Global Livestock CRSP

Micro-finance in Northern Kenya:
The Experience of K-REP Development Agency (KDA)

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Improving access to grass-roots rural savings and credit options has been postulated as an important strategy to improve pastoral risk management in northern Kenya and southern Ethiopia. Therefore, studies of how rural financial organizations actually work helps us understand the problems and opportunities of such intervention strategies. During 2000-01, the author studied the performance of five recently established Financial Services Associations (FSAs) in Marsabit District, northern Kenya. These are community owned and operated entities that receive support in the form of initial physical assets and on-going audit and training services from the K-REP Development Agency (KDA). The five FSAs range from one to three years in age, and together have nearly 1,000 members. To-date, however, per capita savings remain meager. Loans tend to be small and are used to support consumption as well as investment needs of the population. There are also high rates of loan delinquency. Only a minority of FSA members appear to be active in terms of loan acquisition and managing their savings accounts. If FSAs are to succeed in northern Kenya, we believe that more emphasis needs to be placed on: (1) training of FSA staff and shareholders; (2) research on pastoral economic behavior; and (3) bolstering business skills and non-pastoral investment opportunities in the region.

Background

Micro-finance refers to financial services such as cash loans, deposit savings accounts, and insurance made available in relatively small amounts to poorer populations throughout the developing world. Many different forms of micro-finance have emerged worldwide, including in east Africa. This brief presents preliminary findings on one particular type of micro-finance institution, the Financial Services Association (FSA) recently introduced into pastoral areas of northern Kenya by the Kenya Rural Enterprise Program Development Agency, henceforth referred to as KDA.

Under the FSA model, local inhabitants own and operate the institution, electing the Board of Directors and committees and deciding whether to reinvest profits or to distribute them to share owners like dividends. The FSA mobilizes local financial resources through share ownership and deposit-taking savings accounts for lending back to the community for productive investments. The idea is for FSAs to take advantage of informal local rules, customs, relationships, knowledge, and solidarity networks that are believed to increase loan repayment while introducing formal banking concepts and methods believed to improve allocation of scarce financial capital. The hope is that this fosters community empowerment and local democratic institution-building, encourages pastoralists to diversify asset holdings away from the traditional, heavy concentration on livestock, and provides local lending capital for investment in non-pastoral enterprises.

Research has been recently undertaken by the

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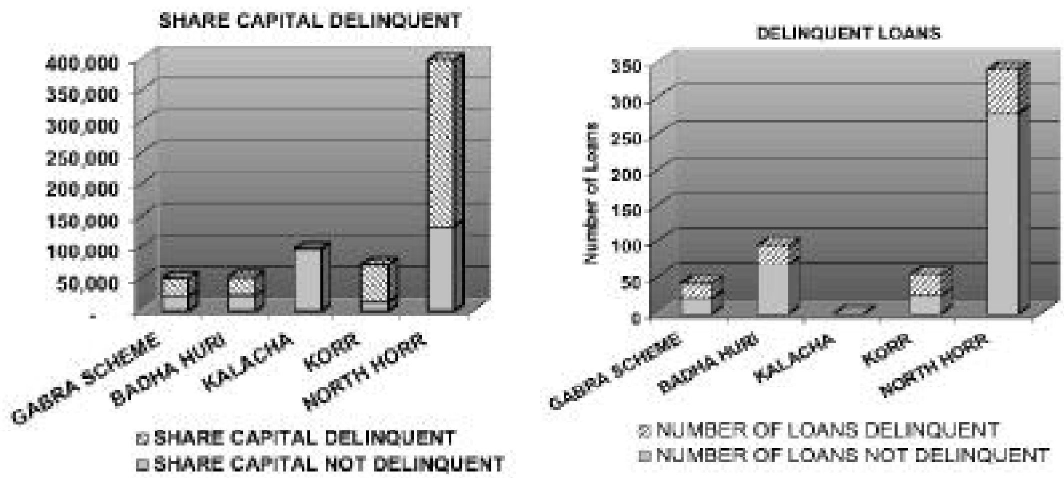
Figure 1: Delinquent loans as (a) a proportion of share capital and (b) as a proportion of loans disbursed.



author to investigate the performance of five FSAs recently established in northern Kenya. This has involved site visits and interviews of various stakeholders. One theme that guides PARIMA efforts is the idea that increased access to rural savings and credit institutions is an important development intervention for pastoralists. Therefore, understanding how FSAs function (or do not function) in a pastoral rangeland setting is important to evaluate this strategy.

Preliminary Findings

In northern Kenya's Marsabit District, the KDA has launched FSAs that sell shares at KSh300 (about USD 3.80). Share capital constitutes the loan fund as the KDA provides no loan funds per se. The contribution of KDA is purely in the form of initial start-up assets including a strongbox, building subsidy, and bookkeeping materials. The KDA also provides on-going auditing and other training and technical support services. Members of an FSA can apply for loans up to the lesser of four times the value of their shareholdings, or 10% of their total share capital. Members can also open savings accounts up to ten times the value of their share capital. Those who invest more in the FSA can thus save and borrow more.

The KDA has opened five FSAs in northern Kenya. These include: Korr and North Horr (1998), Badha Huri (1999), and Kalacha and the Gabra Scheme (2000). These five FSAs presently have nearly one thousand members, about KSh671,000 and KSh318,000 in share capital and savings, respectively, and more than KSh2.5 million in disbursed loans. North Horr is by far the largest of the five by each of these three indicators.

