INTEREST RATE CEILINGS AND THE OPERATIONS OF MICROFINANCE INSTITUTIONS IN KENYA

A CASE STUDY OF KENYA WOMEN FINANCE TRUST

BY

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DECLARATION

I **Sabilah Kimtai Moses** declare that this research report is my original work and has never been submitted for any academic award. Where the work of others has been cited acknowledgements have been made.

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APPROVAL

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CHAPTER ONE

1.0 Introduction

The aim of this research is to investigate the effects of interest rates ceiling on the operations of micro finance institutions in Kenya a case study of Kenya Women Finance Trust. Microfinance institutions have continued to charge high interest rates on loan even after government intervention in setting interest rates ceilings. This prompted research is to investigate factors contributing to the situation and how it can be corrected.

1.1 Background to the Study

The (UN Secretary General, (News journal, 2003) once said, "The stalk reality is that most people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector".

Interest rate ceilings are found in many countries throughout the world. With the expansion of microfinance in developing countries, many legislators and the general public have found it difficult to accept that small loans to poor people generally cost more than normal commercial bank rates. Though meant to protect consumers, interest rate ceilings almost always hurt the poor, (Glen, 1991).

Many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often also face political or cultural pressure to keep interest rates low. Despite good intentions, interest rate ceilings generally hurt the poor by making it hard for new microfinance institutions (MFIs) to emerge and existing ones to stay in business, (Glen, 1991).

In countries with interest rate caps, MRs often withdraw from the market, grow more slowly, become less transparent about total loan costs, and/or reduce their work in rural and other costly markets. By forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have no or little protection, (Santomero, 2003).

To address the challenges that exclude people from full participation in the financial sector, micro finance institutions have to be developed to address the imbalance between the financial well doing individuals and financially crippled individuals.

The high interest rates charged by many microfinance institutions (MFIs) have attracted the attention of policy makers throughout the world. Several concerns have been raised as to why institutions that are set out to help the poor charge such high rates? How can governments support this practice from a political perspective? Should poor people have to pay for inefficiencies that result in high MFIs costs? How can customers be best protected from predatory lenders, where they exist?

Historically, governments use mandatory interest rate ceilings to address these kinds of concerns. Currently, about 40 developing and transitional countries have interest rate ceilings of some kind. Unfortunately, this often hurts rather than protects the most vulnerable by shrinking poor people's access to financial services. Interest rate ceilings make it difficult or impossible for formal and semi-formal micro lenders to cover their costs, driving them out of the market or keeping them from entering in the first place, (Mishkin, 1996)

Poor clients are either left with no access to financial services or must revert to informal credit markets (such as local moneylenders), which are even more expensive. Ceilings can also lead to less transparency about the costs of credit, as lenders cope with interest rate caps by adding confusing fees to their services.

Modem microfinance emerged in the form of small-scale micro-credit facilities for poor households in Bangladesh. Professor Muhammad Yunus pioneered these efforts. The impressive results that he and his team achieved led to the establishment of the now well-known Grameen Bank which provides financial services on a national scale.

Honoring Professor Yunus with the Nobel Peace Prize in 2006 for his pioneering work in the area of microfinance also signifies the importance of microfinance in promoting peace and prosperity around the world,(Chuck, 2008)

The objective of any Microfinance institutions MFIs is bound towards socially responsible reasons. But the long term viability of a microfinance program depends on various factors such as legal, financial and operational feasibility, (Jaffee & Dwight 2001).

Thus, after the government of Kenya introduced an interest rate ceiling of I8°Io, Kenya Women Finance Trust reduced their work in the rural areas and became more segmented because it could not cover its operating costs. The poor have to pay for inefficiencies that result into high micro finance institutions costs, and this has turned the institutions into predatory lenders. Women Lawyers, Bankers, Financial Experts, Entrepreneurs, Managers and Trainers got together in 1981. Their vision was to set up a financial Institution devoted to addressing solely financial needs of women. In fact, their specific objective was to set up a woman serving, woman led bank.

These women of great resolve contributed Kshs. 2,000 (US$25) for those who had better income and called themselves "Founder Members". Those who had moderate incomes contributed Kshs. 500 (US$6.25) and were labeled "Associate Members".

There was yet another category of ordinary members who paid Kshs. 250 (US$3.125). Instead of a bank, they established a "Trust" because of the challenges posed by the banking regulations and requirements.

KWFT has come a long way to be what it is today: a Kenyan success story. The Institution — Kenya Women Finance Trust Limited is unique in Kenya. It is the largest and only micro-finance Institution exclusively for women. It is built on the belief that women can transform their lives, those of their families and the way the world works through entrepreneurship. Kenya Women Finance Trust has grown from small beginnings in 1981 into an Institution with 100,000 members from seven of Kenya's eight provinces.

The Institution had achieved overall sustainability by March 2002. Since then, the Institution has continued to consolidate its break-even status and to post profits that are ploughed back into the Program to grow the portfolio.

In its early days, KWFT depended substantially on donor grants to finance both lending funds anti administrative expenses. Since 1994, KWFT began borrowing from other NGOs and the financial sector for incremental capital. By March 2003, 60% of the outstanding portfolio was financed by funds borrowed from commercial sources locally and internationally. The Ford Foundation as a social investor was the first in this category to support scaling up strategies for KWFT through a US$3 Million loan under the Program Related Investment Facility, (http//www.kenya women finance trust.com)

1.2 Statement of the Problem

The increasing borrowing patterns by individuals, the high interest rates being charged by microfinance institutions (MFI5) have attracted the attention of policy makers throughout the world. Several concerns have been raised as to why institutions that are bound to help the poor, charge such high rates and investigate the reasons.

Microfinance institutions are made to assist the less fortunate and therefore these interest rates should be favorable to them, which is not the case here. This therefore was a good reason enough to instigate the researcher to conduct the study.

The study is to investigate how interest rate ceilings affect the operations of Microfinance Institutions (MFIs) in Kenya and perhaps formulate the way forward to establish the ideal situation for both the customers and the institutions in question.

1.3 General Objective

Pie main objective is to investigate the effect of interest rate ceilings on the operations of Micro-finance Institutions in Kenya.

1.3.1 Specific Objectives

a) To establish how interest rate ceiling influence the loan portfolio in micro- finance institutions in Kenya.

(b) To determine how interest rate ceiling protect borrowers from exploitation by micro-finance practitioners in Kenya.

(c) To examine how interest rate ceilings affects the growth of microfinance institutions in Kenya.

1.4 Research Questions

(a) How does the interest rate ceiling influence loan portfolio of micro-finance

(b) How does interest rate ceiling protect borrowers from exploitation by micro-finance institutions?

(c) How do interest rate ceilings affect the growth of microfinance institutions in Kenya?

1.5 Scope of the scope

1.5.1 Content scope

The study looked at the interest rate ceilings and the operation of microfinance institutions in Kenya.

