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REPUBLIC OF KENYA

THE NATIONAL TREASURY AND ECONOMIC PLANNING

ANNUAL PERFORMANCE REPORT FOR THE MSMEs CREDIT GUARANTEE SCHEME

2022/23 FINANCIAL YEAR

June 30, 2023

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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 4^{th} 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 8^{th} December, 2020, to support MSMEs to access quality and affordable credit. The Credit Guarantee Scheme is anchored on the Public Finance Management Act, 2012 and the Public Finance (Credit Guarantee Scheme) Regulations, 2020. In the 2020/21 financial year, the Parliament allocated KSh.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 KSh.5 million with a tenure 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.

The Scheme is a vital component of the Government's Bottom-up Economic Transformation Agenda (BETA Plan). The BETA plan is built around five priority economic pillars, namely Agriculture; MSMEs Economy; Affordable Housing and Settlement; Healthcare; and Digital Superhighway and Creative Economy. The Government has pledged to implement policies and structural reforms that promote investments in these areas, recognizing their potential to drive economic growth and development. By aligning with the MSMEs pillar of this agenda, the CGS plays a crucial role in supporting the growth and development of small businesses across the country. Through the Scheme, MSMEs can access affordable credit and other financial services, enabling them to expand their operations, create jobs, and contribute to the country's economic transformation.

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 2022 to 30th June 2023. The basis of the report is data submitted by PFIs through CBK.

C. CGS PERFORMANCE REPORT AS AT 30TH JUNE 2023

From inception to 30th June 2023, CGS disbursed a cumulative value of approximately KSh.5,751,289,611 billion to 3,846 MSMEs, across 46 Counties and 12 sectors of the economy as reported by the PFIs through the Central Bank of Kenya. All the three sizes of enterprises (micro, small, and medium) have benefitted from CGS facilities issued. Small enterprises received 2,240(58%), Micro enterprises received 1,047(27%) while Medium enterprises received 559(15%). 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 512(13%), youth beneficiaries were 254(6.7%), while PwDs were 10(0.3%). The beneficiaries of the CGS have so far supported a minimum of 23,631 jobs.

A total of 1,361 facilities have been fully repaid, representing credit amounting to KSh.1.58 billion. A guaranteed commitment of KSh.396.3 million has been released for additional qualifying MSMEs. This is the unique advantage of credit guarantees since funds can be revolved among more beneficiaries, upon repayment, thereby increasing the impact in the economy. The CGS has so far achieved a leverage ratio of 2.12 from KSh.2.71 billion committed to PFIs. This indicates that every one shilling committed by the Government has unlocked private sector credit of KSh.2.12 to MSMEs.

D. CGS PERFORMANCE REPORT FOR FINANCIAL YEAR 2022/23

In accordance with Section 59A of the Public Finance Management Act, 2012, the CGS Annual Performance Report for the Financial Year 2022/2023 is as follows:

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

During the FY 2022/23, approximately KSh.1,854,821,297 was disbursed to 1,356 MSMEs under the CGS. This disbursement represents credit guarantee value of KSh.463.7 million advanced to eligible MSMEs in the financial year.

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

During the FY 2022/23, no credit guarantees were liquidated under the CGS. PFIs have lodged a total of 37 claims for consideration by the National Treasury in line with the legal framework. The claims represent an outstanding principal amount of KSh.51,389,583 and CGS obligation of up to KSh.16,979,584. In addition, 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 2023

The outstanding credit guarantee is KSh.864.3 million as at 30th June 2023. Further, a guarantee value of KSh.396.3 million has been released as a result of full repayment of guarantees. 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 MSMEs 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 2023, CGS had 2,485 active facilities with a total outstanding principal amount of KSh.2,638,244,894. A total of 2,081 facilities were classified as "Normal" while 404 facilities were delinquent, that is, classified as "Watch," or "Substandard" or "Doubtful" or "Loss". The 404 delinquent facilities together represent an outstanding principal amount of KSh.365,404,467 representing potential claims up to a maximum of KSh.129,087,219.

