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KENYA
AGRICULTURE CREDIT EVALUATION

DUPE

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FOREWORD

Given the fact that a large majority of the citizens of Kenya live and work in the rural areas of the country and the further fact that one-half of foreign exchange earnings stem from the export of farm products, the Agriculture Credit Project which is now terminating may be considered as one of the more important undertakings of the United States assistance program to this country. While an evaluation of the project from the standpoint of its success in meeting stated objectives is important, even more essential to the welfare of Kenya is an understanding of the current agriculture credit situation and a balanced view of future needs in this sector so as to accommodate a growing body of commercial farms while at the same time providing services to that large segement of the farming community who have not yet reached the level of economic viability. The following report undertakes to assess the terminating project and its related parts, but also attempts to place in perspective the more apparent needs of the future with some suggestions which may prove useful to the Government of Kenya and external donors as they move along the road to economic development.

Two members of the evaluation team arrived in Kenya on November 16, 1977, with the AID/W representative arriving nine days later. Without exception, we have been treated in a friendly and cooperative fashion and wish to express our appreciation to all of those who have helped us to a better understanding of the various matters to which this report speaks.

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I. SUMMARY OF CONCLUSIONS AND MAJOR RECOMMENDATIONS

Conclusions

The terminating Agriculture Credit Project while having a number of shortcomings in design and implementation has, to a substantial degree, achieved stated project goals and made a distinct contribution to the institutional development of the Agriculture Finance Corporation (AFC), particularly in its branch operations. It is doubtful if the present level of lending by AFC would have been achieved or could now be sustained were it not for the technical specialists and the training of participants which have been provided through the project. There are residual elements in the project, including both the training of several more participants and continuation of the services of three technical specialists to the conclusion of their current contracts. These are important items and should go forward.

Detailed evaluation of the project and its component parts will be found in later sections of this report. However, at this point, the team feels it is appropriate to comment on several matters which bear heavily on the future viability of the AFC and the ability of the organization to cope effectively with enlarged credit demands which certainly will be placed against it.

Accepting and applauding the greatly expanded level of financing in AFC and the strong move toward providing a bracching system into the countryside with increasing services to customers at local levels, the team feels that AFC is reaching a critical juncture in its development. The recently completed Management Study of AFC treated a large number of matters dealing with organization business operations, personnel management and overall top management methodology and approach. We strongly concur with the recommendations of the management study team and urge the government of Kenya and AFC to quickly complete their review of the report and proceed with full implementation of the recommendations. Recognition is given to the fact that a number of recommendations concerning operational matters were already in the planning stage by AFC or are now in process of implementation. Policy items such as organizational structure and suggested amendments to the Agricultural Finance Corporation Act have not been placed under formal study.

The difficult problems presently confronting AFC stem quite directly from the very rapid growth in lending to small farmers which was not accompanied with fully adequate programs for farmer credit education, loan approval procedures, loan supervision, credit review functions or operations to correct deficiencies in those areas. Indeed, the first fullscale formal credit review of an AFC branch has just been completed. It probably will be another nine or ten months before all branches have been reviewed and only at that time will management have its first real evaluation as to the use of loan proceeds by borrowers, quality of loan portfolio and exposure to potential loss. As the reviews progress however, management should move strongly to correct deficiencies as they become known and strengthen weaknesses in branch operations on an individual basis. Other on going programs in AFC such as internal audit, improved methods of loan disbursement and collection, training, computerization and development of a management information system are vital support items to the overall operation and must be pursued diligently. Most importantly, the team believes the singular approach to management as now practiced in AFC will quickly be overtaken by the increased growth of the institution and ultimately can strangle its ability to function effectively. It was not at all clear to the team how AFC would function administratively were it to be deprived, for whatever reason, of the services of its general manager. The team could not observe any automatic fail-safe device to insure continuity of effective experienced management of AFC in the absence of the present general manager. We urge the board of directors and management to take this matter under early study with a view of broadening the management base to include a deputy general manager, an assistant general manager for administration and a national level coordinator of area manager activities.

The team is aware that there are alternate approaches to the question of continuity in the management of AFC. We are more concerned with establishment of a sound organizational structure than with the precise measure in which that job is accomplished.

The team believes that the character of AFC as an institution dealing with credit to the commercial sector of agriculture on a collateral basis should be maintained. There is an apparent large and growing demand in this area and AFC should urgently shore up its capabilities to meet this challenge. Beyond that, AFC should seek as an on-going venture to "reach out" into the non-commercial sector with imaginative programs designed to bring effective supervised credit to farmers who have the ability and desire to accomplish a transition from subsistence to small commercial operations, and the extension of credit on a basis of other than real estate collateral should be an integral part of such a program.

The team stresses its opinion that the AFC should continue to receive a sustained level of support in technical services and participant training at least equal to the present level. Enlargement of the group of technical specialists to include a very senior policy and operations counsellor to the general manager, as well as the national coordinator mentioned earlier, would enhance the overall capabilities of AFC. Such support should continue for a period of two to four years depending upon conditions as they develop. We feel it important, and in support of the extensive efforts already made, to assist the AFC to realize its full potential as a sound and viable credit institution. Likewise, we believe the training of participants should continue but with more attention directed toward work in the fields of accounting, auditing, personnel, research and planning and management.

A training specialist brought in for a period of a year to help improve AFC internal training rpograms could be very useful.

The high liquidity position of banking and credit institutions at the present time and the ready availability of external donor assistance argues against further input of loan funds into AFC for the forseeable future. If, however, AFC, as is contemplated, were to move seriously into the field of agribusiness lending for processing and marketing enterprises designed to support improvement in the area of small scale farming, external loan support would seem worthy of serious study.

