Writing the Next Chapter of Africa's Success Story.

The Kenyan banking industry has proven to be innovative when it comes to financing Small and Medium-sized enterprises (SMEs). Although this may be a little-known fact, the industry's leadership has manifested itself in the increasing number of SMEs that are now able to access funding from commercial banks.

Unlike banks in other parts of the world, including the most developed markets like the United States or the United Kingdom, banks in Kenya do not shy away from supporting SMEs; in fact, they actively compete to channel investments towards growing these businesses.

A recent report by the World Bank illustrates some of the areas that banks are involved in as they finance SMEs; this financial support cuts across all sectors. The report also noted that banks in Kenya are well ahead of their peers in other African markets, including South Africa and Nigeria which have relatively well established financial sectors.

Promoting Enterprise Growth

Increasingly, banks are shaping their business portfolios around the needs of SME clients. A recent survey by the Kenya Bankers Association (KBA) found that more bank funding is being dedicated to businesses, with an industry wide increase in SME lending of about 35 per cent between 2010 and 2012.

In several cases, the Survey noted an increase in SME lending of about 50 per cent, over two years; and in one extreme case, a bank increased its lending by a high of 154 per cent between 2010 and 2012.

KBA found that across all of Africa, Kenya is leading in terms of the proportion of credit that goes towards this sector. Moreover, between June 2013 and June 2014, KBA member banks disbursed more than Ksh 190 billion worth of credit to micro, small and medium sized enterprises.

With increased activity targeting this segment, banks are continually developing unique solutions, including structured financing, cash management consulting, innovative savings products and various other services. In fact, the Survey found that 95 per cent of the respondents have developed on average five products specific to their SME clients' needs. This reinforces the view that commercial banks see SMEs as an important component with substantial growth potential.

It was also observed that the SME product suite ranged between 3 and 23 products per bank; and it is anticipated that more innovation and tailored products will benefit the SME market segment.
Banks are also deploying new technology and driving a more customer-focused strategy, including through channel redesign and client relationship management structures, to harness the business potential SMEs present.

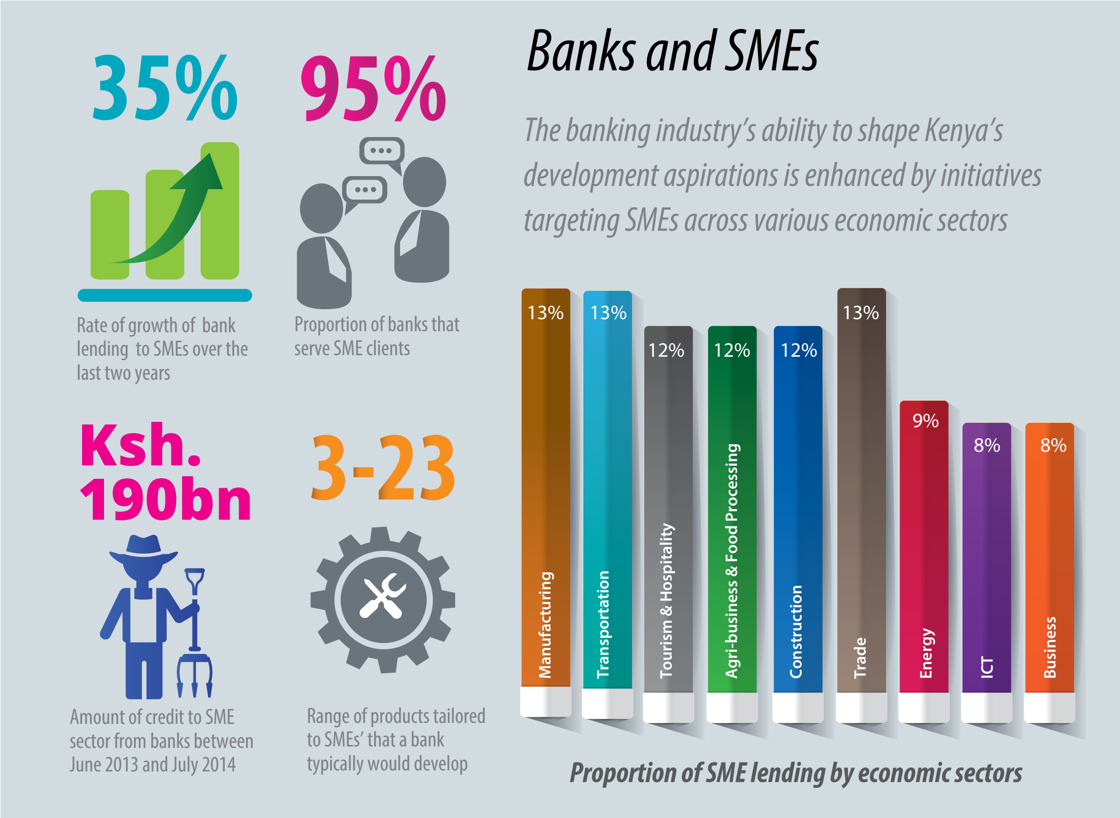
The findings of the KBA Survey conform to those of the earlier mentioned World Bank report in so far as the sectors that benefit from banks' direct funding to SMEs is concerned. These sectors include:

