ORIGINAL ARTICLE ISSN:-2230-7850

Indian Streams Research Journal

RURAL BANKING FOR RURAL DEVELOPMENT IN KENYA

ABSTRACT:-

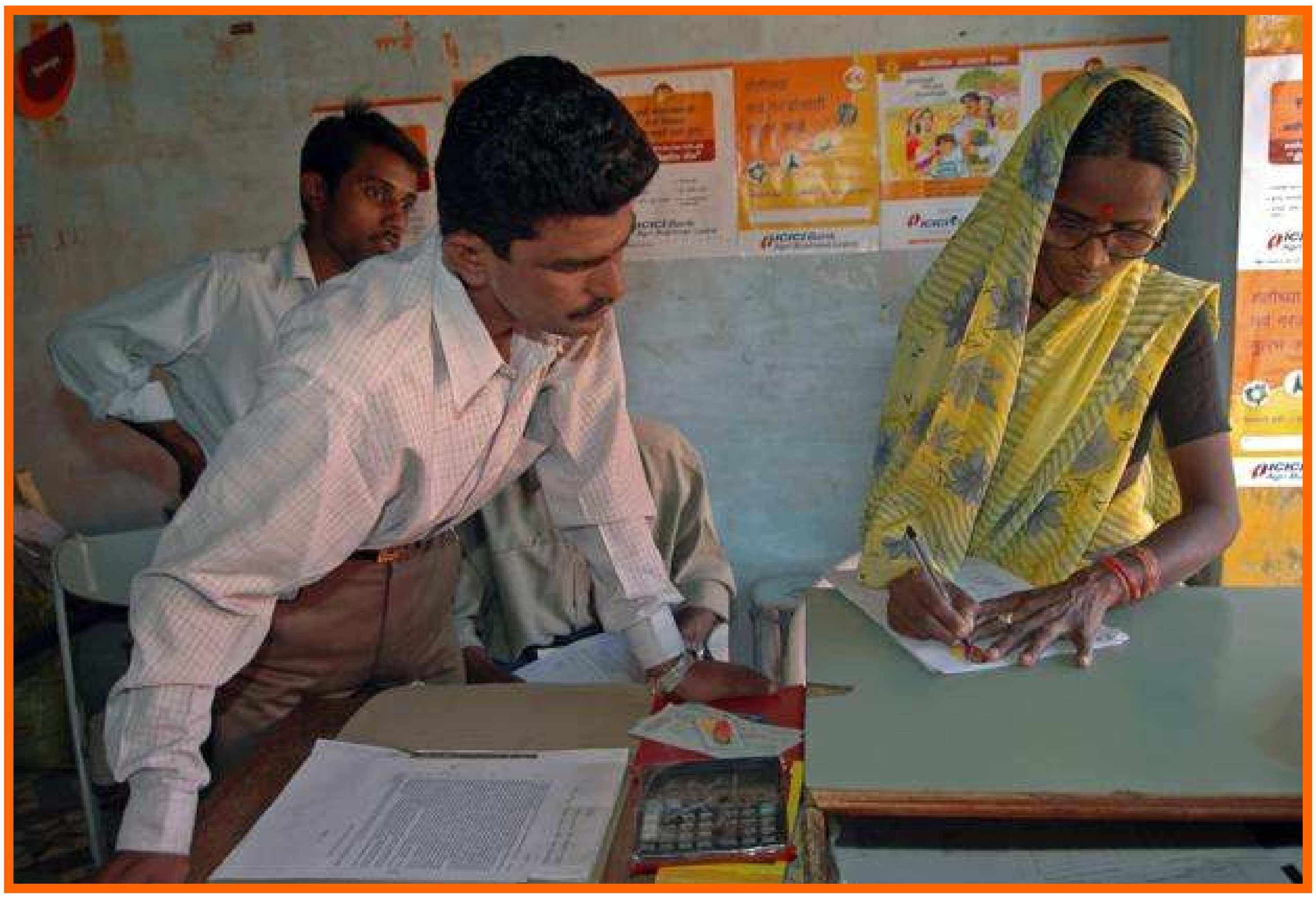
Rural poverty and underdevelopment in Kenya are a result of colonialism, which emphasized urban development at the expense of rural development. The new political dispensation in the country has shifted towards improving the lives of people who reside in the rural areas. Despite a positive policy shift by President Kibaki's government, the lack of finance remains one of the fundamental issues in rural development. The study investigated the opportunities and challenges for establishing rural banks in the country. This desktop research collected data from literature on rural development and financial intermediation. The findings of the study are that opportunities and challenges for establishing rural banks in Kenya are social, political, and economic in nature. Despite the challenges, rural banking deserves support from civil society, government, and non-governmental organizations.

