KDI 국제정책대학원

MICROFINANCE AS A POVERTY REDUCTION TOOL IN KENYA

By

ONGUKO DAVID AMONJE

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY IN ECONOMIC DEVELOPMENT

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Professor Lee Kun-Ho

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Committee in charge:

Professor Prof. Lee, Kun-Ho

Professor Kim, Joon-Kyung

Professor Cho, Man

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ABSTRACT

In recent times there has been a renewed campaign geared at using microfinance as a tool for combating poverty in developing countries. It is against this background that this essay seeks to among other things look into the effectiveness of microfinance in achieving this goal of poverty reduction, using the case of Kenya to test the outstanding hypothesis. The core of this thesis is the argument that microfinance as a laudable pro-poor financial measure lacks the capacity to address the long term goals of poverty reduction Kenya, simply because poor economic governance pillars such as the national legislative and regulatory frameworks needed to nurture economic development is ironically inhibitory in nature. To achieve this, the theoretical methodology of qualitative analysis will be employed to prove that the poverty gulf in Kenya cannot be sustainable on the pillars of microfinance as a pivotal structure. The effectiveness of theory will be measured by the prevailing environmental support mechanism to ensure its success or otherwise.

In this thesis poverty is used as a loose term to describe a complex network of varied socioeconomic phenomena that transcends the absence of purchasing power. Therefore poverty reduction cannot be treated in isolation to the environmental factors required to sustain it.

Key Words: Poverty, Microfinance, Economic Governance, corruption, regulations, institutions.

Dedicated to the Onguko's Family

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Part1.

1.0 Introduction

The advent of microfinance as an alternative means of credit access to the poor has come to be hailed as a potent source of addressing poverty in developing countries.

Much of the enthusiasm stemming from this confidence comes from the uncanny realization of the sterling results of microfinance policy experiment in some developing countries such as Bangladesh and Indonesia (See Morduch, 2000). Indeed in the case of the former it is on record that thanks to microfinance thousands of poverty-stricken individuals and households have been given some degree of reprieve[1].

Far from disagreeing that the policy of microfinance as an effective poverty reduction strategy, at the same time it is worth further scrutinizing this thought to ascertain its veracity or otherwise with particular interest on the possibility of giving it a universal application. By settling for a universal application of microfinance as an effective poverty reduction tool then it stands to reason that addressing poverty in Kenya can also be achieved on the heels of microfinance among many other policy interventions. In other words should there be a blanket conclusion that microfinance is effective in poverty reduction because it has proven effective in some parts of the world? Does this take into account all the loose ends of the definition of poverty? Is there any tentative study to prove that the potential of a universal application of microfinance is not dependent on local environmental conditions? What are the factors that can potentially make microfinance a success or failure if it has to be replicated in Kenya?

[1] The Grameen Bank pioneered by Dr. Mohammed Yunus is at the forefront of leading the crusade against poverty on the heels of microfinance as a development policy. For a detailed discussion of how the scheme is operated and the visionary scope underpinning its functional dynamics visit http://www.bangladesh.com/blog/mohamed-yunus-and-microfinance-in-bangladesh

Using the Bangladeshi and Indonesian cases as a reference point many within policy circles have reasons to believe that should all the potential within this scheme be properly explored then the world is set to unlock the door to poverty reduction on a universal scale. It is against this background that this study serves as a contribution to the discourse on the question of the potency of microfinance as a vital poverty reduction instrument. Yet this study seeks to dig deeper by examining if at all the confidence in microfinance as a poverty reduction tool is true, will it necessarily achieve the same results in Kenya as it has been reported in other parts of the developing world?

The choice of Kenya is well intentioned largely because, like Bangladesh, Kenya has a staggering rate of rural and urban poverty rates (See Jane and Moore 2003). Taking cognizance of the contextual analysis of poverty and development I am inclined to believe that the similarities between both countries are very striking and can therefore provide sufficient basis for comparative and deductive analysis. This notwithstanding this paper wants to argue that with all intends and purposes Kenya lacks the required legislative and policy regulatory mechanisms that can make microfinance work as it has in a model country such as Bangladesh.

Suffice to concede at this juncture that the concept of microfinance is not entirely alien to Kenya, for instance previous studies such as Osterloh (2001) looked at the practice of microfinance in the poverty endemic northern sector of Kenya. Yet the point of departure here is to critically look into the internal dynamics of the poverty factor to establish whether or not in the most tentative sense the viability of poverty reduction through microfinance is inherently sustainable to justify the need for its broad replication.

By and large it is absolutely imperative to appropriately define poverty and place it in its right context as the first step towards the diagnosis. Owing to the understanding that poverty is an interconnected network of highly complicated factors that transcends the lack of access to cash therefore points to the fact that the fight to wrestle down poverty in Kenya must of necessity factor in the broader dynamics of poverty as a complex phenomena. Indeed, this study is even made more relevant in the sense that it ultimately seeks to ascertain the capacity of microfinance to be successful in the light of questionable legal system that offers little or no guarantees at all for the protection of property rights, endemic corruption, bottleneck bureaucratic procedures, political instability, and volatile macroeconomic conditions amongst many others[2].

Consequently, this thesis is broadly divided into four distinctive distinct yet interrelated areas. The first part serves as the introduction with a complete appraisal of the subject matter and all its related constituent parts in conformity with standard academic presentations. The second part addresses the theoretical dimension of the subject matter backed by a comprehensive review of the available literature on the subject matter. There is also the description of the study setting and methodology designed to allow for a synchronized flow of the arguments I advance. The third section of the study is made up of the analysis of the theories and its application to Kenya thus the final part which includes policy recommendations and the concluding remarks of the study.

[2] According to the United Nations Poverty is "as the total absence of opportunities, accompanied by high levels of undernourishment, hunger, illiteracy, lack of education, physical and mental ailments, emotional and social instability, unhappiness, sorrow and hopelessness for the future. Poverty is also characterized by a chronic shortage of economic, social and political participation, relegating individuals to exclusion as social beings, preventing access to the benefits of economic and social development and thereby limiting their cultural development." Retrieved on August 16, 2010 from http://www.un.org/Pubs/chronicle/2002/issue4/0402p28.html

1.1 Statement of the Problem

According to the *2005 Poverty Reduction Strategy Document of the Government of Kenya*, the poverty prevalence rate in Kenya is intolerably high therefore making the need to tackle it an urgent priority. Given the sense of urgency with which the government and its development partners are pursuing the fight against poverty, it is not inconceivable that all types of policy instruments will be tried and tested with the jostling aim of fixing the problem. It is against this background that this paper takes the view that the use of microfinance as a poverty reduction tool literally amounts to the same troubleshooting approach to poverty reduction. Besides, it is prone to failure right from the outset in the midst of the inhibitory environmental challenges that will ultimately derail any meager gains that will be made.

It is worth emphasizing that the *2005 Poverty Reduction Strategy Document of the Government of Kenya* exhaustively outlines the policies designed to achieve the goal of halving poverty in the country within the medium to long term period. Indeed, it is beyond the scope of this current study to look into all the contending dynamics of the government's poverty reduction strategy; nevertheless it is the goal of this study to establish that in the light of the brouhaha behind poverty reduction an overt impediment towards the fight against poverty reduction is the degree of emphasis given to the role of microfinance in the quest to wrestle down poverty.

Unsurprisingly, this policy is an addition to the mainstream rhetoric that places the onus of eradicating poverty into the hands of the poor based on a belief that at the end of the day microfinance can be a source of empowerment that gives the poor the capacity to disentangle themselves from the web of poverty. Little doubt that the work of Mohammed Yunus in pioneering pro-poor microfinance schemes in Bangladesh has received popular acclamation for placing poor people on the driving seat in the march to assail poverty. Among other things this study seeks to look into this discourse most importantly to introduce a caution against a blanket assumption that once it seems to be working in Bangladesh[3] it is bound to work in Kenya.

