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INVESTMENT PROPOSAL

FOR

REVOLVING FUND

KENYAN NON-BANK FINANCIAL INSTITUTIONS PROJECT

TO

NBFI CONSORTIUM FUNDING GUARANTEE FACILITY - US$2,000,000
DIAMOND TRUST OF KENYA LOAN GUARANTEE FACILITY -US$1,000,000

OFFICE OF INVESTMENT

BUREAU FOR PRIVATE ENTERPRISE

MAY 1987

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT COMMITTEE FOR

KENYAN NON-BANK FINANCIAL INSTITUTIONS

Chairperson:	Richard B. Loth, PRE/I
Committee:	Joe Carroll, PRE/D
	Kathy Wilson, PRE/I
	Maury Claeys, PRE/I
	Rob Sonenthal, GC/PRE

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I. EXECUTIVE SUMMARY

A. PROJECT DESCRIPTION

1.01 While encompassing a variety of developmental aspects, this project's focus and subsequent design has concentrated principally on the dual objective of capital market and institutional development. The vehicles to accomplish this task involve Kenyan financial institutions and guarantee mechanisms to support both savings mobilization and small business lending.

1.02 The Kenyan Non-Bank Financial Institutions Project is actually comprised of two related but separate transactions:

(1) A seven-year funding guarantee facility for US$2 million to support the private placement of long-term notes by four finance companies with a local insurance company, American Life Insurance Company (Kenya)(ALICO/K), which is a majority-owned subsidiary of the American International Group, Inc. (AIG). This funding will be matched by the participating NBFIs with their own resources to mobilize a pool of funds for term lending to small-medium scale private enterprises .

(2) A five-year loan guarantee facility for US$1 million to cover a 50% risk sharing agreement with Diamond Trust of Kenya (DTK) for the latter's term loans extended to small-medium scale private enterprises. DTK, a non-bank financial institution which emphasizes merchant banking activities, will utilize its own resources for this purpose.

(3) A US$90,000 (approximate) grant to the NBFI participants in the funding guarantee facility for staff training and borrower education programs.

The two facilities, which address the differing needs of the participating institutions, focus on the mobilization of the KSh equivalent of

US$6 million for term lending to small-medium scale private enterprises.

B. RATIONALE FOR UTILIZATION OF REVOLVING FUND RESOURCES

1.02 Besides the RF's two basic criteria of creditworthiness and developmental impact (see remarks below), the project embodies a number of attractive elements:

(a) The funding guarantee mechanism, which taps an institutional source of local currency for term financing, resolves the cross-currency risk for the RF and its client(s). In addition, AIG has indicated that it is very interested in working with PRE in seeking out other investment opportunities through their international network of insurance companies (e.g. Ecuador and the Philippines). This model appears to provide for a high degree of replicability worldwide, both with AIG and other similar institutional sources.

(b) From the project's inception PRE has received considerable assistance and cooperation from USAID/Kenya staff. In addition, the Mission is committed to obtaining US$500,000 as its funding participation. This project is a good example of PRE/USAID co-design and co-finance for a RF project which is considered an integral part of USAID/Kenya's comprehensive private sector development project.

(c) Selection of intermediate financial institutions - in the case of the NBFI Consortium, PRE is working for the first time with relatively small financial intermediaries whose clients (average loan US$20 thousand) perforce are small businesses. These institutions have a truly "grass roots" orientation as development vehicles for economic growth. DTK is at the other end of the size spectrum. It will be of interest to measure the degree of success (and appetite) an IFI like Diamond Trust develops for lending to small-medium scale private enterprises in the Kenyan business environment.

PROJECT SPONSORS/PARTICIPANTS

1.04 The participants in the NBFI Consortium include four indigenous, privately owned finance companies - Kenya Finance Corporation, Middle Africa Finance Company, Nationwide Finance Company, and Thabiti Finance Company. These institutions are fairly simple operations funding themselves through time deposits and lending on a straight loan, installment, and leasing basis. In the aggregate, these NBFIs have branch offices covering the economically active areas of Kenya. They are relatively small operations, with capital funds (equity) positions in the range of US$1-2 million, and short operating histories. Nevertheless, all "weathered" the banking crisis of 1986 (see Section IV), have good reputations, and ownership and management quality is highly regarded in the business community.

The American International Group, Inc., with headquarters in New York, is one of the world's leading insurance companies, with affiliates in more than 130 countries. AIG's equity and total assets as of 12/31/86 were US$4.9 billion and US$21 billion, respectively. AIG's majority owned subsidiary in Kenya, American Life Insurance Company (Kenya) is one of the country's largest casualty and life insurers. ALICO/K is considered a prime name in the Kenyan financial community.

Diamond Trust of Kenya, affiliated with the Aga Khan Fund/IPS group, is one of Kenya's premier financial institutions. Approximately 52% of DTK shares are held by some 7,695 individual Kenyan investors. The IFC and Samuel Montagu are other major shareholders. DTK's activities are split between general lending and merchant banking. Its management is experienced and, perhaps, the most technically sophisticated in the financial community. As of September 30, 1986 it had a capital funds position of US$10.2 million with total assets of US$100 million.

D. DEVELOPMENTAL IMPACT

1.05 This project conforms with the priorities of USAID/Kenya's strategy for promoting private enterprise development in Kenya. It has the full support of the Mission and is viewed as complement to its recently approved Private Enterprise Development project. The funding and loan guarantee facilities will provide a positive impact in six key USAID policy areas:

- credit availability, at market rates, to small business;

- enhancement of IFI funding/lending activities;

- employment generation;

- additional support to USAID/Kenya's policy dialogue efforts;

- increased agricultural/agribusiness activity through additional credit resources; and

- savings generation.