One hundred and twenty-one (121) of the facilities were classified under "Watch" with an outstanding principal amount of KSh.109,748,313 million representing a potential claim amount of KSh.43,661,545. In addition, ninety-five (95) guaranteed credit facilities were classified as "Substandard" with an outstanding principal amount of KSh.75,761,280 and CGS's liability of KSh.28,051,832. One hundred and fifty-one (151) facilities were classified as "Doubtful" with an outstanding principal amount of KSh.140,294,320 and CGS liability in case of a claim is KSh.44,769,768. In addition, thirty-seven (37) facilities were classified as "Loss" with an outstanding principal amount of KSh.39,602,553 and a potential claim amount of KSh.12,604,074.

"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."

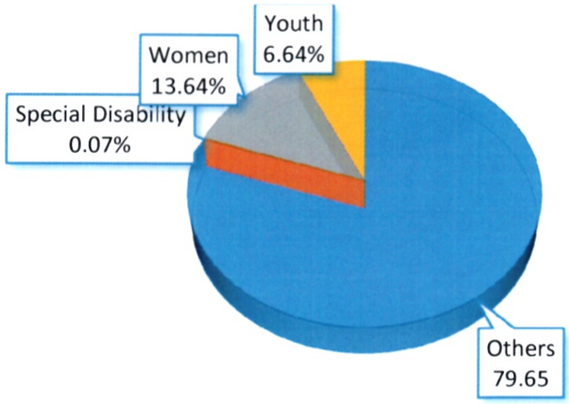
"Loss" facilities are considered uncollectible or if the collections are of such little value that their continuance recognition as bankable assets is not warranted. These facilities must have been due and unpaid for over 360 days.

(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 FY 2022/23, 20.35% of the total number of guaranteed facilities were disbursed to businesses owned by women, youth and persons with disabilities (PwDs). Women beneficiaries were 185(13.64%), youth beneficiaries were 90(6.64%) while PwDs was 1(0.07%). However, in terms of value of credit guarantees the proportion extended to enterprises owned by women, youth and PwDs was 15.53%, suggesting that this category of borrowers receives on average smaller volumes of credit facilities. Women received KSh.194,827,699 of the credit guarantees extended in the financial year, youth received KSh.93,253,019 while PwDs received KSh.150,000. The share of access by women, youth and PwDs has remained fairly constant over the period of CGS implementation. This can be explained by the fact that most enterprises owned by this group of population are informal and would not be eligible for support under CGS in the current legal framework.

The National Treasury will continue working with PFIs in order to increase the number of beneficiaries from these categories. Further, The National Treasury continues with its efforts in collaboration with relevant Agencies to build the capacity with this category of beneficiaries, focusing on formalization of enterprises.

Figure 1: Share of number of beneficiaries of credit guarantees by women, youth, PwDs and others in FY 2022/23



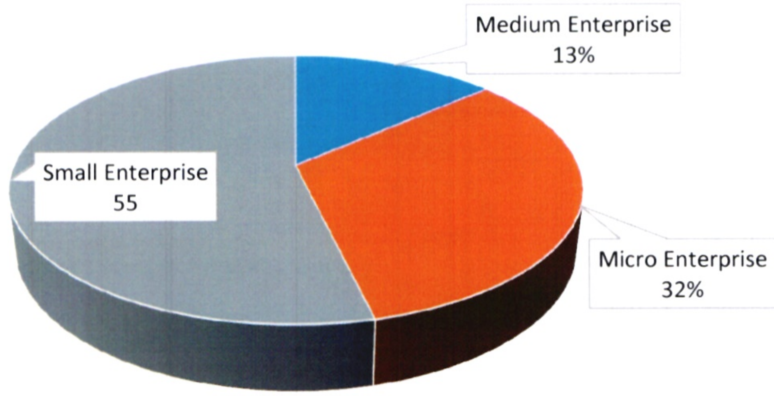
f) information on the total value of credit guarantees, disaggregated into the number of micro, small and medium enterprises guaranteed and by the respective regions;

All the three sizes of enterprises (micro, small, and medium) have benefitted from CGS facilities as reported by the banks through CBK. Of the 1,356 facilities issued under the CGS in FY 2022/23, small enterprises received 739(55%), micro enterprises received 440(32%) while medium enterprises received 179(13%).