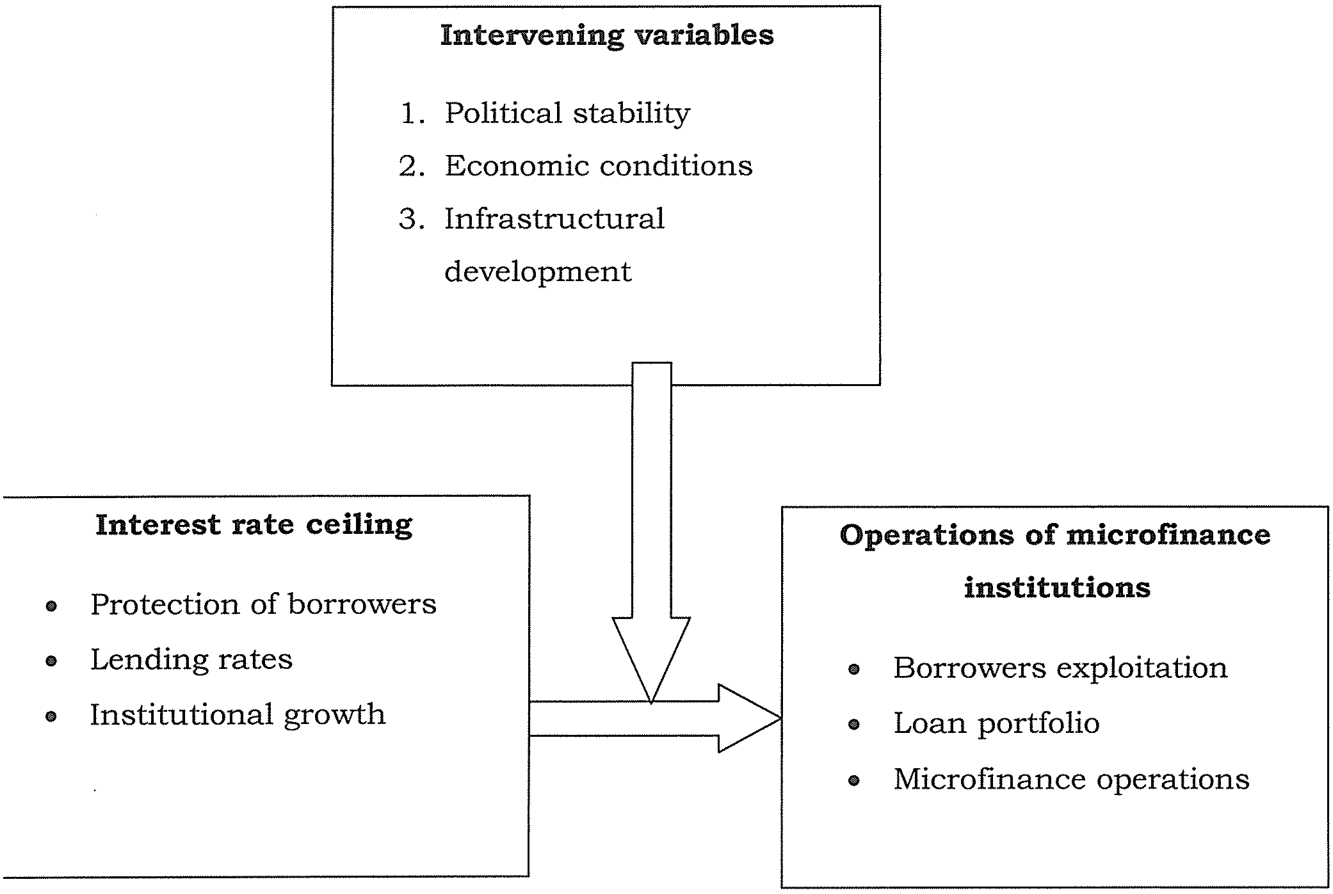
1.5.2 Geographical study

The study was carried out at Kenya Women Finance Trust (KWFT) head offices along Ngong road in Nairobi.

1.5.3 Time frame

The study covered a period of three months that is from March- June 2011.

1.6 Conceptual framework



The independent variables in this study are the interest ceilings while the dependent variable is the operations of microfinance institutions. These among others include; debt financing, loan recovery, expansions etc.

CHAPTER TWO: LITERATURE REVIEW

2.0 Introduction

This chapter gives reference to what other scholars have written concerning interest rates ceilings and their impact on the performance of Microfinance Institutions. The literature review in my study concerns the interest rates ceilings and performance of the micro finance institutions with an emphasis on MFI's in Kenya. The literature review has helped the researcher to document what other researchers have done and to identify the knowledge gap. The material used in the review includes magazines and journals on micro finance and micro finance related websites over the internet.

2.1 Review of Related Literature

Modern microfinance emerged in the form of small-scale micro-credit facilities for poor households in Bangladesh. Professor Muhammad Yunus pioneered these efforts. The impressive results that he and his team achieved led to the establishment of the now well-known Grameen Bank which provides financial services on a national scale. Honoring Professor Yunus with the Nobel Peace Prize in 2006 for his pioneering work in the area of microfinance also signifies the importance of microfinance in promoting peace and prosperity around the world.

2.1.1 Overview of the Market for Micro Finance in Kenya

There is no way to separate the supply side from the demand side of the industry, they must be looked together. The demand functions can change as consumers become more sophisticated in the use of credit and as they understand the costs associated with borrowing or the benefits deriving from borrowing. The supply function can also evolve as the industry grows, becomes more sophisticated, develop new tools to lower costs 4ociated with the risk, and develops new systems to lower administration costs and developing new ways of doing business, Santomero,(2003).

In developing new systems and new ways of doing business, a wide range of firms have developed over the past 8 years to supply micro loans to the population of Kenya. The table breaks out the formal lenders by the legal category as they are registered by Microfinance Association of Kenya. Why this massive demand for credit? In Kenyan context access to financial credit is a rare commodity for the majority. A combination of factors including the formal banking industry shift away from the low income market, a growing gap between real income and inflation, increasing unemployment and irresponsible lending has fuelled demand and led to the growth of alternative financial service providers most noticeably money lenders. “Since many Kenyans do not have access to the financial services offered by the sophisticated banking sector these institutions are instrumental in catering for various social and financial demand of the broader community, (Goldfield, 2000).

2.2 Interest Rate Ceilings Protect Borrowers from Exploitation

Many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often also face political or cultural pressure to keep interest rates low. Despite good intentions, interest rate ceilings generally hurt the poor by making it hard for new microfinance Institutions (MFIs) to emerge and existing ones to stay in business. In countries with interest rate caps, MFIs often withdraw from the market, grow more slowly, become less transparent about total loan costs, and/or reduce their work in rural and other costly markets. By forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have no or little protection. (Malkiel, 2006).

Microfinance institutions (MFI5) influenced by interest rate ceilings have tried to cover their costs by imposing new charges and fees (Mahajan; 1996). Customers do not always clearly understand that these fees are part of the loan cost. Even when enforcement is weak, or when de facto interest rate ceilings exists due to subsidized lending, financial institutions often try to give the impression of compliance by charging an interest rate in line with the ceiling, but then adding fees and commission. Hence this lack of transparency hurts the poor by undermining their ability to comparison shop for loans, (Santomero, 2003).

Even in cases where there are clear rules for calculation of the interest rate, and where the total costs of loans are included, authorities may find it difficult to design interest rate ceilings for other reasons. They vary widely by term (l month, 4months, 6months, and l2months) and repayment structure (daily, weekly, and monthly). “By altering just one of these variables, the effective interest rate on a loan product changes, creating an enormous variety of interest rates according to products” (Harper, 1998).This makes it difficult to compare credit products on price alone and even harder to ensure transparency regardless of whether interest rate ceiling exists.

2.2.1 Alternatives to Protect Customers

High interest rates on lending by financial institutions in the country have made credit accessibility almost impossible to the poor and effectively negated on poverty alleviation. To protect consumers from predatory lending, governments may pass consumer protection laws or schemes (Cordell & David 2001).

Such strategies provide a desirable safeguard without the negative effects of interest rate ceilings. Consumer protection laws generally cover a set of non-prudential regulations, including mandatory disclosure on total loan costs; clearly defined complaint resolution procedures; consumer education to prevent abuse; and effective enforcement mechanisms. (Malkiel, 2006).

Public disclosure of loan costs allows borrowers to comparison-shop for loans, stimulates competition among lenders, and compels them to become more efficient to stay in business. MI MFIs should be able and willing to disclose their interest and fee costs to customers. Although disclosure is generally beneficial, it is not devoid of risk because it may draw political backlash due to the relatively high interest rates in microfinance.

Disclosure is required in most developed countries as well as in some South American countries, such as Peru, Bolivia, and Colombia. In South Africa, the government has mandated the Micro Finance Regulatory Council (MFRC) to protect consumers and regulate microfinance institutions. The MFRC requires full disclosure of loan costs, offers a consumer complaint process, and runs consumer education campaigns on micro lending (Cordell & David 2001).

While microcredit interest rates are nearly higher than commercial bank rates, great efficiency, scale, and competition can lead to lower interest rates. In Bolivia, Bancosol's effective interest rate (interest + fees) was 65% per year when it began operations in 1992 with 4,500 clients. Today, in a highly competitive market and with 55,000 clients, its annual interest rate is 2201o. In Cambodia, its relatively new but highly competitive microfinance market, interest rates have dropped from around 501o to 3.5°Io per month over the past few years. In some provinces where MFIs are particularly active, moneylenders have dropped their rates to match those of the Mrs. (Karaken & John 2007).