In looking at AFC as an institution, the team has been mindful of the intent of the AID program to direct its efforts toward assisting people in the lower strata of the economy. As stated earlier, we do not believe AFC should be looked to as the primary leader for this group. Therefore, our approach has been to try to identify the most effective way to mount such efforts in Kenya. It would have been most helpful if a recent major study of agriculture credit in Kenya had addressed itself adequately to the problems of small farmer credit and to primary alternate means of delivering such credit to this target group. However, the lack of creditable data - which the evaluation team expected to have in hand - hampered our efforts and we can provide only a general overall view on this subject. Actually, the Agriculture Credit Study should have been undertaken some years ago and would, we believe, have been very helpful in the initial planning of the Smallholder Production Services and Credit Project, as well as other efforts in agriculture.

A system to deliver closely supervised credit to the very small scale farmer who are on the margin of economic viability presently exists within the structure of Kenyan agriculture cooperatives. It should not be considered that this is a fully refined system; however, it is in place. Further, two programs, the Smallholder Production Services and Credit Project,and the Integrated Agricultural Development Project are addressed to this traget group and channeled through the cooperatives. Heavy administrative costs coupled with high risk potential of any lending program which gives priority to the needs of this less privileged group argues forcefully for a unified approach by government and external donors alike. Beyond that, it should not go unnoticed that social and political components always weigh heavily in such an activity and at a cost which cannot be easily measured.

Based upon a general review of the lending programs presently aimed at the very small scale farmer, the team holds to the view that the approach through the cooperative system potentially has the best chance for success. Aside from the AFC, we have not observed any other Kenyan institution or system with a similar or equal apparatus for reaching down to this lower level economic group. An informal merging of the two loan programs mentioned above seems to the team to be deserving of close attention. The skills of the remaining group of Nordic cooperative advisors, the Peace Corp volunteers and the extension workers of the Ministry of Agriculture - all of whom seem now involved to some degree in these programs could thus be brought to bear in a cohesive and productive fashion. Logically, if a program to reach the lower economic farmers were being started from ground zero for implementation through the cooperative system, the emphasis and direction should come through the Ministry of Co-operative Development with the Ministry of Agriculture and its extension service in a supportive role. It follows that the cooperatives should have a trained cadre of field workers (or loan supervisors) who would follow the program very closely to see that credit was being used effectively and in conformity with the intent of the program. The team believes that as the on-going programs are brought under more intensive review and study the MOCD should be increasingly looked to as the ministry within government who would carry the main weight of the credit programs. This would entail a slight recasting in emphasis from the present, but we believe it would be beneficial overall. Beyond that, it would also seem appropriate for the government of Kenya to continue with an infusion of its own money as conclusive evidence of government dedication to assisting the lower economic farmers in Kenya. The government funds would be directed toward support for the high costs of training, supervision and education of this target group.

As the Kenya National Federation of Cooperatives Limited is the central unit in the Kenyan cooperative movement, so the Co-operative Bank of Kenya, Limited is its apex financial institution. This bank, which commenced operations in January, 1968, has as its primary objective the mobilization of the financial resources of the cooperative movement and the utilization of those funds for re-lending to the movement. From its very small beginnings in 1968, the bank has grown steadily to a point where by mid-year 1977, it had made loans totaling 387 million shillings*, has loans outstanding in excess of 98 million shillings, deposits of 480 million shillings and share capital of almost 17 million shillings. Clearly, a quite impressive growth record. Looking to the future, leaders of the institution plan to open several branch offices at an early date, as well as a foreign and bills department at headquarters. Further, the Co-operative Finance Company is due for registration and should be in operation in early 1978.

Interestingly enough, while other cooperative institutions have received a plethora of technical assistance from external donors, the bank itself seems to have been largely overlooked in spite of the fact that it has a grassroots base. While to some this might seem to have been a blessing in disguise, the evaluation team feels that a technical assistance package of some dimension might now be a most desirable activity. As the principal financing arm of the cooperatives and with further growth a virtual certainty, the bank will stand

*Current rate of exchange - $1.00 (US) = 8.5 Shillings (Shs) in need of research and planning experts, operational specialists in the fields of finance, credit, cooperative business and in accounting and auditing. Believing as it does that the cooperative system is the logical instrument for mobilizing rural resources and bringing supervised credit to the very small scale farmer, the team feels it logical to buttress that effort by helping to strengthen the present operation of the Co-operative Bank and working with it in preparing for the future. We believe such activity would benefit the entire cooperative movement in Kenya.

It is clear that the government is placing increasing emphasis upon development of rural sectors. It follows, therefore that with a healthy and viable Agricultural Finance Corporation serving the credit needs of commercial type agriculture and working in close harmony with the system of agricultural cooperatives serviced by a strong Co-operative Bank, the welfare of virtually all sectors of the rural economy can be markedly improved.

Recommendations

1. That the board of directors and management of AFC take early action on the recommendations contained in the June 1977, Management Study of the corporation. Further that the board give serious consideration to strengthening the management base as outlined in the narrative comments above. (See pages 26-29.)

2. That the provision of certain technical specialists

to AFC and continuation of a strong external participant training program for staff members of the Corporation be carried on for several more years. (See pages 20-22, 35-37.)

3. That the USAID undertake to field a small consulting team for the purpose of developing information on those important areas of credit and interest rates which were not fully addressed in the Kenya Agriculture Credit Study. (See page 30.)