In terms of value, small enterprises received KSh.1,109,016,372, micro enterprises received KSh.429,788,560 while medium enterprises received KSh.316,016,365. 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 with 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.**

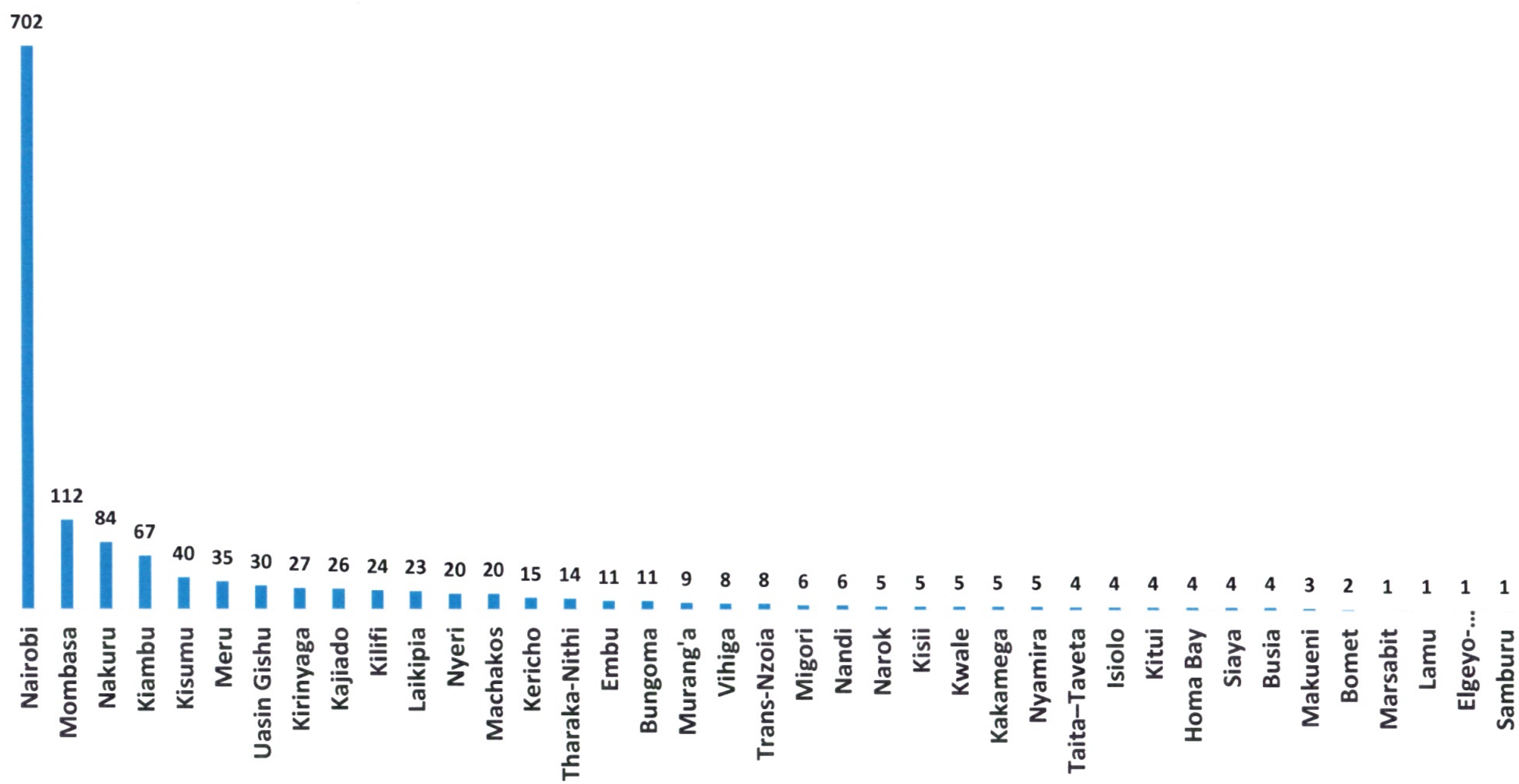
Figure 2: Share of beneficiaries of credit guarantees by enterprise size in FY 2022/23



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 2022/23, CGS recorded beneficiaries in 39 counties accounting for 83% of the total 47 counties in the country with high concentration in Nairobi (702), Mombasa (112), Nakuru (84) and Kiambu (67). 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 could be attributed to the fact that only one of the seven PFIs has presence in Mandera County. The CGS continues 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 for FY 2022/23