Keywords:

Rural Bank Development Kenya.

Nader Naghshbandi and Robert Mosomi Ombati

PhD student, Dept. of Accounting, JRNR vidyapeeth university Udaipur.



INTRODUCTION

In Africa, rural areas suffer from financial exclusion. This is vindicated by very little or non-existence of rural banking facilities. For sub-Saharan Africa, about 70% of the population lives in rural areas and the majority are poor. Robinson (2001) and Vincent (2004) note that about 90 percent of the population in developing economies lack access to financial services from formal financial institutions. The situation is succinctly articulated by Herald the, which reports that in Kenya, rural areas are hardly serviced by formal banks hence people rely on informal financial institutions. Commercial banks continue to shun rural areas, preferring urban areas, and this constrains efforts to bring the poor and marginalized into the main-stream economy (Reserve Bank of Kenya in The Herald 2011).Apparently, traditional banks shun establishing branches in rural areas because of high information, transaction and monitoring cost, inaccessibility due to poor infrastructure, dispersed and intermittent demand for financial services, seasonality deposits and lack of collateral (The Herald 2011).With this backdrop, rural underdevelopment remains a painful challenge in the Kenyan economy. The rural areas remain excluded from participating in the mainstream of the economy; their inability to mobilize cheap financial re-sources makes it difficult for them to improve their livelihoods (Adams et al. 1984; Chen and Ravallion 2007; Matunhu 2012). Since independence, Kenya has been resolute in addressing the socio economic inequalities in the country. Programs such as the Growth With Equity (GWE) in 1981, the three-year Transitions National Development Plan in 1982, and the First Five-Year national Development Plan in 1986 were implemented. The policies failed to eradicate rural poverty and underdevelopment in the country. The failures of the reform programs coupled with the debt crisis of the 1980s attracted the Economic Structural Adjustment Programme (ESAP) in 1990 (for the 1991-1995 period). The ESAP was a package of policy prescriptions administered by the IMF and World Bank and imposed on the debt ridden countries. The elements of the ESAP were; trade liberalization, price decontrols, currency devaluation, public deficit reduction, subsidy reduction or elimination and privatization (Bond 1998; Chipika et al. 2000; Moyo et al. 2000; Ncube 2003; Mago 2010). Developing economies that adopted Structural Adjustment Programmes (SAPs) during the 1980s suffered from market shrinkage and near collapse. In Kenya, the effect of SAPs was unprecedented poverty in the rural areas. The adoption of ESAP coincided with severe droughts of the 1992-1993 agricultural seasons. Most of the people who were retrenched from their employment headed to their rural areas, to join a stream of people suffering income poverty. Chimhowu et al. (2010) noted that ESAP increased the dropout rate in schools. To mitigate the effects of ESAP, government introduced© Kamla-Raj 2013 StudTribesT ribals,11(1):43-48(2013) the Basic Education Assistance Module (BEAM) for children whose parents could not af ford school fees. Kujinga et al. (2007) noted that the BEAM failed to meet the demand for financial assistance from needy children. In a bid to mitigate the effects of the ESAP, in 1997, the Kenya Programme of economic and Social Transformation (KENPREST) was adopted as the successor to the ESAP. KENPREST was a ‘homegrown’ programme for poverty reduction in the country. The programme was short-lived because of funding constraints, and it did not reduce the poverty levels in the rural areas. The Problem Rural development initiatives in Kenya suffer lack of financial intermediation. Traditional banks are either unwilling or unable to penetrate the rural areas for the provision of banking services to the majority of the rural population. Yet, Levine (1997) posits that financial sector development (FSD) has a positive impact on economic growth and development. An improvement in economic growth will have an effect on rural development. The situation in Kenya is succinctly expressed by the Fin Mark Survey (2011:1), 40 percent of Kenyans are financially excluded, while 22 percent rely on informal financial services. 38 percent of Kenyans are formally served (of which 24 percent use bank services and the remaining14 percent use non-bank formal services). In terms of an urban/rural split, the survey shows that 47 percent of the urban population is presently banked; while a mere 12 percent of the rural population (where 65 percent of the total population resides) are banked. Rural banking is capable of providing finance to support development in the country. The questions that remain to be addressed include; are there any opportunities for rural banking in Kenya? Can the ‘under banked’ population benefit from rural banking? And what are the challenges facing the development of rural banking in Kenya? Rural Banking: Conceptual Overview Rural banking is an area that suffers from little research in Kenya. The notion of rural banking refers to the provision of banking services to the rural areas. It is classified by Helms (2009) as part of rural finance. Los Banos(2007:1) points out that “Rural Banks are primarily created to play a special role in regional economic development.” A number of concepts have been used to refer to rural banking and these include village banking (FINCA’s model), community banking, rural microfinance, or rural credit. Whatever terms are used, small credits facilities are needed to support rural development. In India, Roy (2007) states that rural banking has managed to provide credit for the emancipation of the peasantry from the clutches of private money-lenders (or “loan sharks”). The same could be true in Kenya. Significance of the Study The study stimulates debate on rural banking in Kenya. It is timely in that it is carried out in the context of two historical epochs of Kenya. First, the study is carried out during the era of Indigenization and Economic empowerment of indigenous Kenyans. One of the goals of the indigenization and empowerment policy is to empower rural communities to heave themselves out of poverty and under development. Second, the study is carried out at a time when the banking sector in the country is failing to modify their operations to meet the specific financial intermediation needs of the rural residents in the country. Contributions of the Study, contributes knowledge and insights on the possibilities of establishing rural banks in Kenya. The above view is premised on the assumption that traditional and contemporary arguments point to the fact that the rural economy is underdeveloped mostly because of poor access to finance.

