REPUBLIC OF KENYA

THE NATIONAL TREASURY AND PLANNING

THE ANNUAL PERFORMANCE REPORT FOR THE MSMEs CREDIT GUARANTEE SCHEME

2021/22 FINANCIAL YEAR

June 30, 2022

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A. BACKGROUND

Micro, Small and Medium Enterprises (MSMEs) are vital to Kenya's economic development and job generation, as stated in Vision 2030 and the Third Medium Term Plan (2018–2022). According to the KNBS 2016 MSME Survey, Kenya has over 7.4 million MSMEs, which employ over 14.9 million Kenyans across all sectors of the economy and account for roughly 40% of the country's GDP. Furthermore, MSMEs are a significant driver of inclusive economic growth since they cover a wide variety of activities in nearly all sectors of the economy.

Despite the critical role they play, MSMEs continue to face a variety of challenges. Most of the start-up companies do not survive their 4th birthday owing to constrained access to finance for capital and operational demands, market challenges, and weak business strategies. Further, MSMEs that access credit face unfavorable loan conditions due to lack of sufficient collateral, high collateralization requirements, short payback periods, informal markets, inaccurate data and high interest rates since they are viewed as risky by financial institutions. This is majorly due to information asymmetries and informal management techniques, both of which make them unappealing to lenders.

Furthermore, the Covid-19 Pandemic had a disproportionate impact on many MSMEs. With lower turnover and interruptions in the market and supply chains, many MSMEs were affected and continue to be unlikely to obtain affordable and high-quality loans under traditional arrangements.

In light of the above, the National Treasury rolled out the Credit Guarantee Scheme (CGS) by entering into risk-sharing agreements with participating financial institutions (PFIs) on 8th December, 2020, to support MSMEs to access quality and affordable credit. This is anticipated to help MSME businesses stay afloat and safeguard employment during and after the Covid-19 pandemic. The Credit Guarantee Scheme is anchored on the Public Finance Management Act, 2012 and the Credit Guarantee Scheme Regulations, 2020. In the 2020/21 financial year, the Parliament allocated KShs. 3 billion as an initial seed capital for CGS.

The Credit Guarantee Scheme for MSMEs is currently being delivered through a risk sharing agreement between the Government and 7 participating banks. The seven banks are Absa, Cooperative, Credit, DTB, KCB, NCBA and Stanbic. The banks act as the intermediaries in provision of credit to qualifying MSMEs borrowers based on a pre-agreed Scheme Qualifying

Criteria. Lending is done by the banks with due diligence in line with the Central Bank of Kenya Prudential Guidelines.

The maximum loan amount under the Scheme is KShs. 5 million with a tenor of 3 years and up to 5 months' grace period and discounted interest rate based on the MSMEs risk profile. The Scheme guarantees to pay the banks 50% of the outstanding principal amount, subject to a maximum of 25% of the principal amount, in case of default on qualifying credit facilities advanced to MSMEs. This provides an incentive for the banks to offer better credit terms for the qualifying MSMEs.

B. STATUTORY REPORTING REQUIREMENT ON CGS FOR MSMES

Section 59A of the Public Finance Management Act, 2012, requires the Cabinet Secretary to prepare, at least once every year, a statement of the credit guarantees granted to qualifying MSMEs, together with a report of:

(a) the total value of credit guarantees given during that period;

(b) the total value of credit guarantees liquidated during that period;

(c) the total value of outstanding credit guarantees on the date of the report;

(d) the risk assessment of the credit guarantees or classes of guarantees;

(e) information on the total value of credit guarantees, disaggregated into the number of enterprises owned by women, youth and persons with disabilities which have been guaranteed;

(f) information on the total value of credit guarantees, disaggregated into the number of micro, small and medium enterprises guaranteed and by the respective regions; and

(g) any other relevant information prescribed by regulations for the purposes of this section."

The Public Finance Management (Credit Guarantee Scheme) Regulations 2020 expounds on the reporting requirements outlined in the Act. Regulation 20 states that the Scheme Manager shall prepare and submit to the Scheme Administrator regular reports on the credit guarantees given under the Scheme including financial and technical reports on guarantees made during the period including information on:

i. *the products and sectors for which guarantees have been issued;*
ii. *the number of beneficiary micro, small and medium enterprises;*
iii. *the value of credit guaranteed;*
iv. *the repayment periods;*
v. *the guarantees which have been liquidated;*
vi. *reports on repayments made on outstanding credit facilities and details of any outstanding payments;*
vii. *reports on delinquent guarantees and the stage of recovery;*
viii. *reports on the size and quality of the guaranteed portfolio;*
ix. *reports on the liquidity position of the Scheme; and*
x. *the risk assessment of the credit guaranteed.*

This report is prepared pursuant to Section 59 A of the Public Finance Management Act, 2012 and it covers the period from 1st July 2021 to 30th June 2022. The basis of the report is data submitted by PFIs through CBK.