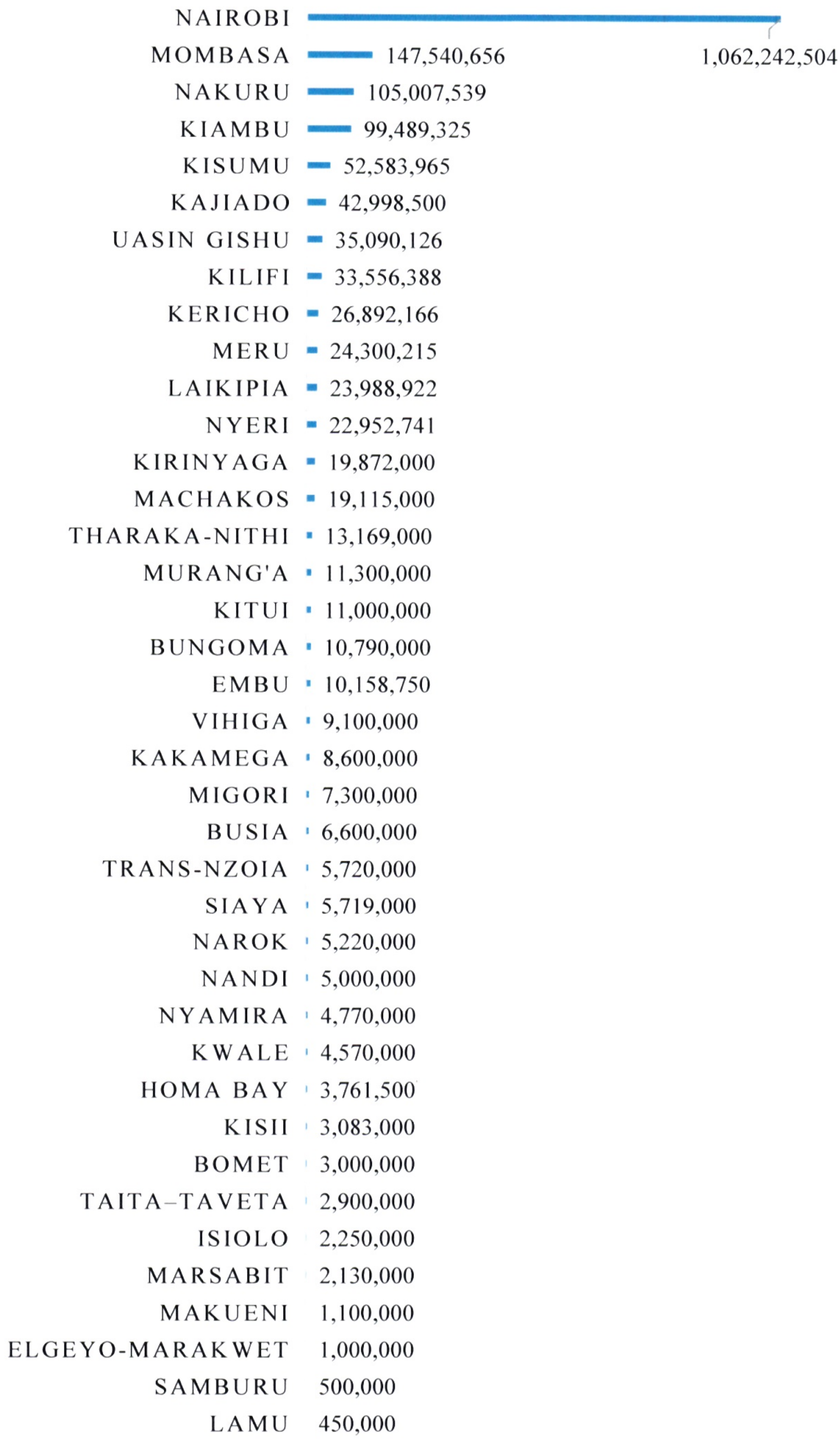


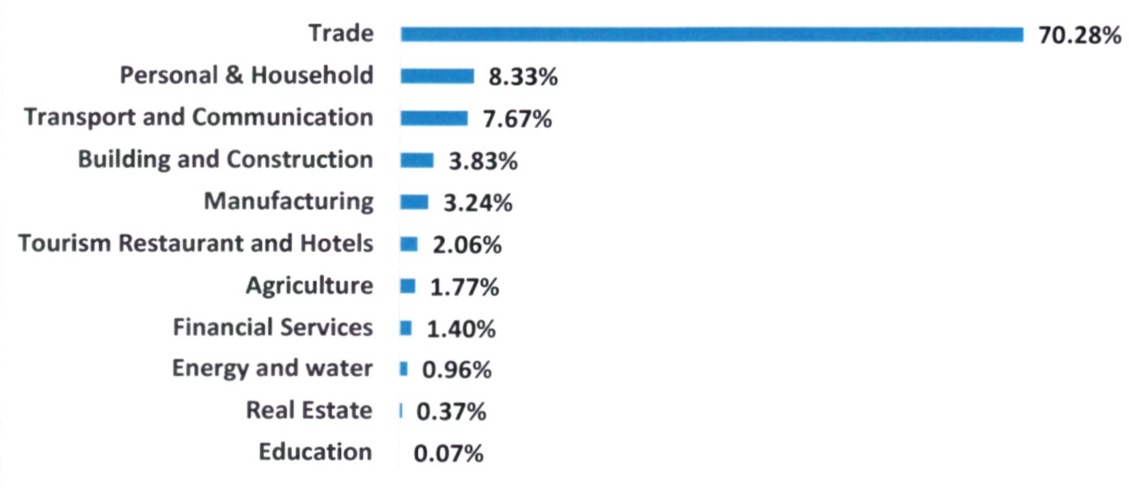
Figure 4: Distribution of value of guarantees by county for FY 2022/23

(h) Other relevant information.

i. Allocation of credit guarantees by economic sector

The facilities placed under the scheme have been distributed across twelve (12) sectors of the economy. Trade Sector has a cumulative share of 76% of the facilities issued under CGS since inception. In FY 2022/23, trade sector continued to receive a