TRANSFORMATIVE BUSINESS FINANCE TRAINING

FROM NECESSITY TO OPPORTUNITY ENTREPRENEURSHIP

Target Audience: Micro & Small Business Owners.

A Training by KFSE.

ACKNOWLEDGMENTS

This manual has been made possible by the generous support of the KOPPA LAB – who also supported the capitalize the KFSE Economic Empowerment Credit, a digital credit provider to support the implementation of the training contained in this manual.

KFSE would like to recognize and appreciate the contributions made by David Mbote the KFSE executive director, who drafted the 1st draft of this manual. Rufus Kandie and Elvis ------ supported in further development through their detailed review and substantial improvements to it…..

CONTENTS

Acknowledgments 2

Introduction 6

Module 1 7

Business Financial Management 7

Introduction 7

Keeping Good Financial Data 7

Business Management 7

a) Planning Activities 8

b) Organization 8

c) Directing 9

d) Staffing & Resource Mobilization 9

e) Controlling 9

Record Keeping for Business 10

1. Cashflow Statement 10

2. Profit and Loss Statement 13

3. Balance Sheet 14

Illustrations 15

Module 2 19

Managing Business Growth 19

Differentiating between Necessity- & Opportunity/Market-driven entrepreneur 19

Characteristics of a successful entrepreneur 19

Challenges facing business growth 20

Converting Necessity Business into Opportunity business 20

Gap in the Market & Market in the Gap. 21

Business Growth Strategies 21

Business Growth Financial Plan 22

Projected Income and expenses 22

Projected Cashflow Statement 24

Module 3 27

Sources of Business Finance 27

Formal & informal Sources of Business finance 27

Banks 28

Microfinance Institutions 29

Digital Credit Lenders/Providers 30
Should your business take a loan? 31
When Not To borrow 31
Preparing the business for borrowing 32
Module 4 34
Loan Management and Repayment 34
Cost of Borrowing 34
Understanding Loan Terminologies 36
Total Cost of Credit 37
Module 5 40
Loan Management and repayment. 40
Loan Management & Repayment 41
Applying the loan for the right purpose 41
Managing cash flow for loan repayment 42
Repayment Discipline 43
Early Warning Signs of Repayment Trouble 43
Responding to Financial Stress 43
Timely loan repayment 43
Loan Negotiation 44
Module 6 46
Evaluating a business ability to pay a loan 46
Why Ability to Repay Matters 46
Practical Valuation Tools for Small Businesses 46
a) Net Present Value (NPV): 46
b) Payback Period: 47
c) Break-even Analysis: 47
d) Debt Service Coverage Ratio (DSCR) 48
e) Scenario Analysis – Interest Rate Sensitivity 48
f) Simplified Discounting and the Cost of Capital 48
g) Stress-Testing Your Business 49
Important Financial Ratios to consider when taking a loan 49
a) Profitability Ratios 49
b) Liquidity Ratios 50
c) Efficiency Ratios 50

Forecasting Cash Flows and Loan Repayment Capacity 50

Alternatives to Loans 51

INTRODUCTION

At KFSE, our vision is to economically empower people at the margins of the society. To empower means - authority or power given to someone to do something. Thus, Economic Empowerment means to give people Economic Power. That is what our work at KFSE is about.

Marginality – in its various dimensions, such as social, economic, gendered, or even geographical can mute a community's or individuals' ability to live at their fullest potential. When twinned with poverty, a feedback loop mechanism that is interlinked and self-enhancing is created. It requires a strategic intervention to disrupt that oppressive mutual amplification of these two factors.

In our economic empowerment interventions, we seek to become a strategic catalyst that will dynamically add an empowering ingredient into people's lives such that they become agents of their own sustainable emancipation. In this manual, this ingredient is an easy-to-understand business finance training, which comprises the following topics:

- Sources of business finance
- Project financial viability valuation
- Cost of capital valuation
- Loan management and repayment
- Negotiating for business finance

Financing for micro & small enterprises (M&SEs) is a critical part of our E^2 initiatives. This training manual aims at enhancing the capacity of these entrepreneurs on how to raise start/scale-up capital and operational resources for their businesses. It also highlights key considerations for borrowing, costs related to borrowing, process of loan management and repayment and loan negotiation.

Yet before borrowing one needs to know whether the expected returns from the project under consideration are enough to adequately cover, not just the capital invested, but also the attendant costs such as interests and other charges; while leaving enough for the entrepreneur to justify their opportunity cost. This is the subject matter of this training manual

MODULE 1
BUSINESS FINANCIAL MANAGEMENT

Module objective: To understand, measure and monitor business performance, plan and enhance business growth and sustainability.

INTRODUCTION

Every business owner deals with money to pay for expenses, buy equipment and stock, receipts from sales and so on. These transactions are either in cash or credit (promise to pay or be paid later).

Business financial management must therefore involve detailed recording of business activities that are of financial nature (book keeping), organizing and summarizing this data and presenting it in reports for use by diverse business stakeholders.

The first and most important user of this information is the owner of the business.

KEEPING GOOD FINANCIAL DATA

The purpose of keeping good financial data is to help in decision making on matters of profitability, investment, cash management, pricing and other aspects of business performance. The cost of making wrong decisions is high and, in many cases, leads to business failure. Financial management helps reduce mistakes in decision-making and enhances management effectiveness (making the right decision).

BUSINESS MANAGEMENT

Business management consist of mobilizing resources and combining and coordinating them effectively to help you meet the goals of the business. To be able to do this, the owner or manager performs the functions of planning, organizing, directing, staffing and controlling (P.O.D.S.C).

DUTIES AND RESPONSIBILITIES OF OWNER/MANAGER

Most micro and small business are owned and managed by the same person. Therefore, he/she can be called an owner/ manager. S/he carries out the following responsibilities:

- ✓ Plans the business resources and activities.
- ✓ Organizes work, recruits staff and allocates work to himself/herself and workers.
- ✓ Leads and communicates with those who work in the business
- ✓ Controls resources – materials, machines, buildings, finances etc
- ✓ Markets his / her business
- ✓ Seeks for investment in the business
- ✓ Communicates and works with others outside the business including handling public relations.
- ✓ Customer care
- ✓ Gathers information on matters that affect the business.

a) Planning Activities

Planning is a process of coming up with a plan of action to achieve a set target for operational activities. This may involve forecasting events, scheduling and re-scheduling of activities and tasks that affect the attainment of a target or goal. Planning is thinking ahead of time. Planning affects all the activities that the business undertakes.

The entrepreneur should plan for everything in the business including and not limited to finance, marketing, buying of stock and even the people he/she employs in the business.

Planning for the business involves the following:

- ✓ Setting goals, objectives and targets. This involves:
  - Making a decision on what target to achieve after a certain period of time.
  - Developing long term and short-term plans for the business.
- ✓ Deciding on the activities that will be undertaken to help achieve the goals, objectives and targets.
- ✓ Developing ways of finding out whether the business is achieving its desired targets.

b) Organization

This is the process of identifying activities and tasks which will be carried out in the business and deciding the order in which the activities will be implemented and the people responsible for the activities.

There are many activities that could be involved in a particular business such as purchasing of goods or materials, banking and selling. The complexity and intensity of these activities will depend on the size of the enterprise.

The entrepreneur would need to involve members of his/her family or employ workers to help in carrying out some routine activities. The entrepreneur should identify the tasks and allocate duties and responsibilities to others. This is organizing.

<u>The following are the main functions in organizing:</u>

1. **Listing or writing down** all the activities that must be carried out in the business. Such activities include accounting, marketing, transport and production
2. **Grouping all the activities** that are related together. For example, for accounting:
   - Record keeping
   - Banking
   - Planning finances (budgeting)
3. **Deciding which activities** must done by the owner/manager and those that others allowing the manager to focus on the core business activity of selling.

4. **Delegating** i.e. allocating duties and responsibility to others. When delegating, the entrepreneur should make sure that others know their full responsibilities.

c) Directing

This is the function of providing strategic direction in the business. In a business there may be people working for or assisting the owner in one way or another. But it is the owner who knows the direction he/she wants to take the business. The business vision may be written or not. To have a successful business, the owner must be prepared to be a leader.

d) Staffing & Resource Mobilization

Leading is seen in the following business activities:

i. *Showing direction and decision making*
ii. *Suspension and coordination of activities carried out in the business*
iii. *Communicating with workers and also the outside world.*
iv. *Customer and public relations.*
v. *Inter-personal relations. How people work together with others.*
vi. *Making sure others remain motivated to do their best for the goal of the business.*

Staffing and resource mobilization involves looking for required resources to implement the activities identified in the business plan. These resources could be people, money, raw materials, equipment and so on. It is the responsibility of the manager/owner to look for these resources.

e) Controlling

Controlling is one of the most important roles for any manager. Control involves knowing whether what has been planned or invested in the business is going according to plan. The owner/manager should take pro-active measures to prevent damages to the business. The following are some of the main control activities:

- ✓ **Control the budget**. This involves ensuring that spending does not exceed what was budgeted.
- ✓ **Controlling cash movement** and the way it is spent (used). It involves making sure that there is enough cash to meet daily business activities.
- ✓ **Controlling credit sales** – reduce the number of debtors.

- ✓ **Controlling stock held** so that the business doesn't have too much or too little.
- ✓ **Controlling performance of workers** so that they are able to meet the targets and that they stick to the work that has been planned.

RECORD KEEPING FOR BUSINESS

Why is recording keeping important for any size of business?

Accurate record keeping is essential to the success of a business. Record-keeping allows you to:

- ✓ Manage stock and raw materials
- ✓ Calculate and monitor profit and loss
- ✓ Plan for the future
- ✓ Filing tax returns

In the course of doing business, many transactions take place and the owner may not trace each and every activity in mind. With record keeping in place a summary could be prepared on what has been happening. From time to time, the owner of a business would want to know exactly what is happening in the business.

