.5	738.5	633.0

Quarter	49	50	51	52	53	54	55	56	57	58	59	60
Amount	633.0	527.5	527.5	422.0	422.0	316.5	316.5	211.0	211.0	105.5	105.5	–

Table G.5.

Rural Private Enterprise Project: Growth of GOK Loan Fund

(Thousands of U.S. Dollars)

Quarter	Received From Banks	Paid To U.S.	Total	Cumulative Total (No-Re-Lending)	Cumulative Total (Re-lending at 13%)
1	-	-	-	-	-
2	58.6	11.9	46.7	46.7	46.7
3	58.6	11.9	46.7	93.4	94.8
4	117.1	23.8	93.3	186.7	191.1
5	117.1	23.8	93.3	280.0	290.3
6	175.7	35.8	139.9	419.9	439.2
7	175.7	35.8	139.9	559.8	592.8
8	281.2	47.8	233.4	793.2	844.5
9	281.2	47.8	233.4	1,026.6	1,104.1
10	386.7	59.7	327.0	1,353.6	1,465.4
11	386.7	59.7	327.0	1,680.6	1,837.9
12	492.2	71.6	420.6	2,101.2	2,315.5
13	492.2	71.6	420.6	2,521.8	2,807.9
14	597.7	83.6	514.1	3,035.9	3,409.2
15	597.7	83.6	514.1	3,550.0	4[illegible]29.0
16	703.2	95.5	607.7	4,157.7	4,761.7
17	703.2	95.5	607.7	4,765.4	5,517.2
18	808.7	107.4	701.3	5,466.7	6,389.6
19	808.7	107.4	701.3	6,168.0	[illegible]9.2
20	914.2	119.4	794.8	6,962.8	[illegible]1.1
21	914.2	119.4	794.8	7,757.6	[illegible]2.6
22	961.1	119.4	841.7	8,599.3	10,495.0
23	961.1	119.4	841.7	9,441.0	11,662.3
24	1,008.0	119.4	888.6	10,329.6	12,912.7
25	1,008.0	119.4	888.6	11,218.2	14,201.9
26	1,054.9	119.4	935.5	12,153.7	15,578.1
27	1,054.9	119.4	935.5	13,089.2	16,996.9
28	1,054.9	119.4	935.5	14,024.7	18,459.7
29	1,054.9	119.4	935.5	14,960.2	19,96[illegible]
30	1,054.9	119.4	935.5	15,895.7	21,523.[illegible]
31	1,054.9	119.4	935.5	16,831.2	23,126.3
32	1,054.9	119.4	935.5	17,766.7	24,779.3
33	1,054.9	119.4	935.5	18,702.2	26,463.6
34	1,054.9	119.4	935.5	19,637.7	28,240.8
35	1,054.9	119.4	935.5	20,573.2	30,052.5
36	1,054.9	119.4	935.5	21,508.7	31,920.4
37	1,054.9	119.4	935.5	22,444.2	33,846.2
38	1,054.9	119.4	935.5	23,379.7	35,831.9
39	1,054.9	119.4	935.5	24,315.2	37,879.1
40	1,054.9	972.0	84.9	24,400.1	39,139.2
41	1,054.9	-	1,054.9	25,455.0	41,408.4
42	949.4	972.0	- 22.6	25,432.4	42,670.6
43	949.4	-	949.4	26,381.8	44,943.9
44	844.0	972.0	- 128.0	26,253.8	46,210.3
45	844.0	-	844.0	27,097.8	48,488.0
46	738.5	972.0	- 233.5	26,864.3	49,756.9
47	738.5	-	738.5	27,602.8	52,041.2
48	633.0	972.0	- 339.0	27,263.8	53,316.9
49	633.0	-	633.0	27,896.8	55,604.1
50	527.5	972.0	- 444.5	27,452.3	56,884.8
51	527.5	-	527.5	27,979.8	59,177.2
52	422.0	972.0	- 550.0	27,429.8	60,463.2
53	422.0	-	422.0	27,851.8	62,761.1
54	316.5	972.0	- 655.5	27,196.3	64,052.8
55	316.5	-	316.5	27,512.8	66,356.6
56	211.0	972.0	- 761.0	26,751.8	67,654.4
57	211.0	-	211.0	26,962.8	69,904.5
58	105.5	972.0	- 866.5	26,096.3	71,268.7
59	105.5	-	105.5	26,201.8	73,385.4
60–148	-	972.0	- 972.0	- 15,679.7	+ 1,310.6
61–159	-	-	-	10,522.1	+ 2,323.8
160	-	972.0	- 972.0	(NPV at t59)	+ 1,423.8
					+ 2,440.0
					+ 1,543.7
					...