C. CGS PERFORMANCE REPORT AS AT 30TH JUNE 2022

From December 2020 to 30th June 2022, CGS disbursed a cumulative value of approximately KSh. 3.9 billion to 2,490 MSMEs, across 46 Counties and 11 sectors of economy as reported by the banks through the Central Bank of Kenya. All the three sizes of enterprises (micro, small, and medium) have benefitted from CGS facilities issued where small enterprises received 1,501, medium enterprises received 381 while micro enterprises received 608. The enterprises owned by women, youth and persons with disabilities (PwDs) received 20% of the total number of guaranteed facilities that had been disbursed. Women beneficiaries were 327, youth beneficiaries were 164, while PwDs were 9. The beneficiaries of the CGS so far support a minimum of 13,901 jobs.

The total value of fully repaid facilities is KShs. 407.2 million which implies that this is released for additional MSMEs. This is the unique advantage of credit guarantees since funds can be recycled among more beneficiaries, upon repayment, thereby increasing the impact in the economy. The CGS has so far achieved a leverage ratio of 1.44 from KShs. 2.71 billion committed to PFIs. This indicates that that for every one shilling committed by Government has unlocked private sector credit of KShs. 1.44 to MSMEs.

D. CGS PERFORMANCE REPORT FOR FINANCIAL YEAR 2021/2022

In accordance with Section 59A of the Public Finance Management Act, 2012, the CGS Annual Performance Report for the Financial Year 2021/2022 is as follows:

(a) the total value of credit guarantees given in the financial year

During the FY 2021/2022, approximately KShs. 3.321 billion has been disbursed to 2,190 MSMEs under the CGS. This disbursement represents credit guarantee value of KShs. 830.3 million given for credit advanced to eligible MSMEs in the financial year.

(b) the total value of credit guarantees liquidated in the financial year

During the FY 2021/2022, no credit guarantees had been liquidated under the CGS since no claim has been lodged out of the total KShs. 974,117,079 of guarantees extended to qualifying MSMEs since inception. Nonetheless, appropriate provisioning has been made based on risk assessment of the portfolio for facilities under "Watch", "Substandard" and "Doubtful". PFIs may lodge claims for guaranteed facilities once classified under "Substandard."

(c) the total value of outstanding credit guarantees on 30th June 2022

The outstanding credit guarantees is KShs. 744,525,739.45 as at 30th June 2022. Further, a guarantee value of KShs. 101,788,013 has been released as a result of full repayment of guaranteed facilities while KShs. 127,803,326.36 have been repaid from the active guaranteed facilities. The repaid guarantee value can be reallocated to additional qualifying enterprises, implying that the credit guarantee achieves a higher leverage ratio in unlocking private sector credit for enterprises. This presents a unique advantage of using credit guarantee schemes to support MSME access to credit.

(d) the risk assessment of the credit guarantees or classes of guarantees

The Credit Guarantee Scheme uses the Central Bank of Kenya risk classification of assets and provisioning outlined in the Central Bank of Kenya Prudential Guidelines (CBK/PG/04). For purposes of risk classification, the facilities are classified as either Normal, Watch, Substandard, Doubtful or Loss.

As at 30th June 2022, CGS had 2,215 active facilities with a total outstanding principal amount of KShs. 2,978,102,957.79. A total of 2,084 facilities were classified as "Normal" while 131 facilities were delinquent, that is, classified as "Watch," or "Substandard" or

"Doubtful". The 131 delinquent facilities together represent an outstanding principal amount of KShs 158,982,996 representing potential claims up to a maximum of KShs 45,385,928.

Seventy six (76) of the facilities were classified under "Watch" with outstanding principal amount of KShs. 82,179,404 representing a potential claim amount of KShs. 24,255,709.88. In addition, twenty two (22) guaranteed credit facilities were classified as "Substandard" with an outstanding principal amount of KShs. 34,467,035 and CGS's liability for the same is up to KShs 9,562,109.94, which is due for claim and processing in accordance with the set claims procedures. Eighteen (18) facilities were classified as "Doubtful" with an outstanding principal amount of KShs. 25,971,360 and CGS liability in case of a claim is Kshs. 7,410,509. A further fifteen (15) facilities were classified as "Loss" with an outstanding principal amount of KShs. 16,365,197 and a potential claim amount of KShs. 4,157,599.