But for an urgent inclusion of an endogenous policy that will accompany the microfinance initiative but as per now, the following reasons undermine the effectiveness of the current policies:

- There is very little empirical research that connects the allocation of microfinance to poor recipients on the one side and their ability to come out of poverty on the other hand besides the undeniable truth that its impacts are expressed socially than in economic quantification[4];
- Unscreened replication of programs doesn't guarantee achievement in reducing poverty some aspects have to be engineered endogenously, barring all unforeseen circumstances.

Having said so, the thrust of this study is to look into the intertwined connection between poverty in its absolute terms and microcredit as policy instrument to addressing the former, whilst doing so it comes with a related stated aim to look at whether the complexities of the policy environment in Kenya by itself is a disenfranchising factor that can ultimately undermine microfinance driven approach to reducing poverty. To achieve this task, this paper will be guided by theoretical microfinace concepts to discuss the contending issues from a poverty reduction perspective.

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[3] See http://www.womenaid.org/press/info/microcredit/micro%20bangladesh.html

[4] In the absence of sufficient supporting research, Dr Mohammed Yunus is reported to have conceded that his microfinance scheme is believed to help a little over 5% of recipients to get out of the poverty line. Watch this interview with Mohammed Yunus on http://article.wn.com/view/2010/07/07/Microfinance_credit_not_enough_to_uplift_poor_loan_manager/

1.2 Motivation and Justification for the Study

As the world approaches the end of the first decade of the twenty first century, international policy makers are resolutely committed to telling the world that the quest to achieving the Millennium Development Goal (MDG) of halving poverty is within reasonable grasp. Moreover, poverty-stricken developing countries such as Kenya are prone to try any poverty reduction policy, in some instances without any detailed prior background of the potency of the feasibility of policies.

A case in point is the Breton Woods sponsored Economic Recovery Program ERP which was re-packaged into the Structural Adjustment Programs (SAP) of the 1970s running into the 1990s, back then exhibiting a semblance of effectiveness yet eventually failed to generate the successes envisaged in its creation. In fact some of the gains from ERP and SAP were short lived in success model countries such as Uganda and Ghana thus (Vanderpuye, 2001). If history is anything to go by, then it is prudent to scrutinize the vigor with which microcredit is being touted as a viable poverty reduction policy as a wise guard against empty optimism.

In another sense, microcredit-driven poverty reduction in my view may also be seen as a means of sending a message to the lending countries that, poor countries in the global south are justifiably capable of managing their development needs and hence literally saying “keep your hands off.” Sounds good but not enough to provide answers to the real questions of what is desired and what is achievable, rightly so because what is desired cannot be achieved if the desired ideal is not put in the right perspective and hence pursued with the right means.

Consequently, in this study I am motivated above every other thing to also discuss poverty in all its tenets before calling for a hasty approach to reducing or alleviating it if you would. Understanding that poverty is a legion of problems conspiring to incapacitate the individual then it would lead to a better understanding of the fact that money alone does not answer the question of the problem of poverty.[5]

1.3 Hypothesis

Institutional weakness in Kenya will weaken the viability of microfinance in reducing poverty.

In the light of the need to reduce poverty in Kenya with a multiple of policy interventions is microcredit capable of achieving this goal?

[5] According to the UN poverty is "the total absence of opportunities, accompanied by high levels of undernourishment, hunger, illiteracy, lack of education, physical and mental ailments, emotional and social instability, unhappiness, sorrow and hopelessness for the future. Poverty is also characterized by a chronic shortage of economic, social and political participation, relegating individuals to exclusion as social beings, preventing access to the benefits of economic and social development and thereby limiting their cultural development." See http://www.un.org/wcm/content/site/chronicle/

Part 2

2.0 Theoretical Framework and Review of Literature

Otero (1999) defines microfinance as “the provision of financial services to low-income poor and very poor self-employed people.” It is these financial services that Ledgerwoord (1999) says is a lump of aggregates including insurance payments and other related financial services. Similarly, according to Schreiner and Colombet (2001) microfinance can also be defined as the “attempt to improve access to small deposits and small loans for poor households neglected by banks.” With this in mind it is apparent that microfinance in its whole state brings together credit, savings and insurance services to poor people across diverse socioeconomic settings.

In most of the literature reviewed, the use of the term microcredit and microfinance are carried out interchangeably thus making it appear as though they represent one and the same thing. However, some researchers have strenuously been able to draw a distinction between them, one which is not often so glaring yet cannot be overlooked if the subject matter has to be exhaustively discussed. One of such examples is Sinha (1998) who argues that “microcredit refers to small loans where as microfinance is appropriate where Nongovernmental Organizations and Microfinance Institutions supplement the loans with other financial services….” Thanks to this definition Okiocredit (2005) puts the two together to concede that basically microcredit is an extract of microfinance because it largely makes money available to the poor and may not include additional services where as microfinance extends to include the other extra details such as savings, insurance, payment services and pensions.

Both microfinance and microcredit are apparently recent innovations within the lexicon of mainstream development as Robinson (2001) alleges. In other words he argues that prior to the 1970s the concept was absolutely alien to development policy makers; which in most cases financial resource schemes offered to poor countries were tabled in the form of subsidization to national governments from donor countries. Due to complex network of government involvement and the unenviable level of pervasive corruption that characterized governance operations in the developing world during the decades in question much of the monies offered went down the drain without reaching the intended target of helping the poor get out of poverty (Robinson, 2001).

Following the advent of the Grameen Bank in the 1980s, according to Robinson (2001), the entire landscape of microfinance witnessed a significant shift for good; judging by the ability of this pioneering initiative to offer broad-based microcredit services to poor people on a grand scale. The progress of this initiative strategically challenged the prevailing conventions that essentially frowned on lending to the poor taking cognizance of the high risk associated with it. MIX (2005) adding word to Robinson (2001) asserts that it was during this period the term microcredit came to prominence.

Whilst microcredit programmes pay considerable attention on the repayment of all borrowed monies the subsidized rural programmes on the other hand do not. The repayment requirement of microcredit schemes also charges very modest interest fees to cater for operational costs and by streamlined consistency generate some profitability further providing the impetus for the so-called common sense model that hitherto advised against offering loans to poor risky lenders by financial institutions.

The stage was thus set entering into the 1990s for microfinance to be given greater leverage in if you like "development-driven-finance" in an unprecedented scale following the proliferation of several microfinance institutions in several developing countries such as India (Dichter, 1999). MIX (2005) further concedes that over time, microfinance institutions began the process of shifting their focus from just the offering of microcredit lending to include other traditional financial services such as savings in response to the increasing demand of these services by the poor irrespective of location.

In a monumental publication, the UNCDF in 2004 acknowledged among other things the enormity of the potential imbued in microfinance to spur development which becomes an extended fulcrum of the goal of eradicating extreme poverty. In this regard the publication identifies several areas that specifically posses the leverage to turn things around namely:

- The capacity to increase the economic wellbeing of poor households;
- Ensuring that extremely poor households are supported in their quest to address their very basic needs and effectively reducing their vulnerability;

It plays an important role in facilitating gender empowerment through enhancing the capacity of women to become economically engaged.

As stated in the preceding section in line with the definition of poverty as put forward by the UN the lack of access to finance represents a latent evidence of poverty and in this context the inability to access financial resources in itself works to perpetuate the severity of poverty. Von Pischke (1991) has identified a clear gap in access of financial resources especially amongst the vulnerably poor represented in the demand and supply of it. In seeking to account for the reason for the emergence of the gap, he points out that the gap is the product of an inherent high risk component translated into mounting costs associated with issuing loans to the poor.

Earlier studies by Weis and Stiglitz (1981) further leans credence to the associated risk in granting financial lending to the vulnerably poor that is made poignant in high transactional costs and an attendant extremely high moral consequence. Yet it has become imperative that the fight against extreme poverty will be lost if the poor are left to their own means; thus providing the motivation for the advent of microfinance institutions and services as an intervention poised to fill the gap in credit access for the poor.

There is also evidence to prove that another barring factor in the inability of the poor to access credit facilities from financial institutions stems from the lack of the capacity to furnish demands for collateral guarantees required by formal financial institutions. Harper (1998) alleges that thanks to this difficulty, a common trend is for poor people to seek alternatives in informal financial sources such as moneylenders to raise credit. Poverty is certainly a multifaceted phenomenon that includes the income perspective and the inclusion perspective. Both sides run concurrently in the general poverty discourse.

