THE IMPACT OF FINANCIAL SERVICES ASSOCIATIONS

JULY 2017

FSD Kenya
Financial Sector Deepening

BFA

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FSD Kenya
Financial Sector Deepening

The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). Current funders include the UK's Department for International Development (DFID), the Swedish International Development Agency (SIDA) and the Bill and Melinda Gates Foundation..

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Table of contents

Tables and figures ii

Abbreviations iii

Glossary of terms iv

Chapter 1
FSAs AS COMMUNITY BANKS 1
1.1 Background 1
1.2 FSA operations 2
1.2.1 Customers 2
1.2.2 Credit 2
1.2.3 Group meetings 2
1.2.3 Voluntary savings 3
1.2.4 Shareholdings 3

Chapter 2
RESEARCH METHODOLOGY 4

Chapter 3
FSAS IN THE FINANCIAL LIVES OF POOR CUSTOMERS 5
3.1 FSAs in the financial landscape 5
3.2 FSAs in the personal portfolio 7
3.2.1 Financing household goods 8
3.2.2 Financing productive investments 9
3.2.3 Financing education loans 9
3.3 How people experience the group guarantee 10
3.4 The FSA is not well suited for emergencies 10
3.5 Not covered: health 10
3.6 Inactive accounts 11
3.7 Why not be in the FSA? 11

Chapter 4
FSAs AS FINANCIAL INSTITUTIONS 12
4.1 Loans 12
4.2 Collateral deposits 14
4.3 Savings 16
4.4 Share ownership 16
4.5 Although member-owned, people see the fsa as a bank 16

Chapter 5
TECHNOLOGY AND COMPETITION 18

Chapter 6
FSA AS A SOCIAL INSTITUTION 19

Chapter 7
FSA BUSINESS MODEL 20
Buying goods – is it part of the fsa business model? 20

Chapter 8
ARE FSAs SERVING THE POOR? 21

Chapter 9
CONCLUSIONS AND RECOMMENDATIONS 22
9.1 Improve transparency and communication 22
9.2 Product improvements 22
9.3 Financing goods – consider it as a business 23
9.4 Expansion considerations 23

Annex
MIS issues 24
Data usefulness for making business decisions 25
Mis ability to take on new technology 25

TABLES AND FIGURES

LIST OF FIGURES

Figure 1:	Characterisation of financial: FSA community	3
Figure 2:	FSA loan offering compared to formal players	6
Figure 3:	FSAs in the informal financial system	6
Figure 4:	What do people value in the FSA?	7
Figure 5:	FSA sweet spot in the personal financial solutions	7
Figure 6:	Goods financed in Bamba and Mukuyuni	9
Figure 7:	Distribution of loan types	12
Figure 8:	Loan repayment rates in Mukuyuni and Kakeani	13
Figure 9:	Loan repayment rates in Bamba	14
Figure 10:	PAR 90 days with years of group age	15
Figure 11:	Customers with loans in 2016 and who have a balance	15
Figure 12:	Median balance in voluntary savings (customers)	17
Figure 13:	Sources of Capital for FSAs.	17

ABBREVIATIONS

FSD	Financial Sector Deepening
FSA	Financial services associations
KCM	Kikundi cha mkopo
KDA	K-Rep Development Agency
KFS	K-Rep Fedha Services Limited
KSh	Kenya shillings (currency)
KWFT	Kenya Women Microfinance Bank (formerly Kenya Women's Finance Trust)
MFI	Microfinance institution
MIS	Management information systems
NGO	Nongovernmental organization
NHIF	National Hospital Insurance Fund
PAR	Portfolio at risk
SACCO	Savings and credit cooperative organization
SMS	Short message service
TOR	Terms of reference
URL	Uniform resource locator

GLOSSARY OF TERMS

Biashara	Business
Chama	Savings clubs
Kikundi cha mkopo	Smaller credit groups within the *muunganos*
Maendeleo	Progress
Masomo	Education
Muungano	FSA member credit groups
Saidika	Receive assistance

Chapter 1

FSAs AS COMMUNITY BANKS

1.1 BACKGROUND

Financial services associations (FSAs) are rural community-level member based semi-informal financial institutions, that are a hybrid of savings and credit cooperative organizations (SACCOs) and microfinance institutions (MFIs). Although they are relatively large with some having over 10,000 members (current membership range for most FSAs is between 8,000 and 16,000 and growing), they exist as self-help groups. FSAs start off with about 300 members but grow gradually based on a number of factors such as economic potential and the population density of the area.

Past performance shows that FSAs have the potential to grow to sizeable financial institutions and to sustainably provide services to their local communities. Being mutuals, they are governed and mainly financed by their members who are also their clientele. Anecdotal evidence indicates that although this self-management and governance structure works relatively well for young smaller FSAs, incentives get quickly misaligned as the FSAs grow and start to become profitable, leading to all sorts of malfeasance. This was the case for FSA Bamba which has the highest portfolio at risk (PAR) of the three FSAs we evaluated. K-Rep Fedha Services Limited (KFS) took over its management only a couple of years back and is still instituting reforms.

Despite the expansion of commercial bank branches into rural Kenya, the establishment of agency banking infrastructure, and mobile banking, FSAs have remained resilient and continue to grow in membership and service use. Available data from the FSAs and anecdotal evidence shows that FSAs are able to meet needs of their members (the majority of whom are low-income households), which more formal financial service providers are not able to. A closer relationship with their customers gives FSAs an edge – a better understanding of their members' needs and use of innovative products and delivery channels for their services.

However, when looking at the FSA database, inactivity of members appears to be an issue. Additionally, there remains a sizeable minority of individuals within the communities served by FSAs who have opted not to join, yet they seem to share the same characteristics as the typical profile of an FSA member. The reasons for high inactivity and lack of participation were unclear and the study seeks to address some of these issues.

The FSA model was established by K-Rep development Agency (KDA), a non-governmental organization (NGO) whose primary objective was to significantly push forward the frontier of sustainable financial service provision in more remote geographical areas where mainstream MFIs and commercial banks were not operating. In 2005, KDA established K-Rep Fedha Services Limited, registered under the Companies Act as a limited liability Company as a specialist FSA management company to provide management services and oversight to the FSAs on a commercial basis, through a services arrangement. Underpinning the approach was the premise that a commercial environment would produce greater incentives for efficiency in service delivery at the level of the support organization.

KFS was created as a solution to the problem of capacity weaknesses in small decentralised financial intermediaries, without simultaneously losing the benefits of member ownership and the low operating cost structure. To ensure FSAs are managed by employing best practices, KFS employs and deploys managers to the FSAs who are charged with the day-to-day running of the FSA operations, while providing the them technical support from the head office. Most of the other FSA staff are employed locally by the local member selected Board of Directors. Ownership of the FSAs remains with its members. KFS provides day-to-day operational management and strategic oversight at a low cost by exploiting the economies of scale and risk management benefits from the use of unified, tested business processes and information systems. In addition to providing oversight, KFS has also been involved in:

- **Business development:** Market research and new product development as well as refinement of the existing ones based on the member's needs, marketing and promotion of the FSAs and branding.
- **Operations management:** Through the FSA manager, day to day running/business management of the FSAs business activities like credit, savings, money transfer and others. Use of best credit practices are employed to safeguard the shareholders' funds and return on investments.
- **Management Information System:** KFS provides the FSAs with the appropriate MIS which includes initial infrastructure/ equipment and software. The MIS support is provided by KFS as a service with the MIS support team centrally located. This has enabled the FSA to exploit economics of scale to acquire and maintain the MIS which would otherwise not have been possible individually.
- **Guidance in development of policies and standardization of operations across the FSA network:** This has ensured that the FSAs are managed using the best practices and through standardization all FSAs receive similar service attention at all times.
- **Capacity building:** Organizes needs based trainings for shareholders, Board of Directors and FSA staff.
- **Financial management:** this includes liquidity management, asset management, liability management documentation and generation of reliable financial reports for the purposes of decision by the FSA Board of Directors.
- **Strategic and business planning:** The KFS head office planning team equips the FSA manager and staff with appropriate planning skills and the FSA boards approves the plans.
- **Human Resource Management:** KFS in conjunction with the Board of Directors ensures staff with the right skills, competencies and attitude are hired, and interviews are conducted jointly. The Board of Directors is responsible for remuneration of the FSA staff while the responsibility of remunerating the FSA manager/ CEO lies with KFS.

- **Risk Management:** KFS consistently reviews the FSA system through process mapping to align them with the best risk management practices. By ensuring the FSAs embrace and employ the best risk management practices, shareholders' funds have been safeguarded.

Currently, KFS is managing 37 FSAs which had a total membership of about 201,000 by the end of December 2015. KFS technical backstopping to the FSAs model realizes results in a range of operating environments, placing high priority on using innovative solutions and ensuring delivery of fairly priced financial services to large numbers of poor and low-income people in rural-Kenya.

Financial Sector Deepening Kenya (FSD Kenya) has been supporting the transformation of FSAs into credible financial institutions since 2005 through KFS with the presumption that FSAs are serving a distinct segment of the population from that served by the banks and MFIs. The current phase of this support is aimed at the creation of a fully sustainable FSA network within the current financial sector prudential regulatory framework. Overall, there has been business growth within the network of FSAs as well as KFS (current operational self-sustainability stands at 109%); hence there are good prospects for long- term sustainability.

FSD Kenya's continued support to the FSAs has been informed by the increasing FSA membership rather that by an empirical assessment of the value and impact of FSAs for lower-income households and the causal mechanisms through which this is achieved. In line with its 2016 to 2020 strategy that aims to create value through financial inclusion, FSD Kenya engaged BFA to assess the impact of FSAs on building livelihoods of the poor and to explore opportunities to deliver additional value to these target households.

1.2 FSA OPERATIONS

FSAs are located in remote rural areas where people are typically poorer than the national average, and earn a living mostly from agriculture. They act as banks in the community, with teller windows to accept cash deposits and loan payments, as well as to pay out loans and withdrawals. All FSAs use a standardised methodology and a centralized accounting system. This section examines who their customers are and how they engage with the FSA.

