



Exploring Opportunities to Increase Credit Supply to Micro, Small and Medium Enterprises

Executive Summary

Navigating beyond the devastating impact of covid-19 is anchored on the growth trajectory of Micro, Small and Medium Enterprises (MSMEs). Kenya National Bureau of Statistics (KNBS) estimates that over 7.4 million SMEs operate in Kenya, employ more than 15 million people and contributing about 30 percent to the national value-added; thus, validating their role as an “engine for growth.” Despite their significant role in the economy, the growth of these enterprises remains choked in part by constrained credit utilization and informality in their operations. To this end, several MSMEs policies have been implemented to spur growth in this segment; however, the traditional brick and mortar models have exposed gaps and inconsistencies in the implementation of policy interventions. Thus, to reignite credit utilization in the MSME sector, there is a need to adjust the policy framework/approach to support the long term growth and sustainability of MSMEs. In this regard, understanding the drivers of MSMEs credit utilization would be critical in identifying mitigations that can be deployed.

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1. Context and Importance

The government of Kenya has adopted interventions over the past years to support the growth and development of MSMEs. As a result, with a total of eleven (11) MSMEs policies, Kenya is ranked 3rd in Africa, just behind South Africa and Nigeria, which, respectively, have sixteen (16) and Twelve (12) policies focusing on supporting MSMEs.

Box 1: IMPLEMENTED MSMEs POLICIES

Creating an Enabling environment

- Micro and Small Enterprise Act of 2012.
- Office of the Registrar of micro and small enterprise associations.
- Micro and Small Enterprise Authority.
- A tribunal (for conflict resolution)

Increase market access

- The Access to Government Procurement Opportunities (AGPO) programme

Use of funds to ease access to credit

- Youth Enterprise Development Fund
- Small and Medium Enterprise (SME) Fund
- Uwezo Fund
- Women Enterprise Fund

Operationalization of Credit Guarantee Scheme

- Public Finance Management (Credit guarantee) Regulations (2020) in place.
- KES. 3 billion credit Guarantee Fund to enable participating

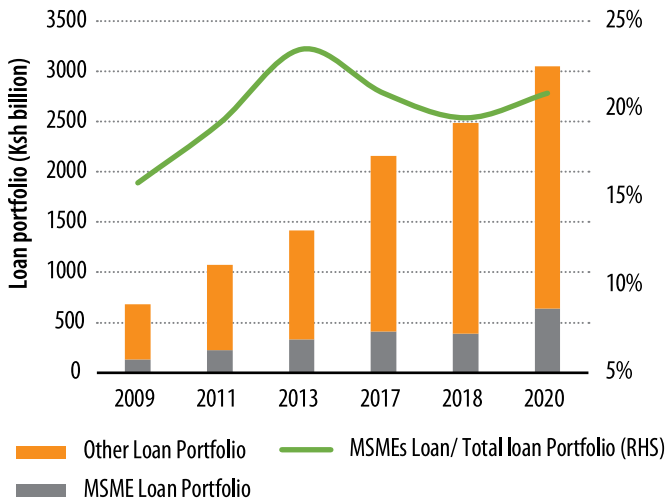
While the MSMEs policies are being implemented in Kenya – supporting the assumption that a majority of MSMEs’ credit accessibility and utilization constraints are being addressed, it may be worthwhile to also examine the MSMEs views, perceptions and preferences in the choices they consider to finance their operations.

The overall credit growth to the MSME sector remains constrained, albeit with some signs of growth. From a sectoral perspective, credit utilization among the enterprises is skewed (**Figure 1**). Enterprises in the trade, real estate, agriculture, transport and Communication, and building and construction are absorbing proportionally more credit from commercial and microfinance banks.

Considering the growing unemployment rate coupled with the slowdown in economic activity, unlocking the demand-side constraints to credit utilization by MSMEs has the potential of greasing the wheel of economy recovery.

Figure 1: Trends in MSMEs Credit portfolio

... Credit growth to the MSMEs sector remains suppressed



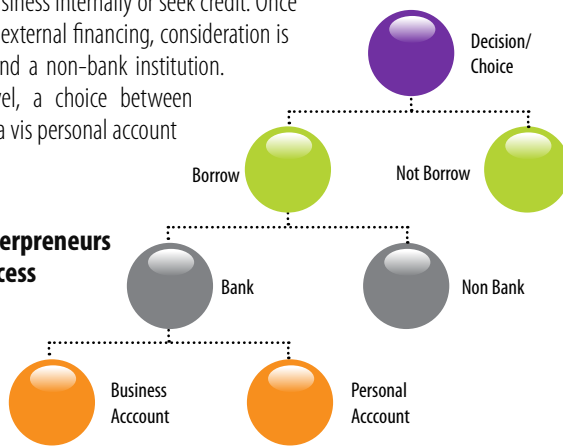
... Sectoral discrepancies on credit utilization by MSMEs

Sector	2019 (%)	2020 (%)
Trade	41.8%	52.1%
Real Estate	15.4%	10.5%
Agriculture	12.0%	9.1%
Transport and Communication	8.5%	10.0%
Finance Services	6.5%	3.9%
Building and Construction	6.4%	8.8%
Manufacturing	3.8%	2.7%
Energy and Water	3.0%	1.2%
Restaurant, Hotel and Tourism	2.4%	1.0%
Mining and Quarrying	0.7%	0.3%

2. Methods and Results

Facing varied financing choices, the entrepreneur decides on whether to finance the business internally or seek credit. Once the entrepreneur opts for external financing, consideration is made between a bank and a non-bank institution. Finally, at the bank level, a choice between utilization of business vis a vis personal account is made (Figure 2).