Table G.6.

Rural Private Enterprises Project: Pro-Forma Amortizations Schedule For Consolidated Loans to Sub-borrowers by Commercial Banks
(Thousands of U.S. Dollars)

Quarter	1	2	3	4	5	6	7	8	9	10
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200
Quarter	**11**	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**
Disbursements:	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200

Debt Service On Each Disbursement: Interest at 7.7032% per semester (16% annually)

Quarter	2	4	6	8	10	12	14	16	18	20	22	24
Total	92.4	92.4	92.4	89.7	163.8	163.8	163.8	163.8	163.6	163.8	163.8	163.8
Principal	-	-	-	97.3	78.8	86.9	95.7	105.0	115.1	125.9	137.6	150.3
Interest	92.4	92.4	92.4	92.4	85.0	76.9	68.1	58.8	48.7	37.9	26.2	13.5

Consolidated Debt Service On Outstanding Disbursements:

Quarter	1	2	3	4	5	6	7	8	9	10	11
Total	-	92.4	92.4	184.8	164.8	277.3	277.3	467.1	467.1	656.8	656.8
Quarter	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**	**21**	**22**
Total	846.5	946.5	1036.2	1036.2	1225.9	1225.9	1415.7	1415.7	1605.4	1605.4	1702.7
Quarter	**23**	**24**	**25**	**26**	**27**	**28**	**29**	**30**	**31**	**32**	**33**
Total	1702.7	1800.0	1800.0	1707.6	1707.6	1517.9	1517.9	1328.1	1328.1	1138.4	1138.4
Quarter	**34**	**35**	**36**	**37**	**38**	**39**	**40**	**41**	**42**	**43**	**44**
Total	948.7	948.7	758.9	756.9	569.2	569.2	379.5	379.5	189.7	189.7	-

Table G-7

SUMMARY OF TERM LENDING PATTERNS

	Less than KSh. 200,000 #	Value	200,000-500,000 #	Value	500,000-1,000,000 #	Value	Above 1,000,000 #	Value	Total #	Value
Program		KSh 000		KSh 000		KSh 000		KSh 000		KSh 000
Investment Opportunity study (IOS)	3	474	5	1,770	3	2,260	11	64,300	22	68,804
KCFC	206	15,837	95	30,094	59	41,364	113	582,988	473	670,283
IFC	-	-	1	436	1	800	18	48,868	20	50,104
KCE Pipeline	4	300	16	6,535	17	13,676	45	253,955	82	274,466
	213	16,611	117	38,835	80	58,100	187	950,111	597	1,063,657
IOS1/	13.6%	0.7%	22.7%	2.6%	13.6%	3.3%	50.0%	93.5%		
KCFC	43.6%	2.4%	20.0%	4.5%	12.5%	6.2%	23.9%	87.0%		
IFC1/	-	-	5.0%	0.8%	5.0%	1.5%	90.0%	97.5%		
KCE Pipeline	4.0%	0.1%	19.5%	2.4%	20.7%	5.0%	54.8%	92.5%		
Composite	35.7%	1.6%	19.6%	2.8%	13.4%	5.5%	31.3%	89.3%		

1/ Adjusted to apply a maximum U.S. contribution of $750,000.

2/ Adjusted to account for devaluations since loans made.

