PD-AAS-132 42192

Mid-Term Evaluation of the Loan to the Kenya Commercial Finance Company, Limited and Grant to the Kenya Commercial Bank, Limited

Evaluation Report No. 1

April 1985

Bureau for Private Enterprise
U.S. Agency for International Development
Washington, D.C. 20523

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FOREWORD

In the Fall of 1984, the Bureau for Private Enterprise formally initiated its evaluation program when we conducted mid-term reviews of our first projects. Loans and accompanying grants to the Kenya Commercial Finance Company/Kenya Commercial Bank located in Nairobi and to the Siam Commercial Bank in Bangkok, Thailand were designed principally to test the hypothesis that AID could develop projects with commercial banks under which they would provide term credit and other services at commercial, market rates of interest to small and medium-sized businesses located in rural areas.

The evaluations and a comparative analysis of these two projects were undertaken by a team consisting of A.I.D. officers and outside experts, including commercial bankers. We believe that the evaluation findings are especially instructive for future projects which AID designs with commercial banks.

The evaluations suggest that commercial banking institutions can be effectively utilized to achieve development objectives and that these two projects (KCFC/KCB is the subject of this particular evaluation) successfully achieved the objectives originally established at the time they were designed and negotiated.

No project, however well-designed, is without problems. The evaluation articulates that the grant to the KCB had some implementation problems related to the operations of the Business Advisory Service (BAS). This BAS was intended to provide business assistance to clients under the project. Grant funds were to have been used in training bank staff in agribusiness analysis, lending and portfolio management. We found the evaluation's to be well-founded and took the team's recommendations quite seriously. In early February 1985 we sent a consultant to Kenya to work with the Bank in developing a detailed implementation and action plan for addressing the problems associated with the BAS.

It is important to note that PRE's role has been defined, at least in part, as an experimental laboratory for private enterprise in development. As such, we have been trying to develop projects which, if successful, may be replicated by USAID Missions as they implement their own strategies. It is noteworthy that the Mission in Kenya, based mainly on our project with the bank, developed a much larger follow-on effort. This is the kind of catalytic role we intend to play.

By presenting the lessons we have learned from our early experiences, we hope to ensure improved Agency project design in the future. While the evaluation points out several specific lessons from this experience there is one general comment which we believe to be true judging from our experience under the project. When dealing with commercial institutions it is critical to have a good understanding, at the onset, of both the objectives of the institution - particularly as related to the project relationships with AID - and policy or operational limitations under which it is managed. A good understanding of these two factors should help result in a project which is realistically designed in terms of both expectations (from the institution and AID) and project results. Simply stated, we should not ask or expect the institution to undertake or complete work or be subject to limitations which are inconsistent, contradictory to or outside of its general operating policies. This would be a serious flaw in project design and could result in disappointment for both parties - AID and the institution. While project design should strive to push the institution to achieve objectives at the outer limits of its operating policies, those limitations should be reflected in the design to assure realistic expectations of project results.

This is but the first in what we intend to be a stream of evaluations on PRE projects. For those interested in substantially more detail on either this or the Thailand project please contact PRE's Program Review Office.

Edgar C. Harrell
Deputy Assistant Administrator
Bureau for Private Enterprise

February, 1985

PROJECT IDENTIFICATION DATA

1. COUNTRY: KENYA

2. PROJECT TITLE: Kenya Commercial Finance Co. Ltd

3. PROJECT NUMBER: 615-T-018 (Loan)
   no number (Grant)

4. PROJECT DATES:

   a. First Project Agreement: January 6, 1983

   b. Final Obligation: On-going project

   c. Project Activity Completion Date (PACD): August 23, 1995

5. PROJECT FUNDING:

   a. A.I.D. Bilateral Funding: $2.5 million loan
      $250,000 grant

   b. Kenya Commercial Finance Co. Ltd./Local Currency Matching Loan Funds: $2.5 million

   c. Other Major Donors: None

   d. Host Country Counterpart Funds: None

<u>Total Funding</u> Loan: $5 million
Grant: $250,000

6. MODE OF IMPLEMENTATION: Implementation by Bank under Central Bureau (PRE) oversight and occasional Mission assistance.

7. PROJECT DESIGN: Bureau for Private Enterprise

8. RESPONSIBLE OFFICIALS:

   a. Bureau for Private Enterprise/Deputy Assistant Administrator: Edgar C. Harrell

   b. Project Officer: Judith Knudson

   c. Mission Directors: Alison Herrick 1982, 1983, and Chuck Gladson 1984

9. PREVIOUS EVALUATION AND REVIEWS: Interim Trip Report dated June 27, 1984, prepared by the Project Officer.

10. COST OF PRESENT EVALUATION:

   a. Direct Hire: $ 9,310
   b. Contract: $ 17,462
   c. Editing: $ 5,000

   TOTAL $31,772

11. DATE OF PRESENT EVALUATION: October 1-17, 1984

12. HOST COUNTRY EXCHANGE RATES:

   a. Name of Currency: Kenya Shilling

   b. Exchange Rate

Mid-1982:	13 KShs. = $1.00
October 1984:	14.84 KShs. = $1.00

KENYA

EXECUTIVE SUMMARY

Problem and Overview: Following the creation of the Bureau for Private Enterprise in late 1981, a Reconnaissance Team sponsored and led by the Bureau travelled to Kenya to explore private sector development opportunities. The team concluded that opportunities existed for small and medium sized agribusiness investments in Kenya. In four days, the team identified thirteen such opportunities. The team considered several financial intermediaries as candidates for external assistance in identifying and financing such agribusiness projects. The Kenya Commercial Bank was the most interested and in 1982 an Investment Proposal was written.

U.S. Assistance: In January, 1983 the Bureau signed a $2.5 million loan (615-T-018) with the Kenya Commercial Finance Company Ltd. That amount was matched by that institution establishing a $5.0 million equivalent fund for on-lending to small and medium scale agribusinesses in rural areas of Kenya. In addition, a $250,000 grant was provided to the Kenya Commercial Bank to train staff in the techniques of agribusiness analysis and term lending, and to give them skills required to provide advisory services to client companies. The project was designed to test the hypothesis that commercial banks can be used effectively to channel term lending on a commercial basis to small and medium sized rural-based agribusinesses and thereby achieve substantial development benefit.

Purpose of Evaluation: This mid-term review, conducted during October, 1984 is the first formal evaluation of the project. The purpose is to provide guidance to the Bureau on corrections and adjustments in the project's design and management to improve project implementation and results. The evaluation findings were also intended to offer guidance to PRE, other Bureaus and AID Missions in trying to replicate this project.

In January/February, 1984 the PRE Project Manager spent several weeks in Kenya examining the progress and accomplishments of the project. Problems associated with implementation of the grant funds were identified and efforts were made to resolve them. At the time of the evaluation, however, many of the issues remained unresolved.

The findings and conclusions contained in this report are the result of a 17 day stay in Kenya by the evaluation team. A detailed institutional review of the KCFC subloan portfolio was conducted by a U.S. private banker. The team also visited nine of the rural enterprises to interview subborrowers. Details are contained in Appendix C and Appendix D to this report.

Findings:

1. The development impact of the subloan activity is evident. First time entrepreneurs received 74% of the loans extended, while the remaining 26% went to existing enterprises for expansion of operations, product line diversification and equipment replacement. Additionally, women constitute the sole owners or participate in joint ownership in 35% of the enterprises to which loans were made. The great majority of the subborrowers (71%) are involved in food processing activities. Loan recipients are located mainly in the Central and Western Regions of the country, and comprise a good distribution of Kenyan ethnic and racial groups. Comparison charts found in Appendix F detail these fingings.

2. The subloans have reached the target group of small and medium scale enterprises. The average size borrower has assets of $77,000, or 10% of the maximum size eligible under the loan; average loan size is about $43,000.

3. The project is of low cost to the U.S. because the interest rate charged by AID to KCB is only marginally concessional (about 1% below the current U.S. Treasury Rate).

4. Draw down of the AID loan funds has been delayed, primarily due to KCFC's limited marketing efforts, the relatively high interest rate, and cumbersome AID procurement regulations.

5. The anticipated institutional development through the operations of the KCB Business Advisory Services to assist subborrowers, has not been realized. At the time of the evaluation, the grant funds had not been used and project outreach as originally contemplated had not materialized. We attribute these problems, in part, to insufficient PRE management attention, in part to organizational problems at KCB, and in part to unrealistic expectations regarding certain aspects of institutional development.

6. The KCB loan operations, while not up to U.S. banking standards, are on par with or better than the general level of bank performance in Africa. There does continue to be heavy reliance on collateral. The shortcomings do not jeopardize the security or integrity of the AID funds lent to KCB.

Project Design and Policy Implications: At the time of project design, it is important for A.I.D. to recognize the policy and operating limitations of commercial banking institutions. Generally, they are not high risk takers. Their practice is to lend to established businesses with substantial collateral in place to support the loan. It is essential that A.I.D. recognize these limitations when trying to encourage such institutions to address a different target business with a broader range of service.

Concerning A.I.D. policy, this evaluation has demonstrated that term lending can be made available to small and medium size rural enterprises on commercial terms through the commercial banking system. This is a first-time achievement for the Agency for International Development. Consideration can now be given to replicating the project concept in other AID-assisted countries.

Conclusions and Recommendations:

1. Conclusion: Term lending can be made available to small and medium size enterprises in developing countries via the commercial banking system.

   Recommendation: Replicate the project concept in other AID-assisted countries.

2. Conclusion: The project suffers from significant implementation problems resulting, in part, by understaffing of the PRE Office of Investment. They are: Inadequate management by PRE resulting in slow draw down of loan funds by KCB, no utilization of the grant funds, and slow progress toward the institutional goals of the project.

   Recommendation: The use of a local Project Manager similar to the one USAID Nairobi will use for its Rural Private Enterprise Project.