disproportionately high share of CGS facilities at 70.3%. This percentage is higher than the sector limit of 40% as per the CGS Agreement. This is followed by Personal & Household (8.3%), Transport and Communication (7.7%), and Building and Construction (3.8%). Agriculture sector received a much lower proportion of facilities at 1.7%. 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.**

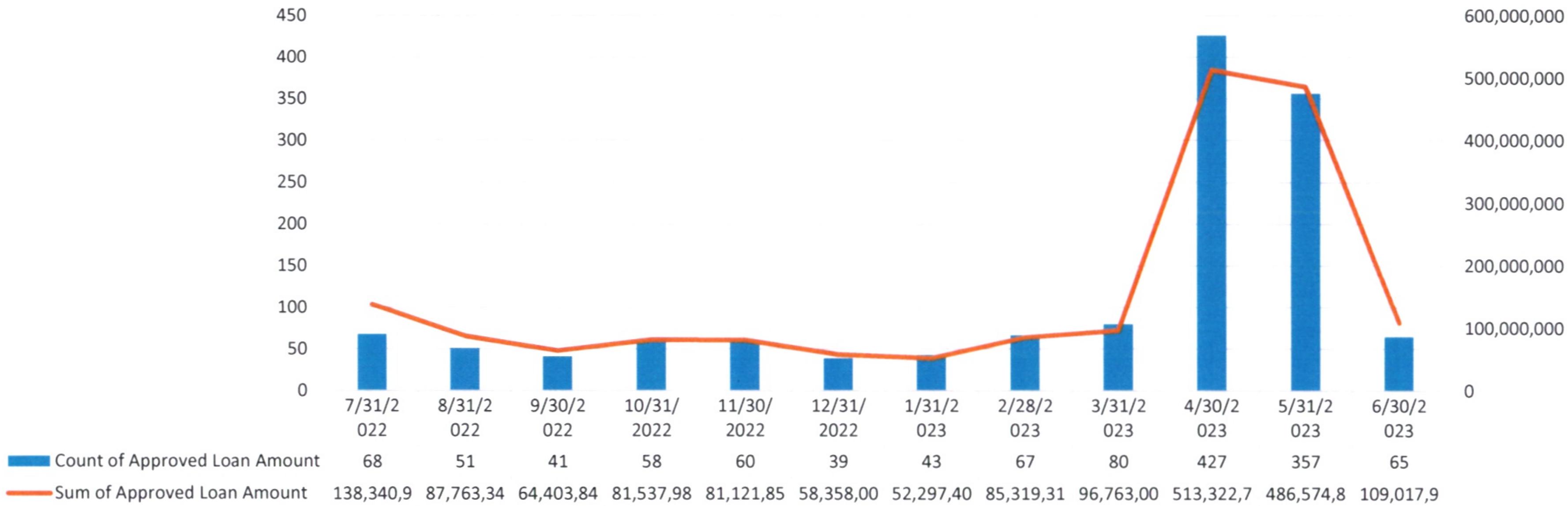
Figure 5: Share of credit guarantees by economy sector in FY 2022/23