Table G-8

Incremental Commercial Bank Costs for Small Loans

		110% [2] Year -1	100% Year 0	90.9% Year 1	82.6% Year 2	75.1% Year 3	68.3% Year 4	62.1% Year 5	Total
IFC Model: Average Loan size of KSh. 3,000,000	Initial Cost	81,840							
	Bad Debt		15,000	15,000	15,000	15,000	15,000	15,000	
	Supervision		40,500	40,500	40,500	40,500	40,500	40,500	
	Subtotal	81,840	55,500	55,500	55,500	55,500	55,500	55,500	
	Discounted	90,024	55,500	50,454	45,868	41,698	37,907	34,461	355,912
OPEC Model: Average loan size of KSh 500,000	Initial Cost	186,000							
	Bad Debt		45,000	45,000	45,000	45,000	45,000	45,000	
	Supervision		75,000	75,000	75,000	75,000	75,000	75,000	
	Subtotal	186,000	120,000	120,000	120,000	120,000	120,000	120,000	
Discounted	204,600	120,000	109,091	99,174	90,158	81,962	74,511	779,496	
									423,584 [3]

1/ Source: 1982 KCB proposal to USAID (See Supplementary Annex F)
2/ Discount rate: 10%
3/ Additional costs for smaller loans valued at KSh 3,000,000 is KSh. 423,584 or KSh 70,600 ($5,430) for each loan of KSh 500,000:

Beneficiary Calculations

1. Proposed PVO Program Levels and Beneficiary Calculations: Technical Assistance

2. Proposed PVO Program Levels and Beneficiary Calculations: Loans

3. Employment Generation

Proposed PVO Program Levels

Technical Assistance

Organization	1982 $	1982 #	Proposed Levels 1	2	3	4	5	Total	75%	Comments
Daraja	12,000	26	15,000	19,000	23,000	29,000	37,000	123,000		Assumes AID pays no more than 75% of total; 10% growth, 15% inflation annually
NCCK	45,000	1,507	56,000	70,000	88,000	110,000	137,000	461,000		
PFP	140,000	3,965	175,000	219,000	273,000	342,000	427,000	1,436,000		
Tototo	65,000	1,070	81,000	102,000	127,000	159,000	198,000	667,000		
TNS(BASIC)	35,000	?	-	55,000	68,000	85,000	107,000	315,000		
	297,000	6,568+?	327,000	465,000	579,000	725,000	906,000	3,002,000		Assumes 50% increase beginning in second year
Other programs				233,000	290,000	363,000	453,000	1,339,000		
		Total	327,000	698,000	869.000	1,088,000	1,359,000	4,341,000	3,256,000	
Beneficiary impact	1982 programs	$\frac{(297,000)}{40}$ = 7,425 x 2				=		14,850		Based on $40/ beneficiary which is current averag of 4 programs, one turnover during LOP
	New programs	$\frac{(45\% x 297)}{40}$ = 3,312 x 2				=		6,624		
		Total						21,474		

PVOs Funding Estimates:

Proposed PVO Program Levels
Loans

Organization	1982 $	1982 #	Proposed Annual Lending Amounts ($) 1	2	3	4	5	Total	Comments
Daraja	76,000	13	76,000	95,000	119,000	148,000	186,000	624,000	Assumes 10% growth +15% inflation annually
NCCK	20,000	83	40,000	50,000	63,000	78,000	98,000	329.000	
PFP	5,000	19	20,000	25,000	31,000	39,000	49,000	164,000	
Sub-total	101,000	115	136,000	170,000	213,000	265,000	333,000	1,117,000	
New programs (Tototo, Women's, World Bank, Maseno South, etc)	-	-	-	85,000	107,000	133,000	167,000	492,000	Assuming 50% more for new programs beginning in second year
Sub-total			136,000	255,000	320,000 (136,000)	398,000 (255,000)	500,000 (320,000)	1,609,000 (711,000)	Assuming re-payments complete in 2 years, interest offsets defaults
Net loan fund requirements			136,000	255,000	184,000	143,000	180,000	898,000	
Beneficiary Impact # loans	Current programs		155	170	187	206	227	945	Assumes $878/ loan which is current average of 3 programs
	New programs			85	94	103	114	396	
		Total	155	255	281	309	341	1341	

3. Employment Generation:

	AID	Banks	Rollover of Credit Funds	Cost/Job	Jobs Directly Created	Jobs Indirectly Created 2/	Total Jobs
Commercial Bank Lending	2,400	24,000	-	8,000 1/	6,000	12,000	18,000
PVO Lending	900	-	1,100	2,000 3/	___ 4/		1,000
							19,000

1/ From Investment Opportunity Study; Smith and Tippett, May 1983.
2/ Assumes 1 formal and 1 informal sector job for every job directly creadted.
3/ From PVO Evaluation/Social Soundness Analysis.
4/ Job impact of non-financial PVO assistance is unknown.