4. That an in-depth study of the Co-operative Bank of Kenya, Limited, be made to (a) assess the capabilities of that institution to finance the Kenya cooperative system, (b) determine its ability to sustain increased growth and activity, and (c) assess potential needs of the bank in the fields of finance, technical services, research and planning, internal training and further development of management skills. (See page 39.)

5. That discussions be initiated with appropriate officials of government and those financial institutions dealing with agriculture to explore the merits and feasibility of establishing a centralized operation for research, planning and policy formulation as they relate to the credit function. Further, to develop and maintain a centralized repository for information on the subject. (See pages 38-40.)

6. That in the event the life of the Agriculture Credit Project is further extended or a new project is developed to encompass a wider field of effort, a coordinating committee be formed so as to provide a regular review and monitoring

process. The committee should be composed of the general manager of any involved financial institution, representatives of appropriate ministries, of USAID and/or other external donors. The role of the committee would be to coordinate activities of the project(s), review progress, correct program deficiencies as they surface and remain currently informed on the activities of technicians/consultants working on the project. (See pages 40-41.)

7. That consideration be given to the merits and practicality of establishing within Kenya or elsewhere a regional institute for the express purpose of providing specialized training in agriculture credit to participants from the developing countries of Africa. (See page 41.)

8. That a careful study be undertaken to develop reliable information on the social and economic implications of extending agricultural credit to women. At present, women in Kenya are active in many farming operations but traditionally are not usually land owners. With women's liberation movements becoming prevalent in Africa and in light of the new social conscience which is developing, we feel that the future of women in agriculture in Kenya should now be addressed. (See pages 41.)

II. BACKGROUND OF AGRICULTURE CREDIT PROJECT

This project was authorized in April 1971, to provide technical assistance to the AFC for a period of ten years, commencing in fiscal '71 and ending fiscal '80. The project was designed to increase the capability of the AFC to provide agriculture credit on a timely and business-like basis to increasing numbers of Kenyan farmers requiring such credit. The project goal was to increase the productive potential of Kenyan farmers.

The project was preceded by a reconnaissance study in May, 1969, by Robert Tootell and a more detailed study of agricultural credit and the AFC by the Tootell Mission conducted from January 19, 1970 to April 3, 1970. An AID financial advisor, Mr. Henry Lowe, served as general manager of the AFC from March 25, 1970 to June 30, 1973. In addition, AID has financed participant training and technicians for the project along with various consultants and studies, including more recently a management study of the AFC, an agricultural sector study and this evaluation study, with a total project commitment by AID in excess of $2 million. The project is currently scheduled for termination at the end of fiscal year '78.

At this time, the AFC is the primary credit institution in Kenya, being the major lender serving both large and small scale farmers. Agriculture production has shown significant increases in volume during the life of the project and exports of agricultural products. principally coffee and tea, are at high levels. The increased volume of exports has contributed to an improved liquidity position for farmers and the commercial banks.

III. Evaluate the terminating Agriculture Credit Project (615-11-140-148) to determine success in meeting overall project objectives and, in particular, the contribution made to the institutional development of the Agriculture Finance Corporation. Analyze project design and overall effectiveness in achieving project goals.

The project in the opinion of the team has been successful in achieving its purpose and overall objective of developing an agricultural credit institution contributing significantly through its activities to increasing the productivity of Kenyan farmers and ranchers. The AFC has been firmly established as the major agricultural credit institution in Kenya with a growing staff and an increasing lending volume. While the AFC has several major deficiencies as outlined in the management study and will continue to need technical assistance, it has the base of staff and branch offices upon which an expanded credit program can be built. The project, by supplying technical assistance as well as participant training, has been a major factor contributing to the growth and development of the AFC. In the view of the team, the present group of consultants has the potential for effecting significant improvements in the overall operations of the AFC now that an institutional base has been established with a cadre of trained participants. As expected, the rate of development of the AFC in the early years of the project was slow but the rate of change has accelerated with the greatest changes yet to come.

In the broader context, agricultural production statistics and empirical observation indicate increased Kenyan agricultural production and a positive contribution by the AFC; however, in absence of baseline data and a sample survey which was beyong the scope of the work of the team, we are unable to comment more specifically.

In evaluating the achievements of the project in terms of the project purpose and the communication of this purpose to the AFC, we have encountered some difficulties particularly as related to the definition of small farmers.

The purpose of the project as stated in the December 16, 1971 PROP was: to improve the capability of the AFC to provide agriculture credit on a timely and business-like basis to increasing numbers of Kenyan farmers requiring such credit. However, the project purpose was later modified as indicated by the PAR dated, May 31, 1975, to specify small farmers as part of the target group and later was incorporated into the Project Paper revision dated December 2, 1975. During the year covered by the PAR as of May 30, 1976, the project was focused specifically to include the capability of the AFC to reach small farmers as part of the project purpose of developing the institutional capability of the AFC to implement and manage credit programs.

As part of the project evaluation, a review was made of the PROPS, PROAG and Internal Evaluation memos covering the period of the project. General documentation was adequate in our view and in the internal evaluation process we found information to be complete with a fair and programmatic assessment of current conditions. In particular, the most recent PAR (10-14-77) and senior evaluation team memo (10-26-77) accurately reflected conditions and accomplishments of the project as we found them a short time later. We note, however, that to date in the life of the project it does not appear that a mutually acceptable working definition of "small farmer" was reached by USAID, AFC and the government of Kenya and translated into activity reports by AFC. More specifically, the AFC's definition of small farmer is based primarily upon the size of the loan with data furnished USAID as to "small scale farm" loans based on the criteria, whereas, AID defines small farmers as being in that group of 1,200,000 smallholders with agricultural land holdings of less than 20 acres of land (IMP Letter No. 1., Agriculture Sector Loan 1).