According to Holcombe (1995) viewing poverty from the income perspective, then the issues to be looked at include material disposition and annual household income earnings. In the same vein Hulme and Mosley (1996) in appraising the inclusion perspective of poverty gauges poverty from a holistic dimension that embraces entire scopes of universal deprivation that reduces victims to servitude, disenfranchisement and what have you. Viewed from the prism of microfinance then it can be inferred that clearly microfinance is relatively equipped to address the income aspect of poverty better than it can address the participation aspect of poverty.

From a policy dimension, *The 2000/2001 World Development Report* has stated that basically there are two main ways by which financial microcredit resources can be used as instruments in combating poverty. In the first instance, the report does concede that arguably the acquisition of microcredit is another means by which poor people can raise money to invest in new business ventures or expand existing business activities. Secondly, the ability of financial empowerment through microcredit to shield poor people from the vulnerabilities associated with deprivation is also acknowledged as another strong point in the report.

There has been a steady increase in the number of microfinance institutions operating in developing countries globally with varied degrees of success across the various operational areas (For instance see Robert Cull et al, 2007; Adongo and Stork 2005). The Grameen Bank under the innovative leadership of Dr. Yunnus Mohammed in Bangladesh so far is the most infamous microfinance institution with an estimated number of over 2 million members and counting. Meyer (2002) also reports that the Bank for Agricultural Cooperative in Thailand has also been carrying out significant microcredit lending to poor subsistent farmers in Thailand, especially with more gains in outreach.

In arguing strongly in favor of microfinance for the poor as part of the combating poverty drive, Otero (1999) is very emphatic in admitting that it serves as a source of providing productive capital for the lenders which can work in collaboration with other vital resources work to achieve this stated goal in a very effective manner. Indeed, flipping her argument to the other side, she is admitting without saying that poverty is a complex combination of several factors of which physical cash is part but not everything about it. One of the shining points of the argument put forward is that it by many indicators provides an empowering force that augments the ability of the beneficiary to be catapulted into the mainstream of the social fiber. And of course the key point here is empowerment which is by itself an integral facet of the drive to eradicating poverty.

Otero further argues that as microfinance is used to fight poverty, the trickling effect transcends the individual scope measured by the extent to which a collective definition of the impact is spread to the wider spectrum. By the wider spectrum we are certainly looking at the dimension of the potency of this widening rippling effect to engender a stronger institutional capacity to sustain the offering of financial services to the vulnerable and financially incapacitated section of society. In any case, as stated several times in this study and confirmed by Littlefield and Rosenberg (2004), the poor are definitely not an attractive target for mainstream financial institutions naturally because of the associated perceived or real risk involved in having any dealings with them.

At the core of Otero's argument about the institutional strengthening scope is that over time as microfinance institutions are engaged in business with the poor they steadily gain grounds on the working dynamics of the existing financial stream and with no doubt become integrated into the wider financial network thus making them good candidates to raise resources from capital markets to support their expanding portfolio structure for increased benefit spreading. International policy makers, academics and governments are progressively becoming convinced about the power of harnessing microfinance into the agenda set for the Millennium Development Goals (MDGs). For a comprehensive assessment of microfinance and the MDGs see (Littlefield et al 2003; IMF 2004; Simanowitz and Brody 2004).

Furthermore both scholars, Simanowwitz and Brody are quoted as saying that "microfinance is a key strategy in reaching the Millennium Development Goals and in building global financial systems that meets the needs of the most poor people." Just in the same way Littlefield et al (2003) are also of the authoritative view that "microfinance is a critical contextual factor with strong impact on the achievements of the Millennium Development Goals therefore microfinance is unique among the development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale." In reaching these conclusions all of them have reportedly conducted extensive studies of the process thereby reaching the certainty that it is a crucial element in promoting education, empowering marginalized women among other things.

Notwithstanding the above, there is still a considerable level of disagreement amongst pundits regarding the feasibility and sustainability of microfinance as a potent development policy instrument. Some of such pundits include Hulme and Mosley (1996) who have persistently maintained a skeptical outlook on the viability of the initiative at different levels. For instance they are quoted as saying that that “most contemporary schemes are less effective than they might be.”

Another skeptic of microfinance as poverty reduction instrument is Rogaly (1996), whose extensive research on the concept resulted in him coming out with several arguments to counter the dominant notion supporting the use of microfinance as a poverty reduction instrument. In fact him like Hulme and Mosley (1996) have come out to strongly argue that there are instances where microfinance turns to worsen the plight of the poor as opposed to improving their lot in contrast to the massive praise attributed to it. In his usual counter argument Rogaly is sternly saying that in the most real situations microcredit is not just useful in any way to the poorest of the poor, judging by the fact that the policy is concealed under an oversimplified presentation of poverty thus leaving out the other appendages of this complex phenomenon, thus at the end of the day we are back to square one.

2.1 Trends of Poverty Profile in Kenya

Kenya like most developing countries does not have a comprehensive reconciliatory layout between the state of poverty in the country and the potential impact it has on the overall policy making and implementation process[6] which results in an unfortunate consequence of limited impact on the poorest of the poor. Indeed, in the past there have been attempts geared at creating independent poverty mapping tools most of which have not been entirely applied by the relevant stakeholders for a host of reasons. One of the most conspicuous reasons has to do with the fact that most of the poverty mapping tools developed in the past were not specifically tailored to what may be considered as the emerging needs of stakeholders within and outside the scope of government. It is also symptomatic of a glaring state of inadequacy in consultation between developers of poverty mapping tools and the final users on the other end of the stick.

This notwithstanding, there is a formidable state of statistical data on poverty and its related trends in household income in Kenya. One of the key pioneering efforts in this direction traces its roots to the so-called Urban Household Budget Survey 1968-69, containing an early approximation of the state of income levels of urban households in Kenya, thanks to the work of the International Labor Organization's (ILO) Mission to Kenya. Following the heels and template of the International Labor Organization (ILO), the government of Kenya through the Central Bureau of Statistics carried out its own independent household income and budget survey but limited to the Nairobi area in 1974 (Vandermoortele and der Hoeven, 1982; Vandermoortele 1987).

[6] It is worth making the distinction between the Poverty Reduction Strategy Policy of the government of Kenya and the central focus on general development policy dynamics.

Ideally, a good starting point to gauge the state of poverty in Kenya is to look at the 1989 World Development Report which also is built on the foundation of the previous surveys carried out by the International Labor Organizations, which explains why it extends as far as the period around which these surveys were conducted. Also significant and worthy of mention is the influence the report has derived from the individual reports of the Integrated Rural Survey spanning a period of 1974-1978. The Integrated Rural Survey therefore provided the basis for deriving data information representing income and consumption trends of rural households especially those captured in the 1974/1975 report. Succeeding reports basically did not cover data explaining consumption and income patterns; which therefore left a void in the discourse about the connecting thread between the distribution of income between rural and urban households (Foster et al 1984).

Land tenure system not just in Kenya alone but across many parts of the world provides an indicator of the state of wealth. Yet the early studies of poverty such as those mentioned above were not charitable enough in providing answers to the question of the correlation of land tenure and the general scope of poverty in Kenya thus leaving a big gap allowing for speculation.

In a related World Bank study of Poverty in 1995, there was a marked transpose of poverty statistical data in forming the final report based on data already gathered from previous preliminary assessments. In fact one of the core issues in the report was to assess the connecting thread between important social indicators that measures wellbeing on the one side and poverty and its prevalence on the other side. The report like many others came out with recommendations about the way forward in tackling the gruesome poverty in the country, yet exhibited distinctiveness through its call for a simultaneous approach to fostering effective multi-stakeholder fulcrum of driving economic growth whilst complementing that with greater social spending to provide greater access to the poor. On one of the indicators of human wellbeing, a good starting point according to the report is to step-up public spending on preventive healthcare as opposed to curative healthcare.