"Normal" facilities are well-documented facilities granted to financially sound customers where no weaknesses exist, and are performing, and are expected to continue to perform, in accordance with contractual terms.

"Watch" facilities may not be past due but exhibit potential weaknesses which may weaken the asset or inadequately protect the institution's position at some future date. Facilities whose installments have become due and remain unpaid for a period between 30 and 90 days are classified under "Watch."

"Substandard" facilities are not adequately protected by the current net worth and paying capacity of the borrower and, therefore, the institution must look to secondary sources such as collateral, sale of fixed assets, refinancing or additional capital injections for repayment. Facilities whose installments have become due and remain unpaid for a period longer than 90 days are classified under "Substandard." PFIs can lodge claims once facilities are "Substandard."

"**Doubtful**" facilities have all the weaknesses inherent in a substandard loan plus the added characteristic that the loan is not well secured. These weaknesses make collection in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable. Facilities whose installments have become due and remain unpaid for a period longer than 180 days are classified under "Doubtful."

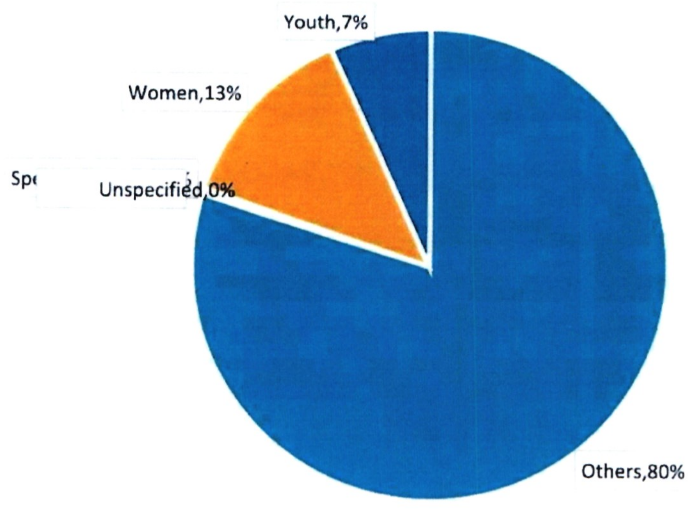
"Loss" facilities are considered uncollectible or if the collections are of such little value that their continuance recognition as bankable assets is not warranted. These facilities must have been due and unpaid for over 360 days.

(e) information on the total value of credit guarantees, disaggregated into the number of enterprises owned by women, youth and persons with disabilities which have been guaranteed;

During the reporting period, 20.1% of the total number of guaranteed facilities were disbursed to businesses owned by women, youth and persons with disabilities (PwDs). Women beneficiaries were 283, youth beneficiaries were 150 while PwDs were 8. However, in terms of value of credit guarantees the proportion extended to enterprises owned by women, youth and PwDs was 14.2%, suggesting that this category of borrowers receives on average smaller volumes of credit facilities. Women received KShs. 319,819,747.60 of the credit guarantees extended in the financial year, youth received KShs. 142,153,601 while PwDs received KShs. 10,190,000.

The National Treasury will continue working with PFIs in order to increase the number of beneficiaries from these categories. Further the National Treasury will continue with its efforts in collaboration with relevant Agencies to do capacity building with this category of beneficiaries.

Figure 1: Share of number of beneficiaries of credit guarantees by women, youth, PwDs and others in FY 2021/22



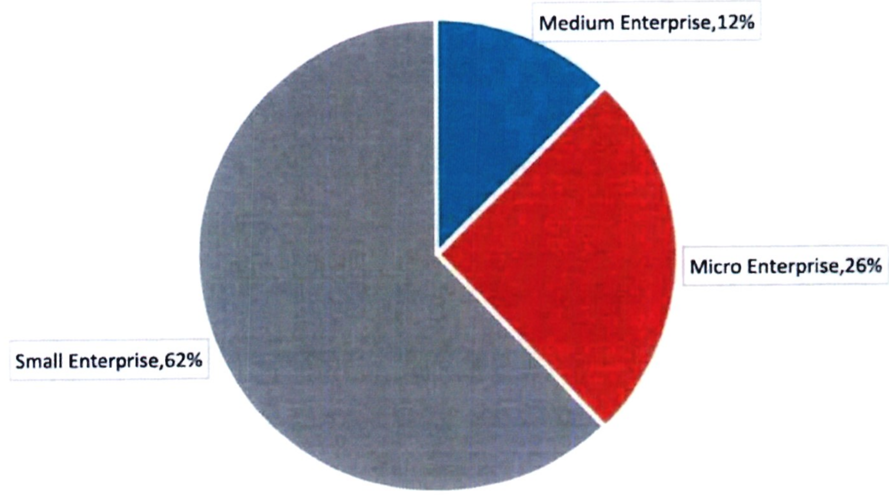
f) information on the total value of credit guarantees, disaggregated into the number of micro, small and medium enterprises guaranteed and by the respective regions;

All the three sizes of enterprises (micro, small, and medium) have benefitted from CGS facilities as reported by the banks through CBK. Of the 2,190 facilities issued under the CGS in FY 2021/22, small enterprises received 1361, medium enterprises received 268 while micro enterprises received 561.