As indicated above, the absence of data on small farmer loans by AFC based upon criteria consistent with the project purpose poses real problems in evaluating the project; however the rpoject, using AFC criteria as to small farmers has been quite successful with approximately 70% of its loans by number and 30% by amount currently extended to small farmers as defined by AFC. The team does not consider the present ratio of large to small scale loans as being unreasonable considering the credit requirements of large farmers which AFC also has an obligation to meet and the increasing role of cooperatives in supplying credit to small farmers. Also that AFC's support of the small farmer is best indicated by the increase in numbers and total amounts loaned to small farmers as compared to large farmers rather than the percentage of AFC's total loan portfolio in small farmer loans. The composition of AFC's loan portfolio consisting of long term loans to large scale borrowers for land purchase and development and relatively short term loans to small borrowers, affects the rapidity with which changes can be made in its overall loan portfolio. All factors considered, the AFC has done a commendable job in meeting the credit needs of small farmers based on their definition of small farmers.

Considering AFC's heavy demand from commercially viable farmers, its expressed desire to minimize risks in lending and its present deficiencies in organization and housekeeping functions, AID is well advised to have looked elsewhere for the primary credit delivery system for small farmer credit. This was consistent with a long standing view of Robert Tootell who in 1970 stated that "the mission (Tootell) strongly believes that many farmer cooperatives offer the best hope for getting needed production credit to larger numbers of Kenyan farmers.

Given the caveat that it is always easy in retrospect to offer suggestions as to how a project should have been designed, the following comments are furnished. First it should be noted that the project design has been modified with targets changed or added as the project progressed, reflecting increased competency in project design, greater understanding of AFC activities and changing conditions. It also appears that the project, at the outset, did not include adequate technical assistance nor an extensive enough participant training program. An overall agriculture credit survey, including a micro economic analysis of farmer credit needs, would have been highly desirable. Such a survey was undertaken in 1977 and is discussed in a subsequent section.

The Tootell Report in 1970, pointed out several major operational and policy areas of the AFC ostensibly requiring substantial outside technical assistance, especially in the mechanization of accounting and branch operations. This study in our opinion, should have been followed by the sector credit study referred to previously by a larger expatriate input at both the central office and field level, with specific targets for accomplishment along with a work plan, to supplement the two expatriates for a three year period provided for in the original program of 1970. According to the final report of Henry Lowe, the expatriate who served as general manager from 1970 to mid 1973, the "project was originally conceived as general in concept, unusual in that it was specific in providing for an expatriate U.S. manager with no directives other than to keep the corporation afloat and preferably with the corporation's own resources. There were no terms of reference, thus objectives and goals were developed through use of brief studies and by observation of needs. However, it should be noted that the Pro Ag dated August 27, 1971, included as one of the duties of the general manager to determine the long term objectives of the AFC in the field of agriculture credit and to initiate a comprehensive technical development program to carry out these objectives. The long term objectives of the AFC remain to be established.

On the favorable side, it should be noted that the positioning of expatriate personnel in the field as area managers of AFC has been reasonably successful. Decentralization of AFC operations to its branches and closer coordination of operations have progressed more rapidly than otherwise might have been expected. The fact that these four positions have now been filled by qualified Kenyans underlines the effectiveness of this project's activity.

The participant training element has made an important contribution to the attainment of project objectives. The team has been impressed with the qualifications and competency as well as the potential of several of the returned participants. They constitute an invaluable human resource base for further development of the AFC. However, in our opinion, the number of participants has not been sufficient in numbers or spread within the ranks of AFC to create a "critical mass" to impact fully on the institution, nor was the participant training program initiated early enough in the project life to provide a cadre of trained counterparts available upon arrival of expatriate advisors. In general, the project has been characterized by an inadequate emphasis upon training as the key institutional development tool.

To remedy this condition, we believe the emphasis for AFC participants should now be shifted somewhat to provide more technical, as opposed to general, training. Specifically, for the near future, and in addition to the participants whose schedules already have been established, we see the need for training of personnel at AFC headquarters in such areas as audit, accounting, computer operations (program and systems specialists), financial management and personnel management and training. AFC is "thin" in these areas and should be assisted in up-grading the skills of carefully selected individuals who would be expected to assume management roles in AFC upon completion of their training. The services of a training specialist as was found earlier in this report could become useful in designing internal training for intermediate level staff in the various disciplines with the senior returned participants serving as course leaders.

While AID supplied technical assistance overall has been satisfactory in the contribution of technicians/consultants, it would be enhanced by establishment of a committee, chaired by the general manager of the AFC, with representatives of appropriate government ministries and the USAID project manager to periodically meet and discuss the reports and recommended actions by technicians/consultants.

A review of the original project design indicates implicit assumptions based on inadequate studies that there was a requirement for credit by farmers for productive purposes, that credit was not otherwise available and, that by developing the capability of the AFC, farmer credit needs for productive purposes would be met. Also, that appropriate technology packages were available and farmers would find it profitable to use them. It should be noted that toward the end of the project various studies, including the Agricultural Credit Study, were initiated to test those assumptions and to fill in information gaps.

In addition to the above aspects of project design, the team has been requested by USAID to obtain information on, or comment on, three factors included in the 1977 project appraisal report: past dues, provision of extension services by AFC and time required to process large scale loans.