For MSME accounting, there are set procedures and guidelines on how this is done. There are three main reports that could be prepared that provide a full picture of financial performance by a business. These reports are profit and loss statement, balance sheet and cash flow statement as discussed below.

1. Cashflow Statement

Every single financial transaction must be recorded daily – both purchases (cash out) and sales (cash in). This is described as cash flow; cash flowing into the business and out of the business. Cash flow is important for predicting how much money will be needed and when it will be needed, or to predict cash surplus (profit) and plan investment.

How to keep a Cash Book

The cash book shows the situation of the business at any given time. It includes all sales and all costs over time. It is important to record every single sale and expenditure. This allows the owner to track sales and expenditures month by month. In addition, knowing the average monthly sales means that one can plan for the future.

- ✓ To work out the cash flow for the month, add up all the **Cash In records** for that month. Then add up all the **Cash Out records** for that month. **Subtract** the **Cash Out total** from the **Cash In total** to find out the balance (profit or loss).
- ✓ To work out **Cash balance**, **Cash Out** is subtracted from **Cash In** into the business

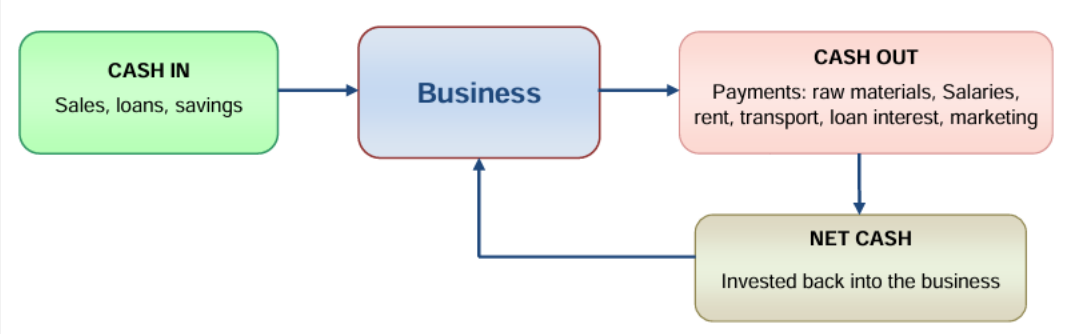


Table 1 : Cashbook

Cash Book					
Number	Date	Description	Cash In	Cash Out	Balance
1	1st Nov. 2025	Initial cash in	2,000		2,000
2	3rd Nov. 2025	Sale of 2 xyz	6,000		8,000
3	4th Nov. 2025	Sale of bzN	2,000		10,000
4	6th Nov. 2025	Sale of 5 Qtw	10,000		20,000
7,8,9…	etc	Sales of….			
38	15th Nov. 2025	Wholesale purchase of Dmv		8,500	11,500
49	29th Nov. 2025	Shop rent		5,000	6,500
50	29th Nov. 2025	Sale of 3 Dvm	9,000		15,500
51	30th Nov. 2025	Payment of salary		15,000	500
		Subtotal for November 2025	**29,000**	**28,500**	**500**

NB: In the training, ensure that participants use data from their respective cashbooks.

Receipt Book

Though it may reduce the speed of working and serving the customer, the use of a receipt book minimizes errors and keeps a hard copy of all past transactions carried out. The risk of not recording could be very high especially when the business has employees handling cash transactions. Cash is very sensitive and easy to steal.

An ideal receipt book should have at least two copies for each transaction, one for the customer and one for the business. Usually, one copy remains in the book (book copy) while the other is given to the customer. The book copies are left in the receipt book until it is time for computing sales.

Generic receipt books are easily available at any stationary shop in Kenya.

Sales on Credit

Selling on credit has the advantages of retaining royal customers or improving sales during low period. Caution has to be taken when selling on credit. Many businesses have gone under due to non-collection of debts.

It is important to assess the credit worthiness of the customer and put in place some control measures for the credit levels. It is advisable for the owner to limit credit to those long-term customers that can be trusted.

Table 2 below shows how to keep a record of sales on credit. It is good practice to inform the customer when the payment must be done. It is also good to send reminders on or before the due date. This same information should be recorded and tracked in the records as shown in the table below. If the customer does not pay the balance by the agreed date, the owner/manager should pursue the client for payment.

Table 2: Sample record for Sales on credit

Sales on credit									
no	Date	Client	Product / service	Unit value	Advance	balance	Final payment date	Actual date of payment	Customer signature
1	2nd Nov 2025	Monica	Ugali	200	50	150	10th Nov 2025		
2	5th Nov 2025	Joseph	Cabbage	160	20	140	15th Nov 2025		
3									

2. Profit and Loss Statement

Profit and loss statement is prepared to provide information on whether a profit or loss was made for that particular period. The more often the owner calculates the profit or loss of his/her business, the earlier he/she can see problems or opportunities.

Commonly known as the P & L Statement, this financial report is critical to helping the business owner to be on the driver's seat of their business. Its benefits are:

- ✓ Helps the owner to assess business performance and can therefore make good decisions
- ✓ Reference and comparison purposes
- ✓ Help in assessing one's tax liability
- ✓ Sourcing funds
- ✓ Detection of fraud
- ✓ Budgeting for future needs
- ✓ Cost control
- ✓ Credit control

A profit and loss statement is prepared as follows:

Step 1: Computing sales

Sales are cash receipts and credit sales for goods sold or services rendered to customers. Computation of sales should include all what was sold and is treated as gross income into the business. Where few items are involved and the selling price is fixed, sales could be determined by multiplying units sold to selling price. This could also be determined by adding all cash sales and credit sales.

Step 2: Calculation of Gross Profit

After computing sales, the next item to estimate are the costs of those sales. For example, if the business is that of selling solar panels, they must have been bought or made them by owner. The cost of getting these panels ready for sell is what is called cost of sales. These costs are deducted from sales to get Gross Profit.

Gross profit = Sales – Cost of Sales

Step 3: Calculation of expenses

In the course of doing business, the owner pays for services like transport, rent, electricity and wages/salaries. He/she may also withdraw money for own use at home. All these expenses drain cash or resources from the business and that money never comes back. They are deducted from gross profit.

Table 3 below shows some workings.

Table 3: Computing expenses

wages	Kshs 15,000
Rent	Kshs 7,500
Utilities	Kshs 2,500
Transport	Kshs 1,500
Other indirect costs (in Kenya e.g., facilitating a county council askaris)	Kshs 3,400
Total Expenses	Kshs 29,900

NB: Use training participants actual data for illustration.

Step 4: Calculation of Net Profit (or Loss)

Net profit is what remains after expenses have been removed. This is computed as follows:

Net profit = Gross Profit – Expenses

3. Balance Sheet

Balance sheet is a statement of wealth; a statement showing assets held and how they were acquired. Assets are items or property of value held by a person or entity. The business is a separate entity from the owner and therefore it can own assets. These assets could have been purchased using own money or borrowed money. Money or assets brought into the business is referred to as capital. Also included into the capital is profits retained into the business for

purpose of expansion. Money borrowed or goods received from other people or banks are referred as liabilities. These are obligations to pay later.

Assets are held for purpose of resale like stock and inventory, to help generate services like machines or aid the flow of business activities like cash. Wealth is created by transacting in or using these assets. Examples of assets are cash in hand and at bank, stock/inventory, debtors, furniture, vehicles, buildings and rent deposit.

Liabilities are incurred in the process of doing business especially when the owner does not have cash to pay for goods or services received. Liabilities are also incurred when other people work for the business but are promised to be paid later. When the enterprise borrows from a Digital Credit Provider – DCP, a bank, MFI, SACCO or a friend of the owner incurs a liability as well.

The Balance Sheet is a statement of all assets of the business, liabilities and capital. The general principle applied in preparing a balance sheet is that all assets must equal capital plus liabilities. Hence the following balance sheet equation:

Assets = Owners Capital – Liabilities

ILLUSTRATIONS

1. Calculating Profit and Loss

Let us assume Karonjo runs a business selling potatoes in Rongai Town and wants to know whether he is making any profit in this business. In the month of April, Karonjo bought 25 bags of potatoes from the farm gate at Kshs. 2,000 each. This translates to a cost of Kshs 50,000. He sold all the 25 bags at Kshs 4,000 each. This makes sales of Kshs. 100,000. But he spent Kshs 10,000 on rent, Kshs 15,000 on salaries, Kshs 500 on phone air time and Kshs15,000 on transport.

How much profit did he make in April?

a) Calculate Gross Profit

Sales	Kshs 100,000
Cost of Potatoes	Kshs 50,000
Gross Profit	**Kshs 50,000**

b) Calculate Expenses

Rent	Kshs 10,000
Salaries	Kshs 15,000
Airtime	Kshs.500
Transport	Kshs. 15000
Gross Profit	**Kshs 40,500**

c) Calculate Net profit

Net profit = Gross Profit – Expenses

Net Profit = 50,000 – 40,500

= 9,500 Kshs.

Karonjo made Kshs. 9,500 as profits for the month of May. Now use your own data for a particular month to establish how much profit (loss) you made for that particular month.

Example 2. Preparing a balance sheet.

Steps in preparing a balance sheet are:

1. Listing all assets of the business with their values on one side
2. Listing all liabilities on the other side. This list includes all debts that have been acquired over the period and not paid.
3. On the same side as liabilities, money brought into the business by the owner is included.
4. Adding totals on each side and getting the difference. This difference is the retained or accumulated profit or loss over the period.
5. To separate retained profits of the past period and that of current period, net profit for the current period is deducted from the difference obtained (retained profits) in step 4 above.