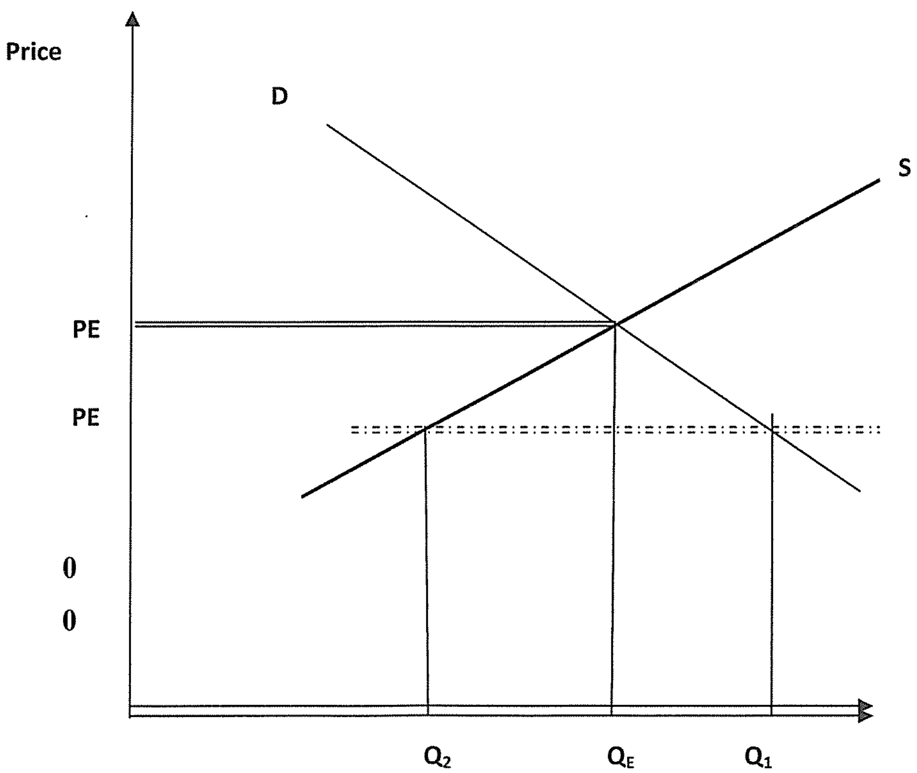
2.3 Effects of Interest Rate Ceilings on Loan Provision

When the government regulates the working of the market, supply and demand cannot interact freely to find the equilibrium quantity and price. When there is an artificial ceiling the allocation of resources is distorted if the equilibrium price is above the ceiling. The consequence is people who want finance, but due to their circumstances does not qualify at the ceiling interest rate are denied access, (Jaffee & Dwight, 2001).

As this large segment of the market cannot access funds in the formal economy they have to resort to the informal economy. By limiting the interest rate chargeable the government may force many actors in this sector underground. The Micro finance banking Act ignores the fact that the reasons high interest rates are charged is that they are uneconomical to service at low interest rates, (Macaulay Fredrick, 2OO3)

By placing a ceiling on the interest rate, but not providing an alternative means of finance, the government effectively excludes the people they were trying to protect. This is clearly shown in the diagram below

Figure l: Effect of Ceiling on Interest Rate



Some interests are not allowed to rise above P1, there are no incentives to expand the quantity of loans offered and this will create a shortage. "Some suppliers may in fact leave the market altogether so that with the supply curve shifting inwards, the shortage will become even more acute", (Santomero, 2003). Basically the cap will encourage people to consume more of the service than if the market price were changed.

2.3.1 The Effects of Interest Rate Ceilings on Credit Supply

Lenders cannot afford to cross subsidized high risk borrowers without risking their competitive position. In markets without price controls specialist lenders meet demand for small sum credit, typically provided at high cost to high risk borrowers, (Karaken & John, 2007).

Such lending models do not develop or lenders withdraw in markets where price controls are introduced. The impact of price controls is evident in both the diversity of credit products offered in a market and in the extent of credit rationing.

Where ceilings are effective in containing price, lenders withdraw from markets where they cannot lend profitably. Lenders in these markets also set minimum lending levels higher than is appropriate to the needs of low income households and high risk borrowers, (Grove, 2004).

The constrained credit product mix in price capped markets leads borrowers to use products which are less suited to their needs and expose them to greater risk. Where ceilings are imposed those without options are diverted to pawn — and illegal's — while others are primarily diverted to mainstream revolving credit. Illegal lending tends to arise in a credit vacuum and is frequently associated with other criminal activity and is both very high cost and damaging to victims. These effects are readily observed in markets with and without ceilings, as are the differences in outcomes for consumers, (Flannery, 2001).

2.3.2 Critique to Interest Rate Ceilings

Some evidence appears to suggest that a rate ceiling will not necessarily reduce the cost of credit for low income borrowers. There is indeed a strong risk that some borrowers under uneven payment conditions will pay more for credit. A rate ceiling would appear unlikely also to prevent over-indebtedness. It is more likely to increase the indebtedness of low income borrowers and to simply shift more debt into revolving credit vehicles being repaid over extended terms, (Goldfield, 2000).

It would appear likely that credit exclusion will result from the imposition of a ceiling and that the consequences will include significant hardship for excluded households who will no longer be able to access small sum cash credit to manage cash emergencies or peaks of expenditure or to enable them to spread the cost of major purchases, (Cordell & David 2001).

Other borrowers now using high cost credit will be diverted to revolving credit, with cash advances likely to become a higher proportion of credit card use. This will likely result in increased delinquency and default and to low income individuals being at greater risk of financial breakdown and insolvency.

As a consequence, more individuals will acquire adverse credit history and find they are unable to obtain credit, increasing the hardship and exclusion earlier effects referred to. There is also a significant risk of creating the conditions for unlicensed lenders to enter the market a development likely to be highly damaging for borrowers and likely to greatly increase the cost of credit for borrowers unable to obtain credit legitimately, (Grove, 2004).

In the event that a rate ceiling is imposed, it would seem likely that there will be a significant need for alternative social lending. The experience of other countries who have pursued this route is that establishing a social lending operation is highly challenging, slow to establish and scale and, for most governments, prohibitively expensive, (Santomero, 2003).

The better way forward in protecting vulnerable consumers would appear to be a greater focus on ensuring best practice in consumer lending, eliminating unfair and exploitative practices and achieving greater transparency on pricing, terms and conditions. The most effective way to reduce prices for low income borrowers may be to foster an environment which stimulates competition (Gramley, 2004).

2.4 Challenges Encountered in Contraction of the Micro Finance Institutions

One of the biggest challenges is to further improve the enabling policy environment. For example, interest rate caps on small loans by banks remain a major issue in a number of countries, including India and the People's Republic of China, where the un-served and underserved market for financial services for the poor is still massive.

Many countries also continue to operate highly subsidized government microcredit programs through state-owned financial and non-financial institutions. These programs fail to adequately deliver financial services to the poor and undermine growth in commercial microfinance. Some countries have shown a tendency to introduce interest rate ceilings for microcredit, thus increasing policy risks and making the investment climate less attractive. Hence, while complex, the issues related to policy environment must be addressed, (Karaken & John, 2007).

The second biggest challenge is building adequate retail capacity to provide a broad range of services in demand among the poor. This is particularly true in countries such as India and the People's Republic of China where the un-served and underserved markets continue to be still very large. In China, massive efforts are necessary to establish retail institutions, reform the existing rural credit cooperatives and build the capacity of domestic banks to become dynamic players in the microfinance industry.

In India, the capacity of poorly performing self-help groups and many other retail institutions which continue to struggle to achieve efficiency and scale needs to be developed systematically. The current retail capacity limitations in many states of India are putting tremendous pressure on a small group of core microfinance institutions to overstretch geographically. Many relatively smaller countries also have to address the issue of inadequate retail capacity, (Malkiel, 2006).

Another challenge is the need for microfinance institutions to significantly reduce the transaction costs of providing a broad range of services. Some poor people are unable to access formal financial services due to high costs. If the industry is to deepen its services to reach the poorer potential clients and those in remote locations that it has not been able to reach on a significant scale to-date, transaction cost reduction is essential.