1.2.1 Customers

FSAs have three types of customers being members, clients and businesses. Members have shares in the FSA and belong to ***muungano***s for group borrowing. They can also maintain individual savings accounts. Clients (who are not members) do not belong to a ***muungano*** but have individual savings accounts. They are not supposed to be allowed to borrow, although we noted some cases where they had borrowed. Businesses (who are not members) have savings accounts. They are not allowed to borrow and we did not note any loans to businesses. Independent savings groups that deposit their money in FSAs were classified as businesses.

In this report, when we refer to **customers** we mean both members and clients, since their accounts were not distinct in the data.

All transaction data referenced in the text covers February 2016 to January 2017 unless otherwise specified.

1.2.2 Credit

FSAs apply the group lending methodology. Members belong to ***muunganos*** which are groups of a minimum of 25 people who are trained by a "teacher" from the FSA. All members of the ***muungano*** must guarantee each other's loan. Within the ***muungano*** there are smaller groups of about 6 people who know each other more closely. These are referred to as ***kikundi cha mkopo*** (KCMs). KCM members track and support each other's loan repayments. The members contribute monthly mandatory savings that serve as collateral for loans, and we will be referring to these mandatory savings as "collateral deposits" in this report. In addition to the guarantee, where possible, the borrower also provides a lien on their physical assets (mostly household chattels) as security.

Although the ***muugano*** is involved in the assessment of the loan, the final loan decision is made by the FSA credit officer. Also, the loan capital comes from the FSA, not the ***muungano*** alone, allowing larger loan sizes than would be possible within the group alone. Members can borrow in proportion to their shareholding (a maximum of four times) instead of their savings as might be the case with SACCOs. The other contrast is that unlike SACCOs long-term savings, members' shares in FSAs are not used as collateral for loans.

There is high usage of credit – nearly three-quarters of customers took a loan in 2016, according to the data we reviewed. It should be noted that because the database does not link customers to ***muunganos***, this number include customers who are not ***muungano*** members and who only use the FSA for saving. Therefore, the rate of credit utilization is probably considerably higher within a ***muungano***.

1.2.3 Group meetings

Muungano meetings are generally monthly but a few meet more often (bi-weekly or even weekly). At the monthly meeting, members meet their teacher for training on the group methodology, repay their loans, apply for new loans, agree to guarantee each other's loans, make compulsory savings contributions, and buy shares. Some see value in meeting more often especially when the group is recently formed. During these additional meetings, members deposit their personal savings, buy shares, encourage visitors to join and plan for the monthly meeting activities.

The ***muungano*** meetings are supposed to last for about 2 hours but they can be prolonged while members seek funds to make their monthly payments – some end up lasting all day (8 to 9 hours). Each group meeting starts with each member depositing the mandatory savings of KSh 200 per month. Mandatory savings cannot be withdrawn except at the end of the year when 25% can be withdrawn. These mandatory savings are used as collateral for loans.

1.2.3 Voluntary savings

Members can save voluntarily, in their own individual savings accounts. Voluntary savings can be withdrawn at any time but they do not attract interest. Clients and businesses can also have voluntary savings that can be withdrawn and do not accrue interest. In addition, although FSAs offer interest-bearing term deposits, they do not promote them partially due to concerns about lack of formal regulation. These are mostly used by businesses.

1.2.4 Shareholdings

As previously mentioned, equity is mobilized through the sale of shares in the FSA. FSAs are owned by their members who can buy as many shares as they like. Members must have at least one share to belong to a *muungano* and to borrow. However, depositors (whether clients or businesses) do not need to own any shares. FSAs distribute 40% of their annual profits in the form of shareholder dividends based on each member's shareholding. The other 60% is retained by the FSAs as capital.

Mandatory vs voluntary savings

Mandatory savings are part of the loan process and serve as collateral for loans. All members must deposit KSh 200 at every ***muungano*** meeting. These mandatory savings cannot be withdrawn, except 25% at the end of every year. There is no provision for receiving the full balance at any time, and no interest is earned.

Members can also save voluntarily in their own individual savings accounts. Members can withdraw their savings at any time, although there is no interest earned.

This research showed that having two types of savings is causing confusion:

- The FSAs database does not in all cases distinguish between voluntary and mandatory savings.
- Customers are confused about the difference between the mandatory savings terms and voluntary savings terms.

It might be advisable not to call both "savings" but instead to name the collateral deposits as such, or by another name such as "membership dues".

Chapter 2

RESEARCH METHODOLOGY

BFA studied 3 FSAs in detail: Mukuyuni, Bamba and Kakeani. For the analytical part of the study, we reviewed all of their transaction data, as well as financial statements.

For the qualitative study, we carried out in-depth interviews with members and non-members at each FSA as below:

Age of *muungano*	**Old (above 5 years)**	**Intermediate (between 5 and 2 years)**	**New (under 2 years)**
Active *muunganos*	1 active member 1 inactive member	1 active member 1 inactive member	1 active member 1 inactive member
Active businesses/ client	1	1	1
Non-member	1 neighbour of active old *muungano* member	1 neighbour of active intermediate *muungano* member	

Chapter 3

FSAs IN THE FINANCIAL LIVES OF POOR CUSTOMERS

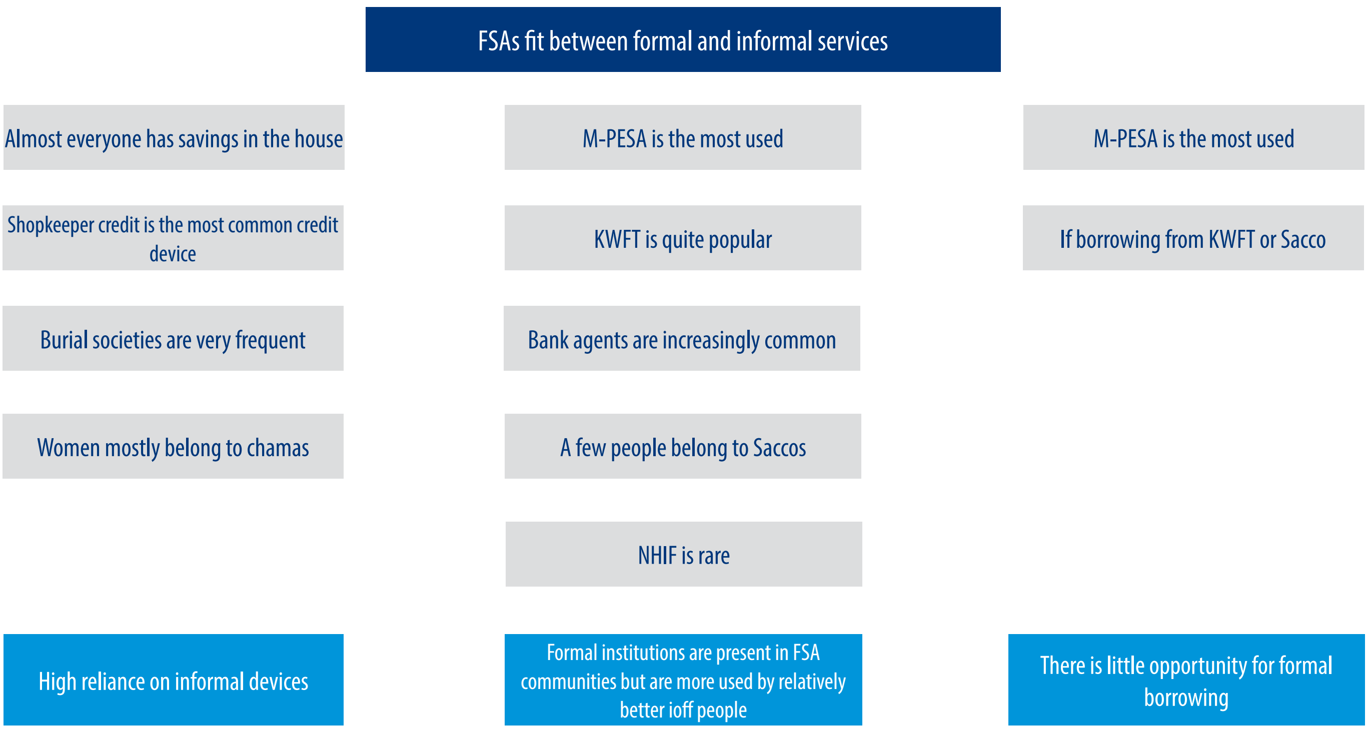
3.1 FSAs IN THE FINANCIAL LANDSCAPE

The communities where FSAs operate are remote and rural, but they are not cut off from broader trends in the Kenyan financial eco-system. Virtually everyone we interviewed had M-PESA, although they used it mostly for receiving money. KWFT was active in all three communities. Bamba area also had an active SACCO. Where SACCOs, MFIs or banks exist, our interviews indicated that they were mostly used by those who were relatively better-off economically. It's typical of financial services everywhere that better-off people use a wider range of financial instruments and institutions; the better-off respondents continued with the FSA even as they added additional products from new providers.

People in all the three communities mostly relied on informal financial services, including saving in the house, credit with the shopkeeper, and burial societies. *Chamas* were also common, especially for women.

The FSAs fitted a unique niche which did not seem to compete with either the formal or the informal sectors. They filled a specific need in the personal financial portfolio (see section below) while at the same time affording low-income people access to structured, safe and formalised financial services of a specific kind (see figure 3).

Figure 1: Characterisation of financial landscape of FSA communities



[1] Chama is a word used to describe various types of savings and borrowing groups, including ROSCAs and ASCAs.

[2] We are using "medium term" to describe loans that are longer than the very short-term credit available from local informal markets (days to weeks); and also longer than the short-term credit available from MFIs and mobile banking such as M-shwari (1- 3 months). Bank and MFI loans are also available in this "medium" term of 6-18 months.

The core FSA product is a medium-term , medium-size loan (~KSh 10,000 for 6-12 months at 18% flat interest) for which there is little competition in the formal market (see figure 2). This amount is below the traditional loan size for banks, SACCOs and MFIs, yet is relatively large for an accumulating savings and credit associations (ASCA), although with the advent of mobile money there are now more options for smaller loan sizes from formal providers. Most people in the communities we interviewed did not have loans from formal providers.