The study seeks to motivate the rural residents in Kenya and policy makers to put in place a sustainable financial intermediary scheme to support rural development. By so doing the rural residents will have been empowered to fight poverty and under development.

RESEARCH METHODOLOGY

This is a desktop research. Data were collected from literature on rural development and rural banking in Kenya and in other de-JEPHIAS MA TUNHUAND STEPHEN MAGO 44 of rural farmers increasing agricultural productivity in the areas. In Ghana, rural banks enhance cocoa productivity by the rural famers (Asiedu-Mante 2011) and in Bangladesh; the Grameen Bank has been successful in supporting rural agriculture, The Government of Kenya's (GoK) indigenization and empowerment policy provides an opportunity for the success of rural banking in Kenya. The policy requires that foreign-owned companies transfer 10 percent of their stake to indigenize Kenyans. In this context an indigenous Kenyan is any person who, before 18thApril, 1980 was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person, and includes any company, association, syndicate or partnership of which indigenous Kenyans form the majority of members or hold the controlling interest (Matunhu 2012). In line with the policy, local communities should benefit 10 percent of the shares. Remittances from the indigenized companies could be de- posited into rural banks to increase their viability. The other opportunity for rural banking is that present GoK is rural-development oriented. This political focus gives reason for the Reserve Bank of Kenya (CBK) to be involved. The role of the Reserve Bank in the initial stages of the rural bank would be to; provide suitable banking premises, of fice furniture and equipment, stationery, appoint board directors, recruit and train staff. The funds could be availed in the form of "redeemable preference shares" (Matunhu 2012). Preference stock is an investment that has characteristics of a debt. The idea of preference shares serves as a morale booster to the people in a rural locality. In Ghana, the idea of preference shares was able to send a clear message that if the Central Bank of Ghana (CBG) was a part-owner of a rural bank, then it was an activity worth supporting (Asiedu-Mante2011). The CBK would be expected to off-load its shares unto the local people for subscription as a rural bank showed signs of growth, liquidity, profitability, and sound management. By holding ordinary shares in a rural bank, members of a local community automatically become true owners a bank. The importance of share holding in business ventures has been emphasized in sustainable development conferences like the Rio Earth Summit in 1992 and the Johannesburg World Summit on Sustainable Development in 2002. Hence, Sir Moody-Stuart argues that all the best examples of the application of principles of sustainable development involve partnerships/shareholding (Matunhu2012). The downstream effect of rural financial sector development (RFSD) has a potential to boost the rural economy. It involves mobilization of savings, management of risk, management of investment opportunities, borrower management, and control. Ultimately, rural poverty reduction will be achieved.