In terms of value of facilities, small enterprises received KShs. 2,296,316,942.30, medium enterprises received KShs. 592,804,030.00 while micro enterprises received KShs. 431,940,781.62. The proportion of credit guarantees allocated to micro enterprises can be attributed to the average size of their loans being smaller than either of small and medium enterprises. The application of the legal definition of micro, small and medium enterprises has been a challenge whereby an enterprise can be micro by one criterion and small by another.

The Scheme is consulting relevant Government Institutions on the application of this legal definition, noting that if the definition was administered in the strict sense it would lock out many MSMEs. In the meantime, the National Treasury is considering a policy direction which requires the annual turnover to prevail as the measure of enterprise size for purposes of reporting on CGS. The share of the facilities by enterprise size is illustrated in **Figure 2.**

Figure 2: Share of beneficiaries of credit guarantees by enterprise size in FY 2021/22



g) information on the number of beneficiaries and total value of credit guarantees, disaggregated respective regions;

CGS has benefitted MSMEs across 46 Counties since inception. In FY 2021/22, CGS recorded beneficiaries in 43 counties accounting for 91.5% of the total 47 counties in the country with high concentration in Nairobi (1,033), Kiambu (157), Mombasa (123), and Nakuru (84). This could be explained by the concentration of MSMEs in urban centres and PFIs branches across the counties implying high demand of credit in these regions. Mandera County is yet to record beneficiaries under the CGS. This may be because only KCB, among the Participating financial intermediaries have presence in Mandera. The CGS will continue to work with PFIs that have presence in northern counties, including Mandera, in order to increase uptake of facilities in those areas. The National Treasury and Development Partners are also undertaking targeted outreach and awareness campaigns in order to increase uptake across all the Counties. The CGS county coverage by number of beneficiaries and value of facilities is shown in ***Figures 3 & 4*** respectively.