On the other hand, respondents continued to participate in chamas and to have credit with local shopkeepers even when they were members of FSAs (see figure three). This reflects that FSAs may serve a different purpose from these traditional financial providers especially since they can provider larger loan sizes and access to household goods. It also reflects that people tend to widen their portfolio over time when the products continue to add value.

Figure 2: FSA loan offering compared to formal players

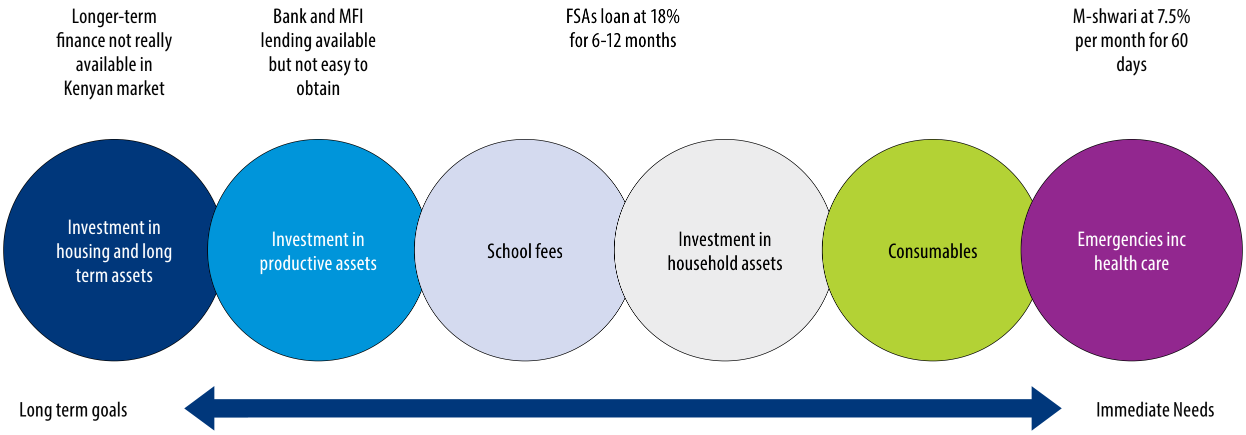
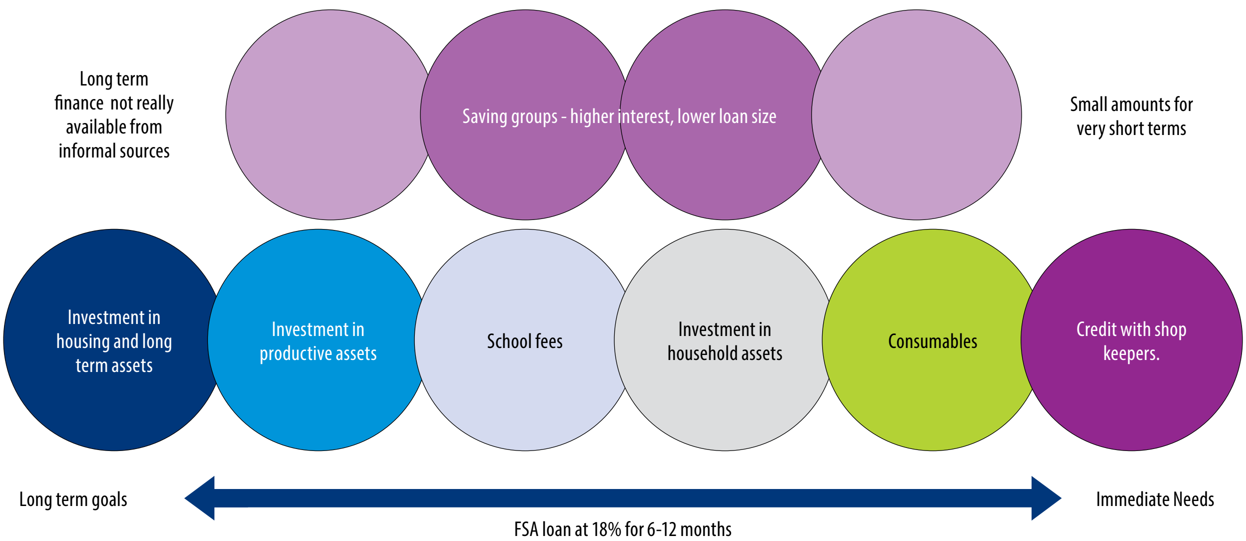


Figure 3: FSAs in the informal financial system



3.2 FSAs IN THE PERSONAL PORTFOLIO

It was clear from the in-depth interviews that people join FSA mostly for the opportunity to borrow. This came through consistently. As show in figure 6 people reported that they valued loans for three purposes: goods, education and emergency. The FSAs have also adjusted their loan products to meet these requirements. For instance, they offer an education loan that is 90% disbursed to the school and 10% to the parent; an emergency loan with a shorter disbursement cycle; and also purchase goods on behalf of members.

Because of their group methodology and centralized access to capital, FSAs are able to make relatively larger and longer loans than informal providers while offering smaller loan sizes than MFIs and SACCOs. They have also been very responsive to member needs in designing their products and thus they offer a sweet spot for financing household goods and education. These are products where there is little competition from either the formal or informal sectors (see figure 7).

Figure 4: What do people value in the FSA?

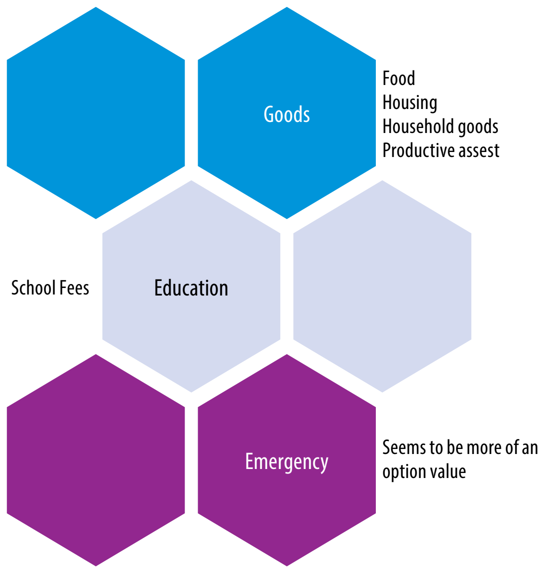
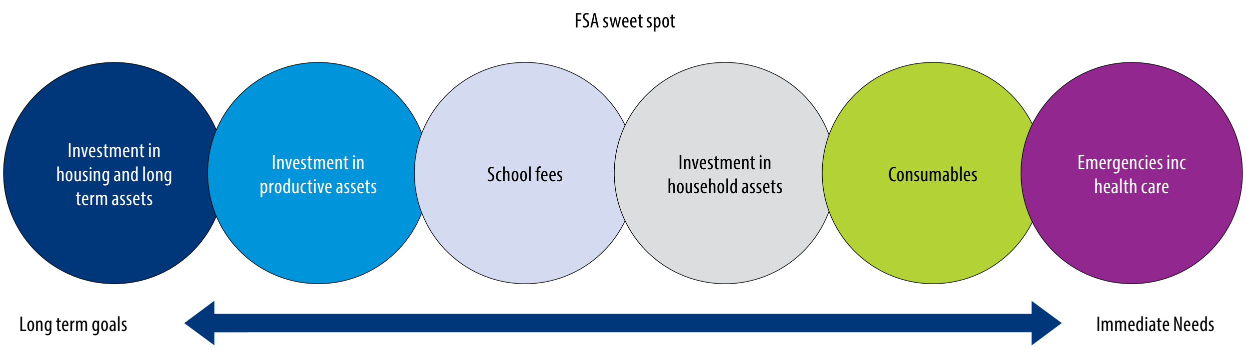


Figure 5: FSA sweet spot in the personal financial solutions? portfolio



[3] In Mukuyuni, purchase of loan assets in the 2015 accounts was about 10% of the value of loans, but in Bamba and Mukuyuni there did not seem to be clear accounting for the purchase of goods

3.2.1 Financing household goods

In the interviews with FSA members and non-members, one of the most important functions of the FSA was cited as finance for household goods, including food and household assets. Here, the role of the FSA is seen to go well beyond finance. The FSA organizes the purchase of the goods and their delivery to the members either at the group meeting, FSA or at their door steps.

The different FSAs handled the goods purchases in different ways. The Bamba FSA bought standardised goods and borrowers could only buy the items already purchased by the FSA. In Mukuyuni and Kakeani FSAs, people could choose from a set of possible goods of varying sizes which the FSAs could then procure on their behalf.
A few realizations about the FSA loans for financing goods:

Goods finance constitutes a significant part of the FSA loan portfolio. The FSAs were not clearly recording the purpose for the loans and hence so much of the asset finance was not reported. We were only able to get records for Bamba, where asset loans comprised 8% of overall lending. We could not get figures from the other FSAs specifically relating to which loans were used for assets purchased by the FSA but we expect it is similar or possibly higher given the importance of these assets in the members' perspective.

The items being financed were basic and contribute to household wellbeing. The main goods included food, solar, water tanks, mabati (iron roofing sheets) and phones. Although these were generally not productive assets, they substantially contribute to wellbeing and were highly valued by members. Non-members cited the inability to get these goods as a major regret for not belonging to the FSA.

FSAs purchase high-quality goods. Respondent said the goods bought by the FSAs were high quality and in the same price range as those available in the shops in town. The goods were available at the right time and at their doorstep. They particularly valued the bulk food they were able to purchase in December. Overall, members were very satisfied with the FSAs goods finance system.

Buying goods or borrowing? We have an impression that many people do not perceive the FSA asset finance exactly as a loan. Instead, they regard it as a payment for an asset, which is spread over time. This is very consistent with asset finance in other markets such as Latin America where goods are advertised as being "Pesos$183 weekly for 18 months" with the full price of Pesos$9,599 in small print . Seeing the loan as a payment is not necessarily good or bad. If FSAs decide to expand this line of business they may want to market their products in terms that customer understand. In Latin America it has raised customer protection issues since this type of pricing can be used to obscure high interest rates, so pricing should be transparent.