3. Conclusion: PRE should place a priority on the utilization of grant funding.

    Recommendation: An implementation plan should be designed jointly with the KCB staff as quickly as possible to attain the desired improvements in the Business Advisory Services. The ultimate goal would be for the KCB to institutionalize this service for its entire loan portfolio.

4. Conclusion: The project is giving the U.S. the stigma of being a high cost lender. The 19% interest rate charged by KCB/KCFC to the subborrowers is at the ceiling of the "market rate" in Kenya for term loans.

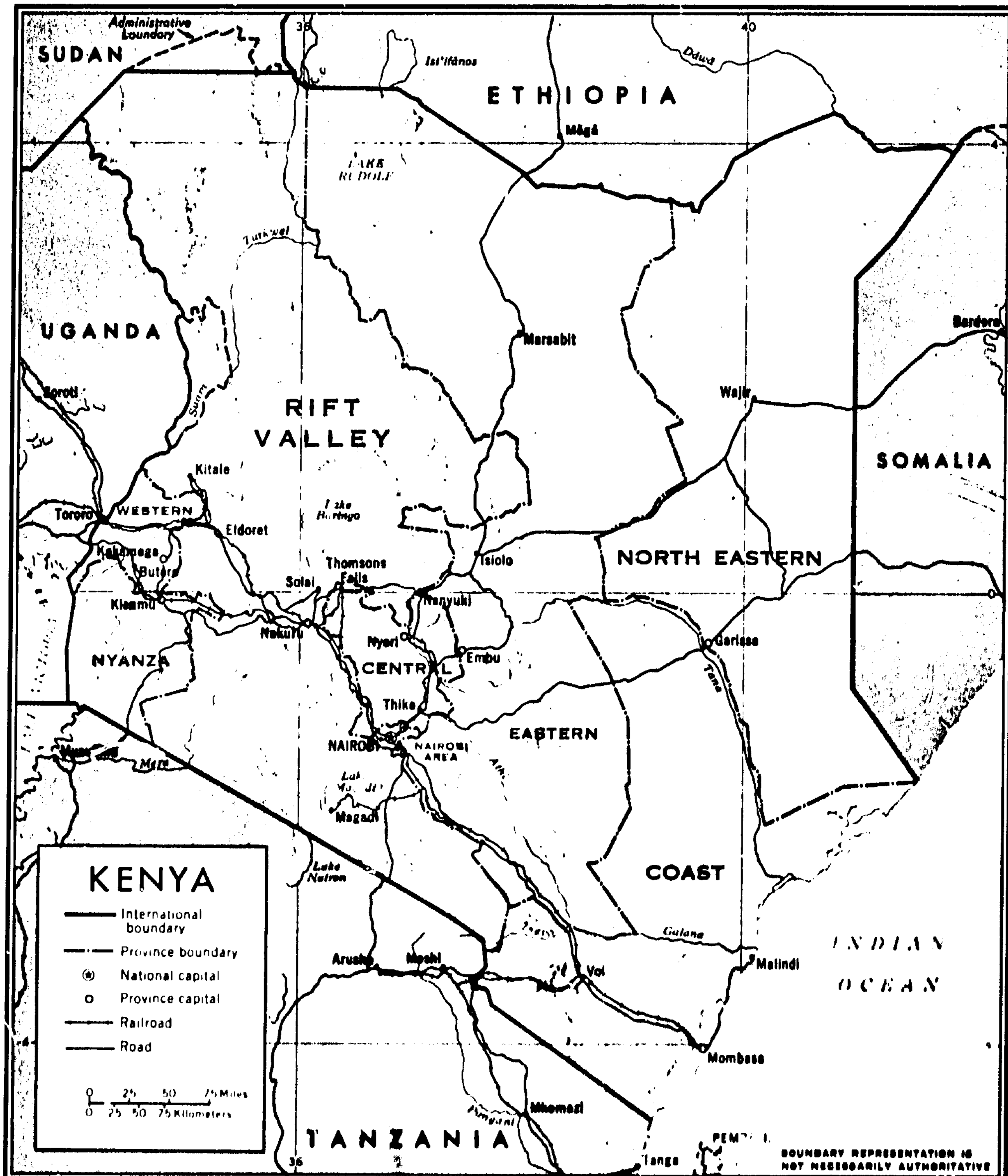
    Recommendation: Try to reduce the interest rate charged to subborrowers. For example, KCB could be required to match the U.S. funds with lower cost money available at their branches; perhaps a combined rate of 16.5%, which falls within the established range of market rates for such loans.

5. Conclusion: The PRE prohibition for use of loan funds to finance integrated agribusiness operations which include agricultural production activities, has been a constraint to the draw-down of funds by the KCB.

    Recommendation: Elimination of this prohibition, to enable the development of more technically viable projects. Specifically, PRE should (1) establish a clearer definition of the distinction between agricultural and agribusiness activities; (2) establish a limit on the proportion of funding to be devoted to the farming component of a project.

The team felt that even though some of the goals were achieved, objectives were limited. Future project goals should be more clearly stated and implementation plans should be provided.

Detailed recommendations are in Chapter V. The most immediate corrective action required is to design and implement a detailed action plan for the BAS at the KCB.


Administrative boundary
SUDAN
ETHIOPIA
UGANDA
RIFT VALLEY
SOMALIA
WESTERN
NORTH EASTERN
NYANZA
CENTRAL
EASTERN
COAST
TANZANIA
INDIAN OCEAN
Marsabit
Wajir
Kitale
Tororo
Eldoret
Thomsons Falls
Isiolo
Solai
Nanyuki
Nakuru
Nyeri
Embu
Garissa
Thika
NAIROBI
NAIROBI AREA
Magadi
Lake Natron
Arusha
Moshi
Voi
Malindi
Mombasa
Tanga
KENYA
International boundary
Province boundary
National capital
Province capital
Railroad
Road
BOUNDARY REPRESENTATION IS NOT NECESSARILY AUTHORITATIVE

I. INTRODUCTION

The $2,500,000 loan to the Kenya Commercial Finance Company, is for on-lending to Kenyan owned or controlled small and medium-sized private enterprises, particularly agribusinesses, with an emphasis on those located in rural districts of Kenya. A.I.D. also provided a $250,000 grant to train selected bank employees in order to provide Business Advisory Services (BAS) to rural, small & medium scale enterprises (SME), and to improve the bank's agribusiness credit evaluation and lending process. The grant also contemplated an expansion of these capabilities to regional branch offices.

The loan agreement was signed on January 6, 1983, with the bank providing matching funds of $2,500,000. The total commitment to the project is $5,250,000. The estimated project completion date is August, 1995.

Total funds disbursed by September 30, 1984 were expected to total $1,040,000. At the time of the evaluation, this project had 38 active sub-loans. The grant activity was scheduled to begin in early October with the arrival in Nairobi of an International Executive Service Corps contractor to work with Bank personnel to finalize plans for a seminar scheduled for November.

II. ECONOMIC OVERVIEW

Since the approval of the project in early 1983, Kenya has continued to suffer from economic recession, foreign exchange shortage, some inflation and a deteriorating investment climate caused, in part, by the attempted coup of August 1982. Government deficits, although less than in previous years, are still a problem. Moreover, a drought in 1984 resulted in substantial grain imports. The exchange rate of the Kenya shilling has moved from about 13K shillings per $1 US in mid 1982 to 14.8K shillings on October 1, 1984 and has important implications with respect to the "foreign exchange" risk associated with this project.

The Government of Kenya continues to give high priority to the agriculture and agribusiness sector. All banks by law are required to keep a minimum of 17% of their portfolios in agricultural loans compared to 10% for non-bank financial institutions. Subloans under the KCFC/AID program are specifically prohibited from inclusion in the 17% requirement.

III. INSTITUTIONAL REVIEW

A. Loan Operations

1. Kenya Commercial Finance Company Organization

The Kenya Commercial Finance Company (KCFC), located in Nairobi, is a wholly owned subsidiary of the Kenya Commercial Bank (KCB) which has a vast network of branch offices throughout the country. It operates as a separate entity with the exception of credit approval which has to be obtained from the Chief Manager for Credit and Marketing of KCB (the group's senior credit officer) or the KCB Board, depending on loan size. As a finance house, KCFC's main activities are in medium term lending, and there has been heavy involvement in real estate over the last decade.

Kenya Commercial Bank is charged with supporting KCFC but only in a passive sense, by offering KCFC's services to those clients whose special needs are better served by KCFC. KCB is not remunerated for these "intergroup" liaison services.

The KCFC is divided into two sections, KCFC Main and KCFC Schemes. KCFC Main handles all locally funded commercial business. KCFC Main's commercial loan portfolio is approximately KSh.900 million (U.S. $61 million). About 50% of this portfolio is in real estate development (hotels, lodges, offices, residential). The rest is spread throughout vehicle leasing, manufacturing and agriculture. KCFC is meeting the legal requirement of keeping 17% of its portfolio in agricultural assets (excluding AID, IFC and OPEC).

The average size of KCFC commercial loans is between KSh.1-5 million (U.S.$67,568 - $337,839), though some are as low as KSh.200,000 ($13,514) and some as high as KSh.50 million ($3.4M). Approximately 25% of its portfolio consists of loans to parastatals.

KCFC Schemes was formed to handle (on commercial terms) activities funded by OPEC, IFC, and AID (with matched funds by KCFC). Presently the OPEC fund is $2 million (200 accounts), IFC Tranche II is $5 million (100 accounts). Tranche I is fully drawn and running down. Of AID's $2.5 million loan, 1.04 million has been disbursed for 38 accounts. KCFC Schemes is headed by a Senior Loan Officer supervising four Loan Officers (one for OPEC, one for IFC and two for AID). Consequently when the funds are matched and totalled, five officers are handling a $19 million portfolio of 337 accounts (with 70% of the AID funds still to be lent). Although the total funds are a relatively small amount, the number of accounts presents a substantial workload considering that the officers have primary responsibility for marketing, credit analysis, account management and loan review. The KCB branch network plays only a supporting role and is not compensated for its efforts.