ii Trend of number of guaranteed facilities

The number of guaranteed facilities stagnated below 100 for Quarter 1, 2 and 3 of the FY 2022/23. This slowdown in CGS performance in the first three quarters may be explained by the electioneering period and the related uncertainties which contract demand and supply of credit. Disbursements picked up in Quarter 4, with the month of April 2023 recording 427 facilities amounting to KSh.513 million in guaranteed credit to MSMEs, the highest CGS performance in terms of number of facilities since inception. This was continued over May 2023 with 357 facilities amounting to KSh.486 million of guaranteed 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 in FY 2022/23



iii. Guarantee Utilization as at 30th June 2023 (Liquidity Position of the Scheme)

The Scheme currently has committed a total of Ksh.2.711 billion to the seven PFIs. Of this amount, **Ksh.1,437,822,403** had been utilized as at 30th June 2023, representing a cumulative utilization rate of **53%**. Since inception of the Scheme, no credit guarantee has been liquidated. However, a total of KSh.141,856,770 has been provisioned for the 404 delinquent facilities as at 30th June 2023.

E. CGS ACHIEVEMENTS

The outreach of the scheme is as follows:

i. Since inception, the CGS has directly benefited 3,846 MSMEs across 46 Counties and 12 sectors of the economy.

ii. The beneficiary MSMEs have a total number of 23,631 employees. Assuming that an average household has 4 members, then the CGS has supported livelihood for approximately 94,524 persons.

iii. The CGS has so far achieved a leverage ratio of 2.12 from KSh.2.71 billion committed to PFIs. This indicates that every one shilling committed by the Government has unlocked private sector credit of KSh.2.12 to MSMEs.

iv. Out of the 3,846 facilities guaranteed by CGS, 2,796 (73%) went to new borrowers, that is, enterprises that had not received loans from PFIs before. This shows that CGS gives comfort to the banks to lend to MSMEs perceived to be risky.

v. Women beneficiaries were 512, youth beneficiaries were 254 while PwDs were 10.

vi. All the three sizes of MSMEs have benefited from the Scheme. Micro enterprises were 1,047, Small were 2,240, while Medium enterprises were 559.

vii. Out of the 7 PFIs, 6 offer lower average interest rates for CGS compared to the average market lending rate offered to MSMEs for the period of 1 to 5 years. This indicates that CGS has a positive impact as the banks are able to offer discounted interest rates for the MSMEs booked under the Scheme, thus reducing borrowing costs for these businesses.

viii. Out of the 3,846 facilities processed under the Scheme, 1,361 have been fully repaid. The total value of fully repaid facilities as at 30th June 2023 is KSh.1.58 billion. A guarantee value of KSh.396.3 million has been released as a result of full repayment of guaranteed facilities. The repaid guarantee value can be reallocated to additional qualifying MSMEs, implying that the credit guarantee achieves a higher leverage ratio in unlocking private sector credit for enterprises.

ix. The CGS has increased the credit worthiness of MSMEs by offering collateral support. Out of the 3,846 facilities booked under the Scheme, 1,938(50%) have zero collateralization indicating increased access to financing for these MSMEs who lack collateral.