E. CREDITWORTHINESS

1.06 The risk associated with the funding guarantee facility with the NBFIs is spread equally among the four finance companies. It is recognized that while these institutions are not large, well-established entities, their operating history is sufficient and their individual financial positions are satisfactory enough to indicate a reasonable assurance of repayment. With the NBFIs we are taking an institutional risk on non-performance as opposed to a specific transaction risk. The additional funding liability which each finance company is assuming represents a relatively modest percentage of their total deposits as of their most recent financial statements - between 4% - 6%.

Our objective with the creation of the "Loan Review Board" (see page) is limited to one of general oversight on a segment of their lending activities. However, this mechanism does give us close, continuous contact with the NBFIs and enhances our client monitoring ability.

With regard to Diamond Trust, the credit quality factor is very high. In this instance, based on historical experience and DTK's level of management competence, we can expect optimum performance results. With the loan guarantee facility we are taking a transaction risk, and look to DTK to undertake proper risk evaluation and collection actions on those loans covered by the risk-sharing agreement.

F. PROJECT TIMETABLE

IOP	6/04
Loan Review Board	6/11
IP	6/15
Congressional Notification	6/24
Project Authorization	6/25
Obligation of Funds (loan agreements signed)	7/15
Project Agreement	7/30

II. TRANSACTION SUMMARIES

A. NBFI CONSORTIUM FUNDING GUARANTEE FACILITY

FACILITY:	To provide for a funding guarantee to support the placement of secured variable rate KSh notes issued by the NBFIs to ALICO/K.
BORROWER(S):	Kenya Finance Corporation, Middle Africa Finance Company Ltd., Nationwide Finance Company Ltd., and Thabiti Finance Company Ltd. Individually obligated for KSh 8,000,000 (US$ 500,000) each.
AMOUNT:	US$ 2,000,000 in the form of KSh 32,000,000 (assumed parity of KSh 16/US$1). USAID/Kenya has made a best efforts commitment to participate (co-finance) up to US$500,000 in funding this commitment in years 3-4 from counterpart funds and/or reflows from the venture capital component of their private enterprise development project.
LENDER of KSh:	American Life Insurance Company, Kenya ALICO/K, a majority owned subsidiary of the American International Group, Inc., New York, USA, will be the soruce of the local currency.
GUARANTEE:	USAID-PRE Bureau/Revolving Fund will effect a guarantee arrangement with AIG to support ALICO/K's placement of funds with the NBFI's.
PURPOSE:	To create a pool of funds to support NBFI lending to small-scale private enterprises (maximum total assets KSh 5MM =

US$ 300M). The funds generated by the facility will be matched in a like amount by the NBFIs and accounted for in a segregated liability account. As loans are made, this account will be charged for 50% of the funding of the loan amount. The loan disbursement schedule calls for four equal, progressive loan booking targets of 25%, 50%, 75%, and 100% as of 6,12,18 and 24 months from facility drawdown date, respectively. The loans will be equally divided between short-term and medium-term credits. (Note: To ensure that the "loan booking targets" are met we are exploring a call provision on the notes placed with ALICO(K) and/or penalty fees. If ALICO(K) cannot accept pre-payment, we would be required to arrange for an alternate use of the funds involved.)

FORM AND TERM: Each borrowing NBFI will issue a series of notes, amortizing the KSh 8 MM (US$ 500M) principal amount in ten equal, semi-annual installments over a 7-year period beginning at the 30th month. The interest on the variable rate notes shall be calculated semi-annually at 700 basis points below the maximum lending rate for NBFIs as established by the Central Bank of Kenya (presently 19% p.a.) with a minimum yield of 7% p.a.

GUARANTEE AGREEMENT: PRE will effect a US$2,000,000 placement of funds offshore with AIG, or a mutually agreeable third party, earning an acceptable market rate of return, under a loan (collateral) agreement which runs parallel to the risk exposure of its ALICO/K subsidiary's investment in the NBFI notes.

GUARANTEE FEE:	Each borrowing NBFI will pay a guarantee fee to PRE equal to 1% p.a. on its outstanding participation under the facility, payable semi-annually in US$ (Central Bank approval will be required).
FACILITY FEE:	Upon signing all facility documentation, an acceptance fee of 1% flat of each NBFI's participation (US$ 500,000) will be paid to PRE in US$ (Central Bank approval will be required).
DOCUMENTATION:	(1) Loan (collateral) Agreement between AIG and PRE. (2) Project Agreement between the Kenyan NBFIs and PRE.
CONDITIONS PRECEDENT	(1) AIG-PRE execute a loan (collateral) agreement. (2) All four borrowers agree to the terms and conditions of this facility as set forth in the Project Agreement and execute same. (3) Establishment of a "Loan Review Board" comprised of three individuals, including one from USAID/Kenya and two other businesspersons selected in consultation with the NBFIs. The LRB is advisory in nature and will function in similar fashion to PRE's Revolving Fund Loan Review Board.

Each NBFI will contribute KSh 4,000 annually to cover LRB costs.

GRANT FACILITY:	PRE and/or USAID/Kenya have agreed in principle to endeavor to arrange for a grant of approximately US$90,000 to provide for NBFI staff training and a borrower education program. USAID, in consultation with the NBFIs, will be responsible for the program's design and implementation.

B. <u>Diamond Trust of Kenya - Loan Guarantee Facility</u>

AMOUNT:	US$1,000,000
BORROWER:	Diamond Trust of Kenya, Ltd. (DTK)
GUARANTOR:	USAID-PRE Bureau/Revolving Fund
FACILITY:	A loan guarantee facility covering a risk-sharing agreement with DTK for the latter's loans extended to 100% privately owned small-to-medium scale private enterprises. DTK's loans, funded with its own resources, to qualifying sub-borrowers will be covered up to 50% against losses due to commercial risk.
PURPOSE:	In accordance with mutually agreed upon criteria, emphasis will be on DTK's lending to small/medium scale private enterprises on a medium to long term basis for activities covering agriculture, agri-business,

light manufacturing, commercial and service businesses. For DTK's purposes, small-scale is being defined as having total assets of no more than $500,000. (Sub loan size to be negotiated at the time project agreement is prepared.)