Members valued household goods financing by FSAs:

If it weren't for the *muungano*, I would still be sleeping on my mat, but now I am sleeping on a mattress.

Active intermediate FSA member (2 to 5 years), Bamba

"They have helped people, because if I were interested I could say I want this house furnished, and I could get the money and they bring me the furniture and that way I am upgrading my standard"

Active old FSA member (over 5 years), Kakeani.

Members and non-members reported that you can tell a household where someone is an FSA member because of household improvements and better well-being:

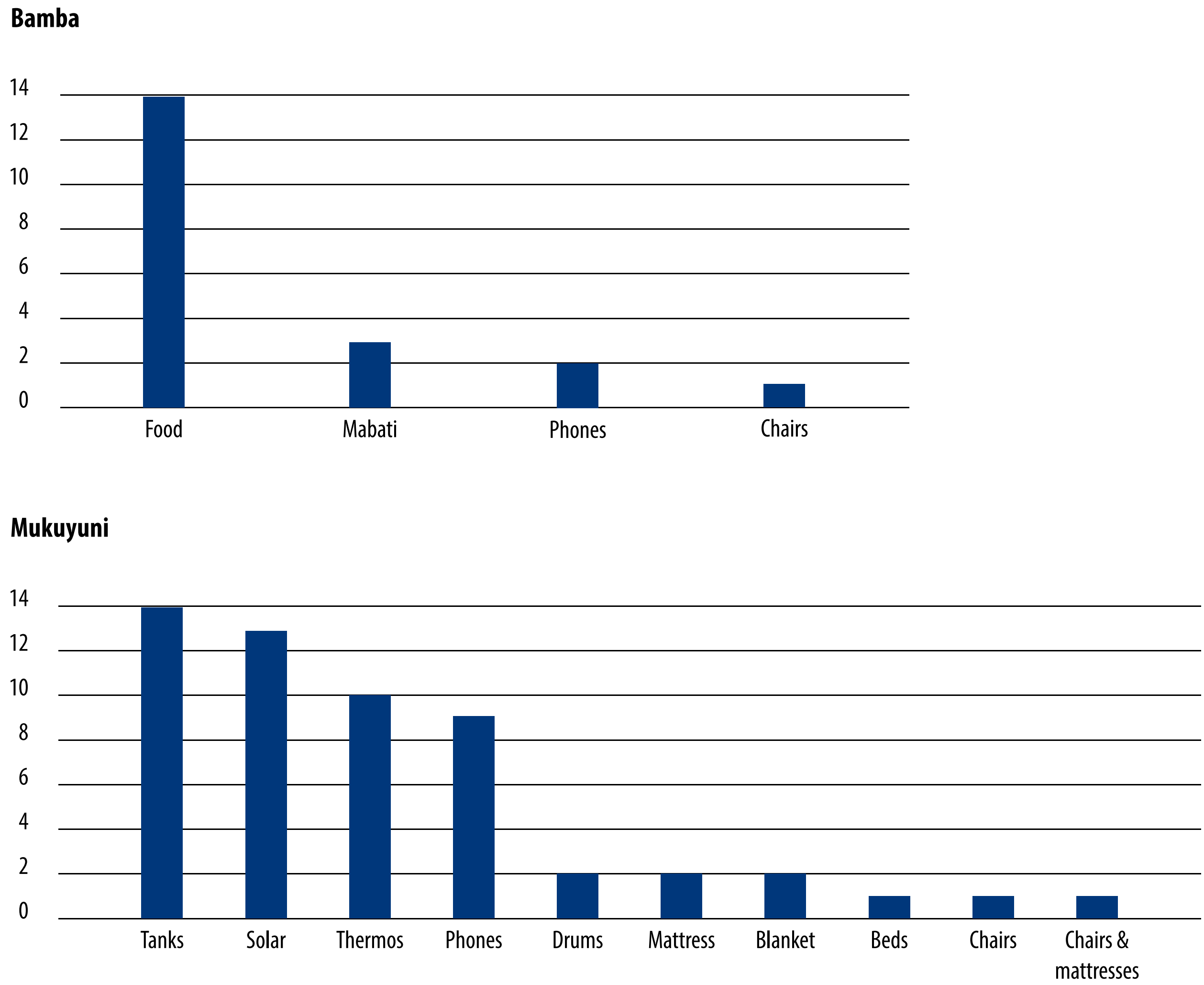
"... after bringing these chairs, there are usually changes at home. There are even mattresses. They have even started building houses that have iron sheets, they have mattresses..."

Active old FSA member (over 5 years), Bamba

"Their homesteads are so developed because when one is given a loan even if he or she does not have a business he or she is managing, when one wants to put up a forest, a garden, one is able. [Also] when you are in the group your child cannot lack school fees. When one is in the group ... they study many things because when you look at a person, his or her thinking is better than that of a person who has not joined the group. In business they are very in front [They are doing well in their businesses]. Me when I buy sugar of one, five kilograms, them they usually buy like one sack or two[While I can only afford a 5 kilograms packet of sugar, an FSA member is capable of buying one or two 50 kilogram sacks of sugar]."

Non-FSA member – neighbor of old FSA member (over 5 years), Mukuyuni

Figure 6: Goods financed in Bamba and Mukuyuni (data for Kakaeni not available)



3.2.2 Financing productive investments

Although it did not show up in the data, the FSAs also purchase agricultural inputs on behalf of members, which members appreciate since they arrive at the right time, even if the member is short on cash at that moment.

Members also take loans for larger productive assets such as motorbikes and tractors, and this was visible in the transaction data with maximum loan sizes of KSh 500,000 to 800,000 in the course of the past year at the three FSAs. However, these assets are not purchased by the FSA. For these one-off individual investments the money is disbursed directly to the borrower.

3.2.3 Financing education loans

Almost everyone in the FSA with a child had taken a loan for education. The FA has a specific Masomo loan that paid 90% directly to the school and 10% to the parent. Respondents were appreciative of the education loan and felt that it also came at the right time of year.

[4] See CGAP internal document: Retailers as Providers of Financial Services to Lower Income Segments, CGAP, 2015

3.3 HOW PEOPLE EXPERIENCE THE GROUP GUARANTEE

People see borrowing as the main purpose of the FSA and understand that the group guarantee is what makes it possible to borrow. Nonetheless, they hate it when people default – because their ability to borrow more is blocked. They would prefer that the FSA take security from the borrower and perhaps from the group members rather than blocking their ability to borrow within the FSA. People thought it was possible that if you cannot pay you could come to the group and explain and they could re-schedule, or your KCM could pay for you. However, few people we met had encountered this in their own experience.

3.4 THE FSA IS NOT WELL SUITED FOR EMERGENCIES

Members cited emergency loans as a reason why they like the FSA, but in fact could not relate cases where they themselves had obtained an emergency loan from the FSA. Emergency loans also constitute less than 1% of all loans at all three FSAs (by value and by volume) so clearly this is not an important function of FSAs. Considering the monthly loan application process and the requirement for guarantees, it's clear that the FSA offering is not suited to emergencies.

3.5 NOT COVERED: HEALTH

Health risk is something members face frequently and sometimes it has led to non-repayment of loans and inactivity in the FSA. There does not seem to be another source of health finance (formal or informal) that covers FSA members, especially given the distance from health facilities.

We heard from members that women are especially vulnerable when they fall pregnant – complicated pregnancies and the cost involved. Others also have members of the family with poor health.

Interestingly, death was not mentioned as a major financial issue – perhaps because burial societies existed in all the communities. Kakeani FSA ran a burial scheme; in Mukuyuni there was a community burial society with over 180 members. In other cases, the FSA members would rely on their ***muungano*** to provide support (outside the FSA credit activities) when a death occurred.

"There was a member who borrowed money in January. We were even deducted KSh 500. When it came to paying the group meeting where we would pay for the loan, she did not show up at all. We called her, she was unavailable. ... I don't like it because we borrow for our own needs but you jeopardize everyone's credit worthiness".

Active intermediate FSA member (2 to 5 years), Bamba

"In 2015, I bought maize worth KSh 50,000 which I sold for KSh 70,000 which gave me a profit of KSh 20,000. I took the KSh 20,000 to FSA and paid for my loan for two months so that I don't use the money. Two weeks later I repeated the process and it gave me KSh 75,000 thus a profit of KSh 25,000. It helped me so much that I finished paying for my loan in 7 months instead of one year."

Active intermediate FSA member (2 to 5 years), Mukuyuni

"[FSAs should bring].. those projects involving cows and chicken. I might want a dairy cow but I don't know where to get it. They should be able to bring it the way it is done at KWFT."

Active intermediate FSA member (2 to 5 years), Mukuyuni

" Since I took these loans here and there, it has helped me very very much especially for my grandchildren in terms of school fees I did not have any embarrassments at all".

Active old FSA member (over 5 years), Bamba

How people deal with emergencies (from the interviews)

Only Kakeani FSA members would turn to the FSA in case they needed KSh 2,500 in 3 days. Others would borrow from friends and family, or the SACCO. Those in Bamba would find it extremely hard to raise such funds. As the amount increases to KSh 5,000 in a week, those from Kakeani would still go to the FSA, while those in Bamba would find it almost impossible to raise that money. One even mentioned a shylock in Mukuyuni. Across the board, most would rely on business deals or cutting back on their lifestyle to raise KSh 5000 in a month

3.6 INACTIVE ACCOUNTS

One of the objectives of the study was to understand why people might become inactive in the FSAs and indeed both the qualitative and transaction studies sought to identify inactivity and the reasons for it. We decided to define "inactive account" as an account that had not had one transaction in the past six months. Based on this definition, there seemed to be a high level of inactivity:

- From the MIS data, 92% of ***muunganos*** and 57% of KCMs appear to be inactive (i.e. not savings in the past 6 months) but this turned out to be due to inconsistent recording of mandatory savings (collateral deposits) rather than that the *muungano*s being actually inactive.
- Similarly from the MIS, 79% of customers appear not to be saving but the group methodology does not allow people to fail to save. Again, this seems to be due to recording issues, not inactivity as such.
- Around 10% of *muungano*s had no transactions and a zero balance. These appear to be *muungano*s that have closed or are so new they have no recorded transactions.