ANNEX I

BUSINESS ANALYSIS

I. Introduction

In order to gain a better understanding of the structure, needs and potential of the rural private enterprise sector four studies were commissioned during project development. These were:" Agribusiness Development in Kenya", Mwaniki & Associates; "Investment Opportunities", Trade & Development International Inc.; "Credit Feasibility Study", Deloitte, Haskins & Sells, and "PVO Evaluation/Social Soundness Analysis" Development GAP, available as Supplementary Annexes A - D from AFR/PD/EAP. These studies and two years of steady contact with about 25 businessmen by USAID staff provide the basis for the analysis which is presented.

II. Background and Current Structure

A. Historical Background

At Independence the modern economy was almost purely a settler crop and plantation economy geared to production for export. Agribusiness was dominated by farmer organizations (cooperatives, associations and trading companies) representing settler interests. In addition, large foreign private investors were engaged in large scale cash crop production and ranching. To administer and control these interests numerous boards (Tea, coffee, dairy, pig, maize, wheat) were established. Other rural enterprise consisted almost entirely of small retail trade. While much of this structure remains there have been significant changes.

Major trends since Independence include (a) increased participation and diversification of operations by certain foreign private firms; (b) greatly increased Government involvement in production, processing and marketing, (c) steady increase in small and medium scale rural business locally owned and managed; (d) mixed performance by the original major participant (fair to good - Kenya Farmers Association, Brooke Bond; poor - Kenya Meat Commission, Uplands Bacon, Mackenzie Inc.).

The overall rate of growth in the agribusiness sector as defined by Mwaniki was 23 percent between 1971 and 1981. Leading growth areas were canned fruit, vegetable oil and sugar processing, grain milling, tobacco, textiles, paper, meat, dairy and wood products. Total value of output increased from KSh.2,220 million to 16,865 million during this decade.

B. Current Structure

The current rural enterprise/agribusiness sector is characterized by the presence and operations of commodity marketing boards, country wide and local cooperatives, parastatals, large private business firms specializing in agro-based processing and manufacturing, large and smaller firms in the distribution of agriculture inputs, manufacturers of small tools, animal feeds and many small service businesses and retailers.

A wide range of institutions also have an impact on rural business, including ministries, the central and commercial banks, boards and departments which are responsible for licensing investments, local trade, imports and exports. This has given rise to a counterpart "bureaucracy" in the commercial sector to deal with Government regulations and procedures.

C. Participants

Approximately 500 agribusiness firms are currently listed in the registry of the Central Bureau of Statistics. In terms of their size and exployment the most important are the sugar companies, Brooke Bond, Kenya Canners, BAT, tea and coffee factories, KFA, sisal processors and oil and grain millers and processors. In the more generalized rural enterprise sector which is less well documented in terms of size, location, number or activity, the major participants are engaged in oil and grain milling, soap making, bakeries, footwear, knitwear, transport and other services and are said to number some 1,500 registered firms. The informal sector may consist of as many as 200,000 enterprises. It has been estimated that roughly 40 percent of rural income comes from off farm sources indicating the importance of the sector. (See Mwaniki Report, Supplementary Annex A for a listing of major agribusinesses).

D. Constraints to Rural Enterprise

Constraints are numerous and of varying importance across types of business and at different times. Of major importance both historically and at present are the lack of medium term credit, management and technical capacity, scarcity of imported materials and spares, price controls and other forms of regulation and limited entreprenial imagination.

Credit: Because of the structure of banking deposits (they are predominantly short-term) and the preference of most Kenyan banking institutions for over-draft lendings, medium-term credit is a serious constraint to business expansion, particularly for those businesses requiring capital equipment. Working capital and equity were also found to be scarce, particularly for smaller scale enterprises. AID and bank credit funds will address the medium term credit constraint, and banks will provide working capital. PVOs will lend AID funds for both medium and short-term credit.

Management and Technical Expertise: Management and technical skills are a problem particularly for small scale enterprises. Large enterprises in the private sector are generally well run and adequate resources are available to provide solutions to management and technical problems. Smaller businesses are often started with limited equity and substantial informal and formal credit for both plant and working capital. Even very small problems can put these enterprises into deep trouble. For this reason informal and small scale formal sector businesses will receive assistance from PVOs and from the management and technical assistance contractor. Additional assistance will be made available by strengthening the bank business advisory services.