Figure 3: Distribution of number of guaranteed facilities by county

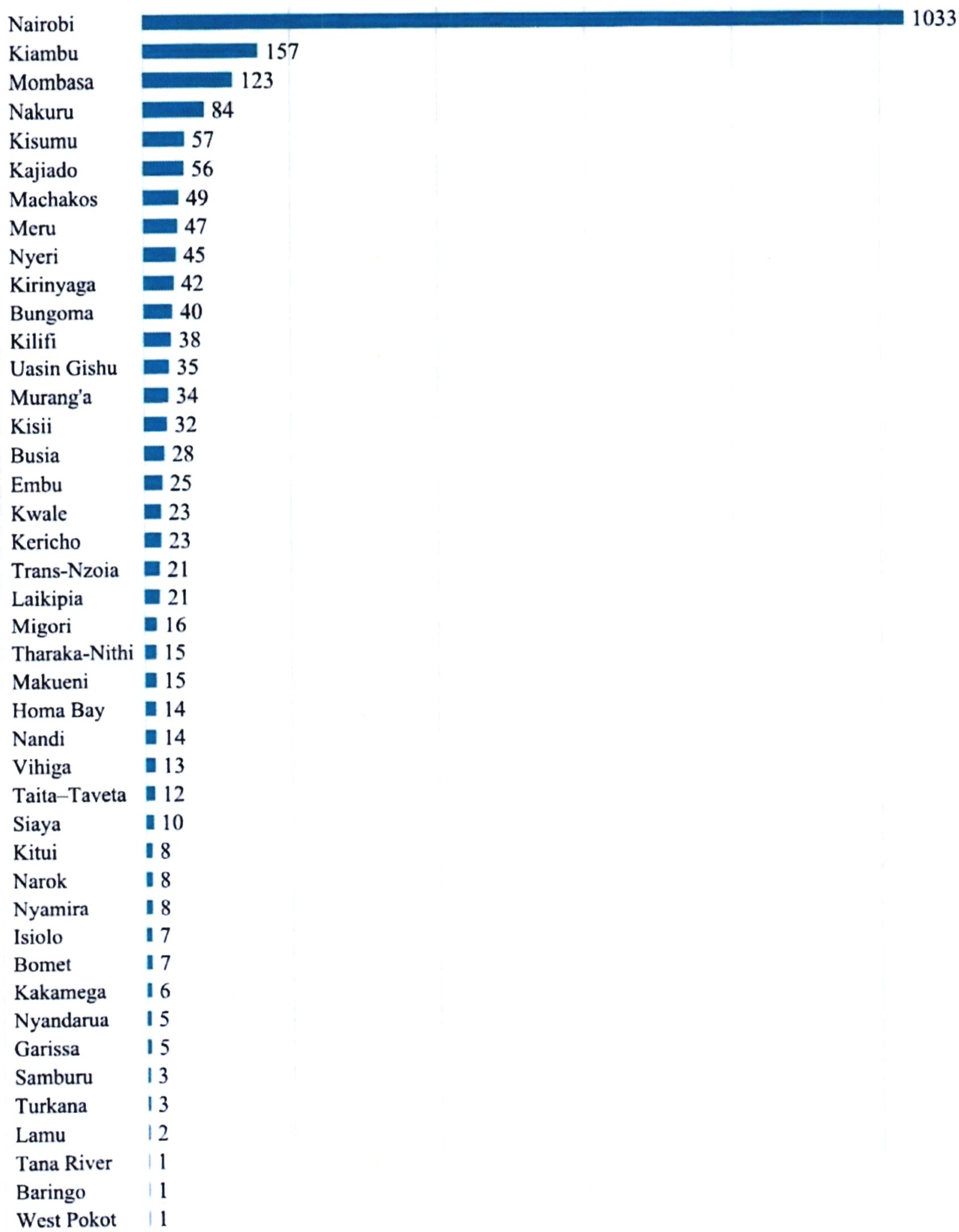
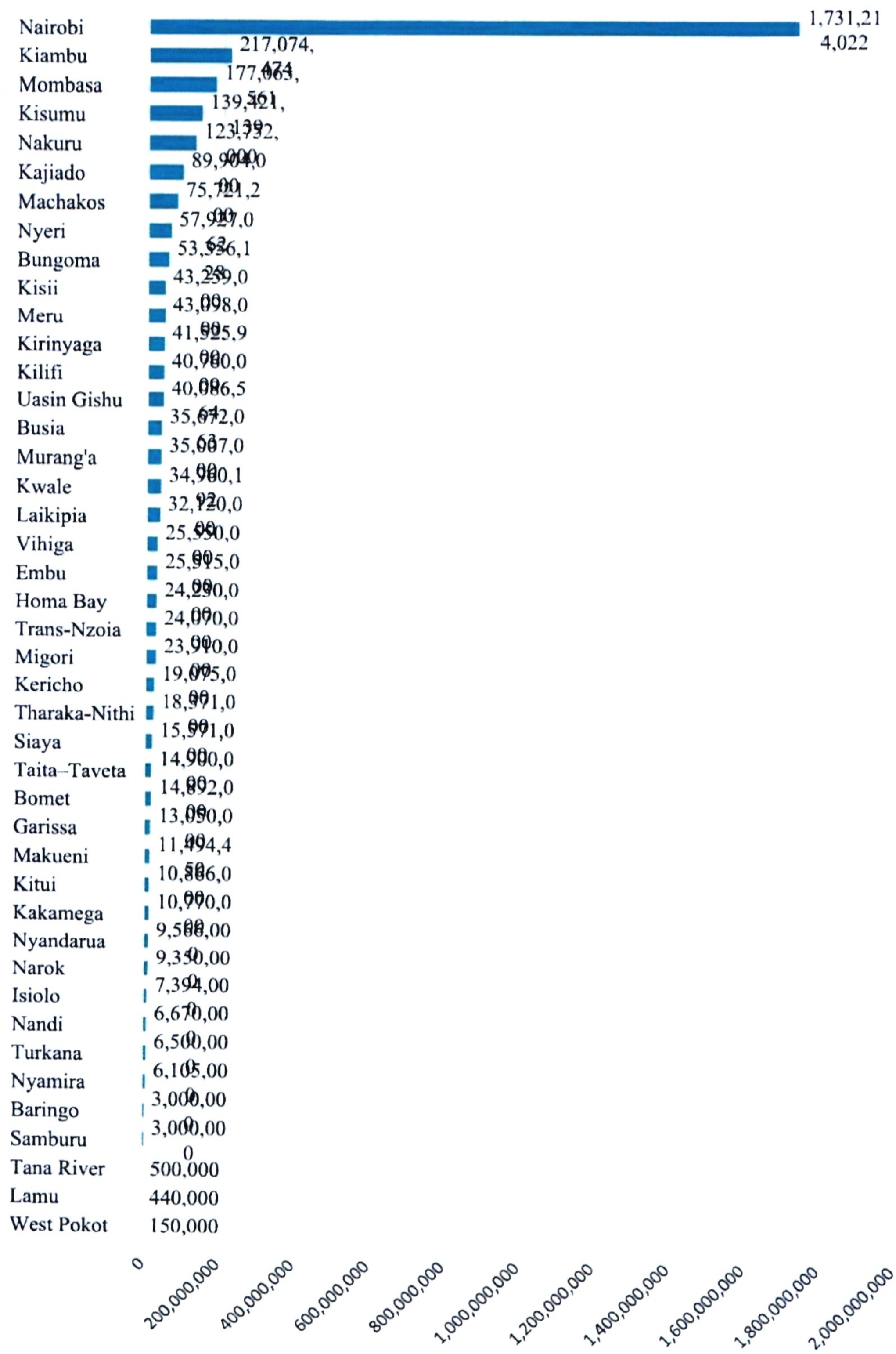