However, it turns out these inactivity rates do not reflect the real situation. Based on the loan data, just under 75% of all customer had taken a loan in the past year. Although we had no way to directly link a customer account to a ***muungano*** or KCM, these numbers would imply that at least 75% of ***muungano***s are in fact active. Therefore, it seems that inactivity rates are actually low. On the other hand, there are serious problems with the recording of savings transactions. KFS has studied this situation and confirms that the system does not reflect savings transactions correctly; it is focused instead on loan repayments and savings balances.

Our field work turned out to confirm the idea that participation is actually high and active. Initially we had used the MIS to select respondents to interview based on their level of activity but it turned out that people who were recorded in the MIS as inactive were in fact active members. Instead, we ended up finding inactive members to interview by asking in the community. Our impression was that these former members tended to regret being forced to leave the FSA for reasons of financial setbacks and would be keen to be able to join again.

We also checked the MIS to ascertain whether older groups tended to be less active (in terms of savings) or to default more often on their loans, and neither was true according to the transaction data.

Overall it seems that FSA groups have quite low levels of inactivity and high ongoing participation in both savings and borrowing, which is quite comparable with about 20% of accounts in the banking sector being dormant

3.7 WHY NOT BE IN THE FSA?

When we interviewed respondents in the same community who were not in the FSA, or respondents who were inactive or who had dropped out, they had similar reasons:

- The main benefit to being in the FSA is access to the loans and particularly those for buying goods
- However, you cannot participate if you're not confident you will be able to repay the loan
- You have to drop out of the ***muungano*** if you cannot afford to keep up payments (whether or not you borrow)

In a few cases, people liked KWFT better because of the individual loan products.

"I was a member . . . . I progressed and got benefits and got my 1st loan .. [of] .. KSh 20,000. [for] . . . making mandazi and selling. I continued repaying the loan until I cleared. I continued and got the 2nd loan. I continued repaying the 2nd loan ..[of].. KSh 20,000. I repaid and when I got to the middle I discontinued since I got pregnant with this baby. I developed pregnancy complications .. [and] .. the doctor advised me not to work again. I had purchased a cow with the loan and sold it to repay the loan. The third time again I took a loan of KSh 20,000. [That] . . . is when I got problems. This baby was born with a cleft lip. I used KSh 5,000 to take him to the hospital . . . I gave my husband the KSh 15,000 to do goat business with. He continued until he got into loss and the business died completely. I continued repaying and finally got stuck . . . I repaid half and there's a deficit of the other half.

Inactive intermediate FSA member (2 to 5 years), Bamba

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5 Self-reported from customers in the FinAccess 2016 survey.

Chapter 4

FSAs AS FINANCIAL INSTITUTIONS

The FSAs appear reasonably well run, with growing numbers of members, very little attrition of the groups, and good repayment rates (with the exception of Bamba, which KFS started managing about 7 years ago, but is still struggling to streamline the methodology). This is reflected in consistent profitability and ability to pay out dividends.

4.1 LOANS

FSAs are using a variety of approaches to encourage and enforce repayment. Principally, FSAs use the group lending methodology in which all ***muungano*** members (approximately 30 people) are supposed to guarantee every loan. This is a cumbersome and elongated process, involving the chief's signature and an affidavit from a lawyer. ***Muungano*** guarantors' mandatory savings are collateral for the loan. Sometimes assets can be pledged as guarantees as well; and asset seizure is possible

Our observation is that all of these rules have exceptions and there may be an opportunity to simplify the loan documentation and guarantee process.

FSAs do accept interim re-payments and these are frequent, with a median of 2 to 3 repayments during each monthly period in all the 3 FSAs that we studied. 2 of 3 FSAs in our study also accept usage of M-PESA for repayment.

The FSAs main lending products are the non-specific Biashara and Maendeleo loans (see figure 9). These loans include most loans for goods, household assets and productive investments. The apparently high rate of Biashara loans in Mukuyuni is probably just that loan officers do not record the loan type with care. Masomo loans are the next most common, with emergency loans barely reflected.

FSAs do offer other types of loans including specifically several that are indicated as being for agriculture. The terms for these loans vary as well as the interest rates , but they comprise such a small share of the portfolio that we did not analyze them (less an 0.2% of all loans). BFA would recommend streamlining the loan portfolio and reducing the number of different types of loans given.

Figure 7: Distribution of loan types

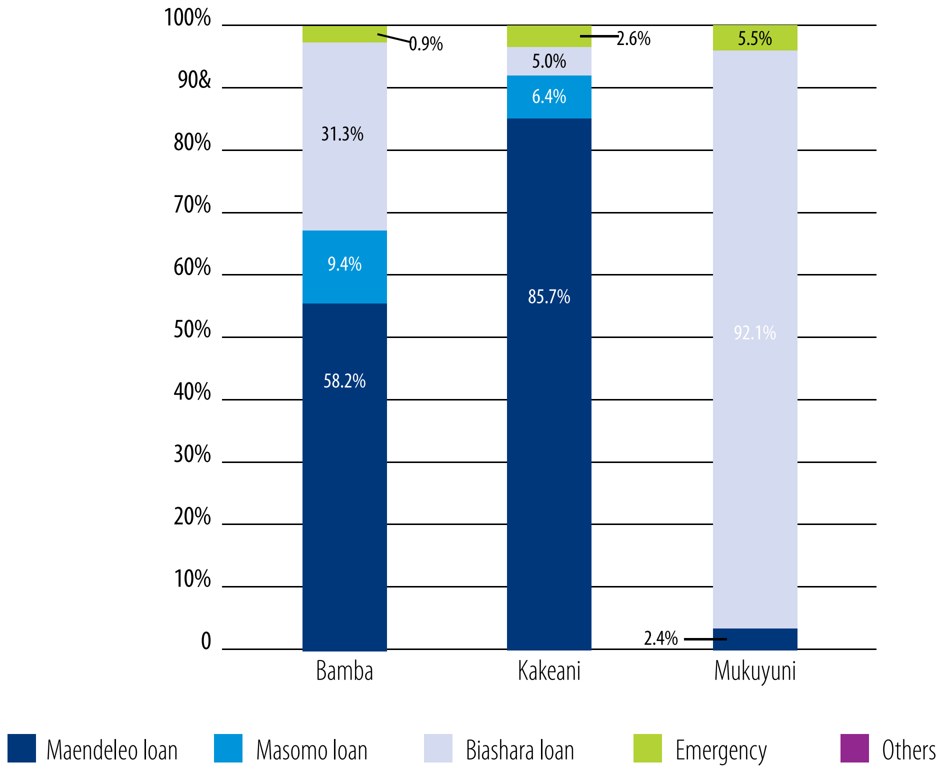


Table 2: Profile of FSA loans disbursed in 2016

	Total no. loans disbursed (1 year)	Total loan amount disbursed	Median loan disbursed	Max loan disbursed
Bamba	2,821	KSh 47,660,532	KSh 10,000	KSh 800,000
Kakeani	11,571	KSh 175,954,650	KSh 9,800	KSh 600,000
Mukuyunu	18,398	KSh 199,270,649	KSh 4,800	KSh 505,500

Figure 8: Loan repayment rates in Mukuyuni and Kakeani

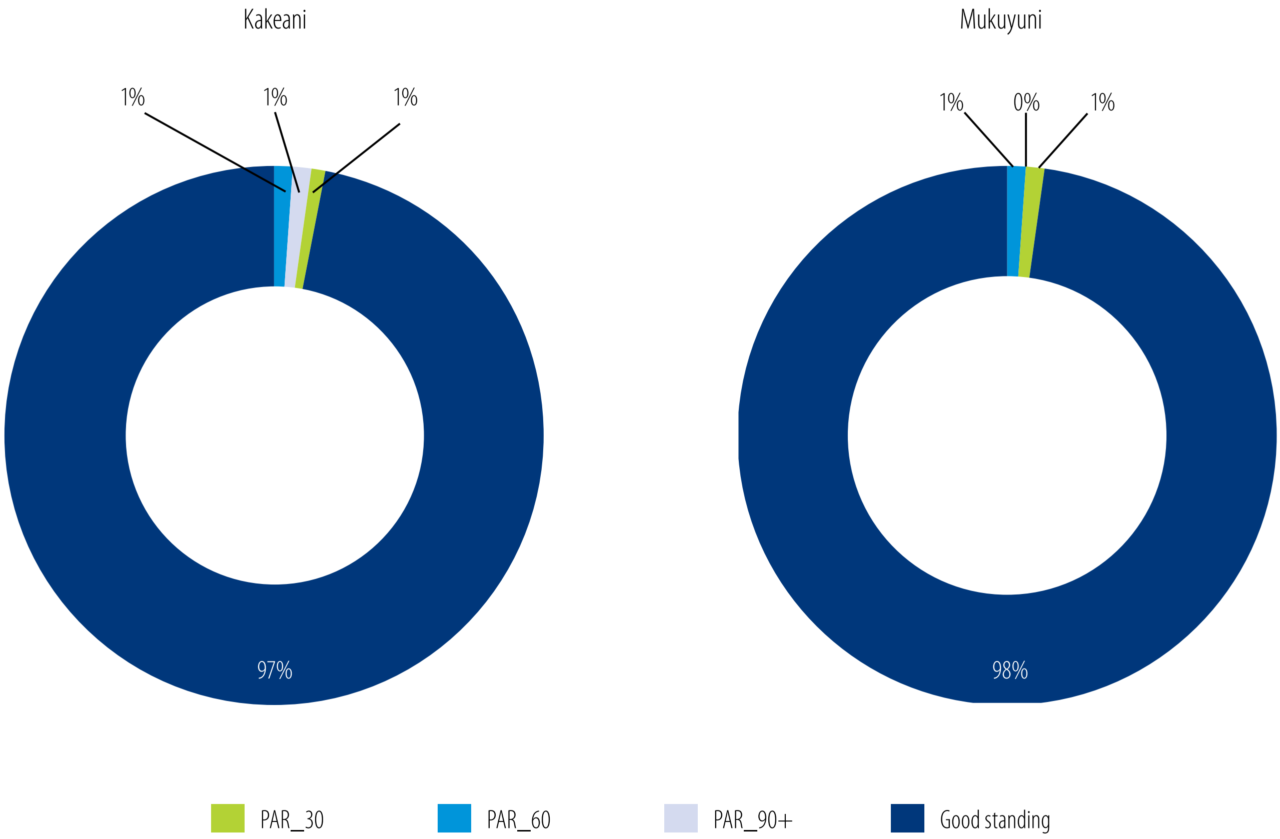
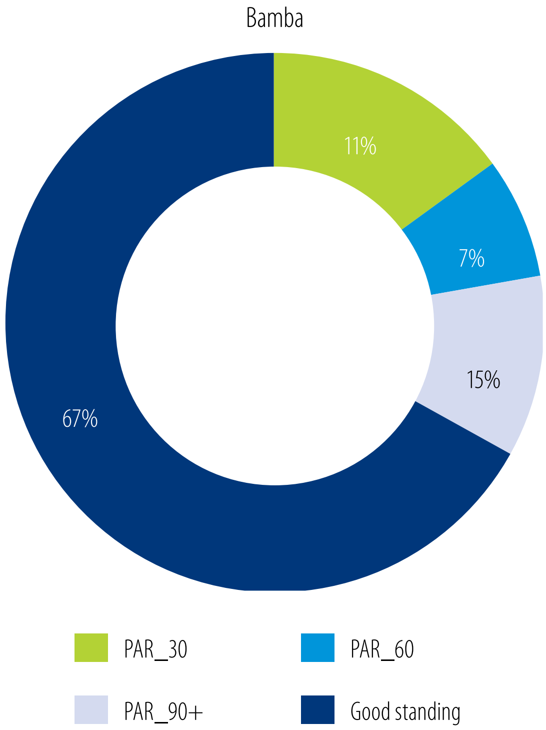


