Faulu Kenya

Enabling People To Succeed Through Small Business Loans

FAULU KENYA LIMITED
PROGRESS REPORT
THROUGH 31ST DECEMBER 2001

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Submitted to:
Re: Award No. PCE-A-00-98-00034-00
U.S. Agency for International Development
Bureau for Management
Office of Procurement
Washington, D.C. 20523-7100

February 14, 2002

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1 EXECUTIVE SUMMARY

(Table FK 1)

Faulu Kenya Limited
Key Programme Indicators
For Calendar Year 2001
(In Kenya Shillings -- Ksh)

(a)	LOAN ACTIVITY	FOURTH QUARTER '2001	YEAR TO DATE	YTD GOAL	YTD +/- VARIA-NCE	YTD % VARIA -NCE	CY, OVERALL GOAL
1	Face Value of Loans Disbursed (1)	224,399,460	702,094,560	606,868,000	+95,226,560	+16%	606,868,000
2	Number of Loans Disbursed	5,925	20,382	18,820	+2,012	+8%	18,820
3	Interest Charged on Loans (Flat Rate Per Annum)	22 %	22 %	22 %	22 %	0	22 %
	PORTFOLIO GROWTH						
4	Total Portfolio (OLB-Outstanding Loan Balance) (1)	336,489,989	336,489,989	312,900,000	+23,589,989	+8%	312,900,000
5	Total Number of Outstanding Loans	11,584	11,584	12,927	-1,343	-10%	12,927
6	Average OLB per loan	27,786	27,786	24,205	+3,581	+15%	24,205
7	Total Face Value of Loan Portfolio	494,719,960	494,719,960	510,980,000	-16,260,040	-3%	510,980,000
8	Average Face Value of Loan Amounts per loan	42,707	42,707	39,528	-3,179	+8%	39,528
9a	Number of new registered clients	1,804	8,118	7,447	+671	+9%	7,447
9b	Total Number of Registered Clients	18,696	18,696	20,480	-1,784	-9%	20,480
10	Number of Active Client Groups	870	870	747	+123	+16%	747
11	Average Number of Clients Per Group	21	21	27	-6	-22%	27
12	Percent Female -- of Registered Clients	47%	47%	> 50 %	-3%	-6%	> 50 %
13	Number of Clients Served	19,664	23,083	21,050	+2,033	+10%	21,050
14	Number of Clients Receiving Loan Orientation/Training		6,315	5,298	+1,017	+19%	5,298
	LOAN SECURITY FUND (LSF)						
15	LSF (Loan Security Fund) Ending Balance	182,979,996	182,976,996	216,496,000	-33,519,004	-16%	216,496,000
16	Average LSF Balance Per Client	9,787	9,787	10,425	-638	-6%	10,425
17	Ratio of LSF/OLB	54%	54%	69%	-15	-21%	69%
	SELF-SUFFICIENCY INDICATORS						
18 *	Operating self-sufficiency (1)	107%	107%	116%	-4	-8%	116%
	RISK ANALYSIS						
19	Portfolio at Risk Rate (%)						
	1 to 7 days	4.45%	3.62%				
	8 to 14 days	0.89%	0.81%				
	15 to 21 days	0.38%	0.44%				