One of the conditions expected to exist upon project completion is the reduction in delinquency rates to about five percent in 1977. This has now been extended to 1978, for small farmer loans. According to the audit report for the fiscal year ending March 31, 1977, prepared by Coopers & Lybrand, the delinquency rate for AFC small scale loans was about 20% and for large scale loans, eight percent. A special government loan program, referred to as GMR loans, is excluded in these calculations. The current delinquency position reflects a tremendous improvement over that of 1971, when 49% of the loans to smallholders (small scale farmers) had been in arrears over one year and 23% had been in arrears over two years. The evaluation team believes that a goal of five percent was unrealistic and that a rate of ten to 12 percent is more characteristic of agricultural credit institutions in developing countries. The team also believes that the trend in delinquencies is more important per se than the absolute rate figure, since there is no commonly accepted definition or method of computing arrears.

One of the qualitative indicators for the output of the project is the availability of farm management advice by AFC field office personnel. This indicator should not be rephrased as follows and retained as a valid qualitative indicator of the project output: "Loan applicants and/or borrowers receiving advice from trained loan officers as to validity of farm management plans as related to use of loan proceeds, maximum loan amount and repayment plans."

Loan officers trained in the analysis of farm management plans are required for a lending institution to base its loans upon the repayment capacity of the borrower and not solely upon collateral. The borrower benefits greatly from an evaluation of his farm management plans for loan purposes provided the lending institution can intelligently analyze those plans and communicate its findings to the individual. However, the loan officer should not be expected to replace the services of the extension agency in developing farm management plans.

As to the time required to process large scale loans, these loans require approval of the board of directors which currently meets eight times a year. A substantial improvement in the processing time will require a change in the Agricultural Act of 1969 to permit the AFC to increase the loan authority of branch offices and increased frequency of meetings of the board of directors. The latter is doubtful given the high level officials and others constituting the board. Changes in the APC Act are underway, but will require one to two years to finalize. This target should be subject to the assumptions that changes in the act and frequency of board meetings will be effected by the GOK.

IV. Evaluate the AFC Management Study (June 1977) and - to the extent possible - review and comment on the Kenya Agriculture Credit Study.

<u>Management Study of the Agricultural Finance Corporation</u>

This study, conducted over a period of several months in early and mid 1977, by a four man team of skilled professionals was completed in June 1977, and constitutes one of the last major elements of the terminating Kenya Agriculture Credit Project. The report was released in August to the government of Kenya and to the AFC. At the time of arrival of the evaluation team, on November 10th, however, the report had been disseminated to only a few of the directors of AFC and to none of senior management except the general manager. Shortly after the team's arrival, the report received a wider distribution to senior AFC officials and to expatriate advisors within the corporation. It is not expected that any formal action on the report will be taken prior to the next meeting of the AFC board of directors on December 16th.

The evaluation team, following intensive review of the study including such checks for content, accuracy and completeness as was deemed necessary, concludes that the final report of the study team should receive high marks in virtually all of its major elements. We believe it would have been a stronger report had more emphasis been placed - as we have done - on the need to broaden the management base to provide for continuity of operation and greater delegation of authority.

Likewise, we believe a greater sense of urgency in undertaking various recommendations could have been expressed by the study group or should have been expressed by USAID when the report was delivered.

A significant number of the management study recommendations either were being planned or implemented during the time the study was in progress. Therefore, it cannot be said that no progress is being made in some operational areas such as internal audit, credit review, disbursement procedures, multiple bank accounts, etc. Work is underway in these areas, and efforts will soon be launched to clean up the backlog of paperwork caused by the centralized processing of loan actions. Also it is expected that development of a management information system will be undertaken early in 1978. All of the efforts mentioned above are time consuming and we would not expect a fully developed management information system to be on-stream for two or three years. We consider the comments and recommendations of the study group relative to external audit of APC to be of particular moment and our review of several audit reports confirm the weaknesses which were outlined. In light of the increasing recognition of APC by external donors, it is vital that the corporation have a creditable audit to allow for a realistic assessment of its financial position. For the same reason, we believe that APC should publish an annual report of its operations and financial position. Although not required to do so by its enabling act, it is commonly accepted business practice to publish such a report in the interest of public knowledge.

Recommendations of the study team which deal with policy, such as changes in organizational structure and major revisions to the Agricultural Finance Corporation Act will take significant periods of time to implement even assuming complete acceptance by AFC and GOK.

Following in-depth discussions of the entire study report with the general manager of AFC, we conclude that he agrees with all of the recommendations which are basically operational in character, but has reservations on policy recommendations such as changes in organizational structure. We do not share the views of the general manager and, as has been stated, feel that the study team could have taken a stronger position on this matter.

In our discussion with the general manager, it was brought out that while we have advanced the view that a deputy general manager is needed to take the load of operational matters from his shoulders, there are other means of accomplishing this goal. As an example, it is generally accepted in business that an organization might usefully have both a chief executive officer and a chief operations officer. In the case of AFC, the CEO might very well be an executive director who would provide overall management while the general manager would function as the chief operations officer. This would provide continuity of management and might obviate the need for a deputy general manager at this time.

The evaluation team supports the conclusions and recommendations of the management study and urges prompt review and action by the AFC board of directors. We assume that USAID/KENYA will receive a formal response from AFC including such requests for technical assistance or other items as the corporation believes essential to its future operation.