Transaction costs result in a wedge between the prices clients pay and the returns that service providers receive. Reducing transaction costs will therefore have a positive impact on both the supply and the demand for services, creating a win-win situation for all. My prediction is that the next revolution in modern microfinance will be brought about by a series of process innovations that will significantly reduce transaction costs and significantly expand the currently limited scope of services, (Grove, 2004).

High interest rates on lending by financial institutions in the country have made credit accessibility almost impossible to the poor and effectively negated on poverty alleviation.

There is need for financial the institutions to strike a balance on borrowing and saving interest rates.

The financial institutions including central banks should stop giving minimal profits to the savings. They should instead balance the (ending and the saving rates to assist the poor to come out of poverty. According to (Ngasongwa.2009), it was not fair for banks to have interests on credit facilities, ranging between 19 percent, to 25 per cent when savings rates were far below 5 per cent. He observed that the anomaly was unrealistic. In this sense, how do you assist the poor to come out of poverty? This is very bad because it is discouraging savings," he lamented.

Governments' world over want people to save more in order to access credit for development, so if the interest rates are high, nobody will be wilting to get a loan or even save. As a result many will hoard money in their homes. This will negatively impact on currency.

CHAPTER THREE: METHODOLOGY

3.0 Introduction

This chapter presents the methods that was used to conduct the study .It includes the research design, area of study procedure of data collection, type of data collection method and data analysis. It also outlines the limitations of the study.

3.1 Research Design.

The study adopted a case study design that is a descriptive analysis of a single entity, the bounded case. This approach enabled the researcher understand phenomenon in its entity, therefore qualitative and quantitative method was utilized to grasp data on process and reasons for the particular outcomes which is both useful for providing adequate information on the study.

3.2: Research Population.

The research population comprised of full time employees of KWFT. The company employs a population of aver 1000 people all of whom are workers of KWFT.

3.3 Sample size

The researcher took a sample size of 50 people using simple random sampling method. 20 of the respondents were interviewed for the study, 30 responded through questionnaire.

3.4: Sampling Procedure.

After deciding on the sample size, the researcher formulated a procedure of selecting the subject to be included in the sample. The goal of probability sampling is to select a reasonable number of subjects, objects or cases that represented the target population. This provided the researcher with accurate information about groups that are too large to study in their entity. It provided the researcher with an efficient system of capturing in a small group, the variations or heterogeneity that existed in the target population.

3.5 Data Collection methods.

Data collection refers to the gathering of information to serve or prove some facts. The researcher had a clear vision of the instruments to be used by the respondents and the selected area. The procedure to be used to collect data was influenced by the research instruments to be used. For example, Questionnaires, interviewing, sampling, reviewing the related literature and data analysis.

(a) The questionnaire.

The semi structured questionnaire was the main instrument of the study that was administered to the staff Dyer and Blair investment Bank (Uganda) Limited. The questionnaire was designed according to Likert scale so as to explore key variables of factors affecting public relations and crisis management. The researcher preferred to use this method because of its ability to solicit information from several respondents within a short time as supported by Gupta (1999). The respondents were given time to consult records for sensitive questions and truthfully answered (Proctor 1997).

(b) Interview guide.

The researcher also used interview guide as an instrument of data collection. An interview guide helped the researcher more in getting appropriate information or data from the respondents.

(c) Observation.

The choice of strategy was to derive the benefits of producing the data based on the real world observation; this was possible in accordance with the way in which the researcher did not get the idea of carrying out the research in this particular.

3.6 Data analysis

After data was collected from the field, it was analyzed both quantitatively and statistically in order to describe results properly in a smart manner. Data was analyzed using Microsoft Excel program and thereafter presented in tables, pie chart and graphs in order to facilitate proper interpretation.

CHAPTER FOUR

4.0 DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Overview

After administering the questionnaires to the respondents the analysis was conducted based on the gender and relationship with the institution in question that is male and female as well as whether they are customers or employees. The researcher used two sets of questionnaires one for employees and the other for customers of KWFT.

The questionnaires were divided into two sections. The first sections entail the details of the respondents while the second entails the relationship and the involvement with KWFT operations. For the presentation of the data analyzed tables and pie charts were used.

4.2 Presentation of findings

4.2.1 Analysis of customers' Questionnaires

4.2.2 Gender

Table 4.1 gender of customers

Gender	Number of respondents	Percentage (%)
Male	12	30
Female	28	70
Total	40	100

The researcher administered questionnaire to 40 respondents where twelve were male and 28 were female. KWFT targets women as their customers hence more female were interviewed. This is represented by the table above.

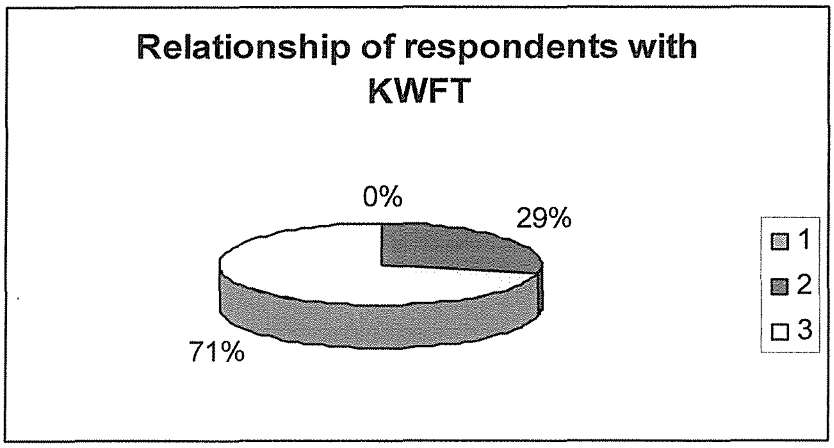
4.2.3 Education level

Table 4.2 Education levels for Customers

Level of education	Number of respondents	Percentage (%)
Primary	5	12.5
Secondary	15	37.5
Tertiary	20	50
Total	40	100

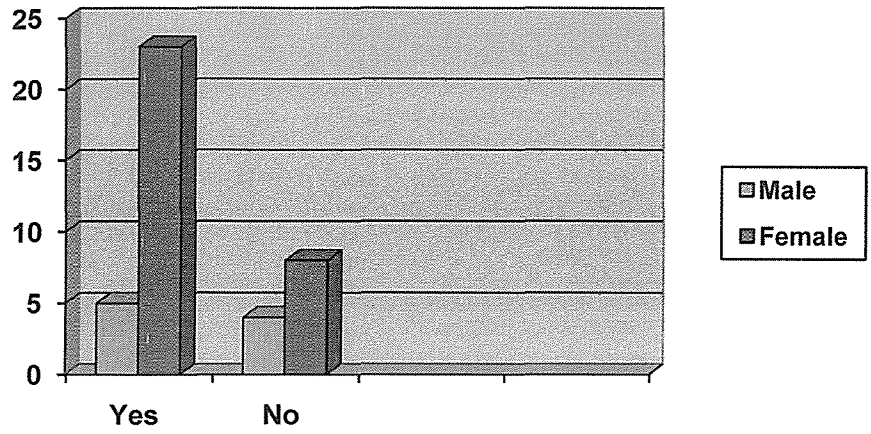
The table above represents the education level for the customers where majority of them were found have education, where tertiary comprises of diploma, degree and postgraduate studies.

Figure 4.1 Relationships of customers with KWFT



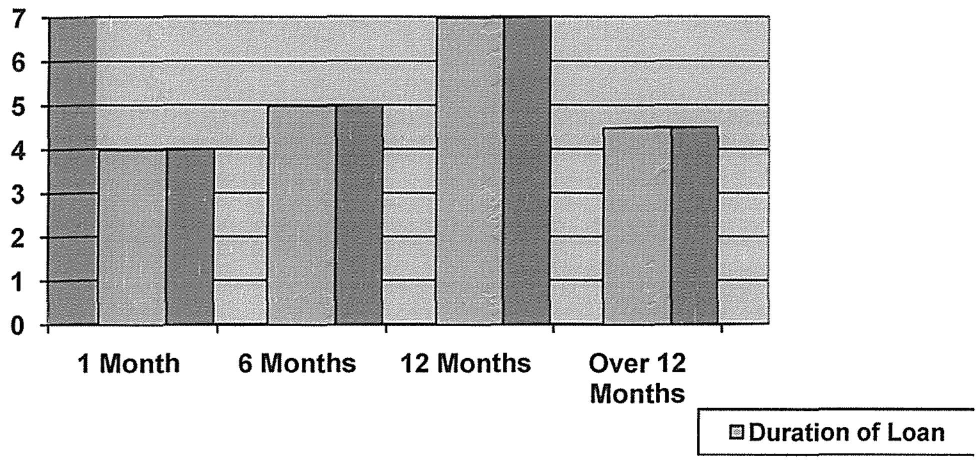
The figure above represents the relationship of respondents with KWFT where 16 out of the 40 respondents were customers who operated accounts for saving purposes, 8 of the respondents were borrowers who operated loan accounts and 16 of the respondents were both customers and borrowers.