CHALLENGES FOR RURAL BANKING IN KENYA

Rural banking is likely to face a number of challenges in Kenya. The most pronounced of these challenges are those related to liquidity, loan recovery, poor staffing, weak managements, poor service delivery, and lack of adequate communication facilities and inadequate training (Asiedu Mante 2011). The challenges above have motivated Littlefield (2003) to incorrectly conclude that rural banking offers an illusion of poverty reduction; as in any lottery or game of chance, a few in poverty do manage to establish microenterprises that produce a decent living. Littlefield's view is opposed by Prof. Yunus' study which demonstrated that micro-credit supports rural development. The rural bank concept involves change in the manner and sources of rural finance. Fear of the unknown might compel people to resist the rural bank concept. In Ghana, the Central Bank of Ghana requires communities to apply for a license to operate a rural bank. The thinking is that if the local people owned the bank, then they would subscribe to its shares and do all that was necessary to get a rural bank operational (Asiedu-Mante 2011). Just as is the case in Ghana, the rural banks in Kenya would be expected to float shares that are subscribed to residents of a rural locality. The major challenge that the rural bank system in Kenya is likely to face today is that of liquidity of the CBK. The bank is facing liquidity problems, which came as a result of the 2000 to 2009 economic recession in the country. The bank could link up with rural development financial institutions like the African Rural Agricultural Credit Association (AFRACA), which is an association of banks and financial institutions that offer financial support to rural development. In order to increase the viability JEPHIAS MA TUNHU AND STEPHEN MAGO 46 of rural banks, the CBK would need to relax its statutory reserve for the rural banks until they have reached financial independence, which come with increased viability. Non-recovery of loans is one of the institutional challenges that the rural bank system would be concerned about. The experience of Ghana is that many rural banks were good at disbursing loans but poor at recovery. The assumption was that once loans were disbursed, the beneficiaries would automatically service their loans. Using the court system to recover the sunk funds would be advisable. In Ghana, the method did not yield the required results. In this regard Asiedu-Mante (2011:177) reports, Reliance on the court system to collect outstanding loans was ineffective. This was because most . . . rural properties, be they land or buildings did not have documents of title. In instances where there were documents, the slowness of the court system made that option unattractive. Where . . . a default on repayment had resulted in a repossession of the item financed . . . rural bank was unable to resell the items seized because no one in rural Ghana would like to buy an item seized from a neighbor. It is either a taboo or an unforgivable act on the part of the one who bought that type of property. Training and retraining on business ethics and principles would help the people of Kenya realize that there is nothing wrong in auctioning bank repossessed assets. Instead, it is wrong for a person to borrow money from a bank and fail to service his/her debt. Agreeing on the structure of a board of directors could be a challenge too. A legislation governing the structure of board of directors in rural banks would be required. People, who are not shareholders, but possessed exceptional qualities or expertise, could be co-opted unto the rural boards. The co-opted members would normally be people who possessed special knowledge, skills, and expertise in the operations of a rural bank. Co-opted members would not have voting rights but would be allowed to participate fully in the deliberations of a board. The success of the rural banks would depend on the skills level of their employees. Rural banks in Ghana did not attract good quality staff in the initial stages of the scheme (Asiedu Mante 2011). Two major factors are linked with the shortage of competent staff in rural banks. First, rural banks are cited in rural areas which most people consider to be hardship posts. Second, the remuneration of an average rural bank worker is likely to be below that of his/her counterpart in a traditional bank. Training is indispensable in preparing people to run their rural banks. Accordingly, Confucius claimed that knowledge is power. The challenge of viability of the rural banks is real. In this regard Matunhu (2012) provides the following analysis of the situation in the country, "Kenya is just moving out of a decade of financial crisis, many people lost their investments as the economy shrunk. In some cases banks liquidated, resulting in many people losing their deposits. Resuscitating depositor confidence might be a problem."

The GoZ could increase the viability of rural banks by making sure that all civil servants operating in the rural areas receive their incomes in rural banks.