FORM AND TERM: Guarantee coverage will be amortized over a five (5) year period, including a two (2) year grace period, with seven (7) equal, semi-annual reductions of guarantee coverage beginning in month twenty-four (24).

GUARANTEE AGREEMENT: PRE will effect a US$1,000,000 placement of funds offshore with IPS, or a mutually agreeable third party, earning an acceptable market rate of return, under a loan (collateral) agreement which runs parallel to the risk exposure of its DTK subsidiary's qualifying sub-loan coverage.

GUARANTEE FEE: DTK will pay a guarantee fee to PRE equal to 3/4% p.a. on its outstandings under the facility, payable semi-annually in US$ (Central Bank approval will be required).

FACILITY FEE: Upon signing all facility documentation, an acceptance fee of 1/2% flat will be paid to PRE in US$ (Central Bank approval will be required).

DOCUMENTATION:	(1) Loan (collateral) Agreement between IPS and PRE. (2) Project Agreement between DTK and PRE.
CONDITIONS PRECEDENT:	(1) DTK and PRE agree to the terms and conditions of the facility as set forth in the Project Agreement and execute same. (2) IPS and PRE execute a loan (collateral) agreement.

III. THE SPONSORS

A. NBFI CONSORTIUM:

3.01 Kenya Finance Corporation (KFC)

3.02 Overview

KFC was founded in 1976 and was the first privately owned, indigenous NBFI to be established in Kenya. Its operations consist of commercial financing and financial services. It has maintained a good reputation in the marketplace and its ownership and management are well thought of in Kenyan business circles. As of fiscal year-end (December 31) 1986, KFC had total assets of KSh 504 million, total deposits of KSh 429 million and capital funds of KSh 27 million (approximately US$ values -US$ 32 MM, US$ 27 MM, and US$ 1.7 million, respectively).

3.03 Ownership and Management

KFC has twenty-nine shareholders, the five largest accounting for 69% of the ownership equity. These holdings represent the interests of respected businesspersons - Francis Uyamo, Albert Ekirapa, Paul Muite, James Kanja, and Godfrey Kariuki - all, except for the latter, serving on KFC's board of directors. The key senior managers are experienced professionals with good educational and professional backgrounds.

3.04 Operations

KFC's lending activities are principally focused on lease and installment financing of transport vehicles and industrial installations and equipment. KFC basically raises its funds through time deposits to support its asset-based financing. It operates two branches in Nairobi and one each in Meru, Monbasa and Nakuru. KFC is a small shareholder in an insurance company, Pan African Insurance Co., Ltd., and a majority owner of two real estae subsidiaries, Kenifer Services, Ltd. and Kenifer Properties Ltd.

3.05 Financial Condition and Performance

KFC's summarized financial statements as of their fiscal year-end, December 31st, follow (figures in thousands of KSh and adjusted for intangibles):

	1983	1984	1985	1986
Primary Assets	46,356	40,531	100,313	118,529
Loans	170,342	313,328	324,492	328,160
Other Assets	17,996	35,635	48,201	57,364
Total Assets	234,694	389,494	473,006	504,053
Deposits	200,152	350,223	415,570	428,874
Other Liabilities	15,016	20,697	29,296	44,990
Total Liabilities	215,168	370,920	444,866	473,864
Minority Interest	-	-	-	2,809
Capital Funds	19,526	18,574	28,140	27,380
Total Liabilities & Capital Funds	234,694	389,494	473,006	504,053
Net Income	4,093	1,789	4,606	3,898
Representative KSh/US$ parity	14/1	15/1	17/1	16/1

Selected Financial Ratios

	1983	1984	1985	1986
Return on Equity	-	9.4%	19.7%	14.0%
Return on Assets	-	.5%	1.1%	.8%
Primary Asssets/Dep	23.0%	12.0%	24.0%	28.0%
Loans/Deposits	85.0%	90.0%	78.0%	77.0%
Capital Funds/Loans	12.0%	6.0%	9.0%	8.0%
Capital Funds/Liab.	10.0%	5.0%	7.0%	6.0%

KFC has doubled in size during the four-year period under review, although the difficulties of the 1985-1986 years are evident in the nominal growth experienced in deposits and loan assets. Earnings in 1986 were adversely effected by a non-recurring charge of KSh 765,800 for the loss experienced on the sale of an investment. Apart from this extraordinary item, 1986 profits approximated 1985 results. The reduction in earnings, even with significantly lower dividends payments, has not permitted KFC to strengthen its capital position in 1986. However, in general the company's overall financial position is satisfactory with relatively good liquidity and capital adequacy. The company's successful eleven year operating history adds additional confidence to KFC's financial durability. The subject's financial statements are audited by Kassim-Lakha Abdulla & Co.

3.06 Middle Africa Finance, LTD. (MAFCO)

3.07 Overview

MAFCO began operations in April 1982 and is the "youngest" of the four finance companies in the selected NBFI consortium. MAFCO is wholly owned and managed by private, indigenous Kenyan business interests. In its short history, it has developed a positive reputation for a well-run institution. Its activities cover agricultural and commercial lending to relatively small-scale enterprises on a one-to-two year basis. As of fiscal year-end (June 30) 1986, MAFCO had total assets of KSh 484 million, total deposits of KSh 445 million, and capital funds of KSh 12.8 million (approximate US$ values - US$ 30MM, US$ 28MM, and US$ .8MM, respectively).

