KENYA-DCA LOAN GUARANTEES

IMPACT BRIEF

On the Cover: The mother in this family has used a loan to buy a dairy cow. Proceeds from the milk sales are helping pay her children's school fees.
Photo: USAID

BACKGROUND

Kenya is recognized as East Africa's regional hub for trade and finance, but the SME sector has faced serious challenges in accessing funding. These challenges are even more difficult in rural areas, where over 70 percent of Kenyans reside. Most formal banks have pulled out of rural areas due to elevated costs of doing business, and the perception that rural clients are high risk. Where finance is available, access is limited by unfavorable terms to the borrower such as 100 percent collateral requirements and short loan tenors.

Through the Development Credit Authority (DCA) program, USAID partnered with the Kenya Commercial Bank (KCB) to encourage lending in underserved areas of the Kenyan economy. By covering 50 percent of the risk exposure with KCB, the DCA 2006 and 2010 guarantees were intended to fix financial market imperfections, and enable the bank to reach underserved borrowers and markets. The targeted borrowers were SMEs operating in the agricultural production and processing, tourism, clean energy, commerce, construction, and manufacturing sectors.

EVALUATION OBJECTIVES

USAID's Bureau for Economic Growth, Education and Environment's Office of Development Credit (E3/DC), which administers the DCA guarantees, commissioned the evaluation of the 2006 and 2010 KCB DCA guarantees. The four main objectives of carrying out evaluations, are: i) Communicate to DCA stakeholders (OMB, Congress, USAID Missions, etc.) and external partners about the development contributions of DCA loan guarantees; ii) Contribute to the dialogue about how to engage financial sector institutions as partners in development efforts; iii) Learn from the intervention's development efforts, and to try to examine impact, and iv) Strengthen USAID's future application of DCA guarantees as a tool for achieving development results.

EVALUATION METHODOLOGY

The evaluation used a mixed-methods approach, including statistical analysis of loan data, key informant and group interviews, and document review. The evaluation team visited Kenya Commercial Bank branches in four regions (Central, Nairobi, Coast and Rift Valley), where they conducted structured interviews with all relevant stakeholders. The questionnaires and secondary quantitative data from the 69 people interviewed were serialized to create a unique code, and then analyzed by a data analyst.

EXOGENOUS FACTORS

During the period of implementation of the two DCA Guarantees (2006-2012), the country experienced four waves of crisis, including the post-election violence, the food and fuels crisis, the global financial crisis of 2008 followed by the subsequent Euro zone crisis; and the 2009 and 2011 droughts. Kenya withstood another difficult year in 2012 as weak global demand and domestic policy reforms slowed economic activity. But, the recent decline in inflation and interest rates, and the successful elections and transfer of power are expected to help the economy achieve at least 5 percent growth in 2013.

KEY FINDINGS AND CONCLUSIONS:

INPUT LEVEL:

Conclusions: The DCA guarantees achieved their objectives of strengthening KCB's ability to target

DCA LOAN GUARANTEES TO KENYA COMMERCIAL BANK

Starting Year	Ending Year	Guarantee Ceiling	Number of Loans	Aggregate Loan Amount	Utilization Rate % of Ceiling	Average Loan Size $	Loan Tenor Months	
							Minimum	Maximum
2006	2011	3,950,000	1068	7,821,130	99.03%	7,323	3	48
2010	2017	2,875,000	847	5,716,230	99.410%	6,749	12	45

Source: KCB Transaction Summary Data

SMEs by covering 50 percent of the risk exposure on the principal loans. The USAID Technical Support enabled the bank to establish an SME unit in 2008 to manage the DCA guarantees, to promote its venture into the SME sector, and to develop new innovative lending tools.

Findings in support of the conclusions include:

- The perceived potential of the SME market prompted KCB to initiate action to capture the SME space, and specifically to identify products that were suited to the market. The bank approached USAID/Kenya to partner with them in working with SMEs, which resulted in the 2006 DCA guarantee and its 2010 follow-up.
- Under the 2010 DCA, with the USAID TA support, KCB was able to initiate in-house trainings amongst its officers to accelerate the use of the guarantee. Unlike the 2006 guarantee that was not fully utilized, improved SME structures enabled the 2010 guarantee to reach 100% utilization after just one year.
- Under the DCA guarantees, KCB expanded collateral requirements for SMEs to include stocks, motor vehicle logbooks, and personal guarantees.
- The segmentation of SMEs into Upper tier SME's (minimum loan USD 11,500 and maximum USD 58,000), and Lower tier SME's (minimum loan USD 1,100 and maximum USD 11,500) with differentiated terms facilitated the uptake of the credit under the DCA guarantee.

OUTPUT LEVEL:

Conclusions: The DCA guarantees enabled KCB to loan to the SME sector without the fear of incurring heavy losses, establish a new SME unit, and develop a clear strategy for its involvement in the sector. The guarantee also enabled KCB's marginal clients to raise their borrowings levels with the bank due to improved collateral margins. The improved terms under the guarantees acted as a major marketing tool for KCB's funds.