Loans to date have been small, with a mean of only KSh4800 (median equals KSh2400). This is far too small to provide working capital for an enterprise of minimum-efficient scale in trading or light manufacturing. There seem to be few business opportunities in Marsabit District that are both feasible given the small loans available from the FSAs and profitable enough to support the necessarily high rate of interest charged for FSA loans. As a consequence, more than 40% of loans are extended in support of consumption rather than production activities.

Savings remain meager. Only 48 of the 925 FSA shareholders in Marsabit District have ever made savings deposits. Of these, only 13 accounts have had more than two transactions, namely the initial deposit and a complete withdrawal. Only one savings account is presently active. Plainly, demand for loans far exceeds demand for savings under present conditions. Pastoralists are not taking advantage of the opportunity to convert livestock wealth into cash savings, even during a period of drought that brought considerable herd stress and relatively high marketed off-take (see PARIMA Research Brief No. 01-04 by John McPeak).

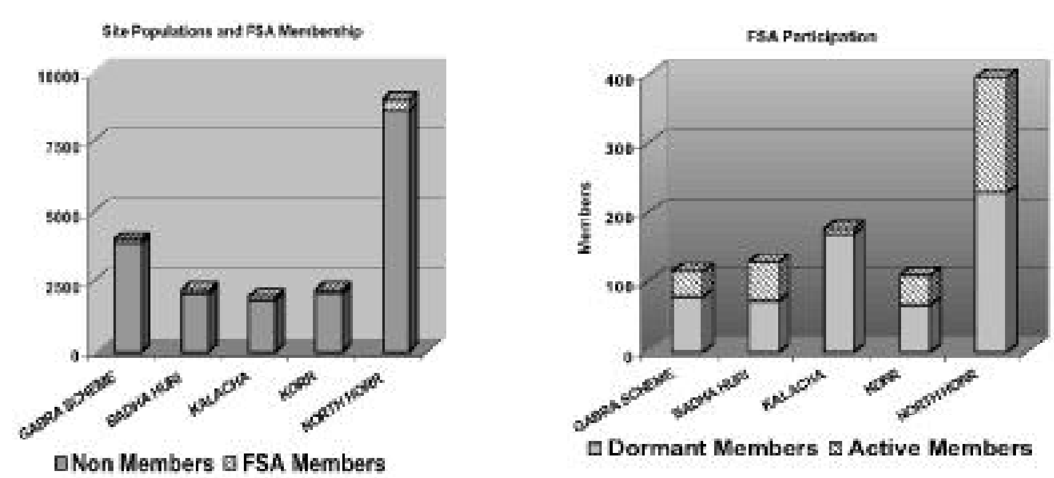
Of the four FSAs in Marsabit District that have been operating at least twelve months, only one shows a profit (North Horr, at 4%). The primary reason for poor initial profitability has been high delinquency for share capital and loans [Figure 1 (a,b)]. Delinquency rates are no greater on loans extended for consumption purposes than those made in support of investment objectives. So, the unexpectedly low repayment rates cannot be attributed to the relatively high proportion of the FSAs' lending portfolio comprised of consumption loans.

Participation in FSAs has likewise proved somewhat less than expected. A small minority of residents in any FSA site purchase shares and thereby become members of the FSA (Figure 2a). Of that minority of local residents who become FSA members, a smaller share still are active, meaning they have taken out loans, opened deposit savings accounts, or both (Figure 2b). Only one-third of FSA members have ever used savings or loan services provided by the associations.

Practical Implications

While local ownership and control may be necessary for good stewardship and satisfactory loan repayment rates, the evidence from the FSA experience to date in Marsabit District shows it is not a sufficient condition. The FSAs there are experiencing high rates of loan and share capital delinquency, low rates of savings deposits, poor profitability, and a weak level of local participation. Supply of micro-financial services does not appear to be a factor limiting either diversification of savings out of livestock or investment in non-pastoral business enterprises in Marsabit District. In order for micro-finance under the FSA model to succeed in such locales, it would appear that greater efforts need to be made to: (1) train local board members, management, and shareholders so as to bolster FSA capacity and improve performance incentives; (2) study pastoralist behavior and re-design FSA financial services packages to meet their current and prospective needs; and (3) bolster business skills and non-pastoral investment opportunities in the region.

Figure 2: Membership of Financial Services Associations (FSAs) at five sites as (a) a proportion of the local population and (b) active participation as a proportion of total membership.



Special Acknowledgement

We thank the K-REP Development Agency (KDA) for facilitating access to the five Financial Services Associations in Marsabit District. Established in 1985, KDA has emerged as the leader in providing innovative microfinancial services in Kenya. With 58 FSAs spanning the coast to the desert, KDA has introduced financial services to over 20,000 people in rural Kenya.

Further Reading

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The GL-CRSP Pastoral Risk Management Project (PARIMA) was established in 1997 and conducts research, training, and outreach in an effort to improve welfare of pastoral and agro-pastoral peoples with a focus on northern Kenya and southern Ethiopia. The project is led by Dr. D. Layne Coppock, Utah State Univeristy, Email contact: lcoppock@cc.usu.edu.

The Global Livestock CRSP is comprised of multidisciplinary, collaborative projects focused on human nutrition, economic growth, environment and policy related to animal agriculture and linked by a global theme of risk in a changing environment. The program is active in East Africa, Central Asia and Latin America.

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