3.08 Ownership and Management

MAFCO has six shareholders and is controlled and managed by Mr. J.S. Muriu and Mr. T.W. Wainaina. Messrs. Muriu and Wainaima are two highly respected professionals in Kenyan financial circles. Muriu was formerly the Manager of the Commercial Bank of Africa, having also held a key financial position with HFC of Kenya (a consumer finance company). He has over twenty-three years of banking experience. Mr. Wainaima, a professional accountant (CPA) has held key positions in both government and private companies, joining MAFCO from Diamond Trust of Kenya where he was a senior manager.

3.09 Operations

MAFCO's loan portfolio of working capital, import-export finance, construction, and commercial installment credit is supported principally by time deposits with maturities up to one year. MAFCO plans to open branches in the interior of the country. Even though MAFCO currently has only one office, located in Nairobi, management favors rural lending and a significant percentage of the current loan portfolio is invested in rural projects. MAFCO has a business advisory service department which works only with its borrowing clients.

3.10 Financial Condition and Performance

MAFCO's summarized financial statements as of their fiscal year-end, June 30th, follow (figures in thousands of KSh and adjusted for intangibles).

	1983	1984	1985	1986
Primary Assets	51,135	113,345	139,961	151,123
Loans	56,321	153,636	234,548	306,655
Other Assets	4,748	16,568	15,324	26,544
Total Assets	112,204	283,549	389,833	484,322
Deposits	100,433	252,477	357,012	444,831
Other Liabilities	6,356	20,330	21,375	26,695
Total Liabilities	106,789	272,807	378,387	471,526
Minority Interest	--	--	--	--
Capital Funds	5,415	10,742	11,446	12,796
Total Liabilities & Capital Funds	112,204	283,549	389,833	484,322
Net Income	472	1,227	704	1,350
Representative KSh/US$ Parity	14/1	15/1	17/1	16/1

Selected Financial Ratios

	1983	1984	1985	1986
Return on Equity	-	15.2%	6.4%	11.1%
Return on Assets	-	.6%	.2%	.3%
Primary Assets/Dep.	51.0%	45.0%	39.0%	34.0%
Loans/Deposits	56.0%	61.0%	66.0%	69.0%
Capital Funds/Loans	10.0%	7.0%	5.0%	4.0%
Capital Funds/Liab.	5.0%	4.0%	3.0%	3.0%

MAFCO has grown in asset size by more than four times during the four-year period reviewed. Management has, however, elected to maintain a relatively safe risk position by placing a high percentage of funds in low risk primary assets as opposed to loans. MAFCO has been profitable, and able to increase its funding base in spite of the problematic environment which the Kenyan financial system has experienced in recent years. These are very positive indicators considering the company's short operating history. MAFCO's capital adequacy ratios are on the weak side but still in the satisfactory range. Profitability margins are on the low side, undoubtedly influenced by the lower yields on primary asset investments, and, perhaps, by a higher than average cost of funds due to its low capital funds position and newness in the market. The subject's financial statements are audited by Price Waterhouse.

3.11 Nationwide Finance Company, LTD. (NFC)

3.12 Overview

NFC began operations in 1982 by private, indigenous Kenyan businesspersons, principally involved in property development, banking and government service. The company experienced some difficulties in the 1983-84 period but undertook to bring in new management and restructure its operations, which has turned the company around (see remarks below). It has established a good name in the marketplace, concentrating its lending activities on relatively short-term commercial financing.

3.13 Ownership and Management

NFC has a small shareholder group of respected Kenyan businesspersons. The dominant shareholder is Joseph Gichui(33%), followed by Peter Mwargi (23%), John Mbuu (17%) and Muai Kibaki (14%). These same persons plus Peter Hewett (lawyer), Mohamed Wanyoike (NFC Chief Accountant) and William Wood (NFC Managing Director - CEO) make up the board of directors. Wood is recognized as an astute financial professional with over thirty years of banking experience (Bank of America), and is clearly the key to NFC's successful restructuring.

3.14 Operations

NFC has good diversification in its loan portfolio with borrowing clients evenly spread over agariculture, manufacturing, transport, real estate and commercial activities. Becuase of its recent liquidity squeeze, management has kept its lending term in the 90 day to one year range, with some loans extended out to three years. However, with monthly repayments the portfolio is relatively liquid. NFC is specializing in the Nairobi market with the discounting of trade bills with subsequent rediscounting to institutional investors. Upcountry branches in Eldoret and Meru handle the more traditional financing associated with NBFIs.

3.15 Financial Condition and Performance

NFC's summarized financial statements as of their fiscal year-end, December

	1983	1984	1985	Interim Stmt. 6/30 1986
Primary Assets	110,781	162,501	28,574	35,320
Loans	139,760	255,271	219,232	206,756
Other Assets	39,054	44,472	66,974	66,215
Total Assets	289,595	462,244	314,780	308,291
Deposits	248,069	419,463	267,492	259,901
Other Liabilities	35,353	36,073	32,471	31,037
Total Liabilities	283,422	455,536	299,963	290,938
Minority Interest	--	--	--	--
Capital Funds	6,173	6,708	14,817	17,353
Total Liabilities & Capital Funds	289,595	462,244	314,780	308,291
Net Income	1,094	534	839	(1,020)
Representative KSh/US$ Parity	14/1	15/1	17/1	16/1

Selected Financial Ratios

	1983	1984	1985	1986
Return on Equity	--	8.3%	7.8%	--
Return on Assets	--	.1%	.2%	--
Primary Assets/Dep.	45.0%	39.0%	11.0%	14.0%
Loans/Deposits	59.0%	64.0%	94.0%	89.0%
Capital Funds/Loans	4.0%	3.0%	7.0%	8.0%
Capital Funds/Liab.	2.0%	2.0%	5.0%	6.0%

As can be seen from the figures above, NFC management has chosen to down-size its operations, sacrificing profits in order to improve the balance sheet. This is particularly evident in the capital adequacy ratios which have improved significantly. Loan loss reserves have also been increased, reaching KSh 22 million as of 06/30/86 against identifiable problem loans of approximately KSh 34 million. Management deems the margin of coverage as very conservative. In addition, NFC has a significant "hidden asset" in the fair market value of its headquarters building, which it partially occupies. Its book value (unencumbered) is approximately 50% (KSh 38 MM) of fair market value. It is expected that full-year 1986 financials will confirm the positive balance sheet trends of recent years and a positive profit performance. The subject's financial statements are audited by Pannell, Bellhouse, Mwangi.