Table 4: Sample Balance Sheet

Step 1: List assets and their values (Kshs)		**Step 2: List liabilities (Kshs)**	
Asset	Value	Liability	Value
Cash at hand	20,000	Creditors (trade)	50,000
Cash at bank	50,000	Sacco loan	150,000
Stock (inventory)	560,000	Other loans	0
Debtors	0	Unpaid bills	10,000
Prepaids (rent etc)	5,000	**Total Liabilities**	**210,000**
Furniture	40,000		
Motorcycle	75,000	**Step 3: Assets – liabilities = total capital**	750,000 – 210,000 = **540,000**
		Initial Capital	200,000
		Step 4: Retained profits/loss = capital – initial capital	540,000 – 200,000 = **340,000**
Total Assets	750,000	Liabilities + Capital	210,000 + 540,000 = **750,000**

Costing and Pricing of Products and Services

Pricing is the method or system followed in setting up the price of a particular product or service. So, price is the worth (value) of a product or service expressed in monetary terms. Once the cost of producing a unit of product has been worked out, the next step is working out a reasonable price to charge customers for the product. The price set should be fair and affordable by the customers and at the same time guarantee some profit margin to the entrepreneur.

In setting the price of a product or a service it is important to know:

- ✓ Direct and indirect costs in the business
- ✓ Competitors' prices, and
- ✓ How much customers are willing to pay

The price must be:

- ✓ Low enough to attract customers to buy;

- ✓ High enough to cover all costs and give the business a profit.

From the example above, Quenter Abor has calculated that one tablemat costs Kshs 1,200 to produce, including indirect costs. This means that for them to make a profit, they much charge more than Kshs. 1,200 per tablemat. They decide to sell one tablemat for Kshs 1,500. This gives them a profit of Kshs. 300 as shown below:

Kshs 1,500 – Kshs 1,200 = 300 per tablemat

In Pricing, Consider the Following Factors

a) **The competition** – Prices charged by competitors. Some competitors are able to obtain their raw materials cheaply and are able to charge reasonable prices. The only remedy is to reduce costs and charge the same as competitors. If there is no competition, one can charge reasonably but don't exploit customers.
b) **Business costs** – i.e. direct and indirect costs. The retail price should cover all of these costs, as well as make a reasonable profit. The trap is that most people consider only the direct costs and forget to include the indirect costs like telephone, own salaries and rent.
c) **Substitute products** – The prices of those goods that can take the place of own goods and serve the same purpose. They may not be the same quality but will affect the price of goods been sold by the business.
d) **Customer price sensitivity/elasticity of demand** - this depends on whether the product/service is necessary; i.e. whether customers have to have it or can do without it.
e) **Own capacity and strategy** – This depend on whether the entrepreneur is introducing a new product (to penetrate the market) or selling cheaply to clear stocks (market skimming) or increasing the price to cover a profit margin.
f) **Distribution channels** – if the entrepreneur sells the product to distributors, they have to make a small profit and so they will mark-up the price given. The mark-up price depends on the position in the distribution chain e.g. manufacturer, wholesaler or retailer. The manufacturer has to charge less and leave a profit margin for the wholesaler and retailer.
g) **Sales turnover** – If items are moving faster, the entrepreneur can do with a moderate price and make enough.

Exercise:

In groups of threes can you describe the factors that you have considered when pricing your service or products. How sure are you that the price you have set is both competitive in the market but also adequately caters for all your costs including your salary.

MODULE 2
MANAGING BUSINESS GROWTH

Once your business has stabilized, you may feel inclined to expand and to grow it. Usually, the focus of the business changes as it moves through the various stages in the business growth lifecycle. An entrepreneur should continually identify opportunities for growth and innovation to ensure the enterprises sustainability and expansion.

Growth can be measured by looking at key statistical measures such as:

- ✓ turnover
- ✓ market share
- ✓ profits
- ✓ staff numbers

However, determining which dimension delivers the most accurate picture of the business' performance depends on the type of business and the stage in the business lifecycle an enterprise has attained.

DIFFERENTIATING BETWEEN NECESSITY- & OPPORTUNITY/MARKET-DRIVEN ENTREPRENEUR

At KFSE we say our value proposition is supporting necessity-driven entrepreneurs to transition into market-driven or opportunity entrepreneurs. Necessity-driven entrepreneurs are those who get into business because they had no other means of earning a livelihood.

An opportunity-driven entrepreneur on the other hand is defined as: '*A person, who identifies an opportunity, takes a calculated risk, brings together resources and sets up a business enterprise and is rewarded with a profit*'.

Entrepreneurship is the process of using creative or innovative ways to create a new business or expanding an existing business in new ways that better serve the needs of customers.

To start up and run a successful business, it is important to have the appropriate characteristics of an entrepreneur.

CHARACTERISTICS OF A SUCCESSFUL ENTREPRENEUR

Successful entrepreneurs have certain entrepreneurial factors or personal characteristics and managerial skills. Entrepreneurial success factors include:

- ✓ **Creativity and innovation**; should be able to discover new ways of producing their products, delivering their services or think of different ways of doing their business.
- ✓ **Risk orientation**; must be prepared to make use of opportunities identified even if no one else has done it that way or even if it may result to financial loss.
- ✓ **Provide leadership**; have strong aspiration and personal drive to consistently convert the idea through into product or service.
- ✓ **Good human relations**; influence people into accepting the new product
- ✓ **Positive attitude**; have a positive perception to his/her business and be willing to accept outcomes of his/her decision and actions.
- ✓ **Perseverance** especially when their businesses are faced with setbacks or hardships.
- ✓ **Commitment to business** – this refers to the willingness of entrepreneurs to commit their personal resources and time to their business.

Managerial success factors include:

- ✓ Planning; successful entrepreneurs spend considerable time planning their business and ensure that they work systematically.
- ✓ Knowledge of competitors; entrepreneurs know who their competitors are, what they are doing and their position compared to their competitors.
- ✓ Successful entrepreneurs are market oriented; they produce, offer goods and services that serve the needs of their target market
- ✓ Offer excellent customer service and high quality
- ✓ Have good insight to financial concepts, profits and financial management systems including the need to have business records.
- ✓ Have knowledge and skills with regard to business management. Sufficient relevant experience is essential to run a successful business.

CHALLENGES FACING BUSINESS GROWTH

Some of the challenges facing entrepreneurs in Kenya include:

- ✓ Access to start-up and expansion finance;
- ✓ Access to markets and information;
- ✓ Access to appropriate technology (digital record keeping tools);

CONVERTING NECESSITY BUSINESS INTO OPPORTUNITY BUSINESS

For a business idea to become a business opportunity it must be attractive, durable and timely, and can be packaged into a product or service, which creates or adds value for the customer.

Finding good ideas and converting them into opportunities is a conscious, deliberate and creative process. Business opportunities can arise when entrepreneurs use their skills, expertise or aptitude to provide a product or service to the market.

Solving existing problems like lack of a particular product/service in a certain area, or even a situation where a particular provider charges exorbitant prices because they are a monopoly can all become opportunities to start a business.

GAP IN THE MARKET & MARKET IN THE GAP.

So, you must ask yourself, what is the gap in the market. But you also need to establish whether there is a market in the gap. In order to determine whether or not a business idea will translate into a lucrative opportunity which possesses the qualities of being timely, attractive and durable business idea, the entrepreneur must follow a strategy of evaluating or screening the revealed opportunity. The criteria to use to screen opportunities could include among others the following:

- ✓ **Sector issues**; e.g. if you want to sell solar products, you might want to observe the increasing need to use more renewable energy in Kenya
- ✓ **Economies of scale** – profitability assessment; cost of production and potential selling price, e.g. selling potatoes in bulk.
- ✓ **Personal criteria** such as passion and interest in the business venture. It may be easy for someone trained in clinical medicine to start a private health clinic and make it profitable in an area that has no health facilities.
- ✓ **Strategic differentiation** which refers to how a venture positions itself to take advantage of the given market conditions to its benefit against its competitors

BUSINESS GROWTH STRATEGIES

Having identified the opportunity, now the entrepreneur is keen on growth. But what is Business growth? Business growth or expansion of the business means expanding the amount of trade it undertakes. It also means that the resources, systems and structures of the business venture will need some expansion.

The purpose of business growth is to increase the stream of cash inflows (remember in business cash is KING), hence more profits and reaching more customers. However, proper timing is critical to the success of implementation of any growth strategy. By answering the following key questions, one is able to judge if the time is right to implement any growth strategy:

- ✓ Can the business cope with expansion, or is it already working at full capacity?
- ✓ Do you have sufficient resources and systems in place to optimally carry out the existing business and expand without exerting adverse pressure to the business?

- ✓ Will the new initiatives disrupt existing performance?
- ✓ How will the entrepreneur ensure her existing customers don't lose out when reaching out to serve new customers?

Before one decides to invest extra resources to expand the product portfolio in the business, the entrepreneur needs to be sure that the core business activity is performing well.

It is also important to review the key business income sources to ensure that the business has sufficient funds to support intended growth.

BUSINESS GROWTH FINANCIAL PLAN

Financial plan is basically a plan about money: the money needed and where to source these finances. It is presented in a form of cash flow or projected income and expenses or both. For a business both cash flow and projected income and expenses are important.

PROJECTED INCOME AND EXPENSES

Projected income and expense statement is also called a budget. A budget is an expression of business plan in numbers. It is also called financial plan because it presents the business activities to be undertaken during the planning period in monetary values.