Figure 4: Distribution of value of guarantees by county

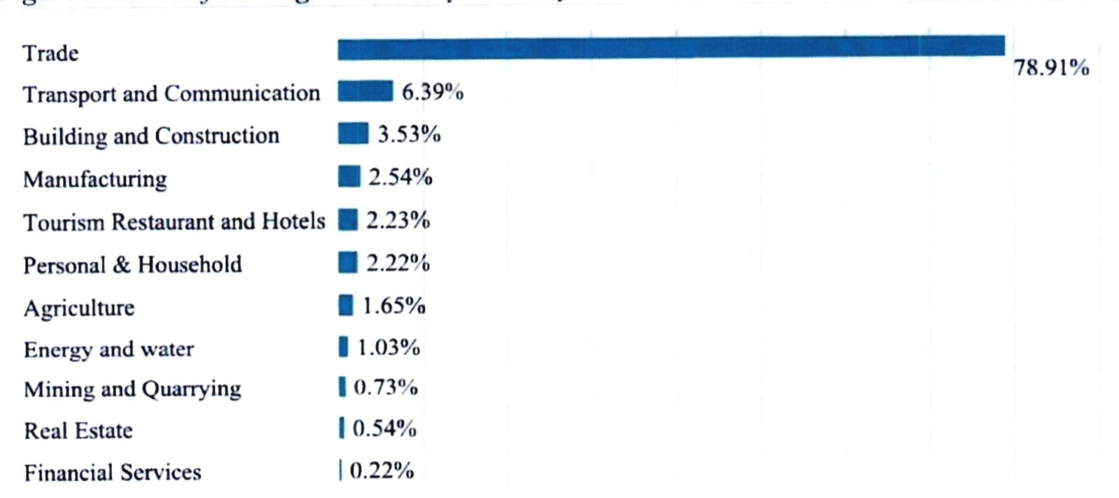


(h) Other relevant information.

i. Allocation of credit guarantees by economic sector

The facilities placed under the scheme have been distributed across all eleven (11) sectors. Trade Sector has a cumulative share of 75.9% of the facilities issued under CGS since inception. In FY 2021/22, trade sector continued to receive a disproportionately high share of CGS facilities at 78.8%. This percentage is higher than the sector limit of 40% as per the CGS Agreement. This is followed by Transport and Communication (6.4%), Building and Construction (3.5%). A disproportionally small number of credit facilities was allocated to Agriculture (1.7%) and Financial Services (0.2%) sectors in FY 2021/22. This could be attributed to the definition of sectors in the banking industry. For instance, agriculture is restricted to on-farm activities and excludes MSMEs in the value chain. The National Treasury is working with the relevant Government agencies to improve uptake in agriculture, including designing sector specific products. The share of the facilities by sector is illustrated in **Figure 5.**