Figure 4.2 Use of loans as a source of finance by customers



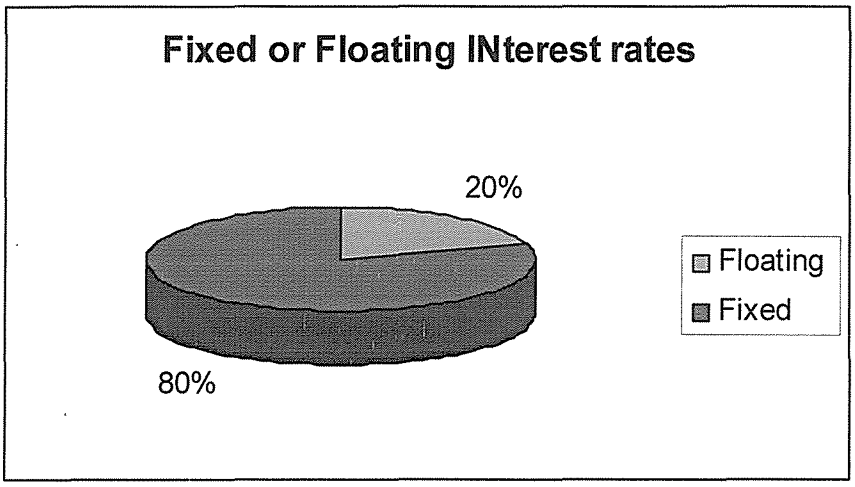
The broad objective of KWFT is to access financial and non-financial services to women with small and micro enterprises to enable them develop their businesses, increase income and generate employment. In this research 28 respondents used loans to finance their business while 12 respondents used other sources of income to finance their business.

Figure 4.3 Duration of the Loan to customers



Due to the nature of loans such as the youth enterprise fund where this loan product is primarily he designed for youths customers who want to start their own business but do not have capital and who were previously unable to join the current KWFT lending schemes. Most of these loans are repayable within a period of 12months or 1year except individual loans which can have a repayment period of more than a year depending on the purpose of the loan.

Figure 4.4 Fixed or Floating interest rates

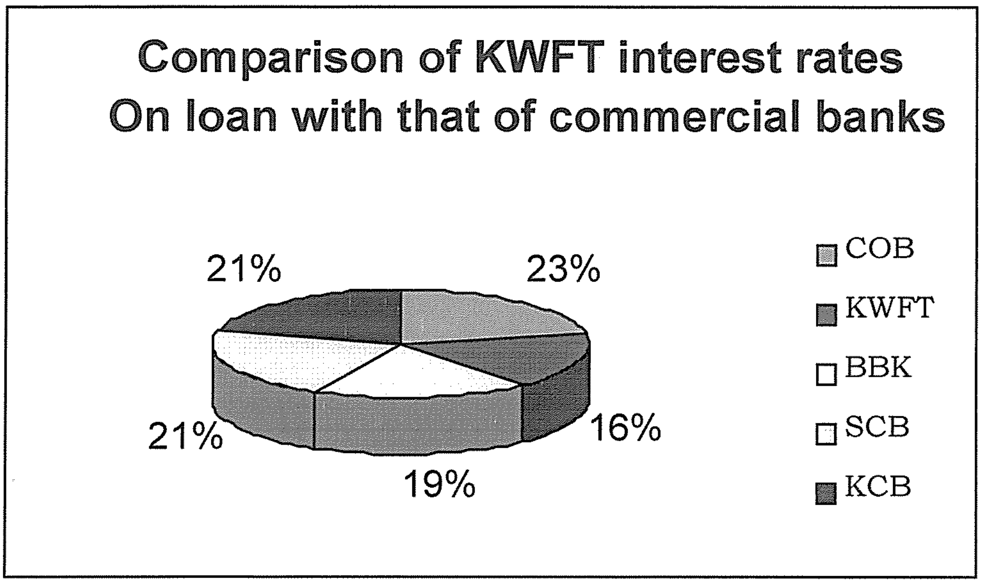


A fixed interest rate loan is a loan where the interest rate doesn't fluctuate during the fixed rate period of the loan. This allows the borrower to accurately predict their future payments. Ngasongwa, 2009. A floating interest rate, also known as available rate or adjustable rate, refers to any type of debt instrument, such as a loan, bond, mortgage, or credit that does not have a fixed rate of interest over the life of the instrument, (Ngasongwa, 2009). The floating interest loans are slightly higher than fixed interest loans which are 14.5% while the fixed interest rate is 12%. Out of the 40 respondents interviewed 32 of the respondents had their loans on fixed interest rate while 8 respondents had their loans on floating interest rates.

4.2.4 Fee charged when applying for loans

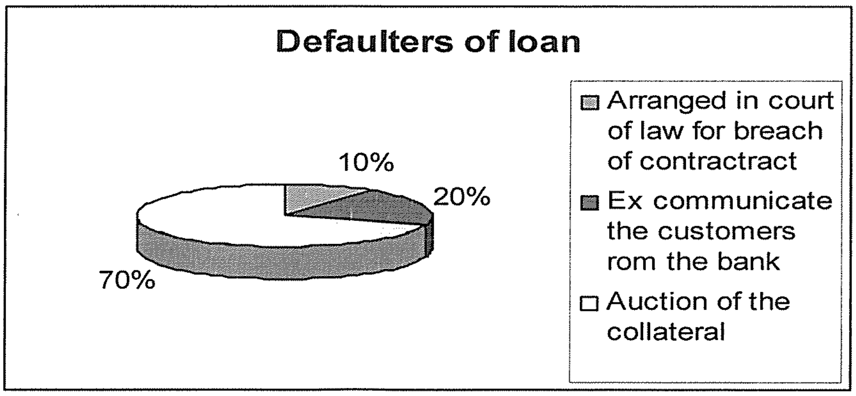
For any loan applied it attracts a negotiation fee of 3% of the loan amount. The negotiation fee is used to facilitate legal transactions and valuation of the collateral.

Figure 4.5 Comparison of interests rates on loan with that of commercial banks.



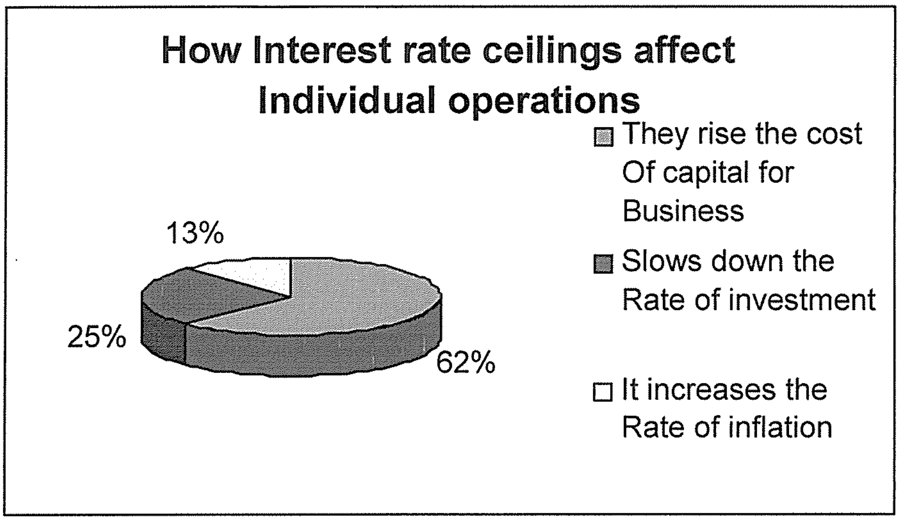
A commercial bank is a type of financial intermediary and a type of bank. Commercial banking is also known as business banking. It is a bank that provides checking accounts, savings accounts, and money market accounts and that accepts time deposits. Glen,1991. Since KWFT encourages serving low-income earners the interest rate is slightly lower than that of commercial banks so as to help and encourage more women to borrow.