The purpose of budgeting is to:

- ✓ **State clearly** what entrepreneur expects to earn or get and what he/she will use or spend for each period in future.
- ✓ **State the expected goals** in clear, formal terms to avoid confusion and make sure they are attainable.
- ✓ **Communicate expectations** to all concerned so that they are supported, understood and implemented.
- ✓ **Help coordinate** the activities and efforts in such a way that the resources are properly used.
- ✓ **Provide** a means of measuring and controlling performance

The following are the steps, which should be taken in preparing budgets:

- ✓ **Estimate the expected incomes** from sales, services and other sources. These estimates are based on expected activity level as described in the business plan. The planner should indicate assumptions made when making the projections, for example, that sales will grow by 5%.
- ✓ **Estimate the cost of goods sold**. This estimate could be based on average margin made per unit of stock sold, e.g., suppose a solar panel is bought at 16,000 and sold

at 20,000, the cost of selling that panel will be 80%. In this case to get cost of sales the amount of sales per month is multiplied by 80%.

- ✓ **Compute the projected gross profit** by deducting cost of sales from sales for each month.
- ✓ **Estimate the expected expenses** for each period. These include salaries and wages, transport, rent, telephone etc. Sum all the expenses per period.
- ✓ **Compute projected net profit** by deducting total expenses from gross profit.

Table 5: Sample projected Income & Expenditure

Income	January	February	March	April	May	June
Sales						
Less: cost of sales						
Gross profit						
Add other income						
Total						
Expenses						
Salaries & wages						
Rent						
Utilities						
Transport						
Personal expenses						
Other						
Total Expenses						
Net Profit						

Nota Bene: An entrepreneur should ensure they carry out a budgetary control analysis often so that they keep within the cost estimates and on track with the business plan.

Budgetary Control: Budgetary control refers to investigating whether there are differences between actual performance and budgets, finding out the causes and taking corrective action. Budgetary control does not limit expenditure but ensures that expenses incurred are justified and brings the desired results. Failure to track budget expenses may lead to cost over runs or spending more money in one area and leaving others without knowing.

Cash flow Management: Cash is the most liquid asset. It is also referred as the life-blood in the business. All assets are acquired through paying cash now or later. Similarly, expenses and debts are settled through cash. Cash runs the risk of being lost through theft by employees and other people. The cash position is affected by the way business transactions take place. Cash balance at the end of the day in a business does not necessarily represent profit but net of cash in and out of business. Therefore, cash flow statement should not be confused with profit and loss though they are related.

PROJECTED CASHFLOW STATEMENT

Projected cash flow statement represents a plan of cash to be received from various sources into the business (inflow) and how that cash will be used or applied in the business (outflow). This is a ***projection*** of how an entrepreneur expects cash to come in or go-out within a specified time, but usually month by month.

- ✓ To be able to prepare a cash budget the following information is important:
- ✓ Cash at the beginning (opening balance). This includes:
    - Cash in the cashbox/safe
    - Money at the bank
    - Money on transit
- ✓ Expected receipts – which money you expect to come in and when
- ✓ Expected payments for expenses and assets

The following steps are could be used in preparing projected cash flow

Step I: Preparing a schedule of cash balances e.g. money in the office, money in bank and cash in transit

Step II: Preparing a schedule of expected sources of cash. In business cash is expected to come from sales and fees from any services. Other sources could be loans or grants. A total of all inflows is then computed.

Step III: Preparing a schedule of expected cash payments. Payments are made for stock supplies, salaries and wages, rent, transport, motor vehicle office expenses, insurances, telephone and other expenses. Payments are also made for assets like furniture and equipment. Compute the total cash outflow.

Step IV: Deducting cash outflow from cash inflow to get net cash flow for each month.

Step V: Adding this net cash balance for the month to the opening cash balance to get cash balance to be carried forward to the next month.

Step VI: Repeating the same exercise for each month that follows.

Exercise: Developing a cash flow projection

Now given your business experience estimate sources of business income or cash and how you use it. A format has been provided below to guide you on what you need to put down. This is just but a guide, use business line items that are relevant to your industry. Ensure these projections are as realistic as possible.

Sources of cash (cash inflows)		Month 1	Month 2	Month 3
1	Sale of tablemats			
2	Sale of necklaces			
3	Sale of hand bands			
4	Sale of beaded bags			
5	Sale of popcorns			
6	Other (specify)			
7				
	a) Total cash inflows (1 to 7)			
Uses of Cash (cash outflows)				
1	Purchase of beads			
2	Purchase of nylon fishing line			
3	Purchase of steel fishing line			
4	Payment of wages/salaries			
5	Loan repayment			
6	Withdrawal for personal use			
7	Other (specify)			
8				
	b) Total Cash Outflow (1 to 8)			
	c) Net Cashflow (a - b)			
	d) Add: Cash balance brought forward (b/f)			
	e) Cash Balance carried forward (c/f) to next month (c + d)			

Conclusion: Now with this data, the training can shift gears and begin to use the data for training participants to understand cost of capital. Here participants will now be able to understand whether they can afford to expand their businesses using the available financing from different providers.



MODULE 3
SOURCES OF BUSINESS FINANCE

Objective: This module discusses the various sources that an entrepreneur can get financing from. Additionally, the module discusses the advantages and disadvantages of the various sources of funds.

Introduction

There are a number of ways SMEs can access financing which can be classified into formal and informal sources. Formal financing is structured and is mostly provided by institutions such as banks, MFI and SACCO.

Formal financing involves the execution of a legally binding contract between the borrower and the lender that governs the terms and provision of the contract between the parties. Informal financing is usually un-structured and conducted on the basis of gentleman's agreement. The contract between the borrower and the lender is not legally binding, but is facilitated by other factors such as friendship, respect, and peer pressure that compel parties to abide with the terms of the agreement.

An SME requires financing for various business needs such as business expansion, working capital, marketing and promotional activities etc. The SME should know that each source has its pros and cons and only choose the source that best suits his/her needs and circumstances.

FORMAL & INFORMAL SOURCES OF BUSINESS FINANCE

There are a number of informal sources of finance that an entrepreneur can use to access financing. Informal sources of finance are normally characterized by lack of contract documents. However, the borrower in most cases is well known by the lender, such as family & friends, unofficial money lenders or table banking chamas.

Informal lenders to a business include:

- ✓ Family members
- ✓ Friends & work colleagues
- ✓ Merry go round groups
- ✓ *Wash-wash*
- ✓ Others? – list them.

In this training we shall focus our attention and evaluation on formal channels of money lending. These includes:

- ✓ Banks

- ✓ Micro Finance Institutions (MFIs)
- ✓ Digital Credit lenders
- ✓ Hire Purchase Instruments
- ✓ Trade Credit

BANKS

While majority of micro and small enterprises can finance their businesses from formal sources like banks, they are often hindered from access due to their 'barrier to entry' requirements. Many banks often require a business to open an account and regularly deposit part of the profit from the business as savings until such a time when they have accumulated sufficient funds to finance the intended business need.

This is known as saving up. However, saving up is not easy as many of the M&SEs needs are immediate and cannot wait for the M&SEs to save-up for need. For that reason, the M&Es may opt to go for a loan (save down) from the bank and tap the opportunity.

That said, some of the benefits of sourcing financing from banks include:

- ✓ **Security:** In comparison to other modes of saving, funds deposited in banks as savings are secure. Funds deposited in the bank are safe from loss, theft, fire, misappropriation and other risks that are associated with holding cash in hand.
- ✓ **Big loans:** In comparison with other sources of financing banks can provide the SME with bigger loans that can meet the intended business needs. Banks are well placed to advance bigger loans to the SME from the deposits mobilized from their clients.
- ✓ **Advisory services:** The banks' credit officers provide guidance and advice on technical areas such as business planning, record keeping, separation of duties and many other areas of the business.
- ✓ **Flexible and Longer loan repayment periods:** Banks' offer the SME flexible and relatively longer loan repayment periods to service their loans. This enables the SME to schedule their loan repayments according to the instalments that they can comfortably service. (It's worth pointing out that the loan repayment duration increasingly becomes a critical factor as the loan amount borrowed increases.)
- ✓ **Wide product range:** Banks offer the SME a wide variety of products over and above the saving account. These products are tailor-made to meet the SME business needs which include:
    - Asset finance loans for business assets such as loans to acquire capital equipment e.g., vehicles and others.
    - Emergency loan in case the business has an immediate need that requires cash.

    - Top-up loan which means an additional loan to top up an already existing loan.
- ✓ **Prompt loan disbursement:** Upon fulfilment of the prescribed requirements and submission of a duly completed loan application form banks are very prompt in making loan disbursement. This is important for the M&SE for some of the financing sources may take long to disburse the funds, leading to loss of business opportunities.
- ✓ **Stringent requirements:** This is the most common shortcoming associated with banks financing M&SEs. Banks have stringent loan qualification requirements. They require a loan applicant to provide guarantors who are regular customers with the bank, or collateral such as logbooks and title deeds. A good number of M&SEs may not meet such requirements for they do not have property that can be used as collateral and cannot access funds from banks.

MICROFINANCE INSTITUTIONS

There are many microfinance institutions (MFI) operating in Kenya. Their mission is to provide financial services to low-income clients that normally cannot access financial services from the mainstream banks. They are characterized by few requirements when joining and provision of unsecured loans or loans that are not backed by physical collateral since they use other forms of collateral such as group guarantee.

Some of the benefits of the SME accessing funds from MFI are:

- ✓ Easy terms of joining: Many MFIs have easy terms of joining and becoming a client.
- ✓ Weekly repayments and Monthly repayments: Many MFIs offer their clients weekly repayments that are easy to make. Majority of the SMEs would be comfortable in making weekly loan repayments that are small and manageable while some may opt for monthly loan repayments.
- ✓ Attractive interest rates:
- ✓ Flexible securities:

There are also some challenges associated with MFIs such as:

- ✓ **Small loan size and slow graduation:** In comparison with banks the MFI advance small loans that at times is not sufficient to meet the SME needs. Additionally, the MFI normally do loan clients the money their business require or the business ability to pay but on strict graduation. For instance, some MFIs only advance a maximum USD 300 for the first loan.
- ✓ **Loan repayment period:** The loan repayment period by the MFI to SME clients is generally short. For instance, many MFI only offer maximum repayments period of

12 months. The loan repayment instalment amounts for bigger loans are big and the loan applicants find it difficult to put together the huge repayment's instalments

- ✓ **Limited number of products:** Many MFIs only offer a limited product range. Some MFIs only offer business loans and the customers have other needs besides the working capital such as Asset acquisition and investment.