Imported Materials and Spares: Foreign exchange shortages and mismanagement in administration of imports have resulted in extreme scarcity of imported materials and spares. In recent months there have been shortages of key materials and several enterprises have been temporarily closed or have worked at reduced capacity. The foreign exchange problem and proposals to improve policy and administration are being addressed through the negotiations concerning program assistance. New import schedules which favor agribusiness and export enterprises are being prepared for implementation in July, 1983. The direct letter of credit mechanism for foreign exchange procurement should ease the spare parts constraint for project borrowers.

Price Control and Regulation: Government regulation impedes the growth of the private sector as parastatal monopolies limit opportunities. Business is faced with price controls on many products, complex licencing requirements for imports and exports, limits on trade or processing and handling of certain commodities and a generally unresponsive administrative structure. Government has become more aware of problems in this area. Both the IBRD and AID (ESF) Structural Adjustment Programs are designed to have an impact on these issues and to effect policies to make the private sector more efficient. While these problems are serious there still exists a high demand for term credit which implies that business can be profitable despite these impediments.

Limited Entreprenural Vision: There is a lack of variety in the proposed investments of rural entrepreneurs. In larger enterprises investors want to pursue the time tested Kenya products of coffee, tea, sisal, fruits, nuts and other horticulture, wood, etc. The smaller business investors repeatedly choose soap, bakeries, mills, shoemaking, small hotels, transport services, furniture making or retailing outlets. Both groups have reasons for these choices. In the first group they are aware of Kenya's advantage with these products and usually have extended experience. In the latter case this is the type of business they see all around them. The fact that another may not survive may be ignored. The changing macro-economic incentive structure should stimulate more innovative investments. The management and technical assistance to be provided by the Contractor and the PVOs will help address these problems. In any case, recent studies indicate there seem to be many good investments in the traditional rural endeavors and some new ideas are being developed.

III. Anticipated Investment Portfolio

A. The Study

It is impossible to predict precisely the types of lending which will be made under the project. Because of the confidential nature of banking relationships it is not possible to examine existing lending in detail nor see a representative sample of new proposals submitted to banks. It is possible to influence lending by establishing criteria of eligibility and by various incentives or rewards. These criteria and incentives will be discussed separately. There is no doubt however, that the project lending will need to be carefully monitored to assure reaching the target group.

In order to find out what kinds of loans were likely to be made under the project it was necessary to collect a sample of investment proposals and analyze them1/. This was done by collecting 50 proposals from USAID files, banks, financial intermediaries and individuals. Approximately one in five to ten proposal reviewed by the study team was selected for

1/ See Smith and Tippett "Investment Opportunities" Supplementary Annex B for further details.

screening according to project criteria. While it is expected that actual loans will deviate somewhat from this sample it is considered indicative of the types of projects to be financed. These proposals were then screened on the basis in compliance with:

- project objectives of increased rural production, employment and incomes;
- private sector, rural location criteria;
- subloan criteria of (1) labor intensity, (2) potential to increase net foreign exchange availability, (3) provision of increased markets, inputs or services for agriculture production based on local inputs.
- business soundness criteria (cash flow, collateral, etc)

The screening process reduced the portfolio to 28 proposals. These investments have the following characteristics.

B. The Results:

Characteristics of Portfolio: Summary Analysis

1. Enterprise Size: By Employment & By Loan Size

SMALL (0-20)	- 10	U.S.$ 0-50,000	-	8
MEDIUM (21-79)	- 7	U.S.$50,000-$500,000	-	10
LARGE (80-UP)	- 11	U.S.$500,000-$3,000,000	-	10
TOTAL	28			28

2. Loan Portfolio by Segment - (U.S.$) - (Based upon Employment/Firm)

	No.Request	Aver.	Total
Small	10	60.300*	603,000
Medium	7	180,000	1,260,000
Large	11	1,969,090	21,660,000
Total	28	840,107	$ 23,523,000

* - Inflated due to 1 loan - closer figure for average is $ 36,700

3. Investment/Direct New Job (U.S.$) by Segments*

	Small	Medium	Large	Total Port.
Range	$1,076 to 25,615	1,923 to 11,000	2,538 to 38,461	1,076 to 38,461
Median	2,230	7,307	10,152	4,807
Average	5,584**	6,175	11,828	8,185

* Based upon employment per/firm
** Inflated due to 1 highly capital intensive investment in category.