- manufacturing
- transportation
- tourism and hospitality
- agriculture and agro-processing
- trade
- real estate and construction
- energy
- information & communication technology
- education
- health
- insurance and other financial services
- business consultancy

In addition to direct lending, by operating profitable businesses banks significantly contribute towards Government revenue through taxes. It is estimated that the Government earns in excess of Ksh 37 Billion from bank profits. This revenue is directed to Government programs which include enterprise development. The other form of contribution that banks make directly to Government is through funding public sector initiatives through direct subscription to instruments such as infrastructure bonds. Whereas banks' lending to Government is typically seen as "crowding out" funds that could have otherwise gone to the private sector, the funding of Government programs geared towards creating capacity and efficiencies is enabling the private sector in general, and SMEs in particular.

Walking the Extra Mile with Clients

The SME Sector faces numerous challenges in a complex and dynamic market environment. Access to financing, as well as limited capacity to leverage market



opportunities and grow their businesses, are two fundamental areas that banks can directly influence thereby fostering accelerated growth of SMEs with a proven track record and potential. The KBA Survey found that the banks are a viable option for businesses that are already operating and need a financial partner to grow their operations and increase their economic impact.

For this SME client, banks are willing to go the extra mile through provision of a variety of value-added services that are mostly centered on capacity building, such as free training and seminars; coaching and mentorship; and facilitating trade expos and international business trips for clients to gain exposure to new markets.

Similarly, banks have entered into financing and capacity building partnerships with the Government of Kenya and other Development Finance Institutions such as the African Development Bank, USAID, World Bank, and European Investment Bank to enhance their clients' capacity.

Following Customers Across Borders

The East African financial landscape has transformed significantly over the past decade. Cross-border banking has become increasingly important especially to Kenyan banks, with 11 of them expanding their outreach across the five East African Community member states and beyond.

In 2013, the KBA Centre for Research on Financial Markets and Policy© conducted research to determine the motivation of banks' expansion across borders. One of the studies - "Determinants of Bank Expansion in the East African Community: An Empirical Analysis of Kenyan Banks" - published in the KBA Working Paper Series - indicates that Kenyan banks extend their footprint in the regional economies mainly because of the need to follow their clients abroad, efficiency and size of the banks, and the potential market opportunities of the host countries.

Another study - "The Drivers of Cross-border Banking Expansion: Evidence from East Africa" – published by KBA also concludes that, the follow-the-customer motive is a strong driver for bank expansion across East Africa.

The fact that banks are following their customers across borders is testimony that the regional integration initiatives have enabled enterprises to expand beyond national borders, and therefore motivate banks to seek to support their business clients wherever they are. These enterprises are not necessarily multinational corporations, but in many cases are home-grown Kenyan entities which often fall within the SME category.