DIGITAL CREDIT LENDERS/PROVIDERS

Digital credit loan providers offer significant benefits in financial inclusion, speed, and convenience, while facing challenges related to regulatory compliance, high default rates, data security, and consumer protection concerns like predatory lending.

Some of the benefits of DCPs include:

- ✓ **Increased Financial Inclusion:** Digital lending brings credit access to underserved or previously excluded populations, including those in remote areas or without formal credit histories.
- ✓ **Speed and Convenience:** The process from application to disbursement is streamlined and often fully automated, allowing for instant online approval and quick fund transfers, often within minutes to 24 hours.
- ✓ **Accessibility:** Services are available 24/7 via mobile phones or online platforms, eliminating the need to visit a physical bank branch and using an online application process.
- ✓ **Customization and Flexibility:** Digital platforms can offer tailored loan products and flexible repayment options that align with borrowers' specific financial circumstances and preferences.

For their convenience, they come with some important challenges:

- ✓ **Can lead to over-indebtedness:** The ease of obtaining loans can lead to multiple borrowings and over-indebtedness among consumers, resulting in high default rates for providers.
- ✓ **Data Security and Privacy Risks:** Handling large amounts of sensitive personal and financial data makes digital lenders prime targets for cyberattacks and data breaches. Concerns also exist around the misuse of personal data for debt collection.
- ✓ **Predatory Practices**: A lack of robust regulation has in some cases led to issues with unlicensed providers, hidden fees, extremely high-interest rates (sometimes over 280% APR), and unethical debt recovery methods, including harassment of borrowers and their social contacts.
- ✓ **Consumer Protection Concerns:** Borrowers may face challenges with inadequate disclosure of loan terms, making them vulnerable to taking on unsuitable products. There may also be a lack of clear channels for complaints and redress.

SHOULD YOUR BUSINESS TAKE A LOAN?

In order to make informed borrowing choices, entrepreneurs need to develop a clear understanding of borrowing as a source of growth and expansion financing. Let us build up this understanding from the ground up. The first question is why business borrow?

Businesses borrow to:

- ✓ To start a new business venture
- ✓ To finance working capital – specifically to increase the businesses work force or increase inventory.
- ✓ Expanding into new markets – the entrepreneur may want to borrow in order to enter new markets.
- ✓ Making capital purchases – an entrepreneur may need to finance purchase of a new equipment for the business or expand another service/product line.
- ✓ Improving cash flow of the enterprise
- ✓ Building a credit history or relationship with a financial Institution- an entrepreneur may not have borrowed before so taking out a loan can help in developing a good repayment history and this helps when the entrepreneur may want to obtain financing in the future.

WHEN NOT TO BORROW

Businesses **MUST NEVER** borrow to fund any form of personal consumption. Yet even if the stated borrowing is to fund business operations, an entrepreneur should not borrow:

- ✓ **When the loan will not directly increase income or productivity:** If the borrowed money doesn't generate new revenue or reduce costs, it becomes a burden, not an investment. Example: Borrowing to repaint the shop instead of restocking fast-moving goods.
- ✓ **When your cashflow cannot comfortably handle repayment:** If weekly or monthly repayments exceed your business's reliable net income, the risk of default is high. Rule of thumb is that your loan instalments should not exceed 30–40% of your average monthly profit.
- ✓ **When your business records are unclear or inconsistent:** Without proper records, you can't calculate realistic repayment ability. Borrowing becomes a guess.
- ✓ **When borrowing replaces discipline**: Many entrepreneurs borrow because they lack saving habits. Borrowing to solve short-term gaps often deepens the same behaviour.
- ✓ **When the loan is meant to cover existing debt**: Taking one loan to pay another only postpones the crisis unless the new one has clearly better terms (e.g. lower rate, longer tenure, or restructuring plan).

- ✓ **When the business environment is too uncertain:** If there's an expected downturn (e.g. drought, election instability, new taxes), borrowing increases risk. Wait until markets stabilize.

PREPARING THE BUSINESS FOR BORROWING

Micro and small business owners need to prepare carefully when borrowing money whether the purpose is to start up a business or to fund growth. It is very important, in fact **CRITICAL**, to make informed borrowing choices. The decision to borrow **MUST** be based on the business performance.

Prior to borrowing entrepreneurs should have:

- ✓ **A thorough knowledge of the business they are getting into:** This should include information such as deep analysis of the business trends – whether it is seasonal (identification of peak seasons, slow seasons, and business cycles among others). Seasonality of a business can affect loan repayment ability during low seasons.
- ✓ **A well laid out business plan:** this will allow the entrepreneurs to forecast on their cash requirements, enabling them to determine business needs as well as identifying the correct timing for finances. This will give them extra time to explore all possible borrowing sources and negotiate the most favourable terms.
- ✓ **Knowledge of competitors in the sector:** This information is important because it helps the entrepreneur assess whether the timing of borrowing will be affected by activities conducted by the competition. An entrepreneur may borrow without studying the competition only to find that he/she cannot make more sales as a result of activities conducted by the competition.
- ✓ **Strengths, Weaknesses, Opportunities and Threats (SWOT)** analysis of the entrepreneur as well as the enterprise. An entrepreneur needs to conduct a SWOT analysis to be able to maximise both personal and business strengths, minimize weaknesses, take advantage of opportunities as well as have contingency plans to take care of threats. Borrowing should not be done when the business weaknesses and threats outweigh business opportunities.
- ✓ **Business Profile** – A business profile defines an entrepreneur's business in detail. For start-ups, the business profile business provides a justification why the entrepreneur wants to start the particular business as well as sources of start-up capital. For business that are expanding or at the growth stage, the business profile highlights when the business was started, how it has grown over time and the direction the business is taking in terms of borrowing finances for expansion and growth.
- ✓ **An explanation of the "Purpose" of the loan** – When an entrepreneur is planning to borrow money, they should provide a well written statement showing the

purpose of the loan, what it will be used for, how the loan will contribute to increased sales and profitability.

- ✓ **Accurate financial records** - these are proof of how an enterprise is performing, this information is used to evaluate whether the enterprise has capacity to repay the loan. Capacity of the enterprise can only be accessed if proper records are maintained and how much money the business is generating against business expenditure.
- ✓ **Cash flow projection** – a cash flow projection shows money expected to flow into the business and out of the business on a day-to-day basis.
- ✓ **Collateral** - this refers to the security an entrepreneur is willing to give a financial institution to secure a loan. Collateral can include business and personal property such as inventory, equipment, and accounts receivable or real estate, stocks, bonds, etc.
- ✓ **A detailed repayment plan:** that shows how and when an entrepreneur will pay back the loan. As a contingency, an entrepreneur might outline a plan of action on how they will pay off the loan if profits alone aren't enough.
- ✓ **Supporting documentation:** These consist of documents that verify the information for a loan request - for instance, a lease, certificate of incorporation, partnership documents and letters of reference, contracts, invoices or vendor quotes.

Conclusion

To conclude this module, it is important to emphasize that borrowing is only advisable where there is an opportunity to acquire an asset, take advantage of a business opportunity that may not wait until entrepreneur gets his/her own money or helps a business reduce its tax obligations.

Moreover, a business can borrow if the cash flow projections clearly demonstrate its potential to pay the loan instalment over time or money is expected in future in lump sum but the opportunity has occurred today. Utilizing such an opportunity today will make a difference rather than waiting.

MODULE 4
LOAN MANAGEMENT AND REPAYMENT

Having taken consideration of the foregoing, and realized that there is a business case for borrowing, you now need to understand the loan you are taking, the terms of the loan, its costs, as well as the best lending partner for your enterprise.

In this module we shall now focus on the issues you need to pay attention to as you continue to evaluate whether to take that business loan and from which provider.

COST OF BORROWING

Banks, MFIs and DCPs are in the business of lending money. They make their profits from lending – mainly in the form of interests and bank charges. Thus, it is important for an entrepreneur to understand that the lender of the loan is not doing them a favour in lending them money, but rather that they too are in business.

The question to ask then is whether you can afford the cost of that loan, by that particular lender. Some financial institutions do not disclose all the costs unless asked to do so by the entrepreneur. It is therefore important for the entrepreneur to understand all the costs associated with a particular loan in order to compare between the loan offerings of different financial institutions.

The following 3 important cost factors that an entrepreneur should consider before taking that business loan:

1. **Interest rates**. Interest rate is the charge for using of borrowed money and is expressed as an annual percentage of the principle. (*Some lenders, such as DCPs, express this interest in monthly or even daily terms – it is important to confirm*). This fee is added to the amount of the loan. There are different ways of charging interest with most common ways being reducing balance and flat rate – this will be discussed in greater details below but it is important to underscore that interest expense charged on **flat rate** will always be **higher** that of **reducing balance**.

An entrepreneur should seek the following information from a financial institution

- ✓ What is the interest payable from as many institutions as possible?
- ✓ How do different financial institutions calculate the interest rate?
- ✓ What is the default rate of interest and is it competitive?
- ✓ Is the interest rate coupled with all fees, competitive with other available loans?

2. **Is the interest rate fixed or variable?** Fixed interest rate means that the interest will remain at a predetermined rate for the entire term of the loan while variable interest rate means that the interest rate will move up or down based on the changes of the interest rate index (base lending rate).

3. **Payment Terms.** Payment terms refer to the duration an SME is given by a financial institution to pay the loan. What happens if an entrepreneur pays before the stipulated end date? What penalties are charged? Some financial institutions charge entrepreneurs for late and delayed payments therefore it is important that an entrepreneur to know how much the FI will charge for late payments.