Figure 4.6 Defaulters of loan



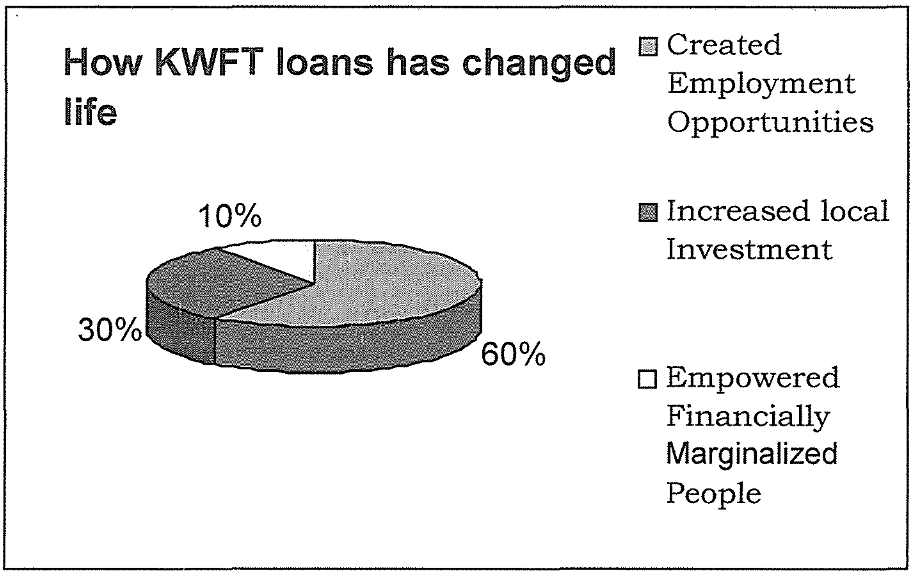
Defaulters of loan are the people who do not repay their loans as agreed with the bank. 28 out of 40 of the respondents interviewed indicated that the collateral will be auctioned, while 8 of the respondents indicated that they will be excommunicated from the banks and their accounts will be closed and 4 of the respondents indicated they will be arraigned in court for breach of contract for not repaying their loans.

Figure 4.7 How interest rate ceilings affect operations



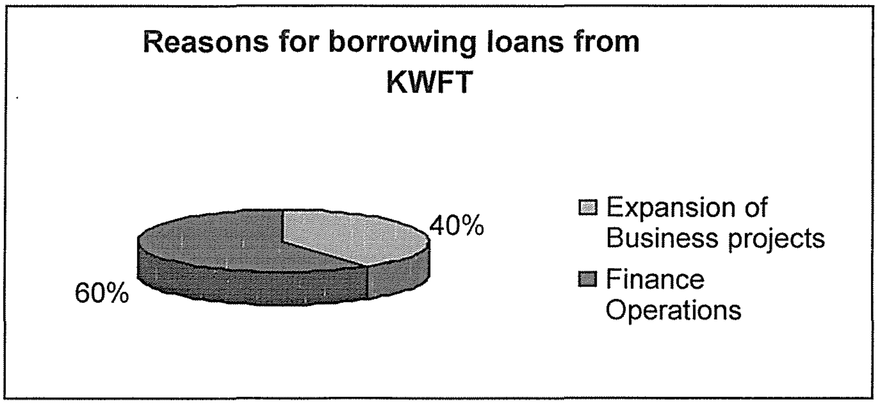
High interest rate ceilings negatively affect the customers. 10 out of 40 respondents indicated that high interest will slow down the rate of investment, while 5 out of the respondents indicated that rate of inflation will increase and 25 of the respondents indicated that the cost of capital will raise hence cost of operating business will be high.

Figure 4.8 How KWFT loans has changed life.



Since the establishment of KWFT its loans have really changed the life of the customers by creating employment opportunities as indicated by 24 out of 40 of the respondents interviewed, 12 of the respondents indicated that it increases indicated that the loans empowered financially marginalized people who are low income earners. A low income client is one who borrows less than KShs. 20,000 (US$250) and pays within a period of nine to twelve months (9-12months). This is a kind of a person who will survive on less than US$1 a day.

Figure 4.9 Reasons for borrowing loans from KWFT



Out of 40 correspondents 24 interviewed they borrow loans to finance their operations such as paying of school fees and emergencies such as hospital bills and fire at business premises, while 16 of the correspondents borrowed loans to expand their business projects through addition of working capital.

4.2.5 Analysis of employee's questionnaire

Table 4.3 Genders of employees

Gender	Number of respondents	Percentage (%)
Male	12	30
Female	28	70
Total	40	100

The researcher administered questionnaires to 40 respondents where twelve were male and 28 were female. KWFT targets women as their customers hence more female were interviewed.

Table 4.4 Educational level of employees

Level of education	Number of respondents	Percentages (%)
Secondary	15	37.5
Tertiary	25	62.5
Total	40	100

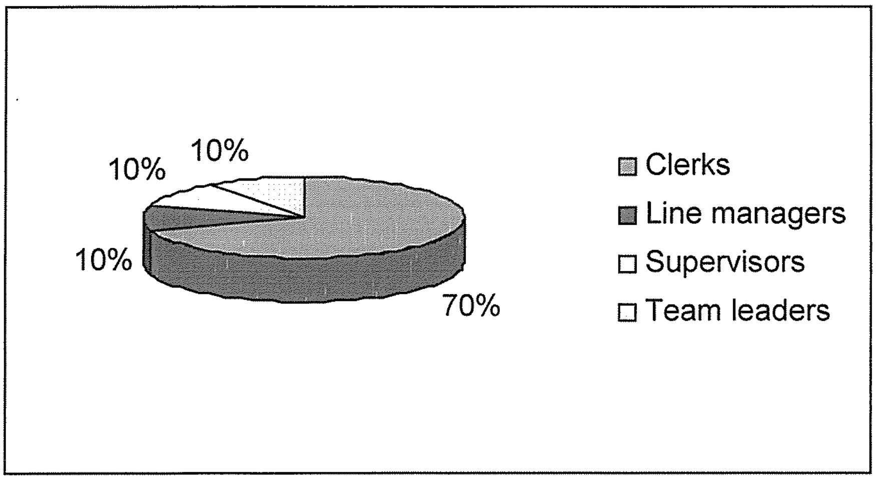
From the data provided in table above, the researcher wanted to find out the level of education of the respondents. It shows clearly that most of have attained tertiary level where tertiary comprises of diploma, degree and postgraduates levels.

Table 4.5 Working Duration of employees

Working duration	Number of respondents	Percentages (%)
Below 2 years	10	25
2-5 years	15	37.5
6-10 years	9	22.5
11-15 years	4	10
Above 15 years	2	5
Total	40	100

The data in above regards the working duration of the employees which have worked in the organization. It indicates that most f respondents have worked from 2 to 5 years followed by below 2 years and those who have worked for 15 years and above are few.

Figure 4.10 Respondent's position



From the pie graph above most of respondents were clerks of 28 out of 40 while 4 respondents were picked from each department. These department are marketing, planning, credit and financial.