KCFC Schemes is supported by its own Operations Section comprised of a Section Head and three clerical staff, and by a Security Section (shared with KCFC Main) comprised of a Security Officer and two support staff. The Security Section is responsible solely for the implementation and documentation of collateral requirements and the Security Officer has to sign off on all loans before disbursal.

Management is competent. All senior managers are KCFC/KCB career personnel with varied experience in the entire group. Junior executives have all received extensive training within the bank and demonstrate average competence within the framework of the local financial community.

KCFC is well organized. Given the high account load in relation to the number of account officers and the scattered location of clients, however, KCFC Schemes is understaffed and this is reflected in the quality of the files, a lack of any serious marketing effort, and limited direct customer contact. Indeed, the characteristics and geographic distribution of the portfolio handled by KCFC Schemes suggest that KCFC may not be the appropriate organization within the KCB group for the activities it presently undertakes. It may be that KCB itself is the more appropriate organization to manage the project.

2. Credit Policies and Credit Management

The comprehensive KCB Lending Manual governs KCFC credit policies. Given KCFC Scheme's client quality, all lending is done on a fully secured basis and this, combined with an overworked staff, results in certain credit policies not being practiced as vigorously as required by the Lending Manual.

The most notable aspects of credit management are reviewed below, based on the examination of credits extended to date under the $2.5 million AID/PRE loan:

a. Strengths

Approval Procedures: All KCFC credit proposals must go from the Account Officer to the Assistant Manager and then to the Chief Manager, who signs off before the loan is submitted to KCB's Senior Credit Officer (the Chief Manager for Credit and Marketing) for official credit approval. Above 7.5 million KSh ($506,757) the senior credit officer has to seek KCB Board approval. (KCFC's Chief Manager does have a small discretionary limit). Since the maximum loan amount authorized under the AID subloans is KSh 4 million ($270,270), none of these loans reach the KCB Board. There is a move presently (since KCFC's credit problems are on the mend) to give KCFC's Chief Manager the authority presently held by KCB's Senior Credit Officer. This would not compromise credit quality.

Documentation and Collateral Control: Given the secured nature of lending, this aspect of credit management is assigned a very high priority and is well executed. A separate Security Officer is responsible for insuring that all collateral is in place and all documentation is in order before signing to release the funds.

Disbursal Procedures: A very effective procedure is in place whereby a series of three officers, including either the Assistant Manager or the Chief Manager have to approve the actual disbursal of any loaned funds.

b. Weaknesses

Credit Analysis: This area suffers substantially because most loans are 150% collateralized and this, combined with the heavy workload, results in the Account Officer's reliance on the collateral and on the client's or outside consultant's financial projections to arrive at a credit decision. A majority of the analyses are descriptive.

Historical financial data is not presented or analyzed, and ratio analyses are not done on the borrowers. Sensitivity analysis is unknown and projections done by clients or outside consultants are accepted at face value rather than being incorporated into a comprehensive financial analysis by the Account Officer.

KCFC does not apply a system of standardizing financial information obtained from clients. It is prudent practice by U.S. bank standards to convert both historic financials and projections to a standard bank format which provides a frame of reference for comprehensive financial analysis. The process of this data conversion is what enables the analyst to fit the information in the context of the bank's credit criteria.

The KCB Lending Manual indicates that collateral requirements should only be used as a fallback to protect against unforeseen events. This means that potential borrowers should be analyzed according to the standards of an unsecured credit, because it must stand alone and be a going concern, regardless of security.

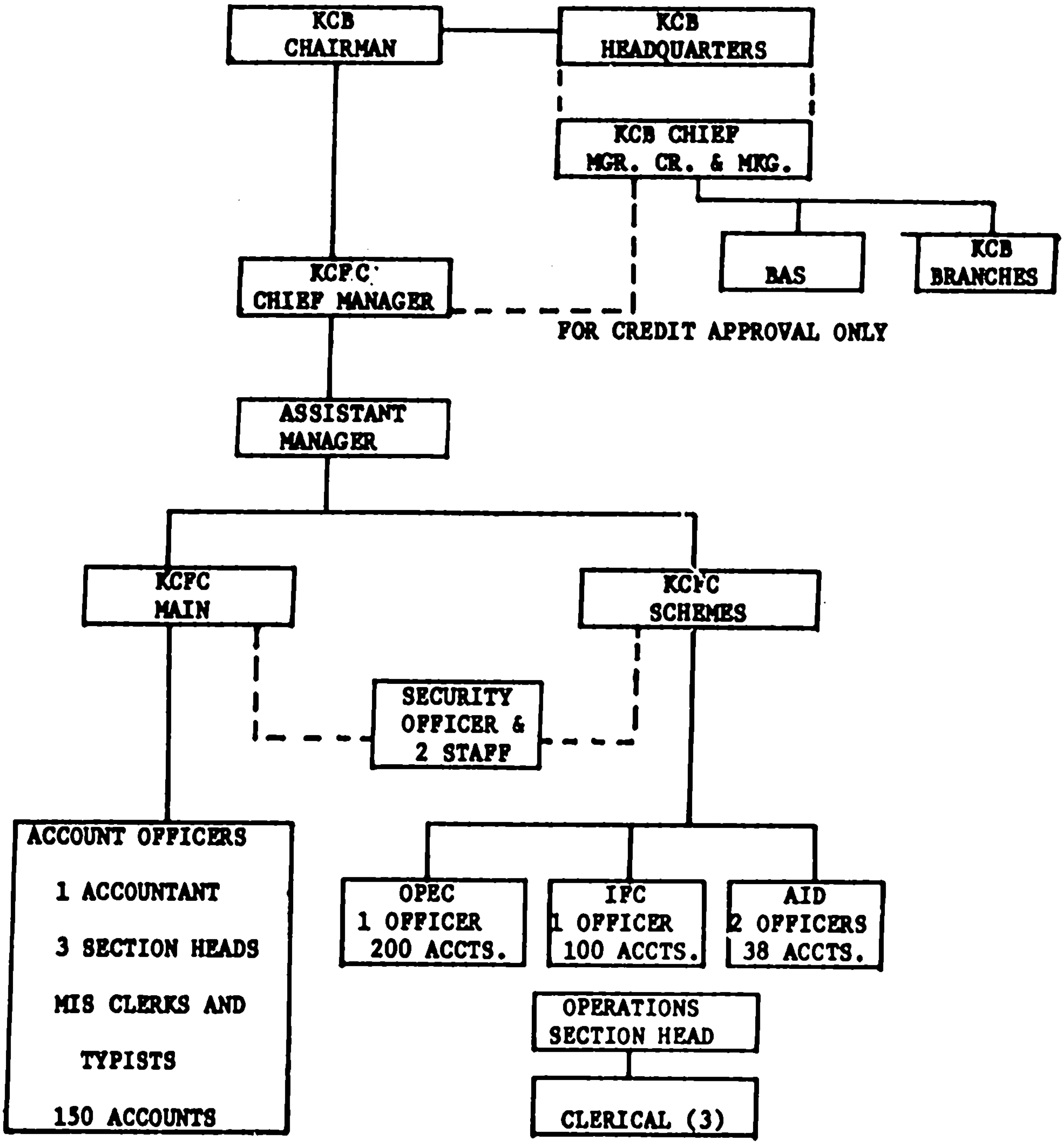
In the majority of cases, it is the team's opinion that KCFC is not able to make a reliable judgment of the creditworthiness of its clients, and is relying on security and/or reputation to arrive at a credit decision.

Problems With Account Management and Credit Files: Client contact is minimal and no real marketing efforts are made. Following credit approval, officers do not have the time to manage the individual accounts properly. The majority of officer time is taken up with insuring the smooth administrative flow of the paperwork being generated by their accounts.

Numerous files have substantial gaps in information, such as missing documentation checklists, and missing financials. Required quarterly status reports with the supporting financial information is also missing in several cases.

The most serious problem is a complete lack of current and historic information on contact between the bank and the client. The "comments" section, where officers record the substance of their meetings and telephone conversations with clients is nonexistent, though this is a common banking practice in the U.S. and is called for by the KCB Lending Manual.

Kenya Commercial Finance Company
Organizational Chart



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B. Grant Funding

The grant for Business Advisory Services was designed to train bank BAS officers in the provision of services to customers nation-wide, such as in-depth feasibility studies, assistance in developing proposals for the Bank and general management advice to diagnose and solve operational and management problems.

It appears however, that little was done during 1983 by either party to the grant/loan agreement to implement the program or to draw down the funds.

In January 1984, the PRE Project Officer responsible for monitoring the agreement visited Nairobi to review progress on the loan and resolve those problems that were delaying the draw down of the grant. An exchange of letters between KCB and PRE followed the PRE field visit. It is clear that KCB did not fully comprehend what the original agreement required of it, nor did it understand what procedures to follow to utilize the AID grant funds for training and enhancement of BAS staff.

It is the team's opinion that there were divided views within KCB's senior management about the desirability of expanding the BAS function. The lack of clarity as to responsibility in KCB/KCFC for management of the AID grant made it difficult for them to arrive at decisions to proceed with implementation. Additionally, personnel changes in senior BAS staff had resulted in some curtailment of their past activities. BAS has not undertaken any new functions as anticipated under the grant, especially those dealing with follow-on assistance to subborrowers after loan approval.

The following is a list of significant findings regarding the Business Advisory Service:

> With the departure of Chairman Ndegwa to the Central Bank, KCB leadership has changed and there is less interest at the top in BAS.

- BAS is poorly positioned in the KCB/KCFC organization. It is not in KCFC, yet its main task at this time is to service the three small and medium scale enterprise donor credit lines managed by KCFC. As a component of a staff marketing and credit operation in KCB, it is not ideally positioned to support the area/branch operational system.