	22 to 28 days	0.21%	0.20%				
	(>28 Days)	1.05%	0.94%	<3 %	-2%	-69%	<3 %
20	On-time Repayment Rate (2)	123%	118%	> 96	+22%	+23%	> 96
21	Effective Repayment Rate (3)	82%	82%	>96	-14	-15%	>96
22	Default Rate to Faulu	0	0	0	0	0	0
23	Default Rate to Clients (LSF Tapping of cross-guarantors)	2.4%	11%	<2 %	+9%	-50.0	<2 %
24	Percentage of Clients Exiting Program	5%	24%	< 15 %	+9%	+46.0%	< 15 %
	PRODUCTIVITY MEASURES						
25 *	Total operating cost	30,420,317	115,116,050	112,843,221	+2,272,829	+2%	112,843,221
26 *	Operating Cost Per Unit Lent	0.14	0.16	0.2	0.04	-20%	0.2
27 *	Operating Cost Per Loan Disbursed	5,134	5,648	5,995	-347	-6%	5,995
28 *	Operating Efficiency (Op. Exp./Avg. OLB)	35%	39%	35%	-3%	-9%	35%
29	Number of All Staff (full-time)	110	110	110	0	0	0
30	Number of Active Loan Officers (with Portfolios)	61	61	57	+4	+7%	57
31	Active Loan Officers as % of All Staff	56%	56%	53%	+3%	+6%	53%
32	Total Portfolio Per All Staff	3,059,000	3,059,000	2,897,222	+161,778	+6%	2,897,222
33	Total Portfolio Per Active Loan Officer	5,516,229	5,516,229	5,489,473	+26,756	+.5%	5,489,473
34	Number of Outstanding Loans Per All Staff	106	106	119	-13	-11%	119
35	Number of Outstanding Loans Per Active Loan Officer	190	190	227	-37	-16%	227
36	Number of Clients Per All Staff	170	170	189	-19	-10%	189
37	Number of Clients Per Active DFO	306	306	359	-53	-15%	359
38	Number of Active Clients Groups Per Loan Officer	14	14	13	+1	+8%	13
	IMPACT (5)						
39	Number of Jobs Created (Estimate)	6,115	6,115	5,646	+469	+8%	5,646
40	Number of Jobs Stabilized (Estimate)	18,534	18,534	20,683	-2,149	-10%	20,683
41 *	Number of People Primarily Benefiting (Immediate family; Estimate)	133,300	133,300	105,250	+28,050	+27%	105,250
42 *	Number of Children Helped (Estimate; included in above #41)	79,980	79,980	36,150	+43,830	+121%	36,150

NB See notes below

Notes:
(a) The same basic table format is used in each section of the report, with the same numbering sequence. Sections needing fewer rows will still reflect the overall numbering sequence.
(1) Exchange Rate: December quarter end was Ksh 79.03 = USD$1; Average for quarter was Ksh 78.8 = USD$1
(2) Operating self-sufficiency = (Total Operating and Investment Income) divided by (Total Operating and Investment Expenses).
(3) On-Time Repayment Rate = Total Payments for Period divided by Total Amount Due for the Period.
(4) Effective Repayment Rate. This is a strict internal measurement used by Faulu that focuses on arrearage. ERR = Total amount due at the beginning of the period less total payments in arrears at the end of the period, divided by total amount due at the beginning of the period. Any payment a day or more late is considered in arrears and thus affects this indicator.
Impact: External studies in Kenya suggest MFIs enable creation of 0.5 -0.7 full-time jobs per each loan. Faulu is using a more conservative figure of 0.3 jobs created per loan disbursed. External studies suggest that there is an average employment of 1.6 per enterprise. Therefore, Faulu is using this ratio times the number of borrowers (outstanding loans). Faulu estimates that there are on average 5 people who primarily benefit by receiving their basic sustenance from the business of each customer served during the year. Of these an estimated 3 are children

1.1 Loan Activity

- Faulu Kenya disbursed a total of Ksh. 224,399,460 in 5,925 loans during this quarter. The 4th Quarter is normally the busiest loan activity period and these disbursements are then above all other quarters in the year. The year to date disbursements stood at a record Kshs. 702,094,560, a 34% growth over the same period last year.

1.2 Portfolio Growth

- The portfolio grew by 26% to Kshs.336,489,989 from Ksh 267,434,342 at the end of the fourth quarter. The number of outstanding loans stood at 11,584 by the end of the Quarter. This growth is much higher than all other quarters, which registered single digit growth. As mentioned above, the 4th Quarter is the busiest one through the year.
  The face value of loans amounted to Kshs. 494,719,960 by the end of this Quarter, signifying a more stable portfolio position as a result of the factors explained above. Client intake increased from 17,860 at the end of the second quarter to 18,696 this quarter, an increase of 836. Client intake is normally registered at a higher level in the 3rd Quarter, as clients anticipate taking loans in the 4th Quarter.

1.3 Loan Security Fund (LSF)

- Loan Security Fund stood at Ksh 182,979,996.The ratio of LSF/OLB went down to 54% from 66% at the end of the second quarter. This indicates that the clients who were building up LSF in anticipation of getting loans in the fourth quarter received those loans. While the ratio is considered high by industry standards, it underlines the measure of trust that clients have in Faulu Kenya. Plans are under way to leverage this trust by offering incentives for parallel LSF products that clients can perceive from an investment angle, rather than loan security.