3.16 Thabiti Finance Company, LTD. (TFC)

3.17 Overview

Thabiti was formed in 1982 behind the leadership of Dalmas Otieno, a highly respected Kenyan businessman with diverse interests but principally experienced in the areas of finance and insurance. Mr. Oteino along with two other prominent Kenyans, Hezekiah Nelson Oyugi and Christopher Walter Obura, are the prime movers of TFC's development as a commercial finance company. In its short operating history it has attained a good reputation in the marketplace. As of fiscal year-end (April 30th) 1986, TFC had total assets of KSh 405 million, total deposits of KSh 386 million, and capital funds of KSh 18.2 million (approximately US$ values - US$25 MM, US$ 24MM, and US$ 1.1MM, respectively).

3.18 Ownership and Management

TFC has thirty-two shareholders with Messrs. Otieno, Oyugi and Obura accounting for approximately 47% of the ownership shares. These persons along with Paul Aludo (TFC's Finance Director) and Peter Nagemi make up the board of directors. Otieno and Aludo are the chief executive and operating officers, respectively. These managers and their support staff are well thought of in the business community.

3.19 Operation

TFC's lending activities are focused on commercial installment credit over a wide range of small-medium sized businesses. The average loan maturity is 1 1/2 years; funding is basically from short-term time deposits. TFC has one branch each in Nairobi, Kisumu and Eldoret.

3.20 Financial Condition and Performance

TFC's summarized financial statements as of their fiscal year-end, April 30th follow (figures in thousands of KSh and adjusted for intangibles):

	1983	1984	1985	1986
Primary Assets	31,878	76,200	125,355	155,152
Loans	43,041	112,870	178,047	231,801
Other Assets	914	1,722	10,034	18,325
Total Assets	75,833	190,792	313,436	405,278
Deposits	68,398	176,648	299,833	384,681
Other Liabilities	296	6,121	1,313	1,386
Total Liabilities	68,694	182,769	301,146	387,067
Minority Interest	--	--	--	--
Capital Funds	7,139	8,023	12,290	18,211
Total Liabilities & Capital Funds	75,833	190,792	313,436	405,278
Net Income	303	884	1,153	1,249
Representative KSh/US$ Parity	14/1	15/1	17/1	16/1

Selected Financial Ratios

	1983	1984	1985	1986
Return on Equity	--	11.7%	11.4%	8.2%
Return on Assets	--	.6%	.5%	.4%
Primary Assets/Dep.	47.0%	43.0%	42.0%	40.0%
Loans/Deposits	63.0%	64.0%	59.0%	60.0%
Capital Funds/Loans	17.0%	7.0%	7.0%	8.0%
Capital Funds/Liab.	10.0%	4.0%	4.0%	5.0%

TFC has had substantial deposit and loan asset growth during its formative years. Management has elected to maintain a relatively high percentge of its resources in safe primary assets. Therefore, its modest loan position (low leverage) has not produced the volume nor yields needed to produce high levels of profitability, as measured by the returns on equity and assets. However, this conservative position, along with a satisfactory capital funds position, will permit TFC to undertake a more aggressive growth and profitability posture in the future. The subject's financial statements are audited by Lalani Nazarali and Company.

B. AMERICAN INTERNATIONAL GROUP/ALICO (Kenya)

3.21 Overview

American International Group, Inc., with corporate headquarters in New York, is a leading international insurance organization and the largest underwriter of commercial and industrial insurance in the United States. Its member companies write property, casualty, marine, life and financial services insurance in more than 130 countries and jurisdictions. AIG's common stock is listed on the New York Stock Exchange and the company has been in operation since 1919. AIG's securities are rated as investment grade (A) by Standard & Poors, and, in general, the company enjoys a highly favorable reputation as a major global insurance organization. A synopsis of its strong financial position and performance follows (in millions of US$ as of year-end, December 31st):

	1984	1985	1986
Consolidated Balance Sheet			
Total Cash & Investments	6,820	9,406	13,079
Other Assets	4,805	6,165	7,944
Total Assets	11,625	15,571	21,023
Liabilities	8,802	11,863	16,155
Capital Funds	2,823	3,708	4,868
Total Liab. & Cap. Funds	11,625	15,571	21,023
Consolidated Income Statement			
Operating Income	277	362	765
Income Taxes (Benefits)	(41)	(11)	108
Net Gains (Losses) Realized	(16)	47	139
Net Income	302	420	796

American Life Insurance Company (Kenya) is one of Kenya's leading insurance companies. Up until recently it was a 100% owned subsidiary of AIG, underwriting both life and general insurance. As a result of Government moves toward "Kenyanization" (local ownership participation in multinationals), ALICO/K will now have 30% private Kenyan shareholders. ALICO/K has an investment portfolio as of year-end 1986 of approximately KSh 720 million. Its KSh 32MM investment in the NBFI notes thus represents about 5% of the latter total.