An entrepreneur should seek the following information from a financial institution

- ✓ What are the monthly or other periodic payment obligations?
- ✓ When is the final principal payment due?
- ✓ Is there a right to extend the due date of the loan?

4. **Fees and charges.** Fees are different from interest rates because they are charges incurred in loan processing and differ from one financial institution to another. Some common types of fees include: loan underwriting fees, loan application fees, loan disbursements fees, loan insurance fees, legal costs, collateral valuation costs, due diligence costs, expenses of arranging the loan among others.

Find out the following:

- ✓ Are there any loan fees, commitment fees, placement fees?
- ✓ Are they payable upfront?
- ✓ Are there any on-going fees or charges during the life of the loan?

Different Types of lenders – who is the right one for you?

Type of Lender	**Characteristics**	**Typical Interest rates charged**	**Risk Level**	**Comments**
Commercial Banks	Provide larger loans, often requiring collateral and credit history.	15% p.a.	Medium	Requires records, collateral, or guarantor

SACCOs (Savings and Credit Cooperatives)	Member-based, lower interest rates, flexible repayment terms.	12% p.a.	Low	Requires records, collateral, or guarantor
Microfinance Institutions (MFIs)	Serve small traders with shorter loan terms and group lending models.	12% p.a.	Low - medium	Requires records, collateral, or guarantor
Digital Lenders	Quick access via mobile apps, higher interest rates, and short repayment periods.	7.5 – 9.5% p.m.	High	Fast access but high cost and penalties
Chamas or savings group	Small sized loans typically less than Kshs. 100,000	10% - 12% p.a.	Low-Medium	Trust-based, limited amount
Government or NGO Loan Programs	Subsidized interest rates or grants for specific target groups.	0% to < 12% p.a.	Low	Opportunity cost of not using money elsewhere

UNDERSTANDING LOAN TERMINOLOGIES

Trainers should explain and discuss each of the following terms, using real loan agreements where possible. Participants should be encouraged to read and interpret sample contracts in small groups.

Term	**Meaning**
Principal	The original amount borrowed from the lender.
Interest Rate	The cost of borrowing, expressed as a percentage per year (flat or reducing balance).
Annual Percentage Rate (APR)	The true cost of borrowing after including all bank charges and fees.

Amortization	The schedule by which loan payments are divided into interest and principal portions.
Nominal Interest Rate	The stated interest rate, usually per year (or per month for many DCPs).
Fees	Charges such as processing, insurance, or penalties.
Grace Period	A time when no payments are required, usually before the first instalment.
Collateral	Assets pledged to secure the loan (e.g., motorcycle, land title, household goods).
Guarantor	A person who promises to repay if the borrower defaults.
Penalty Rate	Extra interest or fees charged for late payments.
Processing Fees	Charges deducted upfront before disbursement.
Insurance	Coverage to protect against default, death, or asset loss.
Default	Failure to meet loan terms, triggering penalties or asset seizure.

TOTAL COST OF CREDIT

In addition to the addition to the interest rate component of the loan, there are a range of other charges levied by the different lenders. These include bank fees as well as charges by third parties which add up to the loan processing costs. Third party fees and charges include:

- ✓ **Legal Fees:** The amount indicated is charged by the appointed external Lawyers according to the Advocates (Remuneration) (Amendment) Order, 2014 (as varied or amended).
- ✓ **Insurance:** The amount charged by the Insurer on the basis of the Option selected by the borrower for the period of the Facility. Insurance includes Mortgage Protection, Credit Life Insurance, Fire Insurance, Property Insurance and Car Insurance, where applicable.
- ✓ **Government Levies:** This means Excise Duty at 20% of the Application / Processing / Initiation/ Arrangement/ Commitment Fees charged.

- ✓ **Stamp Duty:** This is a Government Levy on sale of property charged typically between 1% and 4% of the value of the property.
- ✓ **Valuation Fees:** This is the amount charged by the appointed Valuers according to the Land Valuers Licensing (Remuneration) Notice 2013 (as varied or amended).
- ✓ **Security Registration Fee:** This is amount is payable to the Government Registry where the Security will be registered and has not been indicated within this online APR calculator.

Because loan applicants tend to focus only on the interest rate when making a loan decision, banks in Kenya have proactively adopted the Annual Percentage Rate (APR) model which converts all direct costs associated with the loan (also known as the Total Cost of Credit) into one number.

With the APR, borrowers are now empowered to comprehensively compare different loan products on a like-for-like basis, based on the total cost of the facility; and therefore, make better informed credit decisions.

Therefore, after taking the decision to borrow, an entrepreneur is encouraged to visit the Kenya Bankers Association website - https://www.costofcredit.co.ke to compare the cost of credit between different providers.

The following images below show a loan calculator results if a borrower decides to take a Kshs.2,000,000 facility from NCBA Bank and Kenya Commercial Bank – KCB.

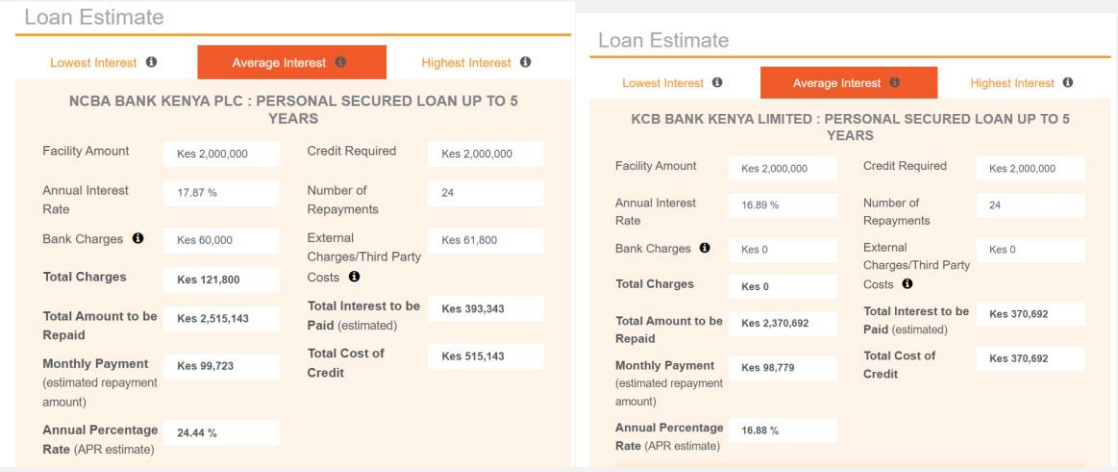


Figure 1: Courtesy of KBA - https://www.costofcredit.co.ke

Exercise 1: Scenario Simulation with the CoC website

As one can see above from these hypothetical simulations, the KCB loan has a lower total cost of credit at 16.88% compared to NCBA's 24.44%.

- ✓ But does that mean that you can or should take KCB's loan?
- ✓ What other factors should participants consider in determining the best loan offering?

NB: Participants should be encouraged to interact with the KBA website in the training to ensure the TCC is internalized.

Exercise 2: Comparing Loan Offers

Participants work in pairs to fill out a 'Loan Comparison Card' using several sample loan offers. They should identify which loan is cheapest in terms of APR.

Ask participants to discuss why some loans appear cheaper but cost more overall – everything considered.

Lender	Interest Rate	Fees (%)	Comments / APR Calculation
Lender A			
Lender B			
Lender C			

Conclusion

MODULE 5
LOAN MANAGEMENT AND REPAYMENT.

Having decide that you need to access credit to finance, and having compared credit offerings from different banks and other financial institutions, it is now time for you to decide whether the business venture you intend to invest in, delivers enough returns, not just to repay the loans, but also to compensate you for your effort.

Every loan should be justified by expected future cash flows, not only by the urgency of need. To be sure, borrowing should be pursued where there is an opportunity to acquire an asset or take advantage of a business opportunity **that may not wait until entrepreneur gets his/her own money**.

You can also borrow if the projected cash flow from an investment today, shows potential to repay the loan instalment over time and the money from the investment is expected in future in lump sum **but the opportunity has occurred today**. Utilizing such an opportunity today makes rather than waiting until you have the money.

You should Not Borrow

The entrepreneur should not borrow if:

- ✓ There is no clear purpose and plan for the loan
- ✓ The cost of borrowing exceeds the benefits to be derived from the use of the loan
- ✓ The loan will strain the borrower's future cash flows
- ✓ The future cash flows are not certain

Caution should always be exercised whenever a financial institution approaches an entrepreneur with an offer to take a loan. As indicated above, borrowing should be pursued to take advantage of a **BUSINESS OPPORTUNITY** that has **OCCURRED TODAY**, who's **PROPERLY EVALUATED future CASHFLOWS** exceed the total cost of the loan.

It is **ESSENTIAL** to exercise caution when borrowing, because once you have committed to the loan, you have commitment to honour the repayment obligations as per agreement with penalties for failure.

By taking that loan, you are committing the future cashflows of your business – before you sign, be sure you want to do that, and that it is justified by the business case – not any other emotional drive.

LOAN MANAGEMENT & REPAYMENT

Once you have taken that loan, it is now time to manage it properly. We must emphasize that many businesses fail because they do not honour business and loan obligations. Good management of a loan ensures that the loan **serves the purpose for it was intended for**.

There is often a great temptation to divert some of the money received to other purposes other than what it was intended for. The temptation often comes from a human weakness of thinking that you will pay it back when it falls due or that future sales will more than adequately cover for the '*little amount'* that you divert to other '*equally urgent'* needs. That is a poor loan management practice.

We must emphasize that poor loan management practices often lead to business failure, loss of livelihoods and in some cases loss of the property that was offered as collateral.