F. 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. To align the Scheme with global best practices, it is critical that the Scheme be converted to an independent legal entity. The conversion of the current CGS framework into an independent legal entity will entail some amendments to the legal framework. This way, the CGS will be able to achieve financial sustainability and reduce its reliance on annual budgetary allocation from the exchequer. Discussions are underway to develop a more sustainable model which is aligned with global best practice for greater impact in the economy.

G. STAKEHOLDER ENGAGEMENT

The scheme has engaged various stakeholders on Credit Guarantee Scheme as follows:

a. CGS forum to reflect on the future of credit guarantee scheme in Kenya

The CGS conducted a forum on 6th July 2022 to explore possible areas for intervention to ensure growth and development of CGS. The forum was attended by staff from the National Treasury, Senior Advisor to the President, representatives from State Department of Industry, Trade and Enterprise Development, Kenya Revenue Authority, Office of the Attorney General, Business Registration Services, University of Nairobi Women Economic Empowerment Hub, Kenya Bankers Association (KBA), CEOs and Staff from the 7 Participating Financial Intermediaries (PFIs), USAID's KIM, World Bank Group, French Development Agency, British High Commission, Swedish Embassy, African Guarantee Fund (AGF), African Development Bank (AfDB) and KFW. The forum took stock of lessons and experiences learned on CGS implementation, documented proposals on areas of improvement to increase utilization, and future prospects of the CGS.

b. Participating Financial Intermediaries (PFIs)

To ensure compliance with the legal and operational requirements of the Scheme, CGS initiated a series of interactions with PFIs. Further, the CGS technical team held separate meetings with all the 7 PFIs to discuss performance at institutional levels. During the sessions, the following was done:

i. The banks were apprised on their implementation status of the Scheme;

ii. PFIs shared their experiences and challenges that led to low uptake of CGS facilities;
iii. The CGS updated the PFIs on the proposed adjustments in the CGS framework aimed at increasing the uptake of the guaranteed product; and
iv. Some banks received training on the process of lodging claims.

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 includes technical and financial support towards implementation of the Scheme. Among the development partners include FSD-Kenya, World Bank, USAID's KIM, IFAD, AGF and KfW. These partnerships are expected to ramp up the coverage and increase the impact of the CGS in the economy.

d. *Training for informal MSMEs:*

The CGS team in partnership with Absa Bank Plc, KRA and BRS conducted a virtual capacity building exercise for MSMEs on various aspects of the Scheme. The MSMEs were apprised on the requirements for registering their businesses, how to file tax returns and the importance of complying with the requirements to access the affordable credit. The major challenge facing uptake of the CGS is the informality of most MSMEs. The training was attended by over 150 participants across the country.

H. CHALLENGES IN CGS IMPLEMENTATION

Some of the challenges facing CGS include:

i. **Informality of MSMEs**: Most MSMEs are not registered and do not have tax compliance certificate as required by Regulation 10 of the CGS Regulations.
ii. **Definition of micro, small and medium enterprises**: Most of the enterprises do not fully fulfill the definition criteria set out in the PFM Act, 2012 and the MSEA 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.
iii. **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 chains are being classified as trade.
iv. **Moral hazard**: The challenge to create awareness on the credit guarantee while safeguarding the CGS from the risk of moral hazard.
v. **Automation**: the CGS continues to undertake manual processing of the CGS data which continues to be risky and unmanageable. Though the Scheme has noted a significant improvement in data received from PFIs through CBK there still exist some inconsistencies, errors and missing entries. It therefore becomes necessary for CGS to adopt a mechanism of data handling and management as it progresses towards finalization of an integrated management system.

I. 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 KSh.5,751,289,611 billion to MSMEs against a Government commitment of only KSh.1,437,822,403. Furthermore, participating financial intermediaries 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 to 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 finalize reviewing the CGS legal framework to enhance its sustainability and impact in line with international best practice.

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

iv. The Government to fast-track amendment of the PFM Act to review the eligibility criteria for more MSMEs to benefit.

v. 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 in consultation with relevant government entities to consider issuing policy guidance on classification of enterprises to improve consistency of reports.

vi. 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.

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

viii. The National Treasury to design and implement credit guarantee products targeting sectors beyond Trade in order to diversify the portfolio.

Signed: ....

NJUGUNA NDUNG'U, CBS

CABINET SECRETARY/THE NATIONAL TREASURY AND ECONOMIC PLANNING