C. DIAMOND TRUST OF KENYA, LTD.

3.22 Overview

Diamond Trust of Kenya Limited (DTK) was founded in 1966 as Diamond Jubilee Investment Trust (Kenya) Limited. Its predecessor company Diamond Jubilee Investment Trust, which operated regionally in Kenya, Tanzania and Uganda, was split into three separate companies following independence. The company was founded by the Ismaeli community with the Aga Khan Fund and related interests playing the leading role. In the late 1970's, with the equity participation of the International Finance Corporation (IFC) and Samuel Mortagu & Co., a London merchant bank, DTK added merchant banking activities to its direct financing activities. Today DTK ranks as one of Kenya's premièr financial institutions with operations throughout the country. As of fiscal year-end (September 30th) 1986, DTK had total assets of KSh 1.5 billion, total deposits of KSh 1.2 billion and capital funds of KSh .2 billion (approximate US$ values - US$ 100MM, US$ 75MM, and US$ 10MM, respectively).

3.23 Ownership and Management

DTK is 100% privately owned company with extensive general public shareholding - aproximately 52% of DTK shares are held by some 7,695 individual investors with less than a .35% holding. The controlling interest is held, both directly and indirectly, by the Aga Khan Fund for Economic Development. The IFC with 10% and Samuel Mortgagu & Co. Ltd. with 9% are the other major shareholders.

The board of directors is comprised of a mix of prominent and respected Kenyan and international businesspersons. DTK has impressive management strength. The senior managers have extensive professional backgrounds and have effectively utilized the technical expertise of its principal investors to operate the business. This high quality management component is reflected in their management information system, a key efficiency item for a financial services company, which is highly developed and fully computerized.

3.24 Operations

DTK's lending and investment banking activities are carried on within the context of a strong development orientation. DTK's management is concerned with the institution's role in Kenya's development, and aware that DTK's size and business philosophy permit actions which contribute to long-term objectives as opposed to narrow goals of immediate profitability.

Approximately 40% of their portfolio consists of lease and installment financing for the acquisition of machinery, equipment and other fixed assets. Working capital loans account for about 10% of the portfolio. Equity financing (investments) in a variety of areas comprise the other 50% of their activities.

Time deposits account for approximately 85% of DTK's funding base with small-depositor savings accounts providing the balance. DTK enjoys a highly respected position in the market and has readily funded its financing activities from local corporate, institutional, and individual sources.

DTK has branches in Nairobi, Mombasa, Kisumu and Nakuru.

3.25 Financial Condition and Performance

DTK's summarized financial statements as of their fiscal year-end, September 30th, follow (figures in thousands of KSh and adjusted for intangibles):

	1983	1984	1985	1986
Primary Assets	149,869	194,757	366,496	473,564
Loans	528,067	609,751	901,716	1,026,792
Other Assets	80,954	89,441	90,750	101,981
Total Assets	758,890	893,949	1,358,962	1,602,337
Deposits	540,241	633,510	1,027,485	1,242,900
Other Liabilities	88,131	105,628	164,480	179,626
Total Liabilities	628,372	739,138	1,191,965	1,422,526
Minority Interest	15,646	15,735	16,001	16,942
Capital Funds	114,872	139,076	150,996	162,869
Total Liabilities & Capital Funds	758,890	893,949	1,358,962	1,602,337
Net Income	22,689	23,190	26,415	31,054
Representative KSh/US$ Parity	14/1	15/1	17/1	16/1

SELECTED FINANCIAL RATIOS

	1983	1984	1985	1986
Return on Equity	--	18.3%	18.2%	19.8%
Return on Assets	--	2.8%	2.3%	2.1%
Primary Assets/Dep.	28.0%	31.0%	36.0%	38.0%
Loans/Deposits	98.0%	96.0%	88.0%	83.0%
Capital Funds/Loans	22.0%	23.0%	17.0%	16.0%
Capital Funds/Liab.	18.0%	19.0%	13.0%	11.0%

DTK has doubled in size during the four-year period under review. Nevertheless, it has maintained a balanced financial position with a high level of profitability. Management has taken a less conservative position regarding the leveraging of its capital funds position during the course of the past four years, however, capital adequacy ratios still remain highly satisfactory. DTK's financial condition and profit performance are indicative of a financially healthy, well-run institution. The subject's financial statements are audited by Kassim-Lakha Abdulla & Co.

IV. FINANCIAL MARKET ENVIRONMENT

4.01 Overview

Kenya has a relatively well-developed banking system and financial sector consisting of the Central Bank, commercial banks, private non-bank financial institutions, public sector financial institutions, the Co-operative Bank and co-operative savings and credit societies. An overview of each type of institution is presented below:

(a) The Central Bank

The powers of the Central Bank of Kenya (CBK) are governed by the Central Bank of Kenya Act and by the Banking Act. As set forth in the Central Bank of Kenya Act, the main responsibilities of CBK are "to regulate the issue of notes and coins, to assist in the development and maintenance of a sound monetary, credit and banking system in Kenya conducive to the orderly and balanced development of the country and the external stability of the currency, and to serve as banker and financial adivser to Government."

(b) The Commercial Banks

There are 24 commercial banks currently operating in Kenya. The three largest, Kenya Commercial Bank (government owned), Barclays Bank and Standard Bank, dominate the banking system, accounting for approximately 60% of commercial banking deposits and credits, and owning virtually all of the commercial banking branches outside Nairobi and Mombasa. Most of the remaining banks are foreign controlled, and tend to concentrate on the areas of domestic trade and import/export financing. Many of these are smaller banks oriented towards serving the needs of foreign companies, including providing forign exchange and letters of credit services. While commercial banks occasionally make medium and long term loans as well as equity investments through their subsidiaries, their lending primarily consists of short-term loans and overdrafts.

(c) Private Non-Bank Financial Institutions

There are currently 44 non-bank financial institutions in Kenya. The proliferation and growth of NBFI's has been one of the most striking developments in the Kenyan financial system in recent years. According to the Banking Act, a financial institution is defined as "a Company, other than a bank, which in Kenya accepts deposits of money from the public repayable on demand, or after a fixed period or after notice and employs those deposits in whole or in part by lending or any other means for the account and at the risk of the person accepting the deposits, and any other Company carrying on financial business which the Minister may by notice in the Gazette, declare to be a financial institution for the purpose of the Act." NBFI's offer many of the same services as commercial banks, but they are prohibited from offering checking accounts or engaging in foreign exchange transactions. Initially, the lending activities of NBFI's were concentrated in the areas of housing finance, lease hire/lease purchase and merchant banking. In recent years, however, many other forms of financing have emerged, including bills discounting, bridging finance and term loans.