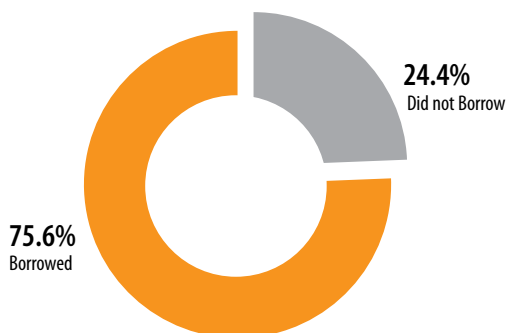
Figure 2: Entrepreneurs Decision Process



Using 279 responses from a survey conducted between May 7 – 21, 2021 by the Kenya Bankers Association (KBA) Centre for Research on Financial Markets and Policy®, the decision process by MSMEs owners in view of bank credit options was assessed. Results show that majority of the MSMEs shied away from external financing. Interestingly, among the 24.4 percent of enterprises that sought credit, high preference was on the utilization of bank credit (86.11 percent) where the use of personal loan accounts dominated (Figure 3).

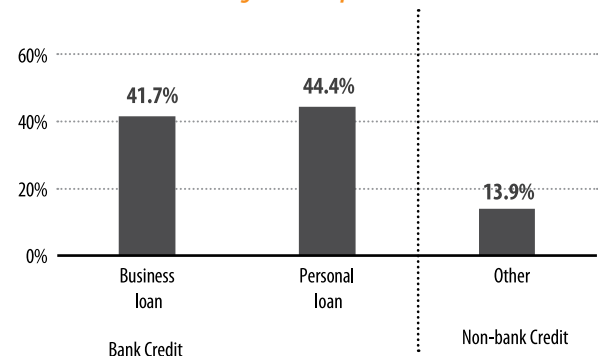
Figure 3: Entrepreneurs credit utilization landscape

3a: Internal versus external funding



...Majority of MSMEs shied away from credit

3b: Credit sources among the enterprises that take credit



...Personal loans highly preferred



While substantial programs undertaken to mainstream women in finance, gender gaps in favour of men in finance continue to persist, thus the need to explore stronger focus to mainstream women, through targeted/impact finance arrangements

It is established that credit choices and consequently the utilization of business and personal loan accounts is mainly driven by:

- The level of MSMEs monthly turnover which influence their choice to borrow, who to borrow from and the type of loan to pursue from a bank. Enterprises with turnovers in excess of Ksh 500,000 have preference for obtaining bank loans using their personal accounts.
- The age of enterprise as it weighed on the choice between a bank and non-bank loan.
- Disparity along sectors that the enterprises operate. For instance, the enterprises in the ICT sector show stronger preferences to utilize business loan accounts over the rest of the enterprises.
- Gender related constraints as female-owned enterprises have less preferences for use of business loan accounts.
- Registration status of the MSMEs. Registered enterprises are inclined to utilizing business loan accounts.

3. Policy Recommendations

The policy recommendations drawn and targeted at supporting the ongoing improvements on the business environment include:

- i) **Broaden the options available to MSMEs to pledge as collateral:** The definition of assets that qualify to be used as collateral has to be broadened to encompass the peculiar nature of MSMEs business. For instance, consideration needs to be made on having the MSMEs turnover level used as a pledge against acquiring credit from a banking institution.

ii) **Promote long-term view of businesses among the MSMEs:**

In a bid to attract long-term funders to the enterprises, the MSMEs need to have good entrepreneurial culture that will help them develop a long-term view of their businesses. It has been established that on average Kenyan establishments have an average age of 3.8 years at closure with about 80 percent of them shutting down before their fifth year of operation. The need for MSMEs to mainstream structures that facilitate their long-term existence need to be explored.

iii) **Deploy peer-based learning models among the MSMEs:**

To benefit from enterprises in specific sectors (such as ICT) that have stronger preferences (ability) to utilize business loan accounts, there is need to explore opportunities for peer learning among enterprises across sectors. Such could include organizing MSMEs networking and empowerment programs.

iv) **Scale up women outreach initiatives:** While substantial programs undertaken to mainstream women in finance, gender gaps in favour of men in finance continue to persist, thus the need to explore stronger focus to mainstream women, through targeted/impact finance arrangements.

v) **Incentivize more enterprises to get registered:** Unregistered enterprises are characterized by low productivity, inferior quality products and services and poor wages. Registered entities also have the power and legal basis to contract fruitful collaborations/partnerships with other formal institutions.

References

Mulindi H., Kiplangat J. Tiriongo S., 2022. *What Drives MSME's Credit Choices? Business Versus Personal Loan Account Utilization in Kenya*. KBA Working Paper Series (WPS/01/2022).



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