1.4 Self-sufficiency Indicators

- Faulu Kenya's Operating self-sufficiency stood at 107% for the fourth quarter, much better than the previous quarter's 103%. This is a highly positive indicator in another direction as it includes the interest expense on all outstanding loans taken to fund portfolio growth during the year, and includes a much lower yield on government treasury bills and bonds.

1.5 Risk Analysis

- While the overall On-Time Repayment Rate stayed very strong at 123% (above 100% due to pre-payments), the portfolio at risk stayed well under the 2% target at 1.05%, while the Effective Repayment Rate remained at 82%, which is below the target of >96%. While this is an internal measures that tracks the promptness of loan repayments, its deterioration is characteristic of the prevailing economic environment and the difficulties that confront our clients, in the face of declining purchasing power and decreasing demand for goods and services in the micro-enterprise sector.
- Specific training for field officers in sophisticated credit appraisal and rating, strategic delinquency management and better understanding of the business environment specific clients operate in, has already been carried out, to deal more broadly with the problem of arrears. These will continue forming part of the next year's activities and has been

allocated a substantial part of the capacity building grants received from both the European Union's MESP and USAID's MicroPED.

- Extra debt collection measures are now being used, with clients and groups being encouraged to use licensed debt collectors and auctioneers where appropriate.

1.6 Productivity Measures

- These continue to be positive as the portfolio and client load grows and DFO recruitment restricted to on a need basis. This is likely to continue as the strategic focus shifts to building value within the existing business.

1.7 Impact

- Estimates indicate that Faulu Kenya helped create 358 jobs during this quarter and helped stabilize over 3,500 others. In an environment where 3,000 jobs are being lost every month, these additions keep the micro-enterprise sector vibrant. It is estimated that nearly 21,000 individuals received their primary sustenance as a result of these loans, with nearly 13,000 probably being children.

1.8 2001 Objectives

- Focus business activities towards meeting the goals set out in the strategic and annual plan.
- Maintain and improve current positive operational self-sufficiency.
- Meet the loan activity and portfolio growth goals, per Table FK 1.
- Utilise the MESP and MicroPED grants to build staff and institutional capacity.
- Pursue a DFID Pounds 1 Million line of credit in grant or credit form.
- Participate in the third round of the FDCF Challenge Fund.
- Pursue a fresh loan from MESP towards portfolio growth.
- Complete arrangements for installing a new MIS system with funding from MicroPED.
- Structure staffing so that at least 50% of staff are active Loan Officers with portfolios.
- Carry out a strategic analysis of all functional areas in the company with the purpose of increasing productivity.
- Ensure that quality financial reporting is produced on time for quality decision making.
- In partnership with MESP, develop a platform for a possible entry into the capital markets through a commercial paper issue that will ensure a constant and cheaper source of funding for future portfolio growth.
- Engage a consultancy to help in the development of a basket of new products for launch when appropriate.
- Focus more attention to portfolio health, risk and delinquency management.
- Ensure that Faulu gets good exposure and publicity through a series of managed events.
- Represent Faulu in the drafting of the micro-finance section of the Poverty Reduction Strategy Paper.

1.9 Key Accomplishments During This Quarter

- 2002 Budgeting process completed.
- MESP Capacity building grants activities successfully concluded.
- 3-year strategic plan finalized and circulated to Board and management.
- Highly successful training on Credit Appraisal and Delinquency Management held for all DFOs and Unit Managers.
- Successful USAID Matching Grant evaluation carried out.
- Job Grading and Competency Profiling/Career Pathing work completed and recommendations tabulated.
- Memorandum of Understanding drawn up with KENWA and Action Aid, ready for signature in 1st Quarter 2002.
- INAFI Africa regional conference attended by CEO, where Faulu is confirmed into membership.
- Successful field day held in partnership with Brookside Dairies in the Mt. Kenya Region.
- Initial development work on Micro Banker Windows completed in Bangkok by IT Manager.

1.10 Key Activities Planned for Next Quarter (1st Quarter 2002)

- Recommendations of Job Grading exercise to be implemented.
- Performance Appraisals to be completed and results implemented.
- Business Unit restructuring to be effected after appraisals.

- Product prototypes to be presented by Fineline Management Systems.
- Joint Board/Management presentation of business plan to be done.
- Market survey to be carried out in Kapsabet/Nandi Hills for a possible market entry.
- DFID line of credit process to be completed and funds made available.
- At least one exchange visit to be made by a section of staff.
- Further refinement of MB Windows to be carried out by IT Manager internally.