Figure 9: Loan repayment rates in Bamba



The FSAs disburse a large number of loans, ranging in size from very small to quite large.

Loan repayment rates generally are high, reflecting the effectiveness of the group guarantee methodology (see figure 9). It's possible some internal defaults (paid up by other members of the group) would not be reflected in these statistics – we heard at least one story where a member had paid for another's default in order to avoid blocking his own ability to borrow.

We analyzed whether the age of the group made any different to the repayment rates. PAR 90 days was under 1% regardless of the age of the group in both Kakeani and Mukuyuni. However, in Bamba loans to members of older groups had a higher PAR, but it was also of concern that a share of brand-new groups had a relatively high PAR over 5% (see figure 13).

People like to pre-pay but there's no reward for doing so. Prepayments affected a significant number of accounts , but there is no reward for prepaying. We heard complaints that the FSAs charge a flat interest rate, but we understood from KFS management that changing interest on reducing balance had been tested and customers had trouble understanding it.

4.2 COLLATERAL DEPOSITS

Mandatory savings are collected by ***muunganos*** at each meeting. The deposit amount is used as the first guarantee for a member's own loan, and can be used to guarantee others' loans.

Members see savings as a gateway to borrowing. The FSAs determine borrowing capacity based on the member's shareholding (generally members can borrow up to four times their shareholding) but also on their mandatory savings, which are used as collateral for their loan (and can also be pledged to guarantee the loans of other group members).

These collateral deposits do not earn interest and cannot be withdrawn except at the end of the year, when 25% of the amount can be withdrawn.
Calling these collateral deposits "savings" has caused confusion both in the FSAs' own records (see text box) and also in the minds of members. Members are not clear how the rules differ between their collateral deposits and their voluntary savings.

The average savings account balance is quite low at less than KSh 500 in all three FSAs (see) and less than 2% of members have over KSh 50,000 in savings deposits. Excessive concentration is a concern for the FSAs, but all three FSAs had a wide distribution of savings balances.

Recording of *muungano* collateral deposits is not done consistently

Mandatory savings are collected by the ***muungano***s at each meeting. However, the recording of these deposits is not done consistently.

According to the FSA transaction database, 60% of ***muungano***s made no deposit in the past 6 months. Nonetheless they keep substantial balances at the FSAs, with a median of over KSh 10,000 per ***muungano***.

From the MIS, it's not possible to distinguish all collateral deposits by ***muungano*** members from voluntary savings. Everything in the MIS that is called "***muungano*** savings" represent collateral deposits, but there are ***muungano***s with zero balances in the these accounts, as well as no recorded activity in the past 6 months.

We believe this is a reflection of how savings are recorded and recommend renaming the ***muungano*** savings as "collateral deposits" across the FSAs and ensuring that they are not recorded in the same records as voluntary savings accounts.

[6] These included loans such as micro leasing (15% interest rate), agriculture (36% interest rate), saidika loan ranging (2% - 30% interest rate) and market day loan ranging (1% - 240% interest rate). Altogether these accounted for 58 out of more than 35,000 loans.

Figure 10: PAR 90 days with years of group age

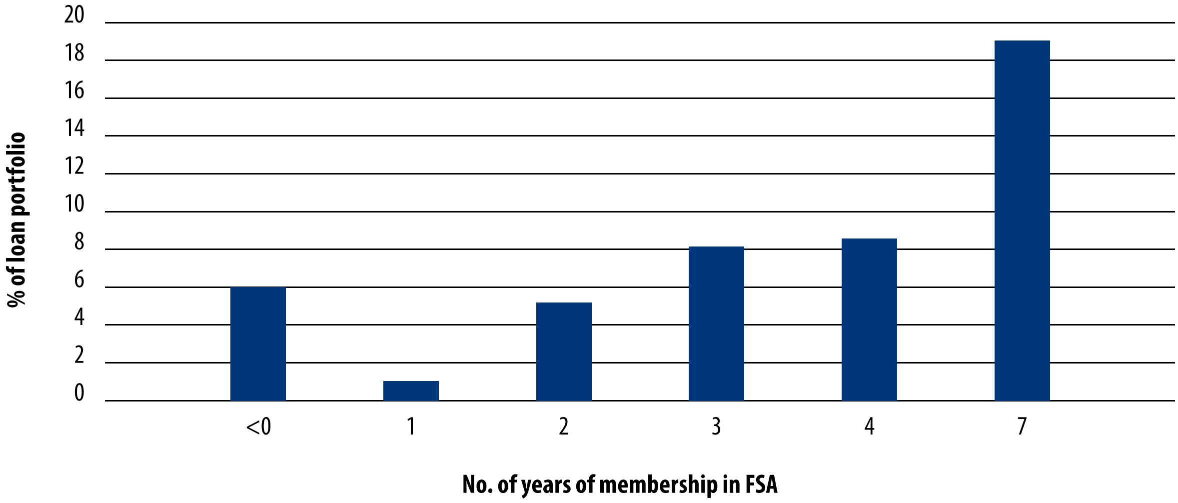
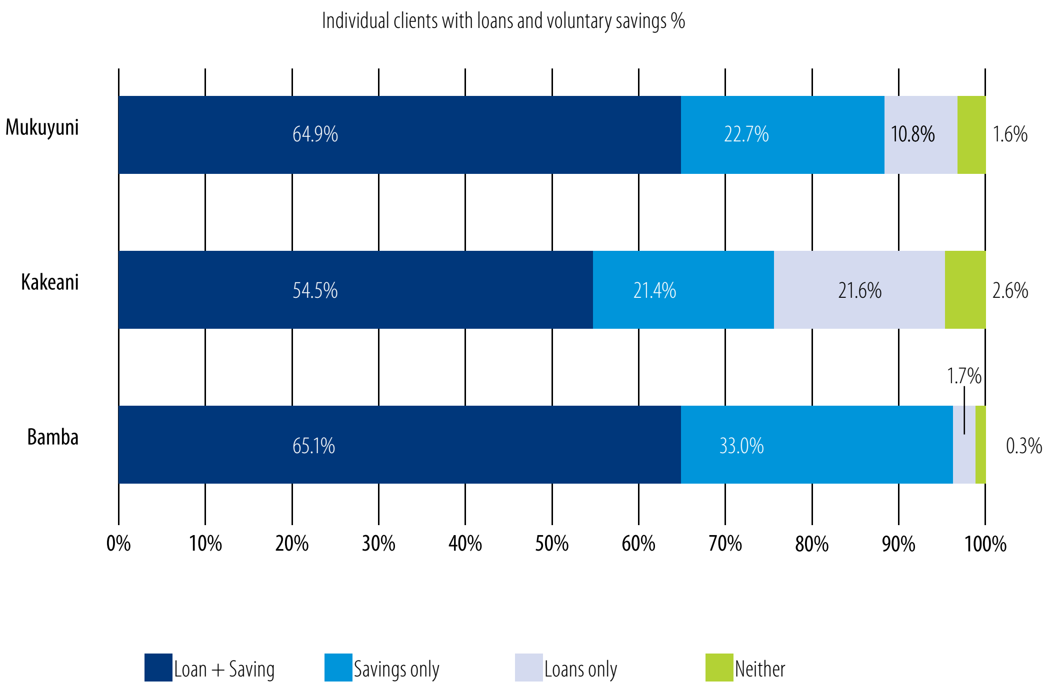


Figure 11: Customers with loans in 2016 and who have a balance >0 in their voluntary savings account.



4.3 SAVINGS

Voluntary savings accounts and fixed deposits are available to members, non-members and businesses.

Savings are not promoted by the FSAs; nonetheless voluntary savings are significant. About a quarter of members did not borrow at all in the past year but only saved in voluntary savings accounts (see figure 12).

There is high usership of voluntary savings accounts – over 85% of all customers had some money in their voluntary savings account (see figure 12).

Despite this high rate of savings account ownership, activity in these accounts is low and so are balances. Only 21% of accounts had a savings deposit in the 6 months to Jan 2017. The average balance in savings was below KSh 500 in all three FSA (see figure 13).

Savers have no other local option, especially for businesses. This came through strongly in the interviews with businesses, who like to deposit cash at the teller window at the FSA.

Respondents believe they cannot withdraw their savings. We repeatedly heard from respondents that they were not able to withdraw their savings balances. The main reason seems to be that do not have clear insight into the difference between voluntary and collateral deposits (mandatory savings). Since collateral deposits can only be withdrawn at 25% and only then at the end of the year, members may either think the same rules apply to voluntary savings, or not understand that collateral deposits (mandatory savings) are different from voluntary savings.