- BAS is understaffed for the role our Agreement intended it to play, though not for the role it is permitted to play. Its Manager has been assigned by the Government to a different organization, its expatriate Advisor has left, and the organization is currently under an Acting Manager from the Training School. A new manager is expected in December.

- BAS is not a bank profit center. Its income generating role is ambiguous. It does not charge for KCB/KCFC work. But it does charge for outside work. The impression is that it charges substantially less than its competitors, yet even on outside work it is flexible and frequently reduces its charges to accommodate ability to pay.

- BAS is not in the same organizational unit as the Staff Training School (Personnel Section of Finance & Administration), though a good relationship between the two seems to exist.

- There is no one person responsible for managing the grant components of the USAID Project Agreement within KCB/KCFC. There is a need for close contact between KCFC, BAS, Training School and Area/Branch operations, if the difficult task of institution building is to occur.

IV. ANALYSIS OF SUBLOAN ACTIVITIES

A. Portfolio Description

First-time Entrepreneurs: Of the 38 subborrowers to whom loans were made, 74% were extended to establish new enterprises. Among these new enterprises, almost two-thirds (64%) are owned and managed by individuals who are engaging in first-time entrepreneurial undertakings. Women represent close to half of these first-time entrepreneurs. Only 26% were operating existing enterprises which required loans for the expansion of operations, product line diversification, equipment replacement, or vertical integration into agricultural processing activities.

Size of Enterprises Assisted: All of the enterprises assisted under the project are small scale, with fewer than 50 employees and average assets of $77,000. The average assets of existing firms which received loans is $125,814; for newly established firms the figure is $60,074. According to the size of their workforces, all of the firms but one are "small scale" and over half are "very small scale" (under 10 employees).

Size of Loans: The average loan size for the total portfolio was $43,000. The range was from $321,429 for the sunflower seed operation to $5,000 for a posho mill.

Types of Enterprise Activities: The great majority (71%) of the sub-borrowers are involved in food processing activities, including posho mills, coffee pulping, and bakeries. The next largest categories of activities are agricultural input and output distribution (11%), the provision of agricultural services ploughing and weeding (8%) and light manufacturing (5%).

Loan Recipients: The loan recipients are located mainly in the Central and Western Regions of the country. To date no loans have been made in either the eastern half of the country, which includes the relatively densely populated coastal area or in the more sparsely populated northern and southern areas.

According to ethnic and racial group, the loans are relatively well-distributed throughout Kenyan society. There is a somewhat disproportionate number of loans extended to Kikuyu, but the numbers of loans to the Kalenjin (the President's ethnic group) and the Asians (the most prosperous commerical group) are proportional to their representation in the overall population.

Women constitute the sole-owners or participate in joint ownership in 35% of the enterprises to which loans were made. However only two loans (5.3%) were made to women as sole-owners of enterprises; this may be largely due to the registration of assets in the family's or the husband's name. (See Appendix D for Comparison Charts.)

B. Portfolio Review

The team examined, from a financial standpoint, 21 loans in detail and scanned 7 others to insure conformity to the pattern found in the detailed sample. The major findings are:

- None of the 21 files have any substantive historical record, in the form of officers' call reports, of the relationship between the bank and the client, making it impossible for a person unfamiliar with the account to develop a reliable account history.

- Three of the 21 files contain financial spreads on internal standardized KCFC spread sheets. The majority contain only client supplied financials or projections accepted at face value.

- Eight out of the 21 files have no documentation checklist.

- In 12 cases personal guarantees form an important part of the security package, yet none of the files contain any evaluation of the individuals' net worth.

- Several of the loans are construction loans. These loans are followed on the basis of building construction consultants' evaluations. The consultants are chosen by the client and the bank receives a copy of this report. The bank does not have its own consultant do evaluations.

- Credit analyses done by bank officers are descriptive and lack any form of in-depth financial including ratio analysis. Often the only comment on financial analysis was "projections show that cash flow will be adequate to service the loan and leave a reasonable profit." In all cases projections were provided by the client or a client-hired financial service. None of the client supplied projections and feasibility studies contained sensitivity analyses. Many did not contain a set of assumptions, making it impossible for any recipient to assess the reliability of the study. Several contained wrong assumptions (e.g. cash flows done on a 14% interest rate when the real rate is 19%). Several facilities were structured incorrectly by committing long term funds to support short term assets.

- Three of the 21 files contain substantially erroneous pricing information. This happened as a result of a pricing change in the bank which was not retroactively adjusted in the files.

- It is impossible to ascertain from information in the files if the client has or had any related loans within the KCB group and/or if there were additional borrowings from other sources.

Five loans of the 21 examined warrant particular attention. One is a problem loan, one is a misapplication of proceeds, and the rest are illustrative of errors in loan structuring and monitoring.

OCAF Limited: This is a problem loan. It is a sunflower growing scheme, where the subborrower finances seed and fertilizer to farmers on contract who in turn repay with the crop (keeping a spread) which the subborrower sells to an oil processing plant. The project was already in existence, financed by a Barclays overdraft, at the time KCFC was approached. A detailed feasibility study did not reveal that the real reason for KShs.2 million ($135,135) long term loan request was to pay

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out the Barclays overdraft of KSh.1.9 million ($128,378) which the company, leveraged 20:1, was unable to service. Barclays provided a positive checking, AID waived the leverage requirement and agreed to allow use of long term funding for short term purposes, and KCFC provided an eight year term loan for crop financing that operates on four month cycles. The company was showing a KSh.400,000 ($27,027) loss at the time for the only year that financials were obtainable.

The idea is good, the rains unpredictable, the loan structuring poor. It is the kind of loan that can, over several years be worked out, but should not be assumed from another bank.

Gum Industries: KCFC made a loan to finance a glue factory. The loan was used to construct one of the biggest office buildings in Thika (3 stories) with a warehouse in its back yard containing a few drums to mix glue and a wood fired steam boiler to provide heat for the mixing process. This is a misuse of funds. KCFC does not have a grasp of what percentage went to finance the factory and the office building respectively. Construction progress reports are by a consulting firm retained by the client. There is, again, no attempt to evaluate the personal networth of the directors who provided their guarantees.

Ima Hauliers: This loan is indicative of the information gaps in the files due to the lack of substantive comments about new developments of an ongoing loan. Ima Hauliers' recent aged receivables show KSh.3,600 million ($243,243) over 90 days, out of total receivables of KSh.3,900 million ($263,514). An April 30, 1984 income statement shows a profit of KSh.896,000 ($60,541) applied to retained earnings. This resulted in a reduction of negative retained earnings to KSh.1,642 million ($110,946). Such information should cause substantial concern, yet there is no analysis on either issue in the file.

Magoko Transporters: The stated purpose of this loan was to finance inventory for a village hardware/agribusiness store, clearly a working capital loan. Yet the funds were loaned for five years. The proprietress of the store sought to redress the situation, at least in part, by using a third of the proceeds to purchase a long term asset in the form of a pickup truck. There is no mention of this in the files.

Saroli Ole Sane: The purpose of this loan was to construct a slaughter house for which a mortgage was taken on unrelated land. Mr. Sane is also in the process of constructing a hotel and bar as part of the slaughterhouse compound. While this may be a good idea, it is not a proper use of funds. Again, there are only the contractor's completion reports to evaluate work in progress. Mr. Sane could say that he is not using bank funds for the Services Division but the bank would have difficulty making the verification.

Given the above observations, it appears that KCFC's loan review policy is not preventive. A loan becomes a problem when the money is not repaid, at which point attorneys are asked to make demand. Until a bad payment record begins to develop, the client may have very little contact with the bank (by the admission of several bank officers). Of the AID subloan portfolio, only one subborrower is outstanding on commitments. Demand is being made by attorneys.

The review of KCFC's credit and marketing procedures, the company's structure and capabilities in relation to the subloan portfolio, and an examination of the subloan portfolio reveal the following:

- KCFC's credit analysis, as conducted at the present time, is not sufficient to enable the bank to make a reliable judgment on the creditworthiness of borrowers.

- The bank implicitly uses security as the key criteria in credit evaluation. Security procedures are rigorously enforced and provide the bank with sufficient protection. Security in the Kenyan market is of paramount importance and its role should not be reduced, but security alone is no reason to make a loan that is not creditworthy on its own merit.

- The logistical problem caused by two Nairobi based officers handling a portfolio likely to reach well over 100 accounts scattered throughout Kenya makes it impossible to follow loans effectively. Consequently, officers have only a general idea about the loans they handle, but have no grasp of the day to day developments in the business activiites of most of their accounts. No effective system exists to monitor the application of loan proceeds.

- The KCB branch nework plays a passive role in assisting KCFC and is not remunerated. The retail character of the subloan portfolio and the location of customers throughout Kenya, but always within easy reach of a branch, indicates that from a credit and opeations standpoint this program would be much better placed at the branch level (rather than at KCFC) with the branch recognizing the income from the relationships it develops in return for assuming the risk.

C. Development Benefit of the Loans

In the loan agreement, PRE has defined development impact according to six criteria: (1) employment generation; (2) foreign exchange generation; (3) management and technical skills development; (4) technology transfer; (5) increased income and economic activity to provincial areas; and (6) poverty alleviation in rural areas. Accordingly, the development impact has been assessed in terms of these six criteria. Each of the sub-loans was to demonstrate some impact in at least one of these areas.

Each of the projects which was visited demonstrated a clear impact in many of these areas, exceeding PRE's objectives. Our analysis of the documentation on those projects not visited suggests that they all achieved an impact in many of these areas. The impact of the individual firms visited is partially outlined in Appendix C. The results are summarized below.

- Employment Generation: The project's anticipated job creation was to be 539 jobs. Site visits revealed that actual employment generation is estimated at 431 jobs. The team was unable to identify any significant labor displacement effect as a result of this job creation.

  The loan cost per job created averaged $4,568. A few of the larger, more capital intensive firms raised this average significantly. If these firms had been excluded from the calculation, the average loan cost per job created would have been $4,000.