Kenya Agricultural Credit Study

This yet to be completed study was intended by USAID/KENYA to provide important data and fundamental insights into the entire complicated question of agriculture credit in Kenya. In a manner similar to the management study of AFC, it was to be a hallmark effort of the terminating Kenya Agriculture Credit Project. It would have been a potentially more useful piece of work had it been undertaken much earlier in the life of the project.

The evaluation team has read the most recent draft of the study report and bearing in mind that it is not possible to fully evaluate a report not yet accepted by the USAID, we do have a few general observations and suggestions.

The report is very confusing to read and in our view quite poorly organized. In fact, it is not until one reaches the final page in Section D of the report, that he begins to have some clearer comprehension of the preceding three sections. Chapters A-C contain, in a number of instances, conflicting data or statements which are inadequately supported. The emotional areas of interest rate structure is treated in a fairly superficial way and does not, we believe, compel the reader to firm agreement with the recommendations on the subject. Most importantly to the evaluation team, the study did not provide a clear understanding as to how the small scale, particularly the non-progressive farmer, can be most effectively provided with institutionalized credit services.

We are aware of the extensive efforts of USAID/KENYA to bring this very important study to a successful conclusion a and there is little we can add to an already exhaustive study of its component parts. As it stands now, the study clearly is not ready for distribution. To the evaluation team, it seems that this uneasy situation might best be resolved by the following two actions:

1. Edit the existing report, clarify the language, reorganize the various sections into a more rational format and print it as a sort of reference piece, which might have some practical value to a reader wanting a general overall picture of agriculture credit in Kenya. This could very well be an internal effort of USAID or handled locally under USAID auspices.

2. Develop an outline for a new effort which would have as its focus those areas where the existing study remains virtually silent. Included in the study would be such items as farmer use of and demand for credit, the monetization of rural areas with particular reference to the small scale farmer and a step-by-step analysis of the manner in which the small scale farmer is receiving or should be receiving credit.

The new study should also require a careful effort to deal with interest rates. Inherent in this operation is a complete investigation into the cost of money (normally as well as currently) and the cost of administering loans. Looking into the future, study and analysis should be undertaken on a variable interest rate structure such as that now in common use in the United States Farm Credit System. This could very well be the shape of things to come in Kenya.

V. Study the need of and requirements for expanding AFC capabilities to provide credit to smallholders and for granting, managing and evaluating loans made on a basis of other than real estate collateral.

As has been discussed in Section III of this report, AFC has been effective in providing credit to the commercial sector of agriculture and the organizational structure is geared to that clientele. Historically, AFC has required that borrowers have title to the land and that the land be mortgaged upon loan approval. This has largely precluded AFC from supplying credit to farmers who do not have land to offer as collateral. The following are suggestions as to approaches which might be explored by AFC to expand its credit service without requiring land as collateral.

1. AFC could require that the farmer has in his possession a properly executed long term land lease guarantee that the farmer has the use of the land for a stated period. The lease could be used as collateral and credit extended by AFC as if the property were owned by the borrower. The long term lease could serve to protect the financial viability of AFC.

2. The acceptance of the crop for which the loan funds were obtained could be used as collateral. Certainly, this type of loan would require that AFC provide supervision to the farmer to assure that the funds are being used for the purpose stated in the approved loan application.

3. The AFC could explore the feasibility of extending

credit to part-time farmers based upon earnings from farm and non-farm sources. There are farmers not presently being served by AFC who receive some family income from non-farm employment. Thus, for AFC to utilize an "income package" including farm and non-farm income as the basis for credit would seem to the evaluation team to be a reasonable practice for AFC.

Even with AFC changing its lending practices as suggested above, there will still exist a large number of farmers who will not be eligible for credit. The limited monetized farm income of this group makes them a high risk and the extension of credit by AFC or any other lending institution must be approached with caution. In particular, this clientele requires a degree of selection, motivation, monitoring and supervision which can only be economically obtained from local voluntary organizations of the type represented by cooperative societies. We concur with the current thinking that cooperatives should be the vehicle for delivery of credit to this group with the GOK expanding its support for such a program.

VI. Review other donor assistance to the AFC in relationship to USAID assistance. Assess the relative quality and effectiveness of both USAID and assistance and that provided by other donors. Seek to determine whether there are short-comings in the totality of assistance from external sources.

Documentation available to the evaluation team indicates quite clearly that Kenya has not been suffering from the lack of external donor assistance either financial or technical. To the contrary, given the input of funds into the agricultural sector, a question might be raised as to how efficiently and effectively those funds can be absorbed into the economy.

Records of the AFC at June 30, 1977, show that loan funds (redeemable capital) had been made available to it in the total of Shs. 389,708,990.15. Principal repayments at that date amounted to Shs. 46,729,170.58, leaving a total outstanding balance of Shs. 342,979,819.57. Government contribution is stated as Shs. 45,886,474.50 and is mixed into the AFC small scale and large scale loans.

This very large contribution of loan funds comes from a variety of sources, including the United Kingdom, West Germany, the United States, Sweden, Canada and IBRD. Loan purposes cover a wide variety of agricultural uses and schemes with British Land Transfer loans going back as far as 1965. External donors obviously accept the quality of AFC as a re-lending institution, witness the most recent loan from IBRD. Discussions with that organization indicates relative satisfaction with AFC performance although funds from Agriculture Credit Project Number 3 may not be drawn down by AFC pending placement in the corporation of an expatriate credit specialist to be funded by IBRD. The role of USAID in provision of loan funds has been minor and those primarily made as grants. The most recent activity began in 1976 with a grant of Shs. 10.4 million for short term production credit (Shs 9.0 million for large scale farms and Shs. 1.4 million small scale). The entire amount reportedly has been loaned out with a recovery rate to date of approximately 80%.