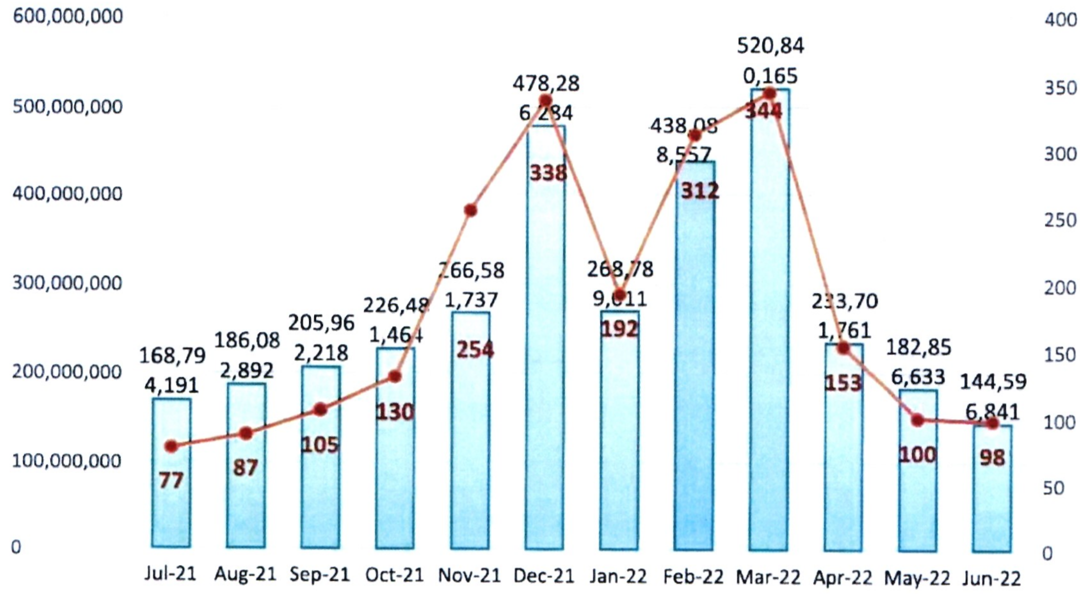
Figure 5: Share of credit guarantees by economy sector



ii. Trend of number of guaranteed facilities

Disbursements of guaranteed facilities has shown a general increasing trend in the months of during the implementation period. The number of guaranteed facilities increased in the months of July (74), August (93), September (119), October (122) and November (251) with March (344) recording the highest CGS performance in terms of number and value of facilities since inception. However the month of April, May and June 2022 reported a decrease in facilities issued under CGS with 153, 100 and 98 beneficiaries respectively. This may be explained by the electioneering period which contracts demand and supply for credit. The trend of number and value of facilities by month is shown below in **Figure 6.**

Figure 6: Trend of number and value of facilities by month



iii. Guarantee Utilization as at 30th June 2022 (Liquidity Position of the Scheme)

The guarantee utilization is an indicator of the amount that the Scheme will pay in the event of a default, which is a maximum of 25% of the principal amount disbursed. As at 30th June 2022, utilization of guarantees stood at KShs **974,117,079** representing a cumulative utilization rate of 35.9%. Since inception of the Scheme, no credit guarantee has been liquidated. However, a total of KShs. 45,385,928 has been provisioned for the 131 delinquent facilities as at 30th June 2022.

E. CGS ACHIEVEMENTS

The outreach of the scheme is as follows:

i. Since inception, the CGS has directly benefitted 2,490 MSMEs across 46 Counties and eleven sectors of economy.

ii. The beneficiary MSMEs have a total number of 13,901 employees up from 10,000 employees reported as at 31st December 2021. Assuming that an average household has 4 members, then the CGS has supported livelihood for approximately 53,000 persons.

iii. Women beneficiaries were 327, youth beneficiaries were 164 while PwDs were 9.

iv. A number of beneficiaries accessed credit at interest rates lower than the average rates reported over the same period by the CBK.

i. ***Sustainability of Credit Guarantee Scheme***

The Scheme is currently operated as a unit within the National Treasury. This is not in line with international best practice, especially the World Bank's Principles of operating public credit guarantee schemes. To align the Scheme with global best practices, it is critical that the Scheme be converted to an independent legal entity with mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.

The conversion of the current CGS into an independent legal entity will entail some adjustments to the current design including amendments of legal and regulatory framework to allow for supervision and regulation of the entity. This way, the CGS will be able to achieve financial sustainability and reduce its reliance on annual budgetary allocation from exchequer.

ii. ***Stakeholder Engagements***

The scheme has engaged various stakeholders on credit guarantee scheme as follows:

a) Engagement of Ministries, Departments and Agencies on sustainability of CGS

The National Treasury has engaged Ministries, Departments and Agencies (MDA's) in the process of converting the CGS into a sustainable model. The MDAs are drawn from the Ministry of Industrialization, Trade and Enterprise Development; Office of the Attorney General; Central Bank of Kenya (CBK); Business Registration Service (BRS); and the National Treasury.

b) **Participating Financial Intermediaries** (PFIs)

CGS initiated a series of interactions with the PFIs to ensure compliance with the legal and operational requirements of the Scheme. During the sessions, the PFIs shared their experiences and challenges that contributed to low uptake of CGS facilities. Based on the feedback from the PFIs, a set of recommendations have been forwarded for consideration by the Steering Committee in a bid to enhance the impact of the CGS.