- <u>Foreign Exchange Generation:</u> There was little direct effect in this category. Only one of the firms is currently exporting, and only two have future plans to do so. There was, however, a net foreign exchange effect achieved through import substitution activities, in which 18% of the firms are involved.

- <u>Management and Technical Skills Development:</u> Although direct training of the enterprise managers was envisioned in the project agreement, this has not taken place. However, through the establishment and expansion of the firms assisted, some improvement of the managerial skills of the entrepreneurs has undoubtedly taken place. In addition, the entrepreneurs themselves have, in almost all cases, conducted skills training for their workforce; all of this has been on-the-job training.

- <u>Technology Transfer:</u> Most enterprises use technology which is already widely practiced within Kenya or they already had access to this technology elsewhere. The two exceptions are the cable manufacturing firm and the agricultural weeding operation, which delivers to farmers a technology not available elsewhere in the region.

- <u>Increased Income and Economic Activity for Provincial Areas:</u> The project clearly achieved this objective through the establishment of the enterprises and the resultant employment generation. Further, almost all of the owners interviewed said that they could not have obtained term loans for these activities through the Kenyan banking system. Currently, the only alternative source of medium term lending for small enterprises is through the IFC-funded program.

- <u>Poverty Alleviation:</u> The achievements in this category are moderate. There was undoubtedly substantial poverty alleviation among the workers hired, since half of them had been unemployed. The entrepreneurs to whom loans were extended are the relatively more advantaged provincial residents; generally, they own some land, other enterprises, or they or their spouses hold salaried professional positions.

In terms of the size and types of enterprises assisted, the size of the loans, and the characteristics of loan recipients, KCFC has largely met the project's objectives.

The Bank should be commended for having reached such a large proporition of very small enterprises, women, and first time entrepreneurs, as well as for having made such a high proportion of small, but apparently successful loans.

V. CONCLUSIONS AND RECOMMENDATIONS

1. Conclusion: Term lending can be made available to small and medium size enterprises in developing countries via the commercial banking system.

   Recommendation: Replicate the project concept in other AID-assisted countries.

2. Conclusion: The project suffers from significant implementation problems resulting, in part, by understaffing of the PRE Office of Investment. They are: Inadequate management by PRE resulting in slow draw down of loan funds by KCB, no utilization of the grant funds, and slow progress toward the institutional goals of the project.

Suggested Options

a. Quarterly visits by a PRE/I officer, who will remain in Nairobi for a sufficient period of time to deal with current issues in a thorough way.

b. Assignment of a PRE Field Manager to the Africa Region, similar to the ones contemplated for Asia and LAC regions.

c. Use of the Private Enterprise Officer and staff at USAID, Nairobi, if this would be agreeable to the Mission Director.

Recommendation: The use of a local Project Manager similar to the one USAID Nairobi will use for its Rural Private Enterprise Project.

3. Conclusion: PRE should place a priority on the utilization of grant funding.

   Recommendation: An implementation plan should be designed jointly with the KCB staff as quickly as possible to attain the desired improvements in the Business Advisory Services.

4. Conclusion: The project is giving the U.S. the stigma of being a high cost lender. The 19% interest rate charged by KCB/KCFC to the subborrowers is at the upper scale of the "market rate" in Kenya for term loans.

   Recommendation: Try to reduce the interest rate charged to subborrowers. For example, KCB could be required to match the U.S. funds with lower cost money available at their branches - perhaps a combined rate of 16.5%, which falls within the established range of market rates for such loans.

5. Conclusion: The PRE prohibition for use of loan funds to finance integrated agribusiness operations which include agricultural production activities, has been a constraint to the draw-down of funds by the KCB.

   Recommendation: Elimination of this prohibition, to enable the development of more technically viable projects. Specifically, PRE should (1) establish a clearer definition of the distinction between agricultural and agribusiness activities; (2) establish a limit on the proportion of funding to be devoted to the farming component of a project.

6. Conclusion: A lack of coordination among the donor community concerning their term lending activities has resulted in a variety of competitive credit alternatives presented to the Banking community.

   Recommendation: Encouraging coordination and consultation among the bilateral donors who are sponsoring term lending activities to the same target group, could enhance the overall development goals of the Government of Kenya.

VI. LESSONS LEARNED FOR FUTURE PROJECTS

1. PRE cannot simply assume that an institution has all of the capabilities it needs to implement a loan or grant agreement. PRE should undertake its own institutional analysis at the time of project design to provide a clear understanding of the bank's capabilities and actual services.

2. To ensure success, and because of the experimental nature of this project, (for both the bank and PRE), frequent monitoring and continuous management attention is required.

3. Keeping the limitations in mind, A.I.D. can now encourage more LDC commercial lending institutions to undertake the risk of providing term loans to small and medium size enterprises.

APPENDIX A. EVALUATION METHODOLOGY

Before departing for Kenya, the team attended a one day, pre-departure workshop at the Bureau's office's in Rosslyn, Virginia. The actual field work was performed between October 1-17, 1984, 21 months after the signing of the loan agreement.

USAID/Nairobi provided the services of an economist, Peter Ochieng Odoyo, who was a participant in the review and accompanied the team to visits of the rural enterprises.

The team spent the first week in Nairobi, meeting with staff members of the USAID, donor community, and bank. Field visits to the subborrowers occurred during both weeks.

In the interest of achieving rapid evaluation feedback, the team conducted a seminar for top staff of the KCB Training School and the Business Advisory Service to present and discuss its findings of the loan portfolio analysis. It also presented its findings to USAID Kenya so that this information might help the AID Mission in structuring its new $36 million Rural Private Enterprise Project. A separate briefing was held for representatives of Delloite, Haskins & Sells (Nairobi) in light of their management responsibilities with respect to USAID/Kenya's Rural Private Enterprise Project. That USAID project is patterned after the PRE project being evaluated.

At the KCFC, the team was able to examine the loan files for each of the 38 approved projects and conducted interviews at nine of the rural enterprises and interviews with two additional firms in Nairobi. The KCFC organizational structure and loan approval procedures were examined to learn the extent to which institutional changes had been made to accommodate medium term lending practices. The team also reviewed the operations of the "Business Advisory

Service" to determine: 1) whether and to what extent it is performing the functions required of it under the loan/grant agreement; 2) how it was utilizing or intended to utilize the grant funds made available by PRE for institution building; and 3) how the training programs for term lending project analysis are being integrated into the bank's training institute. It examined the impact of the project against the development goals set for it in the loan/grant agreement and made an attempt to gain an impression of the direct development impact of the project as a whole, and the subloans in particular.

An attempt was made to expand the development impact criteria to include backward economic and commercial linkages, forwarding economic and commercial linkages, import substitution, provision of consumer products or service and the outreach to entrepreneurs and entrepreneurial development. We hope that the inclusion of this additional criteria in the analysis of subloan activity will provide some additional insights to the reader. Because available time was so limited, much of the information collected could not be quantified, but could only be described in qualitative terms.1/ Nevertheless, for certain key items, such as employment generation, quantitative data was gathered at all sites. Please see the Comparison Charts in Appendix D.

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[1] Site visits averaged one hour, with the actual interviewing taking approximately 45 minutes

APPENDIX B

MID-TERM EVALUATION
AND
COMPARATIVE ANALYSIS
KENYA COMMERCIAL BANK/SIAM COMMERCIAL BANK

SCOPE OF WORK

I. The Projects

KENYA

The loan to the Kenya Commercial Bank/Kenya Finance Company (615-T-018), a public institution, in the amount of $2,500,000 is to provide on-lending, financing and servicing to Kenyan owned or controlled small and medium-sized private enterprises particularly agribusinesses, with emphasis on those located in rural districts of Kenya. In addition, A.I.D. also provided a $250,000 grant to cover training expenses for bank employees in order to provide Business Advisory Services (BAS) to rural, Small & Medium Scale Enterprises (SME), and to improve the bank's agribusiness credit evaluation process. The grant will also assist in the expansion of these capabilities to regional/branch offices.

The loan agreement was signed on January 6, 1983, with the KCB providing matching funds of $2,500,000. Total commitment: $5,250,000. The estimated project completion date is August, 1995.

Total funds disbursed by September 30, 1984 are expected to total $1,040,000. As of August 22, 1984, this project had 27 active sub-loans. The grant activity is scheduled to begin in early October 1984 with the arrival in Nairobi of an IESC contractor to work with Bank personnel to finalize plans for Seminars scheduled for November.

THAILAND

The loan to the Siam Commercial Bank (493-T-032), a private institution, in the amount of $2,000,000 was to create a facility to be managed by the Bank, to provide on-lending, financing, and servicing to private Thai-owned or controlled small and medium sized agribusiness projects located in districts outside of Bangkok. A.I.D. also provided a $150,000 grant to provide training to Bank personnel, in agribusiness term lending. The agreement was signed on September 21, 1982, with the Bank providing matching funds of $2,000,000 for a total commitment of $4,150,000. The estimated project completion date is September 30, 1992.

Total Disbursed to Date: $2,000,000

Although this evaluation is viewed as a mid-term review, this project is fully disbursed, with 15 sub-loans.

II. Purpose And Timing Of The Evaluations

The evaluations are being conducted at this time to provide PRE with an objective analysis of the success and/or failures of these projects. These loans were among the first projects designed by PRE, and in the past have been subject to considerable scrutiny, including Congressional inquiry.

The overall study will begin in Nairobi on October 1, 1984 and be completed in Thailand on or about October 31, 1984.

III. Questions The Evaluation Team Will Answer

The evaluation report should address the following essential questions:

General

1. Have the banks met the objectives of the loan and grant agreements?

2. How are these projects contributing to A.I.D. overall development goals? Host country development goals? PRE bureau overall strategy?

3. Do these projects complement other agricultural banking activities in their respective countries? How?

4. Are there any host government or institutional policy constraints which prevent or inhibit the ability of these banks to accomplish the project objectives? If so, describe them, and provide recommendations on how these may be overcome and how AID/PRE might avoid such constraints in the future?