From the standpoint of technical assistance, USAID input has been and remains a very significant part of the total effort addressed to AFC. Indeed, the terminating Agriculture Credit Project has been the dominant factor in this area and an earlier section of this report deals with the team's view on that subject. During the period in which USAID has provided technical assistance to AFC, other countries - principally West Germany - have also been involved. Both Sweden and Holland have provided short term assistance, but the West German effort stands next to that of the United States, both in numbers and time.

At present, there are eight expatriates working in AFC, four of whom are sponsored by USAID and four by West Germany. The German team primarily is involved in developing a computer operation for AFC, although the team leader presently serves as project manager for a group farm rehabilitation project.

Our discussions at AFC lead us to the opinion that the computer operation, while encountering early difficulty, is now progressing satisfactorily. The project manager mentioned above appears to have been performing effectively since 1971.

Comments on the American effort as it relates to project design have been made in an earlier part of this report. On balance, we feel that effort has fallen somewhat short of what might have been expected or desired. Much the same might be said of the West German effort as it applies to computerization.

The present group of USAID sponsored personnel in AFC have impressed the team not only by their professional abilities, but by the manner in which they are approaching their assignments. It is unfortunate that the senior member of this group will soon be departing, thus reducing the American presence to three people. As has already been stated, we believe there should be a modest expansion in technical personnel. Our recommendation relative to the need for a coordinator of area manager activities is a case in point. The four area manager positions are now held by trained Kenyans and we applaud this accomplishment. What we believe necessary now is to have a highly experienced individual working with the area managers to see that AFC's policy and credit operations are implemented on a uniform basis and to resolve with the managers any problems which surface as they work to improve the capabilities of AFC branches. We look at this as possibly a two year assignment for an expatriate specialist prepatory to placement of a Kenyan in the coordinator's position. Likewise, we see a developing requirement for a computer program specialist and if for any reason, the West German computer team were to be withdrawn, an urgent need would exist to replace those skilled specialists. We trust that USAID and perhaps other donors will give consideration to other needs of APC as they develop.

VII. Provide such other comments, observations or recommendations regarding the agriculture credit situation in Kenya as appropriate in keeping with orderly overall development of the agricultural sector.

Much of the work of the evaluation team necessarily was focused upon the AFC inasmuch as that corporation has been a primary beneficiary of the terminating Agriculture Credit Project. As has been recorded earlier, however, the team believes that while technical services and possibly future loan support should be made available to the AFC, it need not be looked to as the principal supplier of credit to that large segment of Kenyan farmers toward whom the new thrust of AID assistance is directed. Rather, the two loan programs now targeted on that group are being implemented through agriculture cooperatives. The cooperative system is receptive and can be an effective instrument in delivering supervised credit to the target group.

During our short stay in Kenya, the team has been impressed with the current stage of development in the cooperative system and we see much advantage in working with that system. Particularly, we have become aware of the potential ability of the cooperatives to mobilize funds from the rural areas and revolve these resources back into the countryside in support of useful programs. The Co-operative Bank of Kenya, Limited is the principal conduit of funds moving into the cooperative system. This bank was registered as a co-operative society in 1965, and as a commercial bank in 1968. Thus, it has not only a mandate to serve the cooperative movement, but the unique ability to also act as a regular bank.

Over the past 12 years, the bank has been operated in a careful and conservative manner and in the process has achieved solid growth. Data on its financial condition and operating position may be found in its latest annual report dated October 4, 1977. When discussing the financial operations of cooperatives, the extension of credit to the very small scale farmer and other matters, the team found bank management perceptive and well informed. Management is looking toward a rapid rate of growth in the financial requirements of cooperatives and concerned over the pressures which will devolve upon the bank to provide a broadening range of financial and consultative services. We share this concern and feel that this institution will be playing a major role in future development of the agricultural sector. It is for this reason that we strongly suggest an early in-depth study of the bank to assess its present capabilities and determine its ability to sustain increased growth and activity resulting form the financial demands which certainly will be placed against it.

The team has been struck by the great variety of studies, reports and data dealing with agriculture credit in Kenya. We have, however, been somewhat frustrated in our evaluative efforts by difficulties in readily locating such material and extracting useful, reliable information. We perceive this problem as perhaps steming from lack of some kind of central repository, lack of a centralized research and planning function and thus something less than fully satisfactory coordinattion among government and donors. Further, we sense an absence of an integrated agriculture credit policy for guidance in all types of lending by all classes of donors.

A fairly recent action in the Philippines to overcome the problems mentioned above was established by government of a Presidential Council on Agriculture Credit (PCAC) together with a supporting group, the Technical Board on Agriculture Credit (RBAC). TBAC which is housed in the Central Bank of the Philippines constitutes the research and planning activity for agriculture and passes its studies and recommendations on to PCAC for review and decision. TBAC also maintains a large functional system for the gathering and retention of information.

As a result of the above operation, there is emerging in the Philippines a more effective and better understood overall approach to the credit function. This system, or something similar might be worthy of consideration in Kenya.

As we have pursued our evaluation work, it has become clear that the complexity of the many credit programs now going forward in Kenya and the multiplicity of donors involved in such programs has made coordination of effort a very difficult problem. Although we understand that both formal and informal discussions are frequently held at fairly high levels of officialdom, close coordination and cooperation at the technical level often must depend on the willingness of several specialists from diverse institutions to sit down and work together. It seems to the evaluation team that problems of coordination in projects which may involve several ministries and institutions can easily be forestalled by means of a coordinating committee such as has been suggested in the major recommendations section of this report.