4. Number of Direct New Jobs Generated - by Size Segment*

	Small	Medium	Large	Total
Present Jobs	13	-	860	873
Dir.New Jobs (AID Finan)	148	295	4589	5032
Dir New Jobs (Other Finan)	-	-	3895	3895
Total Jobs	161	295	9344	9800

- 5032 - Key Figure - Program-Generated direct new jobs
- Note high frequency of new enterprises (82%)

* Based upon employment/firm

5. New Enterprises vs. Expansion Existing Enterprises

New -	23	- 82%
Existing -	5	- 18%
Total	28	100%

6. Location of Portfolio

Project Criteria

86% Interior (24)
14% Nairobi/Mombasa (4)

REGION	NO.	
Coast	8)	
Central	4)	
Eastern	6)	
Rift Valley	4)	
Western	2)	86%)
Mombasa	1	
Nairobi	3	14%
	28	100%

7. Sector and Sun-Sector Represented in Portfolio

SECTORS	NO.	SUB-SECTORS	NO.
Agro-Production Emphasis	2	Fruit/Veg.	9
Agro-Processing	19	Sisal	3
Manufacture (non-ag)	5	Wood Related	3
Infrastructure Dev. (Irrig)	2	Fish Proc.	2
	28	Edible Oils	2
Integrated Export (from above)	5	Smallscale Ind	3
		Cattle	1
		Coffee/Cotton/ Maize	3
		Feed Proc	1
		Hide Proc.	1
			28

8. Target Markets of Portfolio

KENYA MARKET	NO	% OF TOTAL FINAN
Local Market Focus	8	
National Market	4	
Mixed Nat/Export	1	
Total Kenya Market	22	78.5%
EXPORT		
Export/Exclusive	10	
Mixed Nat/Export	10	
	20	71.4%

9. Import Requirements of Portfolio

Procurement Location - Domestic/Foreign*

Local	1
Partly Foreign	27
Largely Foreign	22
Foreign thru Local Dist.	6

10. Portfolio vs. Development Criteria

	CRITERIA	NO. FIRMS	% OF PORT.
1.	Increase rural employment	25	89%
2.	Labor intensive - Direct empl. (all rural based)	15	54%

3.	Agricultural Links	23	82%
4.	Export Earnings/Import Savings, or New Market Development	21	75%

- All firms in Portfolio meet at least one criteria, most meet 3 of 4 criteria.

C. Analysis:

The portfolio described in the previous section provides a good basis for determining the kind and level of lending which is likely to take place under the project. There are, however, two biases in the sample which make it somewhat unrepresentative of likely project lending. These are the absence of the likely PVO clients and an under representation of potential enterprise expansions expected when long-term customers of commercial banks learn of the existance of longer term credit. USAID expects the PVO component to make some 1300 small loans which will greatly increase the number of loans at the lower end of the portfolio. USAID also expects that more business expansions will be included. This will happen for several reasons including the relationships between present clients and their banks, and the fact that such proposals were underrepresented in the study due to banks' feelings about confidentiality. The result of more expansion investments is expected to be a reduction in the number of large loans from that of the study.

Even when the study biases noted above are taken into account, the resulting portfolio would not fully meet project objectives. This conclusion, together with those of the Social Soundness Analysis led to program modifications to increase lending at the lower end of the portfolio. The principal chances (from the PID), were:

- to lower the maximum AID contribution to a sub-loan from $1.5 million to $750,000;
- to tighten the restrictions on agribusiness loans in Nairobi and Mombasa where the largest enterprises are located (by requiring AID review prior to loan approval);
- to introduce an incentive scheme for lending to small borrowers.

The following section present USAID's estimates of the characteristics of the project loan portfolio in light of the biases of the sample and the modified criteria changes noted above.