5. What are the important host government regulations or legislation affecting the agribusiness sector which have helped or hindered the goals of the lending program?

6. Have there been any significant external phonomena which played a role in the success or failure of these projects?

7. Are the banks involved now in new activities as a result of the A.I.D. loans? If so, what is the likelihood for sustainability w/o future A.I.D. funds? What benefit have the AID loans had for the banks involved? What has been the impact on the banks activities?

8. What risks did AID ask the banks to take? How did AID plan to compensate the banks for any risks?

-Have the banks been successful in managing these new activities and the risks involved?

9. Are these programs being marketed to and through the branches and to the agribusiness sector? If so, how? Is this marketing successful?

10. Is AID assisting in the marketing in any way? If so, how? If not should it be, and if so, how?

11. Did the sub-borrowers know that U.S.A.I.D. was involved when they borrowed the money?

12. Are business advisory services anticipated under the project being provided to client companies by the bank? Why or why not? Have the AID grant funds intended for training been used to help meet the specific needs of the bank in providing needed services to clients or in better analyzing/managing an agribusiness loan portfolio? If so, how? If not, why not?

Will such training be on-going or institutionalized within the bank? How was the training disseminated to other bank employees dealing with potential sub-borrowers?

13. Would the banks have lent to these agribusinesses, w/o AID/PRE assistance on similar terms?

14. Are bank established monitoring procedures adequate to ensure portfolio quality throughout the life of the loans?

Kenya Specific

1. Has other donor activity been a constraint to implementation of this project? If so, why and how?

2. Even though the advisory services grant is just getting underway, do Seminar plans appear sufficient to meet their needs? What have been the reasons for the delays in organizing and implementing the training program?

3. Does the bank have established procedures to ensure that the subloan re-flows go to similar, new borrowers during the life of the loan? If not, why not and how does KCB plan to proceed with reflows?

<u>Thailand Specific</u>

1. Has SCB lent to these firms before? If so, are terms and conditions of A.I.D. facility different ahd, if so, why?

2. Had SCB provided term-credit in the past? If not, would they have w/o A.I.D.'s facility?

IV. <u>Team Composition</u>

KENYA: The Kenya team will consist of two A.I.D. direct hire employees, two U.S. contractors and a Kenyan economist provided by the Mission. Coopers & Lybrand's Nairobi office will provide the services of a junior financial analyst, if needed.

THAILAND: The Thailand team currently consists of two A.I.D. direct hire employees and one U.S. contractor. We are still looking for a U.S. banker. Coopers & Lybrand will provide the services of a junior financial analyst if needed.

All U.S. team members will participate in the pre-departure workshop in Washington D.C. on September 27, 1984 and perform the necessary field work as assigned in Kenya and Thailand.

<u>Mr. Ludwig Rudel</u> - a U.S. contractor, will lead this team. In addition to writing the two evaluation report findings, Mr. Rudel will assess the macroeconomic development impact of the loans in both countries. He will also be responsible for preparing a separate comparative analysis of the two institutions' activities under the A.I.D. loans.

<u>Mr. Charles Gormly</u> - Director of the AID/PRE Office of Policy and Program Review will primarily be responsible for ensuring that the evaluation methods used and the commercial and developmental lessons learned are reflected in ongoing AID/PRE plans, programs and projects. PRE's private sector lending

program, through IFI's and coupled with grant technical assistance funds for institution building, is central to the Bureau's private sector strategy and its hopes for replication at the Mission level. In addition to assisting with all aspects of team activities, Mr. Gormly will prepare an analysis of the grant funding under each project.

Ms. Christopher Mock, from the AID/S&T Office of Rural Development will analyze the individual subloan activities and assess the development impact of the loans on the down-scale.

Mr. Geza Szurovy, Assistant Vice President, International Banking, Bank of Boston, will accompany the team to Kenya to prepare the institutional analysis of the Kenya Commercial Bank/Kenya Commercial Finance Company loan.

Mr. Peter Ochieng Odoyo, a USAID/Nairobi, Foreign Service National and program economist will accompany the team to visits of the subloan activities and provide general assistance to the team, as necessary.

V. Methodology and Procedures

Two weeks will be spent in each country to review the loan portfolios and to visit selected sub-loan activities. The final report and comparative analysis will be prepared in Thailand. An additional week may be required for this purpose. A predeparture workshop will be held for the team on September 27, 1984.

All team members will be provided with briefing books containing pertinent project documentation.

VI. Funding

Funding will be provided as follows:

Mr. Gormly & Ms. Mock will be charged against PRE FY 1984 O.E. account. Mr. Rudel and Mr. Szurovy will be funded under existing contractual arrangements the Bureau has with outside organizations. Mr. Peter Ochieng Odoyo will be funded by USAID/Nairobi.

The team leader will receive an additional $3000 to be used for miscellaneous expenses incurred by the team in-country. For example, secretarial assistance, car rentals, interpreters, office space, etc. Receipts should be submitted for the use of these funds.

VII. <u>Reporting Requirements</u>

1. The following topics will be addressed in the two final reports (one for each project):

A. <u>Economic Overview</u>
Economic context of each country setting since signing of loan, including the agribusiness and financial sectors, and the institutional and legal (policy) frameworks affecting them.

B. <u>Institutional Review</u>
Organizational development
Management
Lending procedures
Characterization of portfolio
Analysis of financial performance
Training programs, if any
Procedures for screening sub-loan applications and for monitoring the portfolio
Grant Funds for Business Advisory Services

C. <u>Analysis of Subloan Activities</u>
Amount & terms of loan
Repayment performance (if any)
Development Impact

D. <u>Accomplishments vs. objectives including</u>:
Those achieved/not achieved
Why/why not
Unplanned achievements

E. Lessons Learned

F. Recommendations for redesign, if necessary
G. Sustainability
H. Replicability

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2. Format of the Report

Each of the two reports will contain the following sections:

--Executive Summary (guidelines attached).

--Basic project identification data facesheet (attached).

--Statement of Conclusions (short and succinct with topic identified by subhead) and recommendations (corresponding to conclusions and worded, whenever possible, to specify who should take the recommended action);

--Body of Report (which includes a description of the country context in which the project was developed and which provides the information on which the conclusions and recommendations were based); and

--Appendices as necessary (including, minimally, the evaluation's scope of work and a description of the methodology used and, possibly, methodological recommendation for future evaluations).

3. Comparative Analysis

A third report will be submitted which does a comparative analysis of the two projects. This particular piece will be most useful to PRE in terms of project replicability in other countries of the overall conceptual framework and approach utilized in the two projects evaluated. The analysis should focus in two major categories of "lessons learned" or "conclusions drawn":

1. Those design/implementation elements that appear to be generic -- i.e. they may be applicable in other environments when developing similar projects; and

2. Those design/implementation elements that appear to be country and/or institution specific and must be so tailored in each case.

In completing this analysis, particular attention should be given to the following:

1. Motivation: What are critical factors motivating commercial lending institutions to participate with AID in this market -- i.e. lending and other services to small and medium sized agribusinesses.

2. Management: Lessons acquired about effective management of an agribusiness lending portfolio.

3. Training: Expertise required of bank staff, which may be gained through training programs, in order to be effective in analyzing agribusiness investment opportunities.

4. Services: Types of services generally required by client companies under this type of lending program and how best to provide them.

Any other lessons which may be learned from the Kenya and Thailand experiences and which may have relevance in future project design efforts also should be articulated.

4. Submission of the Report

The draft report should be submitted to the PRE Evaluation Officer no later than 60 days following commencement of the evaluation.

Drafter:SReinhardt:sw:0310L:09-28-84

APPENDIX C: DEVELOPMENT BENEFITS

	A	B	C	D	E	F	G	H	I	J	K	L	M
Enterprise (Activity)	Use of Loan Funds	Principal Inputs and Origin	Principal Outputs and Destination	Foreign Exchange Generation	Original Work-force	Work-force Expan-sion	Total Loan Size ($)	Asset Size (Original) ($)	Asset Size (Expanded) ($)	Loan Cost Per Job Created ($) (G ÷ F)	Assets Per Worker (Original) ($) (H ÷ E)	Change in Assets Per ▲ Job ($) [(I-H)÷F)]	Other Major Development Impact
1. Kemby Cables (wiring and electric cables)	Purchase machinery (Used extruding armouring, bunding & testing equipment) Working Capital	Imported machinery, imported and local raw materials	Wiring and cables for local construction and communications	Export (20-50% sales) (Import substitution)	15	10*	321,429	407,929	828,786	32,143	27,195	42,086	Skills training Improved product quality Relatively labor intensive equipment
2. IMA Haulers (sugar cane hauling)	Purchase 3 cane loaders and 10 trailers (used)	Locally purchased equipment (local trailers and tires, used and imported tractors)	Cane hauling service for local farmers and sugar company	(Import Substitution)	60	20	71,429	601,071	672,500	3,571	10,018	3,571	Cost-saving to sugar company Dependability of service to farmers

(continued)

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	A	B	C	D	E	F	G	H	I	J	K	L	M
Enterprise (Activity)	Use of Loan Funds	Principal Inputs and Origin	Principal Outputs and Destination	Foreign Exchange Genration	Original Work-force	Work-force Expan-tion	Total Loan Size ($)	Asset Size (Original) ($)	Asset Size (Expanded) ($)	Loan Cost Per Job Created ($) (G ÷ F)	Assets Per Worker (Original) ($) (H ÷ E)	Assets Per Job ($) [(I-H)÷F)]	Other Major Development Impact
3. Musola Agricul-tural Contrac-tor (sugar cane hauling)	Purchase 7 tractors, 10 trailers (new), truck and motorbike Working Capital	Imported equipment	Cane hauling service for local farmers and sugar company	(Import Substitu-tion)	7	38 (65*)	214,286	29,786	315,500	5,639	4,255	7,519	Cost-saving to sugar company Dependabi-lity of service to farmers
4. Gum In-dustries (Adhe-sives)	Factory construc-tion Machinery purchase (motors, generators, boilers, starters)	Imported machinery and raw materials; local con-struction labor	Adhesives to local in-dustry (Hope to export eventually)	(Import Substitu-tion) Projected exports (20-30% sales)	-	35 (40*)	285,714	-	478,214	8,163	NA	13,663	Skills training Anticipate higher quality product
5. J. Lutta (land ploughing and weeding)	Purchase tractor, plough, 2 weeding implements	Locally purchased equipment (imported used)	Cane pro-duction and service to local farmers	(Import Substitu-tion)	-	10	35,714	-	42,857	3,571	NA	4,286	Cost saving to farmers (weeding) Increased agricultu-ral output and pro-ductivity