Table 4.6 Distribution of respondents based on departments

Department	Number of respondents	Percentages (%)
Marketing	7	17.5
Planning	8	20
Credit	15	37.5
Finance	10	25
Total	40	100

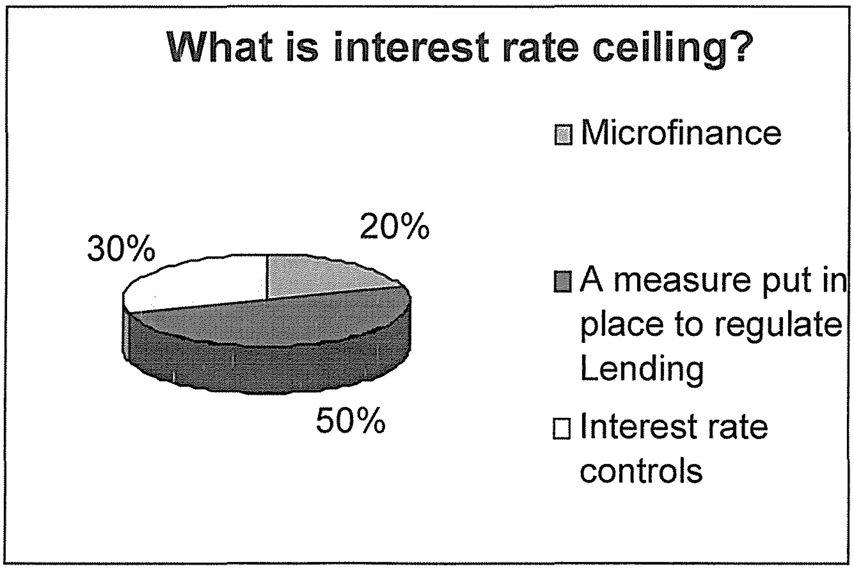
The researcher in table wanted to find out which department the respondents belonged to in the organization. It is clear that most respondents belonged to the credit department, followed by financial department, planning and marketing departments respectively. The credit department had many respondents since it deals mostly with loans to customers.

Table 4.7 factors that the organization consider when offering loans.

Factors to be considered	Number of respondents	Percentages (%)
Repayment period	5	12.5
Collateral	8	20
Purpose of the loan	5	12.5
Loan limit	12	30
Account turnover	10	25
Total	40	100

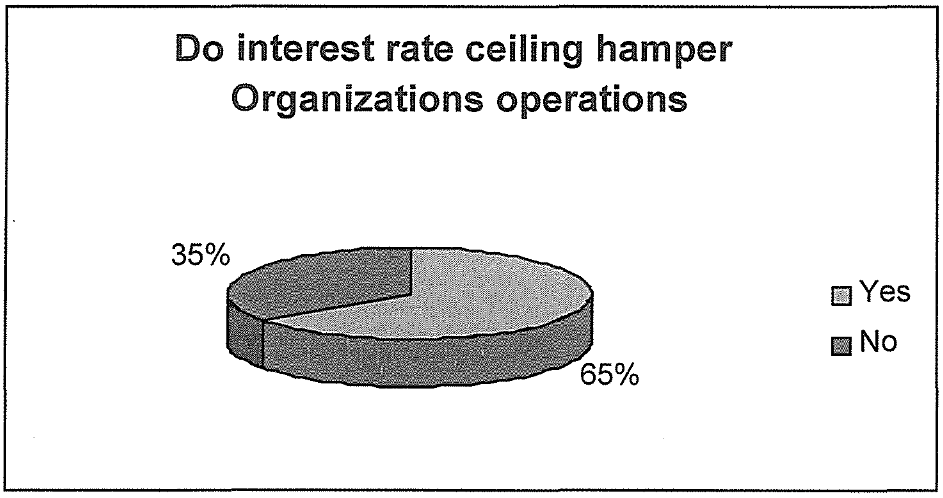
From the table above, it is clearly indicated that the loan limit plays an important role while determining the amount of loan to offer to customers. For individual loans the limit is Kshs 500,000 while for group the limit is Kshs 2million. The account turnover indicates how the account has been operating. Account should be operational for at least six months and active in terms of frequent deposits to the account. Micro finance institutions should take care of what factors to consider when offering credit facilitates to its customers so as to maintain the microfinance focus of helping the poor to get access to the financial world.

Figure 4.11 What is interest rate ceiling?



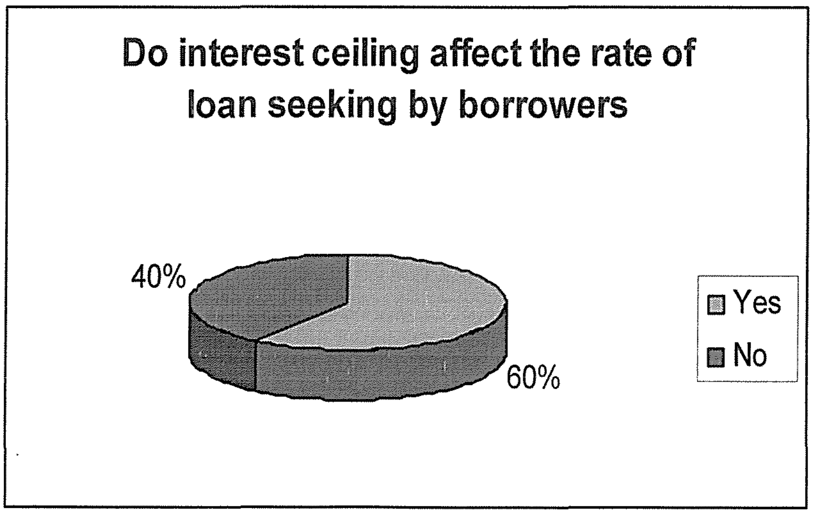
Out of the 40 questionnaires administered 20 respondents indicated that it is a measure put in place to regulate lending. Most of the employees were from the credit department.

Figure 4.12 Do interest rate ceiling hamper organizations operations.



From the data it's clear that interest rate ceilings were impacting on operations of MFI's. The central bank being the market regular should take into consideration and survey clearly the most influencing factor which was contributing to high charges by MFI's instead of relying on ceiling to offer the needed protection.

Figure 4.13 Do interest rate ceiling affect the rate of loans seeking by borrowers?



Interest ceilings will affect borrowers since their interest rates are mainly fixed and they borrow money for a period of more than a year. If there is no interest ceiling, interest rates can be increased hence discourage borrowers as indicated by 24 out of 40 of the respondents.

Table 4.8 Relationship between interest rate ceiling and microfinance

Relationship	Number of respondents	Percentages (%)
Positive	28	70
Negative	10	25
No relationship	2	5
Total	40	100

Interest rate ceiling affect microfinance operations positively because they regulate the interest rates. High rates discourage customers from borrowing hence affecting the profitability of the KWFT.

Table 4.9 How often interest rates are adjusted

Period	Number of respondents	Percentage (%)
Once per year	2	5
Twice per year	10	25
Once after 2 years	8	20
Once after 5 years	20	50
Total	40	100

The data in table above the researcher wanted to identify on how often the organization adjusted interest rates, majority of the respondents indicated that it was adjusted once after 5 years, while few said that it was adjusted once per year. From this information it's clear that the organization does not adjust interest rates frequently in stimulating revenue. It's the duty of the organization to investigate on the consumer readiness and use a proper strategy to rectify the situation. Constant interest rate adjustments make the lending market volatile, thus limiting borrowing options by the public.

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Overview

In this chapter the researcher discusses the main points of interest in relation to the data collected versus literature review available, interpretations were done in line with the known theories and logic summaries and recommendations were developed to act as points of reference and caution to future studies in this area.

5.2 Discussion and Interpretation

The research study indicated that interest rate ceilings were impacting on loan provision by microfinance institutions. The extent to which the customers at KWFT procured loans ranges depending on the interest rate charged. The study also indicated that most microfinance institutions had their operations hampered by charging low interest rates which emanated from the ceilings imposed on chargeable interest rate by the government through the Central Bank of Kenya.

The belief that interest rate ceilings can be effective in increasing loan procurement appears to be well-accepted among the customers. Many examples of increased loan procurement due to effective ceilings on interest rates have been reported in the media, although few data on their effectiveness are provided. For example, in Ngong road branch customers interviewed said that they were now at ease to procure credit facilities since the interest rates were certain and not subject to change.

Relatively few studies, however, have been published to show the effectiveness of interest rate ceilings. A study by Scott (2006) predicts the impact of high interest rates on credit facilities acquisition. Among customers given a loan on high interest rates, only 4% were willing later to procure such a loan, compared with a 9°Jo subscription rate in the control group. This demonstrates that high interest rates were in fact hindering credit access to the deserving customers.

In a field experiment, Lammers (2001) offered a low interest loans to customers who. In the very short term (within months), provision of low interest loans had a positive impact on other customers, though not of the sampled variety. As a result, his findings would be most relevant to microfinance institutions wanting to examine the short-term effects of a low-interest loan on marketing its products, rather than on the target clients.