1.11 Challenges and Opportunities

- The Government seems to be riding the tide without IMF support. While this is considered short term in real terms, the effect seems to be smoothened by excess liquidity in the money market, that allows the government to borrow cheaply, but denies credit to the productive sector, undermining overall economic growth and affecting our clients.
- Increasing insecurity continues, affecting the country in general and the majority of our clients who operate in urban slum areas, which are more prone to incidences of thuggery. The inflow of illegal small arms from war torn Somalia and Southern Sudan, only serve to exacerbate the problem.
- Companies continue to close down and others to lay off staff. Our clients' businesses are affected directly by the loss of a customer base owing to these lay-offs and closures, and this has a direct effect on portfolio growth.
- The "Donde" Bill (Central Bank Amendment Act) is currently in abeyance, awaiting court determination of its implementation. As long as this continues to drag, credit will continue being scarce to the formal sector as banks resist lending at a low and controlled margin, hampering growth for the micro-enterprise sector, that relies a lot on the formal sector. This resistance is creating an artificial excess liquidity position in the money market.
- Though the Government has shown serious commitment to fiscal discipline, the strategy to convert government debt into long term instruments can only hold as long as the liquidity in the market persists. Once the liquidity eases, interest rates are likely to go up tagging on increased T-Bill rates, as the government is not about to reign in spending. This will raise the cost of capital to Faulu Kenya, as commercial borrowing is currently the only source of capital for portfolio growth.
- 2002 is election year and there is heightened anxiety as to how the presidential succession will be handled. Currently this is mired in controversy and intrigue, even as the countdown grows and this is forcing clients and the business community in general to take an extremely cautious position.
- The above mentioned bill to control interest rates is likely to squeeze out smaller customers in the banks, on to MFIs and there is an opportunity to increase the client base. This however, has to be done cautiously, as these are people already used to the high default culture in local banks.
- The new shift in thinking on the part of Development Partners in the MFI industry towards loans and equity instead of grants is likely to put smaller MFIs in jeopardy as few of them are credit-worthy. This is likely to lead to some of them either scaling down operations or closing down all together, bringing in new clients for existing and stronger MFIs, but putting a strain on the resources required to meet the demand from an upsurge of such new clients, for the stronger MFIs.
- The September 11, 2001 terrorist attacks on America is likely to see US hard-line policy to Kenya soften enough to allow aid to come through as the US seeks allies in the war against terrorism. This may spur the beginning of an upward trend in economic growth, which in turn fuels growth in the micro-enterprise sector.
- The AGOA Act, which was previously rigorous for Kenyan small businesses, may be softened alongside the softening of US policy and this may, again, spur some growth in some of our clients' businesses.

2 Progress Toward Key Program Indicators Set for USAID IGP

Following are Key Program Indicators set for the IGP:

Key Program Indicators
Faulu Kenya

	Year 1 (CY99)	*Year 2 (CY00)*	*Year 3 (CY01)*
Number of Clients in the System	11,100	14,965	19,062
Total Number of Outstanding Loans (end of year)	6,805	9,528	14,584
Amount of Loans Outstanding (US$)	$2,765,936	$3,185,358	$5,520,000
Amount of Loans Outstanding (in Ksh)****	201,719,728	248,553,492	276,000,000
Portfolio at Risk (>30 days)*	3%	0.63%	3%
Long Run Loss Rate	2%	2%	2%
Number of active loans per loan officer	231	170	286
Return on Operations**	55.2%	72.8%	92.5%
Operational Self-Sufficiency***	71.54%	96%	114.2%

* Portfolio at risk: Calculated as the balance of the loans outstanding with delinquent payments over 30 days.

** Return on operations: Total Client Income and Fees over Total Adjusted Expenses (Line 20 of Table 1)

*** Operational Self-Sufficiency: Total Client Income and Fees (Line 13 divided by Total Non-Adjusted Expenses Line 17 of Table 1).

**** It should be noted that at the time the indicators were set the exchange rate of Ksh to USD was in the 50:1 range, and was the assumption used.