(continued)

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	A	B	C	D	E	F	G	H	I	J	K	L	M
Enterprise (Activity)	Use of Loan Funds	Principal Inputs and Origin	Principal Outputs and Destination	Foreign Exchange Genration	Original Work-force	Work-force Expan-tion	Total Loan Size ($)	Asset Size (Original) ($)	Asset Size (Expanded) ($)	Loan Cost Per Job Created ($) (G - F)	Assets Per Worker (Original) ($) (H - E)	Assets Per Jobs ($) [(I-H)-F)]	Other Major Development Impact
6. Ken Oven (bakery)	Purchase bakery equipment (oven, molder, prover), mixer), used truck	Imported machinery and ingre-dients Some local equipment and ingre-dients	Bread, rolls, cakes, for local consumption	-	-	23 (10*)	53,571	-	71,000	2,329	NA	3,086	Skills training Service to consumers Improved nutrition (fresher bakery products)
7. Magoko Trans-porters (hard-ware, const-ruction materials agricult. inputs)	Purchase inventory Working Capital Purchase truck	Mostly locally-produced inventory	Retail sales to local community for agri-culture and construction	(Import Substi-tution)	9.25**	1	21,429	30,000	51,429	21,429	3,243	21,429	Service to farmers (availabi-lity, quality of inputs) Service to consumers (availabi-lity of construc-tion materials

(continued)

	A	B	C	D	E	F	G	H	I	J	K	L	M
Enterprise (Activity)	Use of Loan Funds	Principal Inputs and Origin	Principal Outputs and Destination	Foreign Exchange Genration	Original Work-force	Work-force Expan-tion	Total Loan Size ($).	Asset Size (Original) ($)	Asset Size (Expanded) ($)	Loan Cost Per Job Created ($) (G - F)	Assets Per Worker (Original) ($) (H - E)	Assets Per Jobs ($) [(I-H)-F)]	Other Major Development Impact
8. Kibiko Slaughter house	Construction of slaughter house Purchase small tools (knives, hooks)	Local tools and livestock, local construction labor	Meat for local consumption; hides and skins for export	Export hides and skins	-	17	71,429	-	104,286	4,201	NA	6,134	Service and income to herders (time and cost-saving; higher price for hides) Skills training Cost saving to butchers
9. P. Wambani (posho mill)	Purchase posho mill	Imported mill, local maize	Ground maize for local consumption	-	-	4	14,286	-	23,571	3,572	NA	5,893	Service and income to local consumers (time and cost saving in milling; lower food price)

* Projected Workforce:

Kenby Cables	:	Within 6 months
Musola	:	Within the next year
Gum Industries	:	In 1985
Ken Oven	:	With additional flour availability, will expand to third shift

NA=Not applicable

** Part-time accountant accounts for .25/worker employment.

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APPENDIX D(a): SIZE OF EXISTING ENTERPRISES ASSISTED

Enterprise Activity (with portfolio number)	Asset Valuation: Before Loan KShs. (000)	Asset Valuation: Before Loan Dollars[1]	Asset Valuation: Projected, with Loan KShs.	Asset Valuation: Projected, with Loan Dollars[1]	Size Classification: Before Loan[2]	Size Classification: With Loan[3]
1. Cable Manufacturing	5,711	$407,929	11,603	$828,786	S	M
2. Sugar Hauling	8,415	601,071	9,415	672,500	S	S
3. Sugar Hauling	1,417	29,786	4,417	315,500	S	S
9. Bakery	800	57,143	1,000	71,429	S	S
10. Tractor Leasing	300	21,429	800	57,143	S	S
14. Retail: Hardware Construction Materials, Agricultural Inputs	420	30,000	720	51,429	S	S
19. Coffee Pulping	210	15,000	510	36,429	S	S
26. Bakery	1,100	79,000	1,190	85,000	S	S
30. Dry Cleaners	145	10,357	565	40,357	S	S
33. Maize Milling	90	6,429	160	11,429	S	S

Average Size of Existing Enterprise Assisted:	Before Loan	With Loan
	$125,814	$217,000

1: Exchange Rate - 14 KShs. = $1.00 (1984).

2: S = Small
3: M = Medium

APPENDIX D(b): SIZE OF NEW ENTERPRISES ASSISTED

	Enterprise Activity (with Portfolio Number)	Asset Valuation (Projected, with Loan) K. Shillings	Dollars[1]	Size Classification
4.	Adhesives Manufacturing	6,695	478,214	S
6.	Maize Milling	96	6,857	S
7.	Tractor Services	600	42,857	S
8.	Maize Milling	236	16,857	S
9.	Maize Milling	330	23,571	S
11.	Bakery	994	71,000	S
12.	Maize Milling	211	15,071	S
13.	Maize Milling	300	21,429	S
15.	Maize Milling	280	20,000	S
16.	Sunflower Inputs/ Output Distribution	5,824	416,000	S
17.	Maize Milling	270	19,286	S
18	Coffee Pulping	400	28,571	S
20.	Maize Milling	135	9,643	S
21.	Maize Milling	150	10,714	S
22.	Maize Milling	200	14,286	S
23.	Slaughter House	1,460	104,286	S
24.	Maize Milling	153	10,929	S
25.	Tractor Services	275	19,643	S
27.	Coffee Pulping	700	50,000	S
28.	Maize Milling	220	15,714	S
29.	Maize Milling	100	7,143	S
31.	Coffee Pulping	800	57,143	S
32.	Tractor Services	260	18,571	S
34.	Maize Milling	200	14,286	S
35.	Maize Milling	200	14,286	S
36.	Bakery	1,300	92,857	S
37.	Maize Milling	160	11,429	S
38.	Salt Processing/Snacks	1,000	71,429	S

Average Size of Enterprise Assisted: <u>$60,074</u>

Average Size of Enterprise Assisted (New Enterprises, and Existing Enterprises, before loan). <u>$77,374</u>

1: Exchange Rate - 14 KShs. = $1.00 (1984)

APPENDIX D(c): ENTERPRISE ACTIVITY CLASSIFICATION

Enterprise Activity By Category	Number of Enterprises: Original Loans Approved before 6/30/84	Number of Enterprises: New Loans Approved between 6/30/84-9/30/84	Total	Percent of Total Enterprises
1. Food Processing	18	9	(27)	71%
Small Grain Mills (Maize grinding)	(11)	(6)	(17)	(45%)*
Coffee Pulping	(3)	(1)	(4)	(10.5%)
Bakeries	(3)	(1)	(4)	(10.5%)
Salt and Snacks	0	(1)	(1)	(2.6%)
Salughterhouse	(1)	0	(1)	(2.6%)
2. Agricultural Services (Ploughing and Weeding)	(3)	(0)	3	8%
3. Manufacturing	(2)	0	2	5.3%
Electrical Cables	(1)	0	(1)	(2.6%)
Adhesives	(1)	0	(1)	(2.6%)
4. Agricultural Input and Output Distribution	3	1	4	10.5%
Sugar Hauling	(2)	(1)	(3)	(8%)
Sunflower Production	(1)	0	(1)	(2.6%)
5. Retail Sales (Hardware, Construction Materials Agricultural Inputs**	1	0	1	2.6%
6. Retail Services (Dry Cleaning)	0	1	1	2.6%
Total				100%

*Due to rounding-off of subtoal percentages, subtotal sums may not exactly correspond to percent totals for each category of enterprise.

**Since the retail sale of agricultural inputs is a new and limited aspect of this business, this has not been included in category 4, which includes enterprises which are primarily distributors of agricultural inputs or outputs.

APPENDIX D(d): LOCATION OF LOAN RECIPIENTS

Province	Loan Recipients Number	Loan Recipients % of Total	Population % of Total
Coastal	-	-	8.7
North Eastern	-	-	2.4
Eastern	2.5	6.6	17.8
Central	10.5	27.6	15.3
Nairobi	1	2.6	5.4
Rift Valley	8	21.1	21.1
Western	8	21.1	12.0
Nyanza	8	21.1	17.3
Total	38	100%*	100%*

*Actual total is 100.1%, due to rounding off.

1/There are two projects in Embu and part of another near Mt. Kenya; while these areas are technically in the Eastern region, they are in the extreme western part of the region.

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APPENDIX D(e): DISTRIBUTION OF LOAN RECIPIENTS BY ETHNIC AND RACIAL GROUP

The distribution of loans by race and ethnicity is summarized in the table below. As the data demonstrate, there is a relative concentration of loans with the Kikuyu, who represent about 26% of the population, but receive over 42% of the loans. This may be due partly to the fact that the Kikuyu tend to specialize in financial and commercial activities. Aside from this relative imbalance, the loans are fairly well distributed among the other ethnic and racial groups, although the Kamba, received no loans at all. It should also be noted that the Asians, who dominate many of the most prosperous commercial activities, received 5.3% of the loans which is not excessively disproportionate to their representation in the country's population (1%). The two loans to Asians were, however, among the largest loans awarded. It is also useful to note that the Kalenjin, the President's tribal group, did not receive a disproportionate number of loans; in fact, their 10.5% of the loans was less than their representation in the population (11%).