Loan management falls into 3 categories

1. Applying the loan for the right purpose
2. Managing the business finances well
3. Prompt repayment of the loan

APPLYING THE LOAN FOR THE RIGHT PURPOSE

At the risk of overemphasizing this point, it should be noted, an entrepreneur must ensure that each **loan is applied only to the purpose it was borrowed**. While the diversions may be necessary e.g. urgent family problems, doing that leaves the entrepreneur exposed to the burden of repayment.

Strategies to ensure you apply a loan only for the right purpose

- ✓ **Regularize payments to yourself.** When an entrepreneurs factor their pay into the business expenses, they meet their private needs from their own money, not business money.
- ✓ **Separate the business account from own personal account.** This will ensure that one does not mix up his/her money with the business money.
- ✓ **Ensure that borrowed money remains in the bank.** This process will ensure that the borrower just maintains cash levels that are adequate to meet financial obligations as they fall due. This ensures that the funds are safe and minimizes wastage.
- ✓ **Only withdraw amounts that are needed for the business at the time**. The entrepreneur should not withdraw more than s/he requires for that day or week.

- ✓ **Use cheques or formal payment channels** for payments whenever possible. This ensures the entrepreneurs can easily track their expenses and only pay what is required for the business.

MANAGING CASH FLOW FOR LOAN REPAYMENT

Good financial management practices are what will assist the entrepreneur to plan, control and monitor how the business is performing. Ensure that you gather and track all financial data for your business all the time. Assuming the loan was applied as per the purpose for which it was borrowed, and assuming that there was a legitimate business case for the borrowing, then by tracking the flow of the cash in the business, you should be able to repay the loan without any problem.

For that reason, you need to manage your cashflow diligently. The following are some useful practices towards this goal:

- ✓ Bank all excess cash
- ✓ Use a till under lock and key
- ✓ One person should be responsible for collecting cash and making payments.
- ✓ Issue receipts for all cash collected
- ✓ Request payments by use of an invoice
- ✓ Reconcile all bank statement
- ✓ Use a cash book
- ✓ Use a purchases ledger
- ✓ Record all debts and do not exceed a safe level of debts

Reasons for cash management:

- ✓ To ensure that there are enough funds for the organization's operations all the time.
- ✓ To make sure there are enough funds to commit the organizations commitment.
- ✓ To cater for any emergency which might occur
- ✓ To make sure there are funds for future expansion
- ✓ To plan the time when we shall need to borrow or raise more funds.
- ✓ To establish standards for comparing, monitoring and control or money.
- ✓ To avoid over expenditure or certain items.
- ✓ To time properly the out and inflow of funds – including the loan repayment, which has to be scheduled and on time.

REPAYMENT DISCIPLINE

Repayment discipline means paying your loan instalments on time and in full. Consistent repayment builds creditworthiness and opens doors for larger loans in the future.

Tips for maintaining discipline:

- ✓ Treat loan repayment as a fixed monthly expense.
- ✓ Prioritize loan payments before personal withdrawals.
- ✓ Keep an emergency fund to cushion shortfalls.
- ✓ Communicate early with lenders if repayment problems arise.
- ✓ Avoid taking multiple loans for the same purpose.

EARLY WARNING SIGNS OF REPAYMENT TROUBLE

Some early danger signals include:

- ✓ Declining sales or rising stock that doesn't move.
- ✓ Using new loans to pay old ones.
- ✓ Frequent withdrawal of business cash for personal use.
- ✓ Missing two or more loan payments in a row.
- ✓ Ignoring lender calls or notices.

RESPONDING TO FINANCIAL STRESS

When cash flow challenges arise, entrepreneurs should act immediately rather than wait for penalties or default notices.

- ✓ Talk to the lender early to request restructuring or a temporary grace period.
- ✓ Cut unnecessary expenses or delay non-essential purchases.
- ✓ Negotiate better terms with suppliers or customers.
- ✓ Seek advice from mentors, SACCO officers, or financial counsellors.

TIMELY LOAN REPAYMENT

Loan repayment is what shows the health of a business at the time. Proper loan repayment is helpful as it adds credibility to the entrepreneur. The good will attained can be very helpful in future endeavours.

Advantages of timely repayment:

- ✓ **The entrepreneur can easily raise more resources:** Financial institutions can lend an entrepreneur who pays well more money as they are deemed low-risk clients.
- ✓ **Less stress for the entrepreneur:** The client will not be worried about the financial institution so they will run their business better.
- ✓ **More trust in the business:** When an entrepreneur pays their loan very well, they attain a 'good credit history'. This helps them when they want to borrow from any other bank or financial institution. They get better treatment and sometime better interest rates.
- ✓ **Security of collateral:** The entrepreneur has better security for their collateral when they pay their loan well. This can be very bad when the collateral is borrowed or when it is critical to the survival of the business

LOAN NEGOTIATION

Negotiation is communication with a purpose. Negotiating a loan commitment and agreement may at first seem daunting for the entrepreneur. The entrepreneur will think that the financial institution has the money therefore has more power in the negotiations than her/him. But the financial institution is also interested in your business – remember lending you money is one of the reasons why they are in business.

Entrepreneurs must learn to present their case clearly, show repayment ability, and ask for fair terms.

Key strategies for negotiation:

- ✓ Prepare well: Know your business numbers (cash flow, sales, expenses).
- ✓ Gain as much information about the financial institution and specific loan product prior to setting up a negotiation meeting.
- ✓ Consult as widely as possible with different people to get before meeting the financial institution.
- ✓ Compare at least two loan offers before deciding.
- ✓ Ask for clarification on hidden fees and penalties.
- ✓ Never sign a loan document without reading and understanding all clauses.

Negotiations can be on any one or several of the following issues:

- ✓ The amount that may be borrowed.
- ✓ The applicable interest rates.
- ✓ Request a grace period if your business is seasonal.
- ✓ Negotiate for lower rates if you have strong repayment history.

- ✓ The maturity date of the loan.
- ✓ Any rights to extend the maturity date and the conditions for doing so.
- ✓ A description of the fees and their due dates. This includes fees and when the fees are deemed as earned.
- ✓ Financial agreements such as debt service coverage ratios, tangible net worth requirements, or capital expenditure limitations.
- ✓ Collateral requirements – what kind of collateral requirements does the FI require- cash, chattels etc.?
- ✓ Guarantors-The nature, content, and scope of guarantees can only be touched on in this article. The borrower must understand, however, precisely what guarantees will be required and from whom.

During negotiation, the energy entrepreneur should:

- ✓ Maintain a posture of flexibility
- ✓ Maintain open lines of communication, while avoiding looking nervous
- ✓ Be friendly and cooperative while negotiating
- ✓ Demonstrate understanding of the content being negotiated
- ✓ Be willing to explore a range of alternative possible outcomes
- ✓ Be as conciliatory as possible without compromising your position

Exercise: Role-Play Activity

Trainers divide participants into groups of three—Borrower, Lender, and Observer. Each group role-plays a negotiation scenario using sample data from a kiosk or boda boda business. After the role play, the observer provides feedback on communication skills, negotiation tone, and whether the borrower achieved fair terms.

Conclusion:

MODULE 6

EVALUATING A BUSINESS ABILITY TO PAY A LOAN

When you borrow money, the key question is whether the business will generate enough income to repay the loan plus interest. Valuation helps answer this by projecting future earnings and comparing them with the total cost of the loan.

The ability to pay a loan is determined mainly by two business processes. Firstly, the ability to generate adequate cash flow at the end of the month or other agreed interval when the loan instalment payment falls due.

Secondly, the ability to generate enough profit from the extra business associated with borrowed funds to cater for the interest expense as and when it is charged.

Additionally, there is a close relationship between stock management and cash flow and eventually level of profitability. Tying too much cash in stocks may jeopardize the operations and cause unnecessary liquidity problem. It is helpful to predict the volume of each product to make/buy and sell each month. Buying the right stock quantity allows the business to make reasonable profits and release cash for other purposes like paying loan instalment.

WHY ABILITY TO REPAY MATTERS

Many small entrepreneurs borrow based on need rather than the business' ability to repay back the loans. This is one of the main reasons why even very large businesses fail.

Loan repayment capacity measures whether your business will generate enough cash to meet loan obligations without starving operations or personal needs.

It should be emphasized that a good loan should strengthen not strangle the business. Some of the strategies to evaluate whether the loan will strengthen or weaken the business include:

PRACTICAL VALUATION TOOLS FOR SMALL BUSINESSES

Trainers should introduce the following simplified tools with examples:

a) **Net Present Value (NPV):**

NPV measures the difference between the present value of cash inflows and outflows. If NPV > 0, the project is financially viable. Trainers can demonstrate this using a simple discounting example.

Worked Example 4 — Simple NPV Table (KES 50,000 investment for additional inventory)

Assumptions: Discount rate = 18% (approximate cost of capital for micro-business). Project life = 6 months. Monthly incremental net cashflow: Month1=10,000; M2=12,000; M3=15,000; M4=15,000; M5=15,000; M6=15,000. Initial outlay at Month0 = 50,000.

Month	Cashflow (KES)	Discount factor (18% pa ≈ 1.5% monthly)	Present Value (KES)
0	-50,000	1.39%^0	-50,000.00
1	10,000	1.39%^1	9,863.02
2	12,000	1.39%^2	11,673.50
3	15,000	1.39%^3	14,391.99
4	15,000	1.39%^4	14,194.84
5	15,000	1.39%^5	14,000.40
6	15,000	1.39%^6	13,808.62

NPV (sum of present values) ≈ KES 27,932.36. If NPV > 0 the project is acceptable.

b) Payback Period:

Shows how long it takes for an investment to recover its initial cost. Shorter payback periods indicate lower risk.

c) Break-even Analysis:

Identifies the sales volume at which total revenue equals total cost. It helps entrepreneurs know the minimum performance required to avoid losses.