Findings in support of those conclusions include:

- 12% of the borrowers interviewed were first time borrowers. The guarantee also enabled existing marginalized KCB clients to scale up their borrowings with improved collateral terms.
- KCB has continued to achieve growth in net loans and advances from USD 2.2 million in 2011 to USD 2.4 million in 2012. Most of this growth was in its corporate, SMEs, agriculture, micro-credit and construction sectors which are targeted sectors of the DCA guarantees.
- KCB moved to new sectors/ industries outside those targeted under the 2006 and 2010 DCA guarantees including: Education, Housing, Health, Information and Communications, Transport and Forest Wood. Overall 69% of the credit under 2006 DCA guarantee and 91% under the 2010 guarantee went to targeted sectors.
- The DCA guarantee helped facilitate economic additionality: 100% of the borrowers sampled by evaluation experienced growth in sales and profitability when compared with their position prior to the DCA loans from KCB. Employment in the sample enterprises went up by more than 50% after the DCA was enacted.
- The guarantee enabled KCB to target new kinds of SMEs: sole traders, small limited liability companies, farmers, micro-finance institutions, SACCOs, and Non-Governmental Organizations with a turnover of up to USD 57,500
- KCB expanded financial services to underserved clientele, especially women, under the Grace Loans scheme (later discontinued due to management issues leading to higher default rates); opened wholesale lending windows to Microfinance Institutions and Savings and Credit Cooperatives; and grew its trade and commerce and agriculture portfolio substantially. Under the 2006 DCA there were 167 loans to women equivalent to 15% of total loans, while under the 2010 DCA, there were 232 loans equivalent to 22% of the total loans.
- KCB also created a special window for MFI and SACCOs with loans of up to USD 230,000 repayable over 48 months.

OUTCOME LEVEL:

Conclusions: KCB has been exploring alternative ways of securing loans, including cash-flow based loans, stocks, log books, and chattels, all of which were traditionally unacceptable forms of collateral. Yet, KCB maintains their insistence on high collateral while their competitors move toward providing collateral free loans.

The bank allocated the majority of loans toward working capital and channeled very little to capital investment. The bank needs to fine-tune its loan processing to meet changing market practices and borrower expectations in Kenya. Failure to do so will see all gains from the DCA guarantee lost.

Findings in support of those conclusions include:

- The DCA guarantee enabled KCB to introduce alternative forms of collateral such as stocks, log books which was new to the bank, and which were not considered as suitable collateral in the lending policy of the bank.
- The bank has also evolved the KCB Microloans a level lower than SME, between USD 57-5700, with flexible repayment term of up to 12 months.
- As KCB improved lending conditions, more borrowers wanted to continue borrowing: 25% of those interviewed under 2006 DCA and 55% under the 2010 DCA guarantee were eager for additional loans.
- New financing approval rates improved after the DCA subject loan, going from 71% to 88% under 2006 DCA and from 71% to 76% under the 2010 DCA. DCA borrowers were also better able to secure loans from other institutions using their records from KCB.
- KCB still requires high collateral for SMEs while the competition has moved to providing collateral-free loans; the bank needs to change its process to make the progress made under DCA sustainable.
- The DCA guarantee enabled the bank to improve loan tenor from less than a year to 48 months.
- There was a 199% increase in monthly salaries paid under the 2006 guarantee while those funded under the 2010 guarantee saw a 178% increase.
- Over 80% of those interviewed agreed that the loans given under the DCA guarantee made a difference in their lives. 25% under the 2006 guarantee and 55% under the 2010 guarantee indicated willingness to take another loan.

IMPACT LEVEL:

Summary: The loans issued under the DCA guarantees enabled borrowers to grow their businesses, businesses, and achieve some impressive positive social impacts (employment creation, new business creation, better education for children etc.). The DCA guarantees had a big demonstration effect on first time borrowers by giving them confidence to seek additional loans from KCB or outside banks. The guarantee ultimately demonstrated to KCB, and other banks in Kenya, that funding SMEs can be profitable business.

Findings in support of those conclusions include:

- Gross loans and advances in Kenya grew by 19.0% to USD 14.7 billion in June 2012 according to the Central Bank. Some of the critical economic sectors that received credit were Trade, Manufacturing, Hotels and Restaurants, Transport and Communication, Manufacturing and Agriculture sectors also targeted under the DCA guarantees.
- Respondents recorded a change in the quality of life: better houses, better schools. Under the 2006 DCA guarantee borrower savings rose by 37% while under the 2010 DCA it rose by 48%, college enrollment went up from 29% to 35% for DCA 2006 borrowers and from 3% to 27% for 2010 DCA borrowers.
- Apart from the DCA Guarantee, the Financial Sector Deepening Program has partnered with a number of Kenyan banks (ABC Bank, Chase Bank and NIC Bank) to develop and grow the use of supply chain finance products tailored for SMEs.

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