Another staggering phase of poverty in Kenya is manifested in the ugly face of the disparity in income distribution especially within the urban setting. Therefore, poverty and income inequality becomes an inextricable whole of the discourse of poverty reduction in Kenya; justifiably the reasons for this move are founded on cogent current and historical realities that have far reaching implications. Take for instance the 2007 post-election violence that raged through the entire country leaving a massive pool of humanitarian, economic and social devastation in its wake. The violence that engulfed the nation does say a lot about the unacceptably high income inequality in that country. From the macroeconomic perspective there is no gain denying that no sustainable growth can be achieved under a prevailing atmosphere of income inequality. The Table below presents the income distribution disparity in Kenya over a specified period of time.

Table 1: Income Inequality in Kenya from 1997-2006 (Kenya Shillings)

Area	**1997**	**2005/06**	**Percentage Change**
Urban	4,436.59	5,493.96	23.8
Rural	1962.94	1,993.21	1.5
Quintile			
Poorest	708.07	7,02.99	-0.7
2	1,159.83	1,268.59	9.4
3	1,680.82	1,846.75	9.9
4	2,439.84	2,778.18	13.9
Wealthiest	5,758.93	6,895.72	19.7
National	2,349.36	2,698.12	14.8

Source: World Bank 2006

Consequently, to address poverty comprehensive it becomes imperative to get a firm grasp of its trend and impact across the socioeconomic landscape at any given time. One glaring face of the income inequality in Kenya is expressed on the spatial platform one which is very disproportionate on different levels. According to figures from the Kenyan National Bureau of Statistics there is a noticeable level of inequality in income levels across the various provinces in the country, one which also provides credible insights into other similar indicators such as general human development. As it stands now, the most stricken province of the country is the North-Eastern frontier. At the same time Eastern, Western and the Coast are fairing somewhat well relative to the North-East just because they are pegged a little above the average index of the poverty prevalence rate. Nairobi and the Central Provinces have got rates below the national average.

These figures translated into real data shows that during the period under review, conservative estimates states that 17 million Kenyan citizens which adds up to a little over 45 percent could not afford to buy and eat the food that provides them the optimum level of nourishment required to sustain a healthy life. Out of this 17 million, almost 14 million are domiciled in rural communities of the country and even more worrying is that one out of five of this figure could simply not afford getting their meal supplements granted they even expended their entire budgets in pursuit of healthy nutrition.

Poverty still remains a steady reality with very minimal changes towards improvement given that as of 1981 the total percentage of the population according to the World Bank below the official poverty line was pegged at a little over 40 percent; the inability to reduce the trend can be attributed to the erratic economic growth that the country witnessed during this same period (Nyoro et al 2008). Poor households continue to remain vulnerable to internal and external shocks manifested in hike in food prices, natural disasters such as droughts and floods, diseases and what have you. Naturally, the impact of the shocks does not in any way work to improve the lot of the already vulnerable household except dipping them deeper in the poverty slide.

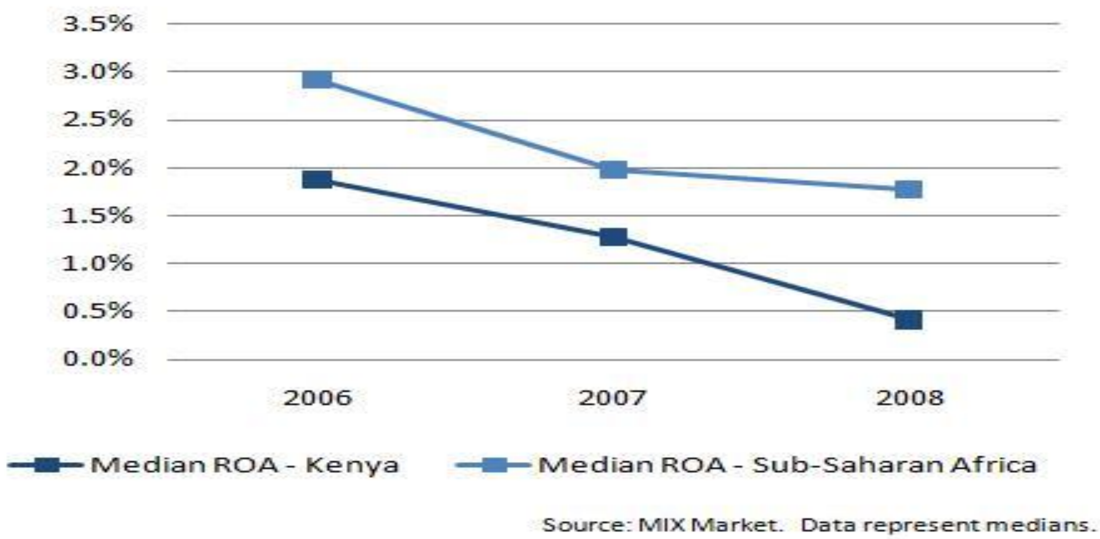
Part 3

3.0 Performance of the Microfinance Institutions

Taking a keen look at the MFIs' median rate of return on assets (ROA) will help us understand the trends in Kenya with Sub-Saharan region as the bench mark. As we can see in the figure 1 below, the ROA percentages in Kenya fell more drastically than those of the Sub-Saharan region, a clear cause definition of this trend will be the political chaos that ramped the country causing great economic and political instability which begun from late 2007 and also affecting the following year 2008.

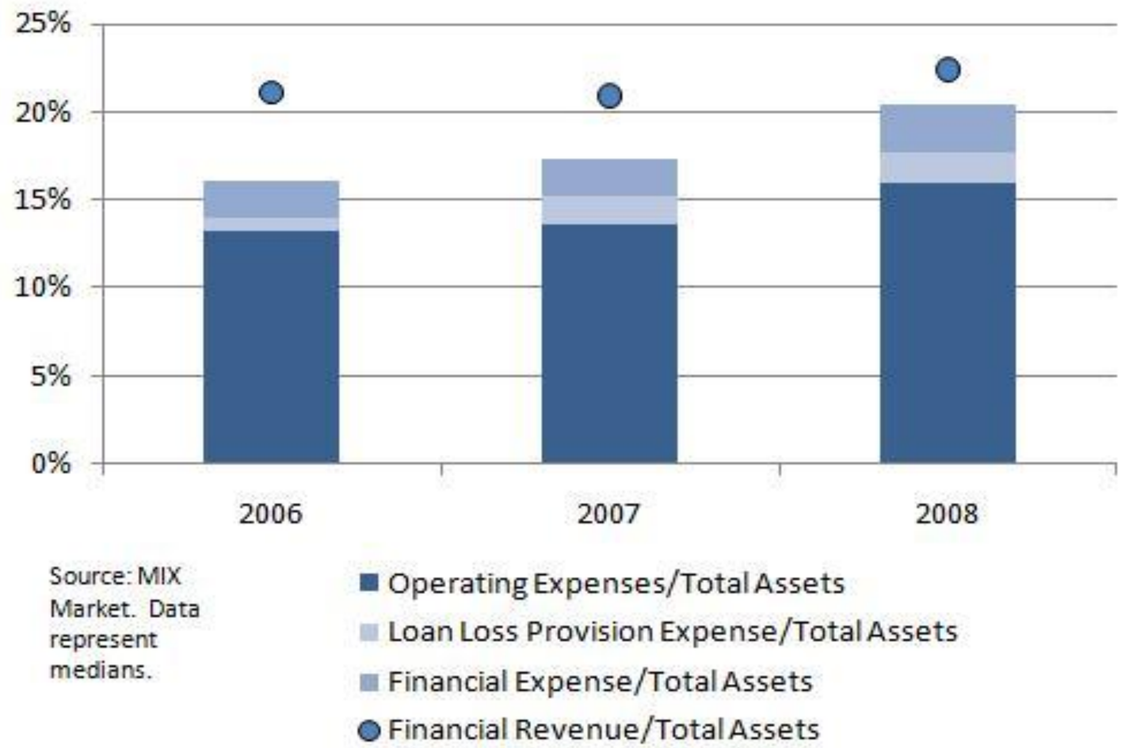
This clearly supports the argument that the microenvironment is important for the performance of any development initiative in the country like microfinance. In the graph below we see that Kenyan ROA fell way down to below 5% meaning that microfinance was not doing well in during this period.