1. Loans: The immediate impact of applying a new maximum loan size the sample portfolio is to lower the average loan size from $840,000 to $240,000. The location and incentive measures are expected to reduce the average loan size even further. Based on the term lending pattern described in the Investment Oppprtunities Study and on three actual cases (See Attachment G), it appears that commercial banks would normally make about 90% of their loans above the KSh. 1,000,000 level. USAID estimates that the incentives provided for loans under KSh. 1 million should at least double the percentage of loans made in that category. Such a result would lead to $9.6 million of loans under KSh. 1 million, which, if incentive funds were utilized so as to exhaust all incentive funds with the fewest possible loans, would result in 178 loans below KSh. 1 million, at an average loan size of KSh. 700,000. Different incentive fund utilization would result either in more monies lent or lower average loan size, depending on bank responses to the incentive scheme. Assuming $9.6 million in loans below KSh. 1 million, the remaining $38.4 million is likely to result in 95 loans at an average cost of $400,000, which is the current average size at loan over KSh. 1 million.

2. Credit Demand: Elimination of projects requiring an AID contribution of more than $750,000 reduced the overall level of investment opportunities from nearly $24 million to a little more than $5 million. This figure is consistent with AID life of project loan financing of $24 million since: (a) loan funds will be disbursed over five years and the loans included in the sample were for current loan proposals only; (b) business expansion was probably underestimated given the nature of the sampling process; and (c) the study team selected only one investment in the sample for every 5-10 they reviewed. This sample information, along with the Credit Feasibility Study estimate of $180 million annual capital formation in the sector, and bank indications of the levels at funds they would like to borrow indicate that life of project loan funding of $24 million is reasonable.

3. Employment: Application of the revised criteria reduces average cost per job from $8,200 to $5,600. However, a review of the remaining sample still shows a wide range of total job creation and cost per job. USAID has therefore estimated that the direct employment attributable to the project would be about 7,000 jobs. This figure is calculated at $8,000/direct job (6,000 jobs) in the formal sector and $2,000/direct job (1,000 jobs) from loan capital in the informal sector. Although the Investment Opportunity Study shows a cost/job of less than $6,000 when revised criteria are considered, the IFC experience of $13,000/job makes an figure of $8,000/job seem more prudent. $2,000/job of capital in the informal sector is the figure cautiously forwarded by the PVO Evaluation/Social Soundness Analysis. Monitoring direct employment created will be a priority task of the monitoring contractor to ensure that project employment objectives are being met. The indirect employment effects are likely to be quite low for small enterprises but significant for the larger projects. An estimate of one modern sector and one informal sector job for each project job has been used, resulting in total employment generation of 19,000.

4. Location: The sample contained considerable location diversity. It may be that land cost is becoming an important factor that results in making Nairobi and Mombasa less attractive to investors. It appears that most of the rural areas are likely to benefit from project investments. To ensure rural lending Nairobi and Mombasa have been excluded except for exceptionally attractive proposals (very strong links to agriculture and rural employment) which may be approved separately by AID.

5. Sectors: Agro-processing, as expected is the dominate activity in the sample and this should be true for the actual loans. Horticulture production, processing, and export are perhaps overrepresented in the sample but this is clearly an area of Kenyan comparative advantage (high labor use, climatic factors). Sisal processing is making a comeback due to production declines in competing countries. Wood, hide and food/grain/oil processing should also make up a significant part of the loans.

6. Markets: All of the micro projects can be expected to focus on local markets. Most of the sample of formal sector projects intended to market both locally and on the Kenya national market. About a third were for both local and export markets and another third export exclusive. These percentages are considered representative. The export orientation may increase with inclusion of more expansion investments. Such a result would also reduce the foreign exchange component in the loans.

7. Development Objectives: The sample contained projects with high impact on program objectives. Nearly all increased rural employment and incomes, and had strong agriculture links. Three fourths had positive effects on the foreign exchange account and the majority are considered to be labor intensive. Potential investors appear to understand Kenyan comparative advantage and relative factor costs. All projects were private sector and Kenyan owned.

8. Business Viability: Most of the proposals reviewed were considered to be viable from the stand point of cash flow, collateral, markets and management. Although our review was not as rigorous as that which will be applied by banks, the percentage of good projects is encouraging. As noted earlier the actual loan portfolio will likely include many more expansion projects and these will have track records which can be more readily evaluated.

9. Loan Terms: Investors are seeking loans from 2 to 20 years with the majority in the range of 5-8 years. Most are willing to pay commercial interest rates but in the sample a few have sought special terms.