Note that the above indicators are for the end of each calendar year. Per Section 1 of this report, as of the end of December 2001 the portfolio was at Ksh 336,872,335 that is above the projected target of Ksh 276,000,000 by 21%. There were 190 outstanding loans per active loan officer versus a projected 286. The portfolio at risk over 30 days was 0.94%. Operational self-sufficiency was 107%. From Table 1 the Return on Operations was 81.1%. The lag is in the number of clients in the system and number of outstanding loans, which stood at 18,696 and 11,584 respectively. Management attributes this to the declining state of the national economy; the need to keep the quality of the client base and portfolio performance high; and the issue of client retention rate.

The Board and Management feel confident that the strategic plan finalized in 2000 will start to see increased positive results in 2001 and beyond.

3 USAID Table 1 – Financial Services

TABLE 1 – Financial Services
Simplified Activity and Financial Statement
Faulu Kenya
In Local Currency - Ksh

		1996	1997	1998	1999	2000	2001
	Activities						
1	Amount of Loans Outstanding, SOY	34,363,951	37,125,439	52,753,534	136,635,556	201,719,728	248,553,492
2	Amount of Loans Outstanding, EOP	37,125,439	52,753,534	136,635,556	201,719,728	248,553,492	321,872,335
3	Ave. Amount of Loans Outstanding	35,944,695	44,939,486	94,694,545	169,177,642	225,136,610	285,212,913
4	# of Loans, End of Year	2,482	3,342	6,132	6,805	9,528	11,584
5	Ave. Loan Size (face value)	27,029	26,442	35,347	45,105	39,450	42,707
5a	Avg. OLB Size per Loan	14,482	13,446	15,442	24,860	26,086	27,785
6	Delinquency Rate	6.07%	5.23%	0.34%	0.62	0.63	0.94%
7	Long Run Loss Rate	0%	1.37%	0%	0%	0%	0%
	Interest Rates						
8	Nominal Rate Charged by Program	49%	49%	49%	49%	49%	49%
9	Local Inter-bank Rate	10%	10%	10%	15%	12%	10%
10	Inflation Rate	8%	10%	8%	11%	10%	2%
	Revenues						
11	Interest Income from Clients	14,699,998	13,195,508	27,925,720	50,712,612	67,984,092	93,709,332
12	Fee Income from Clients (and sundry)	1,701,755	3,232,444	13,921,722	10,845,950	13,452,607	12,957,104
13	Total Client Revenues	16,401,753	16,427,952	41,847,442	61,558,562	81,436,699	106,666,436
13a	Investment Income	6,015,072	16,225,078	14,371,098	11,146,726	15,223,491	16,973,093
13b	Total Client and Investment Revenues	22,416,825	32,653,030	56,218,540	72,705,288	96,660,160	123,639,529
	Expenses						
14	Administration	35,419,553	53,000,615	60,680,243	83,904,235	78,603,872	97,528,436
15	Depreciation of Fixed Assets	1,221,462	1,958,299	2,112,647	2,162,098	3,064,193	3,168,156
16	Loan Loss Provision	171,160	1,160,120	4,655,416	(59,610)	3,243,308	2,293,461
17	Total Non-Financial Expenses	36,812,175	56,119,034	67,448,306	86,006,723	84,911,373	102,990,053
17a	Financial Expenses	2,243,028	3,622,512	5,860,970	2,733,051	6,907,643	13,043,549
17b	Total Expenses	39,055,203	59,741,546	73,309,276	88,739,774	91,819,015	116,033,602
	Adjusted Financial Expenses						
18	line 3 x higher of line 9 or 10	3,594,469	4,493,948	9,469,454	25,376,646	27,016,393	28,521,291
	Totals						
19	Total Expenses (line 17+18)	40,406,644	60,612,982	76,917,760	111,383,369	111,927,766	131,511,344
19a	Total Expenses Including Financial (line 17b+18)	42,649,672	64,235,494	82,778,730	114,116,420	118,835,408	144,554,893
20	Return on Operations (line 13/19)	40.6%	27.1%	54.4%	55.2%	72.8%	81.1%
21	Return on Total Operations and Investments (line 13b/19a)	52.6%	50.8%	67.9%	63.6%	81.3%	85.5%
	Other						
22	Total Savings Outstanding	---	---	89,182,717	120,828,785	143,683,656	182,979,996

23	Percent women borrowers	---	---	52%	53%	50%	47%
24	Number of clients per Loan Officer	---	----	277	331	267	306
25	Number of loans outstanding with initial loan balance < $300	---	---	1,941	3,519	8,030	8,118

* Data up to end December 2001.