Figure 1: Trends in return on assets (ROA)



The other aspect that I would like to look at in the performance of the microfinance is the operating cost; I found out that the operating costs have been increasing steadily from the year 2006 onwards. The analysts of market mix have shown in the below diagram that the profitability of microfinance have been held hostage by the rise in operating cost, financial cost and loan loss provision. The operating cost increments meant that poor people who are the main targets of the microfinance initiative are now being squeezed out of the market, since the increments affected most of the lending NGO MFIs which operate at the grass root level-where most poor people are found. **See graph below.**

Figure 2: The deconstruction of Return on assets



what is the matter with financial expenses and how do they affect microfinance anyway, the issue is that with the increase in the financial expenses due to the increase in the price of debt financing, it automatically results in high operational costs and loans. This means that the operational costs as a loan percentage of the loan portfolio that directly connects with the costs attached to every borrower's borrowing increases substantially. Kenya has of late realized high costs in terms of loan borrowing compared to the rest of the Sub-Saharan region.

Furthermore, the decrease in efficiency and expenses reflect high risk which means that the risk level of the microfinance loan portfolio have been increasing greatly. Thanks to the macro environment in Kenya mostly from the political sphere and corruption that plants paranoia in people making it difficult to work with each other, the political climate in Kenya has persistently complicated the efforts to get non-performing loans (Market mix). As a result the high risk level forces the MFIs to divert more attention and resources into pursuing loans , this move highly increases the costs and decreases the efficiency of the institutions: at the end of it all we are having less loans to the poorest of the poor.

See the graphs below

Figure 3: Change in efficiency two perspectives

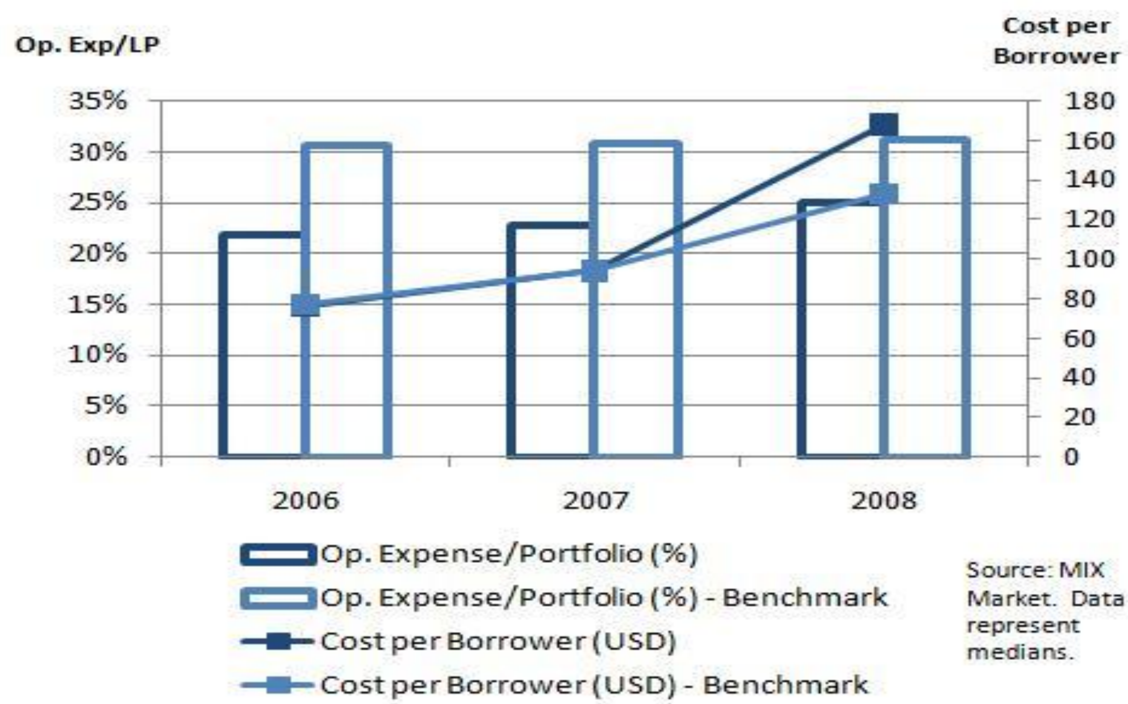
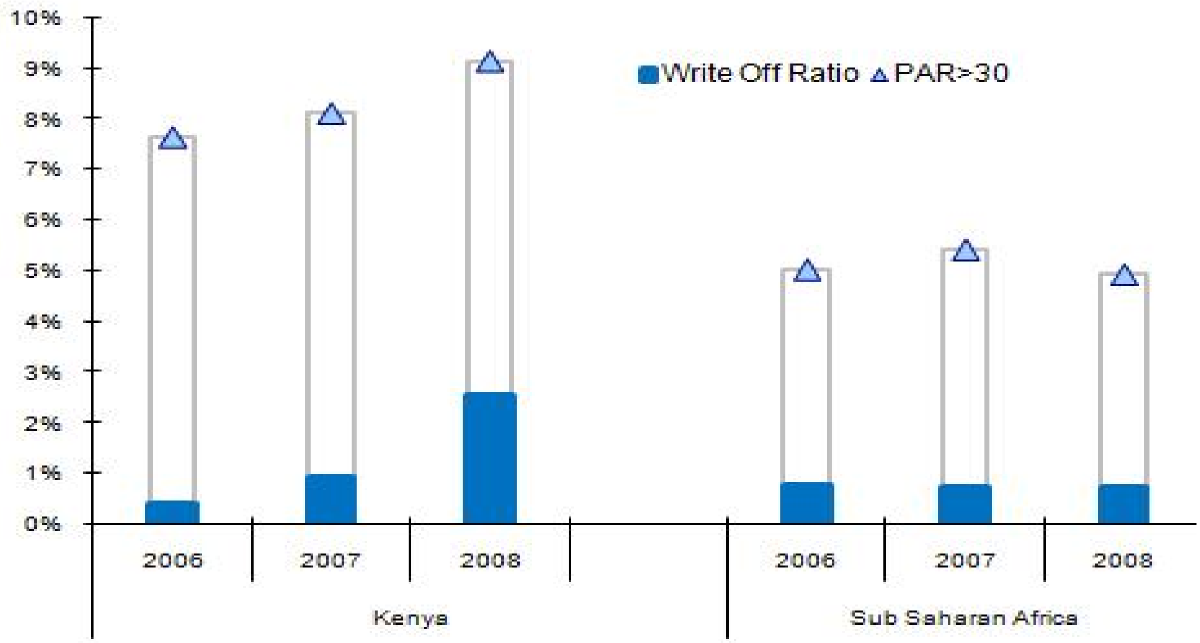


Figure 4: Portfolio Qualtiy Trends



Source: MIX Market.

Looking at the statistics below that comprises some of the well performing MFIs in Kenya, this paper looks at the changes that took place in the year 2008 and 2009, assumingly year 2009 should do better than 2008 because the year 2008 was marked with some chaos that might have affected the performance of the MFIs and the number of participants in the MFIs. Surprisingly we see the data shown which shows that the year 2008 had more active participating in MFIs than year 2009. The reason behind this can be attributed to high operational expenses and borrowing costs that I did mention earlier which in the end made it impossible for people to seek micro-funding however it's important to keep in mind that all the behaviors of the MFIs were a result of the prevailing macro environment, a good macro-environment reflects in the way business is going to be carried out while an environment that threatens the MFIs will eventually make it impossible for the institutions to operate driving away the customers just as shown in the figures below.