Worked Example 3 — Break-even Analysis (Kiosk)

Assumptions:

Fixed costs = KES 20,000/month (rent, utilities), Variable cost per unit (COGS) = KES 80, Selling price per unit = KES 120

Item	Value (KES)	Formula	Result
Fixed costs (FC)	20,000		
Selling price per unit (P)	120		
Variable cost per unit (VC)	80		

Contribution per unit (P - VC)	40	120 - 80	40
Break-even volume (units)		FC / (P - VC)	500 units

Interpretation: The kiosk must sell at least 500 units per month to break even under these assumptions.

d) Debt Service Coverage Ratio (DSCR)

DSCR measures the ability of the business to pay loan instalments from operating cash flow. Formula: DSCR = Net Operating Cash Flow / Total Loan Payment.

If DSCR > 1.2, repayment capacity is comfortable; if below 1, the business may struggle.

Month	Net Operating Cash Flow (KES)	Loan Payment (KES)	DSCR
1	10000	8888	1.13
2	12000	8888	1.35
3	8000	8888	0.9

Interpretation: In months 1 and 2, DSCR is above 1, meaning repayment is possible. In month 3, DSCR < 1, indicating a shortfall that may require savings or deferral of expenses.

e) Scenario Analysis – Interest Rate Sensitivity

Participants assess how repayment changes when interest rates vary.

Interest Rate	Monthly Payment (KES)	Total Payment (KES)	Comment
12%	8,888	106,656	Comfortable repayment
18%	9,168	110,016	Higher strain on cash flow
24%	9,488	113,856	High risk of default

f) Simplified Discounting and the Cost of Capital

Trainers can introduce the idea of 'cost of capital' as the minimum return a project must earn to justify the investment. For necessity entrepreneurs, this is usually the interest rate on the loan plus any additional costs of running the business.

Example: If a loan costs 18% per year, the project must earn at least 18% return to break even. Participants can be shown how to test different scenarios using spreadsheet templates or manual calculations.

g) Stress-Testing Your Business

Stress-testing is a risk management technique to determine the ability of the borrower to deal with a recession or a financial market crisis. Participants should use their own business data to test repayment ability under different interest rates using the following steps:

- ✓ List your expected monthly sales, costs, and loan repayments.
- ✓ Create three sales scenarios (+20%, base, -20%).
- ✓ Calculate net cash flow for each scenario.
- ✓ Compute DSCR for each case (Net Cash Flow ÷ Loan Payment).
- ✓ Discuss what adjustments would help improve repayment capacity.

IMPORTANT FINANCIAL RATIOS TO CONSIDER WHEN TAKING A LOAN

Financial ratios help entrepreneurs assess how healthy their business is. They show whether the business is profitable, liquid, and efficient.

a) Profitability Ratios

Ratio	Formula	Meaning
Gross Profit Margin	(Sales - Cost of Goods Sold) / Sales	Shows how much profit is left after buying goods.
Net Profit Margin	Net Profit / Sales	Shows overall profitability after all expenses.
Return on Investment (ROI)	Net Profit / Total Investment	Measures efficiency of capital use.

b) Liquidity Ratios

Ratio	Formula	Meaning
Current Ratio	Current Assets / Current Liabilities	Measures the ability to pay short-term obligations.
Quick Ratio	(Cash + Receivables) / Current Liabilities	Measures liquidity without relying on inventory.

c) Efficiency Ratios

Ratio	Formula	Meaning
Inventory Turnover	Cost of Goods Sold / Average Inventory	Shows how fast inventory is sold.
Receivables Turnover	Sales / Accounts Receivable	Shows how efficiently credit customers pay.

Example: Kiosk Business Snapshot

A kiosk makes Ksh 60,000 sales per month. Cost of goods sold is Ksh 40,000, and other expenses are Ksh 10,000. Total investment in the business is Ksh 100,000.

- Gross Profit Margin = (60,000 - 40,000) / 60,000 = 33%
- Net Profit Margin = (60,000 - 40,000 - 10,000) / 60,000 = 17%
- ROI = 10,000 / 100,000 = 10% per month

FORECASTING CASH FLOWS AND LOAN REPAYMENT CAPACITY

Cashflow forecasting has been covered in our previous training programs, but here we are interested on how cash flow forecasting helps you to determine whether the business can meet expenses and loan obligations.

It tracks money coming in and going out.

Month	Cash Inflows (Sales)	Cash Outflows (Expenses + Loan)	Net Cash Flow
Jan	60,000	50,000	10,000
Feb	65,000	53,000	12,000
Mar	55,000	54,000	1,000
Apr	70,000	58,000	12,000
May	75,000	60,000	15,000
Jun	72,000	62,000	10,000

The cash flow statement above shows that this kiosk is generating positive cash flow in most months, suggesting some ability to repay a loan, but tight liquidity in March.

ALTERNATIVES TO LOANS

Sometimes borrowing is not the best or only option. Trainers introduce alternative financing mechanisms that may be safer or more flexible for microenterprises.

Alternative Source	Description
Personal Savings	Reinvesting profits to grow the business without external debt.
Chamas or SACCOs	Group savings and lending with flexible repayment and lower interest.
Supplier Credit	Delayed payment arrangements with wholesalers or distributors.
Leasing or Hire Purchase	Accessing assets (e.g., motorbikes, fridges) without full upfront payment.
Grants or Seed Capital Programs	Non-repayable funds for startups and marginalized entrepreneurs.
Invoice or Purchase Order Financing	Getting short-term cash advances against pending customer payments.

Understanding Lender Terms

Participants must understand what they are agreeing to when they sign a loan contract. The following are the common lender terms that an entrepreneur should become familiar with:

- **Flat Rate Interest:** Interest is calculated on the full loan amount for the entire loan term. For example, 12% flat on KES 100,000 for 1 year = KES 12,000 interest, regardless of repayments made.
- **Reducing Balance Interest:** Interest is charged only on the remaining balance. For example, the first month you pay interest on KES 100,000, but in the second month only on KES 91,000, etc.
- **Processing Fees:** A percentage deducted upfront, e.g., 2% of the loan amount. Reduces the amount received.
- **Insurance or Risk Fees:** Charged to cover loan default or death; often 1–2% of the principal.
- **Grace Period:** Months before repayment starts. Helpful for seasonal businesses but increases total interest.
- **Penalty Rate:** Extra interest charged on late payments, e.g., 3% per month on arrears.

Loan Comparison Table

Example: Comparison of two loan offers for KES 100,000 (12 months)

Lender	Interest Type	Interest Rate	Fees (%)	Effective Cost of Credit (KES)
Lender A	Flat	12%	2	112,000
Lender B	Reducing Balance	18%	1	110,000

Interpretation: Even though Lender A has a lower nominal rate, its flat-rate calculation makes it more expensive than the reducing-balance option.

Conclusion: Practical Strategies to building loan repayment resilience

- ✓ Keep a minimum cash buffer equal to one month of loan payments.
- ✓ Negotiate flexible repayment terms with lenders if your business has seasonal cash flows.
- ✓ Diversify income sources to reduce dependency on a single product or customer.
- ✓ Regularly monitor DSCR and update cash flow forecasts every 3–6 months.

Exercises and Practice

a) **Activity 1: Cash Flow Projection**

Participants list their own monthly sales and expenses, then calculate projected net cash flow. Trainers guide them to compare monthly net cash flow with expected loan instalments.

b) **Activity 2: DSCR Calculation**

Participants compute DSCR for three months and interpret whether their business can safely repay the loan.

c) **Activity 3: Loan Comparison**

Trainers provide two sample loan offers. Participants fill a comparison table to determine which offer has a lower effective cost.

d) **Cash Flow Forecasting for a Small Kiosk**

Encourage participants to discuss the ability of this kiosk to repay its loan given the cashflow projections. Where possible a participant can volunteer their own cash projections for group discussions.

Month	Sales (KES)	Expenses (KES)	Loan Repayment (KES)	Net Cash Flow (KES)
1	50000	35000	8888	6100
2	52000	36000	8888	5112
3	54000	36000	8888	9112
4	56000	37000	8888	10112
5	58000	38000	8888	11112
6	60000	40000	8888	11112

Trainer should emphasize: consistency in monthly surplus is what ensures sustainable repayment.

e) **Exercise: Should I Borrow?**

Using your own business financial data or the kiosk example above:

1. Calculate gross profit margin, net profit margin, and ROI.

2. Prepare a 3-month cash flow forecast.
3. Test repayment ability at 15% and 25% interest rates.
4. **Decide:** Is borrowing advisable? Why or why not?

f) Exercise: Choosing the Best Financing Option

Participants work in small groups to analyse three sample scenarios—a kiosk owner, a boda boda rider, and a food vendor. For each case, they must decide whether to take a loan or pursue an alternative, justifying their choice using cash flow and repayment analysis.

5. Example: Loan Repayment Tracker

Date	Installment Due (KES)	Paid (KES)	Balance (KES)	Remarks
1 Jan	8,888	8,888	0	On time
1 Feb	8,888	8,000	888	Late payment
1 Mar	8,888	9,000	0	Cleared arrears

g) Exercise: Building a Monitoring Routine

Participants create a weekly monitoring plan using their real business data. They list which records to update daily and which to check weekly or monthly. Trainers facilitate peer review of plans and help participants design reminder systems using diaries or mobile apps.

- ✓ IF you are currently not keeping well written records – that is already a danger sign.
- ✓ Remember small habits (daily entries) lead to strong financial control.
- ✓ You may want to use digital templates or if not possible then use printed books that are already there in our bookshops.
- ✓ Remember transparency builds trust with lenders – treat your business lenders as your business partners, for them to succeed in their business of lending your money for trading, you must first succeed as a trader.
- ✓ Never forget that your lenders need you as much as you need them – so engage with them as a partner.