Businesses however reported no problem withdrawing savings except when larger amounts were involved and the local FSA did not have cash on hand (in which case they would be given a cheque).

There was no compelling reason for saving in the FSA, and we believe this could be a competitive weakness for the FSA as banking agencies become more available even in remote locations. The exception was the fixed deposit accounts, which earned an interest of 4-6% (less than banks which are required by law to provide interest currently at 7%). However, these were a very small share of total savings.

[7] Percent of pre-paid accounts 30% - Bamba, 4% - Kakeani and 5% - Mukuyuni.

4.4 SHARE OWNERSHIP

Share ownership represents the larger share of capital available for lending, but savings balances are also increasing and represent an important source of funds for lending (see figure 13)

The dividend payout mechanism is quite complex, paying out proportional to the length of time you have held a share (with shares sold in the course of the year earning no divided).

According to the audited financial statements for 2015, dividend payments were KSh 20 in Bamba, KSh 38 in Kakeani and KSh 31 in Mukuyuni, representing a return of 7-13% given the share price of approximately KSh 300.

Although this is the principal way to earn a return on their money placed in the FSA as either deposits or shares, members do not seem to understand the difference between dividends and interest, or how dividends are calculated. In our study, members report that they do not invest in the FSA to earn returns, but to be able to take loans. Nonetheless there is a minority of members who have relatively large shareholding in the FSA, who mainly join the FSA to earn a return on their shares. KFS is actively monitoring the level of concentration in shareholding in order to avoid the feeling that the members are "working for" a few major owners. None of the three FSAs we reviewed had a very large shareholding from a tiny number of shareholders.

4.5 ALTHOUGH MEMBER-OWNED, PEOPLE SEE THE FSA AS A BANK

Although they understand that they are members, respondents do not feel much responsibility to participate in governance and do not have a clear understanding of their rights and responsibilities as members. They understand the FSA as an institution with a set structure.

There was some complaining that the group process is not applied fairly – members complained that group officials are not subject to the same seizure of assets or loan repayment terms as everyone else.

In addition, they complained that while they had enough shares, they were not able to obtain what they thought was the full amount of credit – i.e. 4 times their share value. While this was explained to BFA by a manager as being the result of the credit officer reviewing the member's assets and not only shares, it did not appear fair or transparent to the member.

Whenever they encounter a problem, members did not see a way to seek recourse and did not see themselves in a position to demand accountability by virtue of their shareholding. The FSAs could improve actual and perceived fairness by using technology to guide and enforce adherence to the rules, monitor how officials' loans are performing compared to members and communicate with members.

Figure 12: Median balance in voluntary savings (customers)

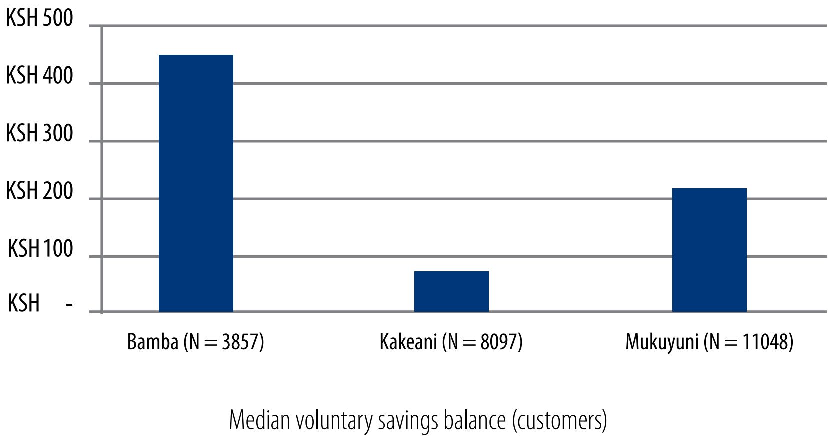
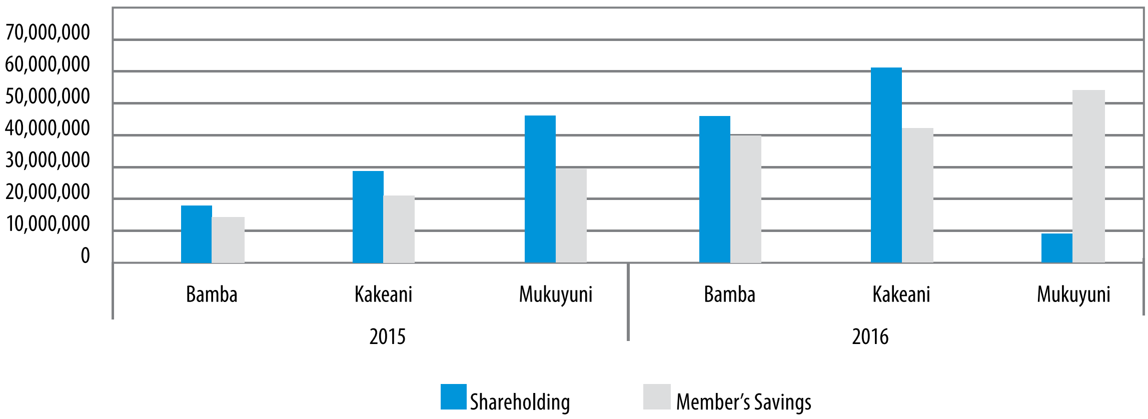


Figure 13: Sources of capital for FSAs.



(2015 source: audited accounts. 2016 source: transaction data.
However it should be noted for 2016 that it was not possible to fully separate voluntary and mandatory savings.)

8 Parliament passed amendments to its banking act to put a floor on the deposit rates at 70% of the CBR. The current deposit rate is about 7% according to the key rates reported on the Central Bank of Kenya website: https://www.centralbank.go.ke/?s=capping

9 In Bamba, the interest was broken down by loan type, but not expenses.

Chapter 5

TECHNOLOGY AND COMPETITION

There are a few trends going on in the larger banking eco-system, which could potentially threaten the existence of FSAs:

- Banks are increasing their outreach in rural areas and have agents in or near the communities where FSAs are active.
- Mobile banking allows customers to obtain loans immediately on their mobile phone. The sizes of these mobile banking loans is increasing and now overlapping with the loans offered by the FSAs. While these loans are mostly short-term and costly, KCB M-PESA and Equitel are offering existing customers longer loans at better interest rates. This trend could increase and expand even to the type of customers who are members of FSAs.

In addition, bank lending does not require attending meetings or guaranteeing other people's loans, both of which are burdens to FSA members. There was concern amongst some FSAs prior to the study that if people could repay by M-PESA they would cease to attend group meetings and the process of group lending would fall apart. However, from this study it seemed that members understand and value the group process and this would not end if they were able to make payments and deposits more cheaply and conveniently using digital financial services.

Based on this study, FSA lending does not appear to be threatened by new technologies, since their product niche is different from that being offered by other financial services providers. On the contrary, FSAs would seem to have an opportunity to improve their services by adopting new technologies. Already two of the three FSAs that we studied were sing M-PESA for deposits and loan repayments, and this was appreciated by members.

One possible threat would be from an ambitious consumer-finance lender in the Latin American style, which would use higher volumes and better logistics to compete with the FSAs in offering household assets at lower prices. However, this is unlikely given the remote rural locations of the FSAs.

However, there could be a competitive threat around savings. From other research such as the financial diaries we understand that people like their money to be working for them. Voluntary savings in the FSA do not earn interest and do not contribute to a member's ability to borrow. In addition, due to confusion with mandatory savings, people understand savings to be illiquid and unavailable when they need them. Meanwhile the banks are now required to offer higher interest on savings deposits , and funds are more available through agents. This would make bank deposits more attractive to potential customers.

While FSA members do have an opportunity to put their money to work through share ownership, it's almost impossible to liquidate and most members have only the minimum shareholding required for the level of borrowing they want to undertake.

What to do with people whose borrowing needs outstrip the typical FSA sizes? We heard frequent stories of people who are taking much larger loans (KSh 500,000 and more) and saw a few occurrences in the data. One question is whether FSAs need to adjust their processes to allow individual loans so as to keep these customers in the FSA as they grow.

From our study, it seems these higher-income people still appreciate the FSA and do not have other alternatives for individual loans, even though some belong to other banking institutions especially KWFT. We do not see a need for the FSA to take on the risk, processes and staffing necessary to implement individual lending.

Nonetheless, the burden of guaranteeing a large loan is heavy on a poorer person. FSAs could form specific KCMs where the borrowing appetite and the guarantee burden is more similar across the group. This should be tested for customer acceptability as it could also offer a solution for poorer people. For now, it appears the FSAs have sufficient funds to cover larger loan sizes but this may change if the demand continues to increase.

"When one of us has a problem such as a funeral, harambee or a wedding, we usually help them fund raise.. We visit them and raise funds for them."

Active new FSA member (under 2 years),
Mukuyuni

"We help each other in things like Muthoko (dowry negotiations and payment)".

Active old FSA member (over 5 years),
Kakeani

Chapter 6

FSA AS A SOCIAL INSTITUTION

FSAs are community-owned and can harness community knowledge and relationships, which they have done quite well in terms of developing loan products that are responsive to member needs. The group process takes into account existing social relationships, and expands the network of contacts to the ***muungano*** and other members in the FSA. Generally, FSA products and services are appropriate to the local economy and financial needs.

Do FSAs replace chamas? While FSAs share some features of informal financial groups, they also have some differences:

- They have access to a larger pool of capital
- They charge a much lower rate of interest
- Have longer loan periods
- Savings are safer in FSAs since the default rate in savings group is quite high

From our interviews, it does not seem that FSAs are replacing informal groups or vice versa. Instead the FSA complements membership in these informal groups (chamas).