(d) Development Banks

Kenya's five government related development banks are the Industrial Development Bank (IDB); The Development Finance Company of Kenya (DFCK); Kenya Industrial Estates (KIE); The East African Development Bank (EADB); and the Industrial and Commercial Development Corporation (ICDC). The Government used to be a major source of funds through budgetary allocation, however, these allocations have been virtually eliminated. Additionally, their problematic loan portfolios and the competition for deposits from the private financial institutions have made it virtually impossible for the development banks to raise funds from the general public. These activities today are severly restricted.

(e) Other Public Sector Institutions

There are also several public sector financial intermediaries, such as the National Social Security Fund (NSSF), the Kenya Post Office Savings Bank, and six official specialized insititutions providing development finance for agriculture, housing and tourism. These are the Agricultural Finance Corporation, Agricultural Development Corporation, National Housing Corporation, Housing Finance Company of Kenya, National Construction Corporation and Kenya Tourist Development Corporation.

(f) Co-operative Bank/Savings Credit Societies

The Co-operative Bank finances the co-operative movement by way of loans and overdrafts; it also provides banking facilities to its member co-operatives. There are about 100 co-operative savings and credit societies in the country. These societies accept monthly payment for shares and provide loans of up to three times the members' shares.

4.02 Problems Addressed

The soft spots in the Kenyan financial system are those common to many developing countries. Government owned and/or controlled financial institutions tend to dominate the credit markets, financing from private financial institutions tends to be rather short-term in nature, lending activities focus on borrowers in urban areas, and, in general, the small-medium scale enterprise finds it difficult to access financing.

In addition, in 1986 the financial sector in Kenya was subjected to a number of financial institution - banks, finance companies, savings and loan companies - failures, accompanied by an endless string of alarming newspaper headlines, which caused a serious crisis of confidence in the system as a whole. The smaller, less established institutions like the NBFIs in the consortium were under considerable liquidity pressure during this period. It was in the context of this "banking crisis" that PRE first considered the possibility of intervening in some form to assist the finance companies, or "non-bank financial institution," sector.

First, it should be noted that USAID/Kenya was attempting to implement in 1986 a major program (a US$24 MM Rural Private Enterprise project was just approved earlier this year) of credit assistance to the rural sector and wished to include both commercial banks and the NBFIs as delivery vehicles. During the negotiations for this project with the government authorities, it became clear that the NBFIs were not going to be allowed to participate. Therefore, the mission encouraged PRE to direct its assistance to the NBFIs and worked with us to identify a select group of appropriate institutions.

The proposed facilities address the issues mentioned above. In the case of the NBFI consortium, A.I.D. is assisting privately owned, indigenous Kenyan institutions which, because of their relatively small size, tend to focus their lending to the small business community. In the aggregate, these NBFIs have offices in the rural-oriented communities of Meru, Kirumu, Eldoret and Nakruru, as well as offices in Nairobi and Mombasa, from which a significant amount of credit finds its way, directly or indirectly, into rural enterprises. The funding guarantee provides the NBFIs with the ability to lend long-term by matching liability and asset maturities. The nature of the facility will strengthen their balance sheets and, in general, enhance the "confidence factor" for the participating NBFIs with the general public.

It should also be recognized that while, at this point in time, it is necessary to provide a 100%

guarantee to ALICO (Kenya) for the placement of their investment funds with the NBFIs, A.I.D. will have initiated a "familiarization" process for an institutional source of long-term funds with the NBFIs which could eventually conclude over the years in a direct relationship without A.I.D. support. This example could prompt other insurance companies and pension funds to give equal consideration to this type of investment model. Asset-based guarantees for the NBFI securities are another possibility.

In the case of Diamond Trust, a highly respected, established name in Kenyan financial circles, PRE has the opportunity to influence the direction of this institution's operations. Because of its position, DTK does not have a funding problem to support long term lending. A.I.D.'s assistance therefore seeks to encourage DTK to extend their financing to small-medium scale private enterprises on a term credit basis by sharing the risk for this segment of its business.

In summary, the PRE Revolving Fund project fully conforms to USAID/Kenya's CDSS of 1984 which identifies private enterprise growth as a major priority. Specifically, the non-bank financial institutions have been targeted for assistance as an important component of the financial system that mobilizes savings and directs investments to the most productive uses and beneficiaries - small-medium scale private businesses.

V. CONTRIBUTION TO DEVELOPMENT

5.01 Impact of PRE Participation on USAID Policy Areas:

PRE participation in this proposal will provide a positive impact in six key USAID policy areas: the private sector development, institution building, basic human needs, policy dialogue, increased agricultural production, and savings generation.

-Private sector development will be promoted through the use of market rates on NBFI loans to small and medium-sized private enterprises and the additional availability of credit.

-Development of institutional financing will be supported by expanding NBFI lending activities to small and medium-sized enterprises.

-Basic human needs will be advanced by additional employment which should accrue as the smaller enterprises, which tend to involve large numbers of women, receive the needed capital for supporting their activities.

-Policy dialogue fits well with the USAID's recently approved enterprise development project.

-Increased agricultural production will be promoted by providing additional credit resources which will impact directly and indirectly on agricultural and agribusiness development.

-Savings generation will be enhanced through the matching funds component of the funding guarantee for the NBFI consortium, and, in general, those sub-borrowers receiving institutional credit for the first time will become depositors in the formal banking system.