Table 2. Showing **8 MFIs** reporting data for **2008** and 2009

Name	Gross loan portfolio	Gross loan portfolio	Number of active borrowers	Number of active borrowers	
	2008	**2009**	2008	**2009**	
BIMAS	2,741,020	**2,631,820**	12,252	**10,353**	
Jamii Bora	8,553,871	**9,568,460**	81,989	**79,194**	
K-Rep	79,293,150	**71,128,108**	58,578	**56,534**	
Opportunity Kenya	2,616,697	**3,377,015**	10,332	**6,758**	
PAWDEP	5,601,190	**8,207,836**	42,000	**27,624**	
Equity Bank	535,813,060	**818,101,516**	542,249	**715,969**	
Faulu_KEN	37,630,058	**39,643,494**	91,105	**102,371**	

Sources: Mix Market (2010)

4.0 Constraints to the Success of Microfinance in Kenya

Admittedly, granted microfinance is properly administered under very conducive supporting environment then the resulting effects can be felt in both direct and indirect ways on development. In direct terms microfinance creates an opportunity to foster entrepreneurship which also results in income generation; employment and asset building to say the least. Viewed from the perspective of its impact in indirect terms the local economy stands to improve from the process of employment creation. There is also the aspect of empowerment that it offers to beneficiaries who are able to break through the vicious cycle of poverty.

Grandiose as these factors are, there are inherent integers that are exclusively capable of crippling the attainment of any of the gains mentioned above. The first test case of the success or otherwise of every form of economic activity in Kenya can be determined by the tenacity of the environment under which such an activity is going to be conducted. It brings to mind questions on issues such as the prevailing legal and regulatory environment that will be the base of the operation of the activity in question. Even in cases where there are good legislations or regulations it becomes also crucial to find out if there regulations and legislations are enforced or not. Having a legislation is one thing and its enforcement an entirely different thing though they are supposed to be very complementary at the root level.

Beyond these comes the added factor of the institutional capacity to sustain the running of an effective microfinance system in the country. The relevant institutions backed by the required resources to ensure the formulation and implementation of policy regulations at all levels reflects a sensitive aspect of the monumental challenges that have to be addressed. There should also be a comprehensive infrastructural base, which currently is clearly absent in Kenya. Consequently, the next several paragraphs will be looking extensively into this aspect of the thesis. Meanwhile, due to the constraint of space and time emphasis will be placed on the institutional and regulatory dimension of using microfinance as a poverty reduction instrument in Kenya.

4.1 Where We Stand today?

As the curtains of colonialism were been drawn during the early parts of the second phase of the twentieth century, it became very prudent to place national planning on the highest scale of the priority list of the emerging independent states of Africa. Indeed, planning was viewed as the precursor to sustainable economic development at all levels of the economy (Reference). Kenya as an illustration, soon after gaining its independence from the United Kingdom set in motion the process of institutional building to support the newly born state structure which was to be in continuum with the pre-independence policy of national planning. Post-independence bureaucrats in Kenya were of the view that the institutional base of the new state was not yet firmly consolidated and therefore required some centric guide to enable it eventually stand on its feet.

Much of the early economic development planning back then reflected a centralized government controlled economic management process. Understandably, this was unavoidable taking cognizance of the fact that the private sector was relatively undeveloped thus leaving the state with the monopolistic leverage to set the rules, implement the rules as well as being the sole player through state run corporations (Reference).

Over time the dynamics of the global economy compelled the government of Kenya to reconsider its state-centered approach to economic management, hence pursued very robust privatization processes to enhance compatibility with the new world free market economy. Whilst this has been laudable, it lacked a real sense of moderation in the extent to which the role of the state in the economy was utterly obliterated to the point where the state currently hardly recognizes its role as the facilitator of the economic process of the country.

The role of the state in the creation and consolidation of vibrant institutions to keep the economy optimally functioning has been lost in the charade of a so-called free market economy; though still very debatable. The missing link in the rapid deregulation process in the Kenyan system is undeniably the failure to properly define and articulate the exact role of the state in a free market economic setting (Shah and Mati, 2001, Pp, 7). By literally washing off its hands, the state is without knowing creating a vacuum that should otherwise be occupied by strong institutions that will facilitate a good partnership between the private sector and the state in steering the economic destiny of the country. Consequently, this is reflected in the multitude of ills that has saddled the country in the form of filthy corruption, poor property rights, poor macroeconomic management and political instability.

To enable the state perform its functions within the defining limits of the free market economy the World Bank initiated several policy measures designed to guide the government of Kenya towards the realization of these goals. They came in the form of conditionalities that required the civil service of the country to be overhauled and increasing the momentum of the fight against endemic corruption (World Bank, 1997).

Shah and Mati (2001) report that strengthening institutional capacity to deal with the public sector overhaul featured as the cardinal principle espoused by the World Bank during the period in question.

As a sign of its commitment to this goal, the World Bank insisted on the government of Kenya measuring very highly on accountability in financial and administrative management especially in the public sector (See World Bank, 2001).

For this reason the World Bank in 1998 reported that “This eroded institutional checks and balances reflects the lack of effective linkage between policy-making and budgeting, which is one of the critical weaknesses in Kenya’s economic governance” (Pp 08). Meanwhile, corruption still remained a source of headache in the quest to achieving effective economic governance in the country.

Despite the best intentions of the public sector and governance reform programs, much was not achieved largely because of the lack of political will to implement the reform measures to the latter. Leftwich (1996, Pp 15) points out that the depth of the conflict came mainly from the unwillingness to break with traditional populist politics that had deep roots in the governance system in Kenya. With the recent recognition of the devastating effect of diverse forms of corruption in the governance system of Kenya it has become abundantly evident to all stakeholders that corruption leads to a better conceptualization of the governance challenges confronting Kenya. To do justice to this topic it will be prudent to turn attention to the effects of corruption on economic governance in Kenya.

4.2 Costs of Corruption on Economic Governance

Being the leading development partner of the government of Kenya, the World Bank has the advantage of gaining an independent appraisal of the effects of the canker of corruption economic management within the country. As a result the World Bank has been able to study the trend and the phenomenon in very explicit terms and thus come out major areas that hemorrhage the most in terms of needless and wasteful costs to the economy of the country.

The World Bank classified the practice of "buying" officials in government bureaucracy charged with the responsibility of making or implement regulations. The sell out results in a state of compromise one in which an official trades off the public interest for his personal gains by intentionally neglecting to enforce legislations for sheer personal gain at the cost of the public. Cooksey (2000) likens the practice to a transactional trading process that involves the illicit give and take of demand and supply of public services, perpetrated by public officers.

Several scandals of "buying" of public officials have been reported in the past in Kenya with absolute impunity to the perpetrators reflecting the pervasiveness of this culture of "give and take" of financial payments between public officials and citizens.

Under such a culture of pervasive bribery and illicit payments, the biggest gainers become the highest bidder at the expense of the poor. In practical terms those with the means to offer hefty bribes to public officials will always have their where as those without the means to do so will be denied their legitimate service. Unhealthy competition is therefore the order of the day. This explains why Ikiara et al (2000) says that payment of bribes have become part of the fixed cost of production with a negative impact on efficiency and profit at the end of the day. A highly corrupt system also has the added disincentive of bolstering costs associated with transactional activities involving all the other factors of production.

Taking cognizance of the pervasiveness of the culture of bribery and inducements then it becomes a real concern to stand by binding contractual agreements knowing that money can always alter the terms of any written agreement. It highlights the general state of the inability to enforce contracts and other forms of property rights. The legislative regime has not been spared by the cancer of corruption meaning that they cannot be trusted to be impartial in their enforcement of contractual principles leaving in its wake an aura of uncertainty which ultimately does not auger well for the conduct of business.

As an example of a classical case of the atmosphere of uncertainty arising from the failure to enforce contracts is that businesses get around this problem by limiting activities to groups and individuals within a narrow caste that bars outsiders without regard for the viability or otherwise of the transactions they engage in. Credit is not also a very attractive form of payment in this environment thus compelling all transactions to be effected on a cash and carry basis which may not be very good for new entrants and worse of all small enterprises.