Prior research has also demonstrated the positive effects of interest rate ceilings on measures such as belief, strength and attitude (Marks and Kamins, 198S), perceptions of loans (Bettinger et al. 1979, Hamm et al. 1969), and the initiation of interpersonal communication about the brand (Holmes and Lett, 1977). While these studies did not examine the long-term effects of interest rates, they suggest that higher interest rates could cause hindrance to acquisition of loan facilities by poor individuals.

Surveys conducted by the Sunflower Group (1997) suggest that the incidence of higher interest rates in microfinance institutions is several times that which is commonly charged by conventional banks.

In general, the findings indicate that interest rates influenced credit facility acquisition largely. It has also been realized that consumers felt protected by interest rate ceilings. This is mainly so because many consumers felt that once microfinance institutions are left to set interest rates on their own, they tended to go for profitability.

5.3 Recommendations

This study has shown that marketing free samples influenced sales. For there to be a great influence, it is however important to tailor the sales promotion to each stage of the consumer purchase decision since each promotion has an influence of its own at each stage. Proper research is important before determining which tools will be effective in influencing the purchase decision of each product at each stage.

5.3.1 Loans as a Source of Finance

Since loans are widely used as a source of capital, there is however need to regulate the rate at which this credit should be extended. The regulatory body in this case the government should engage into deep consultation with the financial institutions involved before deciding which rate should be effective. There should be a consensus between the two parties such that these rates do not turn-out to be lenient on one side and bias on the other.

5.3.2 Floating or Fixed Interest Rates

Microfinance institutions should emphasize on fixed rate loans which seem to favor the majority. More negotiations should be encouraged to amend the fixed rate loans in which case both parties should be considerate enough not to scare the customers who are the most affected victims. The government should also put into consideration that these MFIs need funds to carry on expansions if we were to improve lives of the poor in this economy and therefore should not set too law or too high interest rates.

5.3.4 Difference of KWFT Rates with Those of Commercial Banks

The deference as represented by the findings in chapter four is so big and need some adjustments this could be a way to solving the mentioned effects that these interest rate ceilings have on the operations of the microfinance institutions. However the adjustments should be such that they don't go too high to hinder the borrowers who are law income earners from borrowing.

5.3.5 Effects of Interest Rate Ceilings On Individual Operations

It is evident from the findings that the high interest rates negatively affect the operations of individual business operations. The rates should be set to protect the clients as well as the financial institutions and not the customers only as is the case at the moment. The government is therefore urged to conduct further in analysis involving all stake holders before coming up with the rates so as to ensure harmonious coexistence of microfinance institutions and operations.

5.3.6 Whether Interest Rate Ceiling Affect the Organization's Operations

From the findings, it's evident that a certain no of employees 16 out of 40 to be precise, is not aware that these interest rate ceilings have an impact on the operations of these financial institutions. Therefore MFI's are urged to conduct refresher courses to their staff and create awareness among their employee's fraternity.

5.3.7 Whether Interest Rate Ceilings Affect the Rate of Loan Seeking

Again some employees are not aware that the interest rate ceilings affect the loan seeking rate from customer and so the management of these institutions are called upon to emphasize on refresher courses to educate the staff on such issues.

5.3.7 How Often Interest Rates are adjusted

Microfinance institutions should review interest rates in accordance to the economic change which is dynamic and so should the regulatory body the government through the central bank. This would go a long in solving the negative effects that these ceilings have on MFIs operations.

5.4 Summary

Organizations should strive to identify any effects of marketing free samples on sales affecting their organization. This will enable them to be aware of change affecting them so as to deal with it properly.

Given that interest rate ceilings have been used for a long time and that considerable research has been conducted, it is surprising that they as they should be. Second, there do not appear to be any controlled field experiments other than the study by Scott (1976) on interest rate ceilings. Third, with the exception of the (Gedenk and Neslin, 1999) study on higher interest rates, there do not appear to be any empirical studies that have examined the effects of interest rates beyond the first 2 months after grant of a loan.

5.5 Areas of Further Study

Due to funding and logistic limitations, this project was conducted as a pilot study that utilized a small sample size, relatively short time duration, and a convenient sampling technique. It is suggested that a follow-up study should be carried out over a longer time span (about 15 weeks of instruction), and that the study should use a much larger sample size, and if possible, adopt randomization procedures in sample composition. A sufficiently large sample would make it possible to include a sizeable number of male and female participants in the study such that more hypotheses could be built into the research design. For example, it would be interesting to investigate both the possible effect of gender on loan provision, and a possible interaction effect between treatment (socio type) and gender.

Further studies on interest rate ceilings at microfinance level should be conducted in relation to small and medium enterprises. An investigation of the attitudes towards loans offered by MFI's, as compared to those offered by conventional banks could prove to be important.

This study has just touched upon relationship between interest rate ceilings and loan provision in the country. Kenya is a an open economy with a blend of different financial institutions and an in-depth study wherein the issue of loan provision in relation to one's socio class would be valued.

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APPENDICES

APPENDIX I: RESEARCH INSTRUMENTS

(A) QUESTIONNAIRE

Dear respondent,

I am **Sabilah Kimtai Moses** pursuing a Bachelor of Business Administration in Finance and Banking option in Kampala International University. Am doing a research project on assessment **of Interest Rate Ceilings on the Operations of Micro Finance Institutions in Kenya**. I would like you to fill for me this questionnaire. All the information will be treated confidential and only for academic purpose. Thank you.

Questionnaire for employees

Dear: Respondent

Ref: Collection of survey data

SECTION A

Instructions: Tick the appropriate answer

1. Tick your appropriate gender

Male ☐

Female ☐

2. Indicate your education level

Secondary education ☐

Tertiary level ☐

3. How long have you worked for Kenya Women Finance Trust?

Below 2 years

2-5 years ☐

6-10 years ☐

11-15 years ☐

Above 15 years ☐

4. Indicate your position in this organization

Line manager ☐

Supervisor ☐

Team leader ☐

Clerk ☐

5. Which department o you belong to?

Marketing department ☐

Planning department ☐

Credit department ☐

Financial department ☐

SECTION B

6. What factors does your organization consider when offering these loans?

Repayment period

Collateral offered ☐

Purpose of the loan ☐

Loan limit ☐

Account turnover. ☐

7. What do you understand from the term interest rate ceiling?

A measure put in place to regulate lending. ☐

Interest rate controls ☐

A micro finance term ☐

8. Is your organizations operations hampered by interest rate ceilings?

Yes

Please explain..

No

9. Do interest rate ceilings protect borrowers from exploitation?

Yes

Please explain..

No

Please explain..

10. What is the relationship between interest rate ceilings and microfinance operations?

Positive

Negative

No relationship

11. How often do you review your interest rates?

Once per year

Twice per year

Once after two years

Once after five years.

THANK YOU FOR YOUR CO-OPERATION

(B) INTERVIEW GUIDE

1. Are there any fees charged when applying for the loans?
2. Do interest rate ceilings protect borrowers from exploitation?
3. How has the KWFT loans changed your life/created or development?
4. What happens in case you don't repay your loan as agreed?
5. Is the interest rate on your loan lower compared to that of commercial banks?
6. What do you understand from the term interest rate ceiling?
7. What factors does your organization consider when offering these loans?
8. How long have you worked for Kenya Women Finance Trust?

APPENDIX II: BUDGET

No	Activity	Cost	
		Kshs	**Ushs**
1.	Stationer	4,000	100,000
2.	Typing and printing	2,500	62,500
3.	Transport	3,000	75,000
4.	Meals	2,000	50,000
5.	Photocopy	1,000	25,000
6.	Internet and airtime	1,000	25,000
7.	Miscellaneous	5,000	125,000
Total		**18,500**	**462,500**

APPENDIX III: TIME FRAME

Activity	Period	Output
Proposal writing	2/04/2010	Proposal submission for approval
Field customization	April 2010	Initial information collection
Developing instruments	May 2010	Developing instruments
Data collection	June 2010	Coding and entering of data
Data analysis	July 2010	Analyzing and interpretation of data
Preparation of report	August 2010	Submission of dissertation