10. On-farm/Off-farm: A problem encountered is the question of what criteria should be used to distinguish between on and off farm investment for project loans. Originally the intent was to exclude on farm investments because it was felt that adequate funds from other sources were available. While this basic assumption is still valid a certain amount of flexibility is required. Hence vertically integrated operations can be financed if the on-farm portion cannot be secured from existing sources such as the Agricultural Finance Corporation. Straight farming enterprises will not be financed from the project.

Another rationale for excluding on-farm loans is that the commercial banking sector does not currently achieve the targets established by Government for agriculture lending. Presumably they are making all the straight agriculture loans that seem prudent at the present time.

D. Conclusions:

The studies and investigations confirm that there is adequate demand for term credit in the rural sector and that loans can be made which meet the development objectives of this project. Through the provisions for technical assistance and upgrading bank advisory services the smaller enterprises will be supported. The loan portfolio will need to be monitored closely to assure that the positive effects on rural employment, production and incomes indicated by the studies is in fact, achieved. The major beneficiaries of the project will be the owners and employees of those enterprises receiving project financial loans. These owners and employees are in enterprises that range from very small (1-2 employees) to quite large (up to 5,000 employees). It is estimated that more than 7,000 jobs will be directly created in project-financed enterprises. Commercial banks will benefit directly from technical assistance and from an expansion of their market to include rural, medium term credit. PVO's will benefit from financial, technical and management support in providing assistance to the poorest and smallest businesses.

ANNEX J

IMPLEMENTATION SCHEDULE

DATE	ACTION	ACTION AGENT[1]
July/1983	- Project Agreement signed	USAID; GOK
August/1983	- Conditions Precedent to 1st disbursement met	GOK
	- PIO/T's and Requests for Proposals/Applications prepared for:	
	(1) Banks	USAID; GOK
	(2) Management and Technical Assistance Contractor	RCO; USAID; GOK
	(3) PVO Management Grantee	RCO; USAID; GOK
September/ 1983	- Requests for Proposals/ Applications issued for:	
	(1) Banks	USAID; GOK
	(2) Management and Technical Assistance Contractor	RCO
	(3) PVO Management Grantee	RCO
October/1983	- PIO/Ts and RFPs prepared for monitoring contractor and evaluation contractor	USAID; RCO
	- Responses to initial RFP and RIA received and evaluated	RCO; USAID; GOK
November/1983	- RFPs for monitoring and evaluation contractors issued	RCO
December/1983	- Bank Agreements, Cooperative Agreement with PVO/MG and contract with MTAC negotiated and signed	RCO; USAID; GOK

1/ Commercial Banks: CB
Government of Kenya: GOK
Management and Techbical Assistance Contractor: MTAC
PVO Management Grantee: PVO/MG
Monitoring Contractor: MC
Regional Contracting Officer: RCO
Studies and Evaluation Contractor: SEC

DATE	ACTION	ACTION AGENT
January/1984	- MTAC, PVO/MG startup activities	MTAC; PVO/MG
	- Responses received to monitoring and evaluation RFPs	RCO
	- Banks solicit loan proposals, recruit technical assistance personnel and request Letters of Commitment	CB
February/1984	- Expatriate MTAC, PVO/MG personnel arrive in Kenya	MTAC; PVO/MG
	- Responses evaluated and contracts signed for monitoring and evaluation	RCO; USAID
March/1984	- Cooperative and Guaranty Studies begin	SEC
	- Initial bank loans approved	CBs
	- MTAC, PVO/MG set up local offices and commence operations	MTAC; PVO/MG
April/1984	- PVO Management Grantee solicits PVO proposals	PVO/MG
	- Banks request initial disbursements	CBs
May/1984	- Initial Loans made	CBs
	- PVO submissions evaluated and submitted to USAID with disbursement request	PVO/MG
June/1984	- USAID approves initial PVO grants	USAID
	- Initial PVO grants disbursed	PVO/MG
November/1984	- First quarterly reports due	CBs; MTAC; PVO/MG
December/1984	- First quarterly reports verified and reviewed	USAID; MC

DATE	ACTION	ACTION AGENT
December/1985	- Study on Finance Companies begins	SEC
June/1986	- Mid-Term Evaluation	SEC; GOK; USAID
July/1987	- Indirect Impact Study begins	SEC
July/1988	- Final Evaluation	SEC; GOK; USAID
March/1989	- Project Assistance Completion Date	