4.3 The Impact of Institutional Weakness on the Conduct of Business

Corruption as a sign of poor economic governance has been cited on several forums as a leading problem hampering the conduct of legitimate business transactions in Kenya. Then it becomes good to know just how this has direct impact perhaps in empirical terms on stifling business. The international anti-corruption watchdog Transparency International through its country office in Nairobi recently conducted a survey by gathering data from respondents with the aim of gauging the costs to businesses and individuals under the pervasive culture of bribery and corruption in the country. The methodology of the study was designed to capture all aspects of the economy of the country namely the corporate sector, small and medium size enterprises and lastly the random sampling of street respondents. The survey amongst other things sought to find information about the following key areas of the economy of the country:

- The frequency and trend of corruption in the country;
- The extent to which corrupt practices erode the profit of business entities;
- To provide information about the most corrupt public institutions;
- To quantify the ultimate cost of corruption on the economic output of the country. Based on a sampling data of respondents by categorizing them according to age, gender, socioeconomic status and educational level, the results of the survey indicated that 67 percent of participants encountered some form of coercion or open demand for the payment of bribes at public institutions. Out of the 67 percent of respondents who encountered one form of bribery situation or the other in soliciting for services from public institutions, 78 percent of the corrupt practices were encountered at institutions that offered regulatory and law enforcement services to the public.

It should be noted that each of these services are legally supposed to be offered at no charge to the person seeking the service. Among the many public institutions that have been damned for massive corruption by the survey respondents are the Judiciary Services, the Ministry of Lands, the Ministry of Works, the Immigration Department and the Police Service. The survey did also provide evidence to prove that those most vulnerable to extortion and the payment of bribes in the form of direct financial payments happened to be the poor and those with the least formal education. Translating this into quantitative terms where over 45 percent of the Kenyan population is considered to be poor then it means that the payment of direct bribes is almost an entrenched norm when it comes to seeking service from public institutions.

In a related survey conducted by Transparency International in 2008 to gauge the level of pervasiveness of the culture of bribery made use of a more inclusive methodology that brought in demographic indicators such as gender, location, age group, income status and educational level. The findings of the survey are presented in both appendixes I and II to serve as the reference point of the deductive and inferential analysis that will be used in this paper.

Think of the fact that the survey sample involved 2, 400 respondents out of which 87 percent representing 2,088 having experienced a situation where a bribe was been solicited in exchange for the offer of a public service clearly points to the state of governance in the country. Judging from the evidence presented in the data, there is certainly no gain denying that corruption in all its forms is highly symptomatic of institutional weakness revealing the poor state of general economic governance in the country. It promotes a culture that bloats transactional costs at all levels of doing business in very legitimate ways. Another cogent factor to this culture of imprudence as the data reveals is that ultimately the poor and the lowly educated turn to suffer the most by this system. If poverty reduction is going to target the poor by empowering them through microfinance services for them to be able to engage in productive micro-enterprise activities, then this same poor social group will become very inhibited in their bid to succeed. Business activities as mentioned in previous sections cannot thrive in an aura of uncertainty, high risk, high operational and transactional costs stemming from making illicit direct financial payments to regulators.

In any case, if the poor recipient of a microcredit service would have to make multiple payments by accruing debts on unproductive aspects of business then chances are that clearly if any gains in terms of profit is going to be made at all, at the end of the day its impact is going to be very insignificant so much that the goal of reducing the state of poverty of the beneficiary would have been defeated. For this reason, for microfinance to be successful as a poverty reduction tool there has to be a preceding commitment to reforming economic governance in Kenya to provide the supportive landscape for the implementation of a policy such as this. A porous state of economic governance is only fertile for more wasteful spending at the expense of productivity.

Having said this, it becomes imperative for future research to be focused on coming out with a concise quantitative study that will provide real empirical evidence of the amount of money that is lost in real terms from the state of poor economic governance in Kenya. Such a research will be a guiding roadmap to painting a better picture to policy makers both within and outside the government of Kenya as the country seeks to engineer economic development. In the interim it is uncontested that poor economic governance that is currently holding the government of Kenya siege would in the same way bound the policy of microfinance as a poverty reduction tool to a future of gloom that would not achieve its aim.

Part 4

5.0Policy recommendations and conclusions

Admittedly, the case for the success of microfinance as a potent source of reducing poverty in Kenya holds significant prospects in the long term granted the right policies are put in place in a holistic fashion. These include amongst other things understanding that microfinance as a pro-poor financial system cannot be treated in isolation to the core elements of the bigger picture of governance. Rapid political and economic reforms are required to create the ideal framework for the implementation of poverty reduction interventions. It calls for the entrenchment of good governance through strengthening the capacity of state institutions bolstered by strong political will to succeed.

The other area that I changes to be made is how different institutions especially those greatly involved with the poor is how they go about with the **Aggregate Measurement of Poverty in the country: It has to be revised.**

In order for Kenya as a country to be able to fight poverty successfully, there is a need for accurate measurement of poverty levels and its trends within the country. Thanks to the Kenya Institute for Public Policy Research and Analysis (KIPRA) which is the main Kenyan policy "think tank"- some milestones have been realized in terms of calculating the poverty levels in the country. Head-count index has been the most widely accepted method used to measure poverty in the country, the formula used to calculate poverty is very important since it help us determine the actions that need to be taken and also give an evaluation of the policies that have been implemented before to fight poverty. Consider the example in **Appendix 3 a.**

b. Yes the head count gives us results which are easy to calculate but not good enough to capture the exact level of each person's poverty making it difficult for the reflection of policy implications, in other words with the head- count index we cannot measure the exact reflection of the policies that were implemented nor the changes in income levels among the poor. See example in **Appendix 3b**

In both cases, the difference in poverty depth is not captured. Even though the income for most of the poor in 2) is increased by 1, the values of headcount index are the same making it difficult for any policy changes and recommendations.

My way of thought out of this circle-just as I mentioned earlier there is an urgent need for us to revisit the different methods and policies that we have been using, there should be a cautious approach to policy replicating from other countries and the urgent need to embark on restructuring our systems to what works best for us. We can move from using the head-count index and poverty gap index to using the **distributional sensitive index** which is much more accurate in tracking the levels of poverty. This will be the first step in monitoring and evaluating the policies that we are pursuing as a Nation i.e. the microfinance policy as policy to fighting poverty.

For a clear explanation of how the distributional sensitive index works please see appendix 4.

Equation: $p_2 = \frac{1}{n}\sum_{i=1}^{q}\left[\frac{z-yi}{z}\right]^2$

As we can see from the example above the distributional-sensitive index P2 yield results that are consistent with the *intuition*, this is due to the fact that P2 captures the income gaps among the poor. In the first year, there appears to be more poverty gap between the poor compared to the second case- as a result of changes in the income levels among those living below the poverty line. This will help the country know which policies work and which one to be abandoned as we wrestle down poverty, and what other constraints might be working against the growth of the policies thus offering guidelines or indicators to what needs to be done. Currently this is a big loophole in our in the Kenyan operational structures to fighting poverty.

Another successful and applicable story in pursuing growth endogenously is to borrow lessons from the South Korean "New village Movement" Saemual Undong**.**

The development of South Korea as a big power in the comity of nations is not a mere coincidence. It came as a result of hard work and dedication. The transformation of South Korea's economy from one of the poorest to an advanced industrialized one over the last five decades provides a case study for Africa to get out of her economic woes. This requires sacrifices and self help as exemplified by South Korea.

To borrow a catch phrase boldly written at the entrance of Posco Steel manufacturing industry in South Korea, "Resources are limited but Creativity is unlimited" amplifies the crux of the country's development. Africa, and for that matter, Kenya, has a lot of the natural resources and yet undeveloped. South Korea on the other hand, lacks these natural resources yet the country is developed and industrialized.

Koreans believed that their country can develop through proper planning and concerted efforts. In pursuance of this conviction, "Saemual Undong which literally means the new village movement education was replicated across the country based on the principle of diligence, self help and co-operation. This yielded concrete dividends shown by Korea's rural community development, and rapid socio-economic growth and development.

Consequently, Korea's institutions have imbibed the mind-set and behavior of hard work and see things done with diligently. A catch phrase "pali pali" meaning "hurry hurry" has been part and parcel of average Koreans in service delivery across the country today an aspect that still lags behind in Kenya.