c) **Development Partners:**

The National Treasury has continued to partner and collaborate with various development partners for the growth and development of the CGS. This partnership include technical and financial support towards implementation of the Scheme. Among the development partners include FSD-Kenya, World Bank, USAID, IFAD, AGF and KfW. These partnerships are expected to ramp up the coverage and increase the impact of the CGS in the economy.

d) **African Women's Studies Centre, University of Nairobi (AWSC):**

The CGS Unit has partnered with the AWSC that hosts the Women Economic Empowerment (WEE) Hub to explore ways for improving access to guaranteed credit by women owned/led enterprises. The CGS technical team together with the WEE Hub undertook a study on the possible explanations for the low uptake of guarantees among women entrepreneurs. The findings showed that most women owned enterprises are informal and therefore may not access the CGS. The National Treasury is engaging relevant MDAs, partners and private sector on appropriate measures to enhance uptake of guarantees among women.

e) **Kenya Association of Manufacturers (KAM)**

The National Treasury partnered with Kenya Association of Manufacturers in May 2022 to provide information on the CGS to its member enterprises. Two of the PFIs presented their MSME credit products to the participants. One CGS beneficiary presented a testimony of the impact the guaranteed loan had on his enterprise.

F. CHALLENGES IN CGS IMPLEMENTATION

i. **Utilization:** Utilization of credit guarantees as at 30th June 2022 was 35.9% and had started to stagnate towards the end of the financial year. It is also noteworthy that Mandera county is yet to record a beneficiary under the CGS. This may be because only KCB Bank among the seven PFIs has branch presence in Mandera County.

ii. **Informality of MSMEs:** Most MSMEs are informal and hence are not tax compliant and most of these enterprises are not registered by the relevant Government Agency as required by Regulation 10 of the CGS Regulations.

iii. **Definition of micro, small and medium enterprises**-most of the enterprises do not fully fulfil the definition criteria set out in the PFM Act, 2012, and the MSE Act,

2012. Consequently, an enterprise could be micro by number of employees while according to turnover it could be classified as small or medium enterprise.

iv. **Sector classification-**the definition of economic sectors in the banking industry may be contributing to misclassification of some MSMEs. For instance, some enterprises involved in health care services, education and agricultural value chain are being classified as trade.

v. **Moral hazard:** The challenge to create awareness on the credit guarantee while safeguarding the CGS from the risk of moral hazard.

vi. **COVID-19 pandemic and ongoing Russia - Ukraine War:** This has affected global supply chains, negatively affecting economies and businesses, including Kenyan MSMEs.

G. CONCLUSION AND WAY FORWARD

The CGS performance report demonstrates how the Government has leveraged on private sector resources to provide credit to MSMEs while advancing its development objectives. Through the scheme, the PFIs have been able to lend KShs. 3.9 billion to MSMEs. Furthermore, participating banks are implementing the Scheme through their existing branch networks and infrastructure allowing them to reach out to MSMEs in more counties compared to other government initiatives. This is evidenced by the outreach to 46 counties, outreach to women and youth and to both micro, small and medium enterprises.

The following actions are necessary to ensure that the Scheme achieves its founding objectives:

i. The National Treasury to bring on-board additional financial intermediaries to the CGS in order enhance uptake of credit guarantees across regions and MSME profiles. This will also be coupled with targeted awareness creation in collaboration with relevant Ministries, Departments and Agencies, Development Partners and Private Sector players. It is expected that this will improve overall utilization of CGS as well as enable the CGS to register additional beneficiaries in the northern counties including Mandera.

ii. The Government to review the establishment of the CGS with a view to enhance sustainability and impact of the CGS in line with international best practice. This may involve amendment of the Public Finance Management Act, 2012, the Central Bank Act and Credit Guarantee Scheme Regulations, 2020 in order to anchor the establishment and implementation of the CGS in a sustainable and effective manner.

iii. To promote the formalization of MSMEs, the CGS continue engaging the relevant Government Agencies (Business Registration Services and Kenya Revenue Authority) to explore on various ways of increasing penetration of informal MSMEs, for registration and tax compliance.

iv. The National Treasury to engage with relevant Government Institutions to address the challenge of MSMEs classification as per the law. In the meantime, the National Treasury is considering issuance of a policy guidance on classification of enterprises to improve consistency of reports.

v. The National Treasury to work with the CBK on sector classification to expand the scope of options including value chains and nature of businesses to enhance accuracy in sector reporting.

vi. The National Treasury to continue to work closely with the MDAs, PFIs and development partners in designing and executing appropriate communication strategies to minimize the risk of moral hazard.