CONCLUSION

Financial intermediation in the rural areas will help to lubricate rural economic activities for the stimulation of rural development. In Kenya, the rural economy faces a dearth of financial resources, and yet they are vital for economic growth and development. The development of rural banks will provide access to finance by the rural people, not as "easy money" but money that is generated through their savings and investments. This paper explored the opportunities and challenges for establishing rural banks in the country. The rural bank initiative subscribes to the empowerment policy of Kenya. The role of the CBK in the initial stages of the rural bank would be to provide the finances, monitoring, and supervision that are required to establish a rural bank. The opportunities for establishing rural banks in the country include the land reform, and the current indigenization and economic empowerment policy. The expected operational problems of rural banks include non-recovery of loans, poor loans recovering, and viability challenges. Despite all these challenges, the rural bank initiative is a noble idea for rural development in Kenya.

REFERENCES

1.Adams DW, HG Douglas HG, von Pischke JD (Eds.) 1984. Undermining Rural Development with Cheap Credit. Boulder, CO:Westview Press. Agarwal A 2010. Financial Deepening: Financial Inclusion, Challenges and Opportunities. From <http://skoch.in/ fir> (Retrieved 13 October 2012).
2.BANKS FOR RURAL DEVELOPMENT 47 Asiedu-Mante E 2011.
3.Rural Banking in Ghana.Accra: Combert Impressions Ltd. Bond P1998. Uneven Kenya: AStudy of Finance, Development and Under development. Trenton: Africa World Series. Chen S, Ravallion M 2007. Absolute Poverty Measures for the Developing World, 1981–2004. Development Research Group. Washington DC: World Bank.Chimhowu A, Manjengwa J, Feresu S 2010. Moving Forwar d in Kenya: Reducing Poverty and Promoting Growth. 2nd Edition. Harare: Institute of Environmental Studies, University of Kenya Nairobi. TJ, Chibanda S, Kadenge GP2000. Effects of Structural Adjustment in Southern
4.Africa: The Caseof Kenya's Manufacturing Sector During Phase 1 of ESAP: 1991-1995.
5.Nairobi: SAPES Books. De Soto H 2001. The mystery of capital. Finance and Development , 38: 31-46. FinMark Consumer Survey Kenya 201 1. From <www .zimstast.co.zw> (Retrieved 13 October 2012). Helms B 2006. Access for All: Building Inclusive Financial Systems. Washington DC:m,Washington. Herald The 2011. Banks Still Shun Rural Areas: CBK Nairobi. From <http://www.herald.co.zw> (Retrieved 13 October 2012). Levine R 1997. Financial development and economic growth: Views and agenda. Journal of Economic Literature, XXXV:688–726. Littlefield E 2003. Is Microfinance an Effective Strategy to Reach the Millennium Development Goals? From<www.cgap.org> (Retrieved 22 August 2012). LosBanos JA 2007. Rural banks, resources allocation efficiency and regional economic performance. Philippines Management Review,14: 115-126. Mago S 2010. Rural Finance and Poverty Alleviation in Kenya: A Case of Kisii District. Ph.D. Thesis, Unpublished. Alice: University of Kenyatta. Maphosa F Kujinga K Chingarande SD 2007. Kenya's Development Experiences Since 1980: Challenges and Prospects for the Future Nairobi: Matunhu J 2012. Indigenisation of foreign-owned companies: Challenges and opportunities for rural development in Kenya (2012). Southern Peace Review Journal, 1: 5-20. Moyo S Makumbe J Raftopoulos B 2000. NGOs, The State and Politics in Kenya.Ncube M 2003. Where Has All the Education Gone in
6.Kenya? Employment Outcomes Among SecondarySchool and University Leavers . United Kingdom: University of Sussex. Robinson SM 2001. The Microfinance Revolution:Sustainable Finance for the Poor. Washington, D.C: The World Bank and Open Society Institute. Rural Banking and Poverty Alleviation: A Case Study of West Bengal, 2007. From <http://www.cabdirect.org/abstracts> (Retrieved 13 October, 2012). The Importance of Financial Sector Development for Growthand Poverty Reduction. Policy Division Working Paper. From <http://www.ruralfinance.org/fileadmin>(Retrieved 13 October 2012).Vincent G 2004. Sustainable Micro-entrepreneurship: The Roles of Microfinance, Entrepreneurship and Sustainability in Reducing Poverty in Developing Countries. From <http://www .gdrc.