5.02 Relationship to USAID/Nairobi CDSS.

This project conforms with the priorities of USAID/Kenya's strategy for promoting private enterprise development in Kenya. USAID/Kenya supports a theme of Kenya's Fifth Development Plan, "mobilization of domestic resources for equitable growth". And, "unless a supportive policy climate is created, and private initiative and investment become a cornerstone of development policy, there is little hope that sufficient growth, as measured by increased production of goods and services and expanded employment, can occur to keep pace with the number of Kenyans seeking improvement in the quality of life." USAID/Kenya views the fostering of market-oriented private sector as the key mechanism for supporting these objectives, and, in this regard, this project provides additional support to the Mission's policy dialogue efforts.

Support to the NBFI sector is consistent with these objectives by supporting the provision of term finance to the indigenous private sector Support for the use of the Revolving Fund to achieve this is specifically identified and supported by USAID/Kenya and will be partially co-financed by them.

5.03 Relationship to PRE Objectives and Policies.

PRE's objective is to meet the Basic Human Needs objective of the Foreign Assistance Act of 1961, as amended, using self-sustaining private sector vehicles. In addition, PRE utilizes a variety of operating policies for its Revolving Fund investments to ensure high development and secure financial returns. The loan and funding guarantee facilities with the NBFIs and DTK satisfy both. The proposed investment is responsive to the Basic Human Needs mandate by targeting its resources toward small business. These are typically the most disadvantaged, especially in the area of credit. The facilities will mobilize US$6 million equivalent in credit on a self-sustaining basis. This credit will be a net addition to the investment resources presently available. The project also meets PRE guidelines for management of Revolving Fund investments. These are as follows:

-Has a demonstration effect by: (a) promoting private financial institutional lending activities with a developmental impact, and (b) mobilizing alternatives to public sector, subsidized credit, and (c) accessing an institutional source of funds with worldwide potential.

-Exhibits financial viability based on a backdrop of effective demand, proven management, and market pricing.

-Targets developmental impacts appropriate to Kenya by responding to identified constraints on credit delivery and capacity utilization in the private sector.

-Makes resources available to the small-and-medium-sized enterprise sector by leveraging the PRE/A.I.D. facility to create a pool of credit.

In addition the facility meets project-specific financial constraints, namely: (a) the facility cannot exceed US $3,000,000 (b) the facility cannot be more than 50 percent of project capitalization rates.

5.04 Economic Impact on Kenya

The proposed Revolving Fund facility specifically targets the small-medium-scale enterprise sector with a pool of funds totaling US $6.0 million equivalent. This amount will be made available to provide short and medium-term financing to productive private enterprise activities in agriculture, manufacturing, agribusiness, services and commerce. This source of capital represents additive credit and, as such, will stimulate incremental investment and sales.

5.05 Women in Development.

A substantial number of the NBFI's borrowers will involve women, both directly and indirectly. As in other developing countries, many of Kenya's small entrepreneurs are women and/or form part of the family unit that operates a small business. The percentage of women employees in Kenyan small business is also relatively high. To the extent possible, the parameters for qualifying loans set forth in the project agreements with the NBFIs and DTK will seek to facilitate the delivery of credit to women.

5.06 Statutory Requirements.

- Bumpers Amendment: Not applicable because the project is not "...specifically and principally designed to increase agricultural exports."

- Lautenberg Amendment: Not applicable because project assistance is provided through intermediate financial institutions, and current A.I.D. policy does not require that A.I.D. funds be traced through to the ultimate beneficiary.

- Environmental Clearance: The project should qualify for a categorical exclusion.

VI. MONITORING AND EVALUATION

6.01 Project monitoring will consist of review of: (a) lending activities, (b) adherence to development convenants, and (c) financial condition and performance of project sponsors. Both (a) and (b) will be done on a semi-annual basis based on debt service schedules and reporting requirements agreed to by the sponsors.

6.02 Reporting on the project will consist of: (a) periodic reporting by the project sponsors of sub-borrower data, and (b) sponsor financial information. An evaluation of the project is planned two to three years after first disbursement. Its objectives will be to determine:

-the extent to which small-to-medium sized enterprises lending has been effective in Kenya;

-costs and performance of the loan and funding guarantee structure. This information will be available largely from data submitted by the borrower;

-impact on employment generation, business expansion and ownership and investment promotion with particular emphasis on urban/rural and gender factors;

-profitability of this lending program as calculated from statistics reported by the participating institutions on lending terms, collateral rates, spreads, and losses. Terms, rates, and loss data will be reported semi-annually to AID/PRE. Conclusions as to profitability and developmental impact on jobs, foreign argument for replicability of this type of regional facility; and a summary of the participating institutions' management systems for delivering credit to the sub-borrowers and how management indicates that this has changed over the life of the facilities to date; and conclusions as to institutiona capability to service non-urban areas of Kenya.

6.03 In anticipation of the evaluation PRE will integrate into the project implementation plan a reporting system to track the targeted borrowers. The reporting system will give A.I.D. a reasonable notion of the program's profitability and impact.

6.04 A.I.D. will apply standard financial analysis to measure the institutional evolution of the participating NBFIs. Our objective will be to look at quantifiable indicators such as asset, deposit, equity and earnings growth trends, on a comparative basis, which characterize sound financial condition and profitability.

VII. GRANT FACILITY

We intend to arrange for a US$90,000 (approximate amount) grant which will be utilized by the NBFI Consortium for staff training and borrower education programs. The scope of work is to be provided by USAID/Kenya.

In general we are seeking to strengthen the overall management frameworks of these institutions which are relatively new to the Kenyan financial scene. At present, there is a dependency on a few key executives and all concerned are interested in obtaining a greater breadth and depth of financial institution management skills. These include both operational and lending activities as well as business advisory services to their clients. As noted, the NBFI's natural client is small business, and there is a substantial need by this sector for a wide range of educational services related to management, particularly financial, production and marketing.