In earlier sections of this report the evaluation team has pointed up a continuing need to provide professional training to Kenyans in a variety of disciplines. Although we do not fault the level and type of training which heretofore has taken place, we feel the general subject is one requiring an on-going scrutiny as to overall effectiveness. In many cases, we believe, short term training programs in the United States may not be as effective, when relating to the Kenyan scene, as a well rounded in-country program carried out by a university or other specially qualified institution. Regional training institutes have been developed in other areas of the world under the joint auspices of several countries and AID or other external donors. Example: the Regional Training Center at the University of Philippines in Los Banos. The team feels there might be merit in giving consideration to establishment and support of an African Training Institute at a selected national university on the African continent.

During many discussions on agricultural credit at the central and branch offices of AFC, the role and rights of women in agriculture was a frequent topic. We learned, among other things, that although women may legally own farm land, traditionally this is not a common occurence. More frequently they are looked to as the base human resource, the working operator of the farm, assuring repayment of a land collateral loan obtained by the husband. Further, such loans may often be made without the wife being aware of the transaction. Even though the lender may require that a wife join in a loan, such action has no face under law.

Accepting that there are many facets to the subject of women involvement in farming, the team believes there are merits in exploring the social and economic impact of women in agriculture in general and farming in particular. Kenya, like many other African countries, is moving toward new and modern concepts of social justice and inevitably the equality of women will be a major thrust in the transition. It is evident that change in this direction already is taking place, witness the fact that the chief personnel officer and the legal officer of AFC are women.

VIII. SCOPE OF WORK

A. Evaluate the terminating Agriculture Credit Project (615-11-140-148) to determine success in meeting overall project objectives and, in particular, the contribution made to the institutional development of the Agriculture Finance Corporation. Analyze project design and overall effectiveness in achieving project goals.

B. Evaluate the AFC Management Study (June 1977) and - to the extent possible - review and comment on the Kenya Agriculture Credit Study.

C. Study the need of and requirements for expanding AFC capabilities to provide credit to smallholders and for granting, managing and evaluating loans made on a basis of other than real estate collateral.

D. Review other donor assistance to the AFC in relationship to USAID assistance. Assess the relative quality and effectiveness of both USAID assistance and that provided by other donors. Seek to determine whether there are short comings in the totality of assistance from external sources.

E. In A through D above,

1. Identify what, if any, additional external assistance may be required for the further development of AFC.
2. Indicate those areas in which further external assistance may no longer be required and identify those where additional input of services or funds could be beneficial to the Kenyan farmer and the economy.

3. Identify and describe any areas of AFC in which personnel training (both formal and informal) would appear necessary or desirable to strengthen operations and further institutional development.

F. Provide such other comments, observations or recommendations regarding the agriculture credit situations in Kenya as appropriate in keeping with orderly overall development of the agricultural sector.

IX. PERSONS CONTACTED

The following listing shows the people with whom the team made contact during the course of the evaluation and from whom we received a great deal of information and help.

<u>Headquarters, Nairobi AFC</u>

Mr. Francis G. Maina	General Manager
Mr. Benjamin B. Blanks	Financial Specialist (Advisor)
Mr. Burton Behrens	Credit Specialist (Advisor)
Mr. Dan Winniger	Internal Audit Specialist (Advisor)
Mr. Radigei Von Erffa	Farm Management (Advisor)
Mr. Lane Hannan	Credit Review Specialist (Advisor)
Mr. Stephen Hinga	Head, Large Scale Loans
Mr. R.A.H. Hermitte	Financial Controller
Mrs. D.W. Muiruri	Personnel Officer
Mr. Joseph Chege	Credit Review Specialist
Mr. J.K. Nkubitu	Interal Audit Specialist

<u>Field Contacts</u>

Mr. James Ngarua	Mt. Kenya Area Manager

<u>Embu</u>

Mr. Abade	Branch Office Manager
Mr. J.K. Gicira	Loans Officer

<u>Kerguya</u>

Mr. Mutegi	Branch Manager

<u>Machakos</u>

Mr. Amos Njage	Loans Officer

<u>World Bank</u>

Mr. Lennert Ljungman
Mr. Ralph Hannan

<u>German Agricultural Team</u>

Dr. Jorn C. Pitter	Team Leader

<u>Nordic Group</u>

Mr. Jorgen Lindh	Project Coordinator

Harvard Study Group

Dr. John Thomas	Team Leader

Smallholder Production Services and Credit Project

Mr. Francis Bennett	Project Operations Advisor

Ministry of Cooperatives and Development

Mr. W.C. Were	Assistant Commissioner
Mr. Gitau	Senior Credit Officer

Cooperative Bank of Kenya, Limited

Mr. Bernard B. Kathanga	Chairman
Mr. J.K. Kimbui	General Manager

USAID

Mr. Charles J. Nelson	Mission Director
Mr. Ernest Wilson	Deputy Mission Director
Ms. Lois Richards	Program Officer
Mr. David Christenson	Project Officer
Mr. Michael Rugh	Project Officer
Mr. Kevin O'Donnell	Head Technical Services Office

Ministry of Commerce and Indistry (UNCTAD/GATT)

(Handicraft Cooperative)

Mr. Malcolm Benjamin	Export Marketing Advisor

Kenya National Federation of Cooperatives

Mr. Cyrus K. Kinyua	Merchandise Manager