Ethnic/ Racial Group	Number of Loans	% of Total Loans	% of Total Population
Kikuyu (including Mera)	16	42.1%	26%
Luhya	5	13.2%	14%
Luo	4	10.5%	13%
Kalenjin	3) 7	10.5) 18.4%	
(including Masai)	4)	7.9)	11%
Kamba	-	-	6%
Kisii	4	10.5%	6%
Asians	2	5.3%	1%

Finally, the project agreement specifies that the ownership of the recipient enterprises is to be at least 50% Kenyan. Apparently all of the Africans to whom the loans were extended are Kenyan citizens. However, the citizenship of the nine Asian shareholders in the two Asian-owned enterprises is not clear. Most, if not all, of the Asians have lived in the Kisumu area for decades, although the owners of both enterprises do own other enterprises and assets in England. Thus, they may be Kenyan citizens but they may not be intending to stay in Kenya indefinitely.

APPENDIX E. HISTORY OF TERM CREDIT FACILITIES IN KENYA

Kenya's banking facilities derive from England's merchant banking structure, with heavy reliance on short term overdraft facilities that are often heavily collateralized and regularly rolled over. Project lending with medium term periodic repayment schedules is an innovation of the 1970's. As the modern sector grew, with increasing monetization of the economy, new entrepreneurs with no previous business or credit history found themselves constrained by the absence of financing facilities for the start up capital investment of their enterprises.

Public Sector

The Government of Kenya, with the support of bilateral donors such as the World Bank, established a number of lending facilities including the Rural Industrial Development Companies (RIDCs) and the Kenya Industrial Estates (KIE). These credit facilities required borrowers to put up only small amounts of equity and did not require security collateral other than liens on the equipment being purchased with the loan. Interest rates were set well below the market (8% to 11%) and loans were made for 3 years.

The focus by aid donors soon turned to Kenya's well established commercial banks, to channel medium term credit (more than 4 years) to viable private sector projects. But the banks were reluctant to make such loans, in part because this was a departure from their traditional lending practices, in part because of their fear of disintermediation, since virtually all of their deposits were short term (less than 1 year).

The Role of the IFC

The International Finance Corporation (IFC), a World Bank affiliate, entered into an agreement in 1976 with Kenya Commercial Bank (KCB) to make term loans. A total of $2 million was put up by IFC (at 9% interest) to match KCB resources on a 70% IFC/30% KCB basis with each institution assuming a proportionate share of the risk and return. These term loans were made by the bank using their normal collateral requirements. KCB received a 2% management fee. A condition required by IFC of KCB was the establishment of the Business Advisory Service (BAS) within KCB to provide assistance to borrowers in structuring their loan applications. The BAS was financed with a grant from the Commonwealth Fund. The then Chairman of KCB, Mr. Ndegwa (who is now head of Kenya's Central Bank) appointed Mr. Adam Ali to organize and manage the BAS. IFC also provided an advisor, Mr. R. Bhatia, to KCB. Under Mr. Ali's direction, from 1978 to April 1984, BAS became a highly respected organization and a powerful unit within KCB/KCFC.

The successful implementation of the initial IFC program gave rise in 1981 to a second IFC tranche in the amount of $5 million matched on a 50/50 basis by KCFC. However, this time KCB assumed the full risk of repayment to IFC with the foreign exchange risk borne by the Government of Kenya. IFC charged interest to KCB at 10 1/2% while KCB/KCFC on-lent the funds to borrowers at about 19%. The IFC loan was denominated in D-marks. 10.5% was the then market rate for D-mark funds. IFC does not provide concessional financing. The full amount of this $5 million plus KCFC's matching funds will be drawn down by KCFC by March 1985.

IFC reports that KCB has requested a third tranche of $20 million, plus $5 million from OPEC. The third tranche has not been approved by IFC even at the scaled down level of $7.5 million, because the Government of Kenya is no longer willing to guarantee the foreign exchange risk. While there may be some dissatisfaction on the part of IFC with respect to the operation of BAS since the reassignment of the former Chairman of KCB to the Central Bank and the departures of KFC advisor R. Bhatia and Adam Ali, we are informed that IFC would proceed with the loan if the foreign exchange risk issue were resolved. The IFC interest rate to KCB for the third tranche would be the current market rate. At this writing the D-mark rate is 10.5% and the US dollar rate is 15%. OPEC is likely to provide an additional $5 million to KCB as requested.

OPEC

The Oil Producing Exporting Countries (OPEC) joined IFC at the time of the second IFC tranche by providing an additional $2 million to KCFC at 0% interest, with the interest charged to borrowers (12% to 14%) to be used to finance the BAS. It is expected that these funds will be fully drawn down by the end of 1984. These funds were also matched by KCB/KCFC. The team was told by one of KCB's area managers that the KCB branch nearest the borrower was given a 50% participation in the loan, and the interest earned on that 50% was retained by the branch as its earnings for servicing the loan. This was verified orally by Mr. Pereira, Senior Loan Officer in charge of administering the OPEC loan. This participation induced the KCB branch network to market the program. This statement was subsequently denied by the Manager of KCFC. Unfortunately pressure of time did not allow the team to sort out this conflicting data.

DFCK

The Development Finance Company of Kenya (DFCK) began a term lending program for Small Scale Industry in 1978, supported in part by the Netherlands and other European donors. In 1983 a special subsidiary organization was spun off, called Small Enterprise Finance Company (SEFCO). It has made about 64 loans and has 850 pending applications about half of which they believe to be financeable if their collateralization requirements were somewhat relaxed. It offers 5 to 12 year financing, 3 year grace at 14% interest. Funding for the pending applications is not a constraint but the new organization is unable to process and manage them rapidly enough. SEFCO is negotiating with a Kenyan bank that has a substantial branch network to process these borrowers applications, with SEFCO guaranteeing the loans to the bank. In effect, SEFCO will be encouraging the bank to use its deposits for term lending by providing the bank with a partial guarantee against risk of default.

U.S. Agency for International Development

In 1982 AID/PRE negotiated its loan with KCFC, which was patterned after the International Finance Corporation arrangement, with AID providing $2.5 million to KCFC at 8 3/8% interest to be matched by an equal amount of KCFC funds and on-lent by them for their risk and account at the maximum interest rate allowed by law (now 19%). A grant of $250,000 was provided to the KCB to enhance the BAS and to finance bank staff training. The thrust of this project was to get KCFC/KCB more deeply into term lending. At the time of the evaluation approximately 38% of these funds have been lent to borrowers. The grant, which expires January 6, 1985, has yet to be drawn down. The AID Mission in Nairobi, however is now negotiating with KCB and other banks to inject $24 million into the term lending market. This new Mission project is patterned after the PRE loan to the KCB.

APPENDIX F: COMPARISON OF AID, IFC AND OPEC TERM LOAN SCHEMES

Name of Scheme	Date Approved	Amount of Line of Credit	Amount Matched by Kenyans	Purpose and Eligibility	Terms	Interest Rate	Maximum Size of Loan	Restric-tions	Exchange Risk	Security	9/30/84 Number of Loans Outstanding Drawn Down	9/30/84 Percent Drawn Down
AID	1/6/83	2.5 M. Plus Matching KCB		Agri Business & Rural Private Enterprise at least 50% Kenyan Assets: Small - Less than US$750,000 Medium - Less than US$ 1.5 M.	2 Yr. Grace Minimum 4 Yrs. Maximum 10 Yrs.	19% + 1% Fx. Fee	Small - KS 2.4 M. Medium - KS 5.5 M.	Up to 3 X Net Worth	Borne by Govn't Borrower pays 1%	Normal KCB/KCFC	22	35%
IFC 1st Tranche	1978	$2 M.		Small and Medium Scale Enterprises in Agriculture, Agri Business, Manufacturing, Service. Limited Liability Companies Assets: Small - Less than KS 10 M. Medium - Less than KS 25 M.	2 Yr. Grace 8 Yr. Term	19%	Small - KS.3-4 M. Medium - KS.4-10 M.	Up to 3 X Net Worth	Borne by Govn't Borrower pays 1%	Normal KCB/KCFC	11 remaining	100%
2nd Tranche	1982	$5 M. Plus Matching Funds									27	57%

Name of Scheme	Date Approved	Amount of Line of Credit	Amount Matched by Kenyans	Purpose and Eligibility	Terms	Interest Rate	Maximum Size of Loan	Restrictions	Exchange Risk	Security	9/30/84 Number of Loans Outstanding Drawn Down	9/30/84 Percent Drawn Down
OPEC * Rural Enterprise				Growth of Small Scal Rural Enterprise in Agri Business, Industry and Service Industry. Person or Corp. 100% Kenya owned, Total Fixed Assets not to exceed KS 1.25 M.	2 Yr. Grace 8 Yr. Term	12%	KS500,000	Not to Exceed 3 Times Net Worth	Borne by Govn't of Kenya	Normal KCB/KCFC		
OPEC * Agriculture		3 Million Plus Matching Funds		Kenyan Farmer with principal source of income from farming on land holdings not exceeding 150 Acres	2 Yr. Grace 8 Yr. Term	12%	KS500,000	Not to Exceed 3 Times Net Worth	Borne by Govn't of Kenya	Normal KCB/KCFC	216	83%
OPEC * Urban Enterprise				Growth of 100% Kenyan owned urban private industrial enterprises in government selected priority areas. Total Fixed Assets less than KS 2.5 M.	2 Yr. Grace 8 Yr. Term	14%	KS1,000,000	Not to Exceed 3 Times Net Worth	Borne by Govn't of Kenya	Normal KCB/KCFC		
KCFC + Schemes	N/A	Plus 823 M.		Generally Mid-Term (some working capital related to Med-Term. Property loans Leases Exim loans Misc.	5 Yrs.	19%	Open	Not to Exceed 3 Times Net Worth	None (All local Lending.)	Normal KCB/KCFC	429	N/A

* 50% of OPEC Loans have to be lent through the Branch with risk assumed by Branch (50%) and 50% of income recognized by Branch.