While visiting Hyundai Motor Company I did respect the perspective and strong vision that the company has in its dealings, what the speak goes hand in hand with what they do and that has seen to it that the company is now among the leading motor companies in the world. They have coined their vision around meeting the needs of the customers both present and future needs.

If at all we are to make growth in Kenya sustainable, then there has to come a time where free lunch has to be replaced by rewarding the hard working, the Korean "Pali pali" "hurry hurry" spirit has to be amalgamated with the Hakuna matata "no problem" mindset, self help diligence and cooperation have to define the way we as Kenyans go about doing our daily business.

Borrowing lessons from Dani Rodrk's work "Goodbye Washington Consensus, Hello Washington Confusion" then three most important steps call for an urgent need of implementation:

- What is the most significant constraint to economic growth in the country that if tackled will yield greatest returns.
- Once we have identified specific constrains we need to come up with a creative and policy targeting the specific constrain of which this paper has identified corruption and institutional weaknesses as major constrains to economic growth.
- Then the third and most important is to institutionalize the process of diagnosis to ensure that economy forever remains dynamic.

Poverty reduction has for the last decade or so featured prominently on the agenda of international development policy makers. It in part informed the momentum with which the UN Millennium Development Goals (MDGs) were crafted and adopted. Giving that poverty is clearly a multidimensional phenomenon that transcends the absence of purchasing power many have wondered what is the most ideal approach to wrestling down poverty in its worse forms especially in the developing world such as Kenya. This has given rise to a barrage of proposals designed to reduce extreme poverty and one of such policy models that has gained an enormous amount of support is the role of microfinance as a poverty reduction tool.

Microfinance policies have been used as a source of alternative credit to the poorest amongst the poor who are traditionally not attractive targets to lenders. By offering credit services to the poor they in essence capacitated to initiate their own enterprises that should ideally engineer profit and a consequent spill over community development effect. It offers very modest micro development of empowerment to beneficiaries as evidence of some of the success stories in places like Bangladesh.

Kenya being a developing country with an unacceptably high rate of poverty, the adoption of microfinance as a poverty reduction tool should certainly be seen as a welcomed development. Yet this is far from the real practical situation on the ground. The particular case of the environment of the economic governance of Kenya does not in any way instill confidence in the adoption of microfinance as a viable poverty reduction policy instrument in Kenya. The core reason that has been articulated throughout this paper is that the macro environment is essentially an inhibitor to any sustainable and viable micro-enterprise. Tackling the challenges of the macro environment is in many ways an integral first step towards the realization of progress.

Another key argument advanced in this paper is the call to treat problems and solutions as two sides of the same coin rather than isolating them. Within this system actions and the respective actors are all playing within the same defining parameters of social engagement. Poverty reduction in Kenya should gyrate from an understanding of the complex dynamics of the phenomenon and an accompanying commitment by all stakeholders in the private sector, public sector and development partners to ensure that poverty is given a resolute assault.

A multisectoral collaboration towards poverty reduction in Kenya is imperative largely because the depth and scope of economic governance in the country is by no means near the level of efficiency; taking cognizance of the fact that economic malfeasance is the country receives a fertile ground for growth because of laxity of governance institutions that are acting in collusion against economic efficiency.

Suffice to acknowledge that the current situation of domestic institutional weakness is not a complete dead end situation because efforts are being put in place to reform the system but crucially the success of reform will be dependent on the level of corresponding political will that comes with it. It should also come in with a handy anti-graft public awareness creation to the public especially the poor and uneducated folks.

Public officials should also be held to the highest standards of ethical codes by the entrenchment of good governance and democratization. Indeed, many observers have hailed the recent adoption of the new constitution as the sign of a new dawn in Kenyan democracy. Effective governance at all levels is therefore an undeniable precursor to productive economic activities in Kenya which also means a trickling down effect on poverty reduction.

6.0 Appendix

6.1 Appendix 1: Sample Distribution by Province

Province	Total	Urban	Rural
Nairobi	421	421	0
Central	264	79	185
Coast	251	172	79
Eastern	320	82	238
North Eastern	76	14	62
Nyanza	357	151	206
Rift Valley	486	143	343
Western	225	45	180
Total	2,400	1,107	1,293

Source: Kenya Transparency International 2008

6.2 Appendix 2: Sample Distribution by Socio-Economic Characteristics

Variable	Total	Urban	Rural	Male	Female
Age					
18-24	32	36	28	30	33
25-29	21	22	19	19	23
30-34	14	14	14	14	14
35-40	12	12	12	12	12
41-44	5	5	5	6	4
45 and more	17	10	21	19	14
Education					
Primary School only	29	21	34	25	32
Post-Primary	8	6	10	7	9
Secondary School Only	37	40	35	38	36
Post-Secondary	17	24	12	20	14
University Degree	4	8	2	5	3
No education	4	3	5	3	5
Employment Status					
Unemployed	45	45	45	37	55
Self-Employed	33	31	34	37	29
Employed in Family Business	6	4	8	8	5
Employed in Private Sector	8	12	5	10	5

Employed in government or civil service	5	5	4	5	4
Employed in Community Sector	2	2	2	3	2
Parastatal	1	1	1	1	1
Monthly Household Income					
Less than 4,999	23	13	31	22	24
5,000-9,999	28	24	31	30	26
10,000-24,999	19	23	15	21	16
25,000-49,999	5	8	2	5	4
50,000-99,999	1	2	1	1	1
Greater than 100,000	0	0	0	0	0
Don’t Know	13	14	12	10	16
Declined to answer	12	16	8	10	13

Source: *Kenya Transparency International 2008*

6.3 Appendix 3a.

a. Looking at income distribution among 10 Nairobi residents in Kenya, (in dollars/day): [1, 2, 3, 4, 5, 6, 8, 8, 8, 8]. Suppose the poverty line is z = 7. Compute the headcount index H for the Nairobi residents.

Head-count index *H* = *q* / *n*.

Let *q* = number of people who live below z.

-> As 6 residents [1, 2, 3, 4, 5, 6] earn below poverty line (z=7),

q = 6

Let *n* = total population size.

-> 10 Nairobi residents [1, 2, 3, 4, 5, 6, 8, 8, 8, 8], n = 10

$H = q / n$.

$= \frac{6}{10} = 0.6$

6.4 Appendix 3b.

1) Head-count index for [1,2,3,4,5,6,8,8,8,8]

H = q / n = 6/10

2) Head-count index for [2,3,4,5,6,6,8,8,8,8]

H = q / n = 6/10

6.5 Appendix 4

Assuming the poverty line in Nairobi is z = 7, I will compute the distributional-sensitive index

P2 for Nairobi, in both the initial year and 1-year later, Showing the calculations.

Poverty line is z = 7

Equation: $p_2 = \frac{1}{n}\sum_{i=1}^{q}\left[\frac{z-yi}{z}\right]^2$

The first year:

$$P_2 = \frac{1}{10}\left\{\left(\frac{7-1}{7}\right)^2 + \left(\frac{7-2}{7}\right)^2 + \left(\frac{7-3}{7}\right)^2 + \left(\frac{7-4}{7}\right)^2 + \left(\frac{7-5}{7}\right)^2 + \left(\frac{7-6}{7}\right)^2\right\}$$

$$= \frac{1}{10}\frac{(6^2+5^2+4^2+3^2+2^2+1^2)}{49}$$

$$= \frac{1}{10} \times \frac{91}{49}$$

= <u>0.1857</u>

The second year:

$$\mathbf{P_2} = \frac{\mathbf{1}}{\mathbf{10}} \cdot \left\{ \left(\frac{7-2}{7}\right)^2 + \left(\frac{7-3}{7}\right)^2 + \left(\frac{7-4}{7}\right)^2 + \left(\frac{7-4}{7}\right)^2 + \left(\frac{7-4}{7}\right)^2 + \left(\frac{7-4}{7}\right)^2 \right\}$$

$$= \frac{1}{10}\left(\frac{5^2+4^2+3^2+3^2+3^2+3^2}{49}\right)$$

$$= \frac{1}{10} \cdot \frac{77}{49}$$

=<u>0.1571</u>

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