Photo credit: villageenterprise.org

Chapter 7

FSA BUSINESS MODEL

BFA was able to examine the 2015 audited financial statements from all three FSAs (2016 audited results were not yet complete). Overall, they appear to show a healthy financial situation with all three reporting profits. Nonetheless, the FSAs struggle to have enough capital available to cover all loan requests. Core capital is growing but not as fast as outstanding loans. While savings are also growing, they are not growing as fast as demand for loans; in addition, FSAs maintain 40% of savings in cash so as to remain liquid against customer withdrawals. Consequently, the FSAs frequently need to borrow to on-lend to members, although none of the 3 FSAs had borrowed in their 2015 audited accounts.

The accounts do not break down expenses and interest by loan type, so it was not possible to determine which products are the most profitable . Since the main loan types used standard 18% interest rates, had a similar group methodology and low defaults, the profitability of each product was probably similar. The four main loan types which together accounted for over 99.8% of all loans given were: Biashara loan, Maendeleo loan, Masomo loan, Emergency loan.

BUYING GOODS – IS IT PART OF THE FSA BUSINESS MODEL?

While members report that the FSAs do a substantial amount of purchasing goods (food, agricultural inputs and household assets) on their behalf, this activity did not reflect clearly in the FSA accounts. Only in Mukuyuni was there activity in the loan asset account (which represented about 10% of the total value of loans disbursed), and even then there was no way to tie the loan asset account (in the financial statements) to the loan repayments (in the MIS). There was no specific accounting for other costs of goods sold, such as transport. This makes it difficult to analyze the actual size or profitability of the activity of purchasing goods on behalf of members. We believe than improving the transparency and accounting for goods purchased by the FSAs could help FSAs to decide how to treat this activity in their overall growth strategy.

There could be an opportunity for FSAs to develop the goods purchase as a business line. Without properly accounting for the expenses as well as revenues, it's hard to tell whether FSAs could be making money on the sale of assets but certainly in Latin America large companies are making significant profit from selling goods. If the FSAs decide to treat goods as a potential source of future business growth and resilience, there is substantial scope for improving efficiencies:

- **Procurement**. With each FSA taking its own procurement approaches (which are not documented), it's likely there are substantial gains to be made from more structured procurement. KFS is already handling some aspects of the procurement process and this could be expanded to be a centralized procurement function available to FSAs.
- **Logistics**. Similarly, delivery costs could potentially be reduced, which is an important component given the remote location of most FSAs.
- **Order process.** Over time, the FSAs could use technology to allow members to place orders, aggregate them for procurement efficiency, combine shipments and overall expand the range of items available to members, at progressively lower costs.

Photo credit: villageenterprise.org

Chapter 8

ARE FSAs SERVING THE POOR?

FSAs are targeted to poor communities. FSAs operate in poor and remote communities. Within the community, they serve a wide range of people. Our assessment is that people who use FSAs are poor as reflected by:

- Remote and rural location
- Members principally use informal financial services
- Members value FSAs for provision of basic household assets and food
- Member could not raise KSh 2,500 in three days or 5,000 in a week in case of an emergency

However, FSA cannot serve the poorest within a community. This is because FSAs main activity is providing loans through the group mechanism. The successful FSA model depends on a rigid monthly payment schedule for both mandatory savings (collateral deposits) and loan repayments. The poorest do not have an income that is sufficiently regular to participate in the FSA group mechanism, although they could still save voluntarily with the FSA. People who had left the FSAs had mostly done so because they could not keep up with the payments due to unforeseen circumstances like a health emergency.

FSAs could potentially offer valuable services to very poor communities (e.g. graduation model). This would be possible if there is an economic activity that the very poor can engage in which would permit regular savings and loan repayments. For this to be possible, the minimum savings amount may have to decrease further. Coaching and financial capability trainings which are usually part of a graduation model would be important.

"That is the reason since this baby; since I gave birth to him till now he has not breast fed [cleft lip]. . . . .the charcoal business, I go sell one sack, I buy milk, I buy potatoes. . . everything to cater for the baby. I don't even have a shilling to save."

Inactive old FSA member (over 5 years), Bamba

". . . I broke my leg then trouble started. . . . they [My children] said they wouldn't be able to give me money to make my . . . I did not have enough money to continue.

Inactive intermediate FSA member (2 to 5 years), Mukuyuni

Chapter 9

CONCLUSIONS AND RECOMMENDATIONS

FSAs form an important part of the financial landscape in low-income communities, fitting a niche that is not covered by formal providers, and complementing existing chamas. Their products are generally tailored to the requirements of their members and in consequence are highly valued. FSAs have high loan repayment rates and draw much of their strength from the group methodology. Inactivity rates appear to be low for both savings and borrowing. Nonetheless, there was some shortcomings with FSAs that were reported by members and lead to some recommendations for further improvement and development:

9.1 IMPROVE TRANSPARENCY AND COMMUNICATION

Although the FSAs are well-appreciated by their members, there were a number of aspects that members did not understand, particular relating to savings. At a low cost the FSAs could introduce SMS-based communications with members to allow them to check their savings balances (including the balance available for withdrawal from voluntary savings) and loan repayments. Short Message Service (SMS) communication could also inform them about dividends.

Using an older technology, FSA offices could have posters explaining key concepts, and the passbooks could be printed with some of the important messages. This messaging could include information about recourse to FSA management and KFS in cases where members feel they are receiving unfair treatment or have other problems.

9.2 PRODUCT IMPROVEMENTS

Overall, FSAs are offering products that members value and are well tailored to their needs.

FSAs continue with group lending: We recommend that FSAs keep what works. We do not recommend that FSAs go into individual lending which they are not well set up to manage.

We have a few product recommendations for KFS and the FSAs to consider:

Is it possible to develop a more effective health product? FSA members rarely default but when they do, health emergencies are frequently to blame. Obtaining health care is clearly a challenge given the FSAs remote location, but as National Hospital Insurance Fund (NHIF) is in the process of expanding its coverage and access it may be worth considering NHIF again. If NHIF will not work, it may be outside the scope of the FSAs to develop a full-service health offering in cooperation with NGOs.

Streamline the loan approval process. Kakeani is already experimenting with a streamlined process yet they continue to have high repayment rates. Lessons for other FSAs include:

- Loan approval and disbursement is fast - within 3 days.
- The loan applications forms are brought to the branch immediately the meeting is over.
- The manager relates well with the members and takes a proactive approach to calling them to avoid a loan default.
- In addition to receiving M-PESA by paybill, Kakeani also operated a mobile money agency within the premises. This made it easier for people to pay their loans because when they receive remittances they come to the bank to withdraw and then pay up the loan.

Reduce the number of loan products and focus on the most common. The FSAs were offering a variety of loan products with different interest rates that hardly anyone was using. Probably most of these additional products are not necessary.

Allow people to grow at different rates by having KCMs guarantee according to their loan appetite. This would allow a wider range of the community to continue to participate in FSA – some KCMs might be for richer people who want larger loans while others might be for poorer people who want smaller loans. This could be worth trying on an experimental basis.

Be one step ahead of the competition for savings. Currently, savings are on an increasing trend, including voluntary savings. However, with banks extending their reach, they may start offering savings products that compete with FSAs in rural areas. FSAs may need to offer a more competitive savings offering. FSAs should potentially consider bonuses and other non-interest returns to keep customers engaged without incurring excessive interest costs.

Update the name and definition of "mandatory savings". We recommend that the FSA consider changing the name of "mandatory savings" to something that represents its role more clearly. "Collateral deposits" might be one option but another possibility is to call it "membership dues" – with the 25% end-of-year withdrawal labeled something like a "bonus." By framing it as a required payment with a positive rebate, members would understand more clearly what the nature of the payment is, and would also regard the 25% as a generous allowance rather than a limitation on their using their own money.

Promote shareholding as an investment with a return. At present, members do not value shareholding as an asset that brings a return (except for the relatively few with larger shareholding). Instead, they value shareholding because it allows them access to credit. Members could be reminded that shares yield dividends with good returns.

9.3 FINANCING GOODS – CONSIDER IT AS A BUSINESS

FSAs are already engaged in the business of purchasing goods for members, however it's not recognized in their business plans and books of account. If they are going to continue with this activity, which is highly valued by members, we recommend that they treat it as business. A first step would be to develop a strategic plan for this business including:

- Procurement
- Ordering system
- Logistics
- Business plan
- What regulation may apply in the consumer lending business

It would be useful to study the experience of Latin American retailers who are now some of the largest banks for low-income people. Although coming at the problem from the opposite direction they have demonstrated that large numbers of low-income people want and can afford many basic goods, if they can be facilitated to spread the payments over a period.

In order to provide the goods efficiently, the Latin American companies have developed sophisticated IT systems for procurement, ordering and logistics. It is not clear that the FSAs (through KFS) should set up a similar system themselves or alternatively perhaps they should partner with retailers or third parties to manage the physical goods.

9.4 EXPANSION CONSIDERATIONS

FSAs may also consider expanding within their current communities. While the FSAs are mostly already growing and this trend is likely to continue, we do not believe there is a large scope for bringing on additional members. Our interviews reveal that people are well aware of the FSA and that most who believe they are capable of making the monthly payments already do belong to the FSA. The FSA could potentially go deeper by varying its minimum monthly contribution so that some groups have lower (and higher) rates, potentially attracting an additional slice of the market.

By making better use of technology to reduce the cost of transactions, FSAs could also increase the membership in the further-away geographic areas under the catchment of existing FSAs. This could bring in a considerable number of additional members.

On the whole, we think that the major expansion potential for FSAs lies in areas beyond their current coverage. FSAs do offer a value proposition that would be attractive, and if they decide to take up asset finance as a major product which they promote with new users, it is possible that there's a large untapped population who are interested to join. Despite a possible temptation to expand more rapidly, we recommend relatively cautious outreach, allowing the time to implant the group methodology and understand local conditions. We also recommend that the FSAs continue their focus in remote areas where competition from other financial institutions (and retailers) is weaker and their impact will also be higher.

Photo credit: villageenterprise.org

Annex

MIS issues

The data provided by the FSA points to several integrity and administrative challenges with the MIS.

For the savings transactions, it was not possible to disaggregate voluntary savings by ***muungano*** members from those of non-*muungano* members.

While institutional knowledge refers to the use of M-PESA for either loan payment or savings deposits, the data provided did not capture this.

Regarding the loan information, the loan products indicated in the data were questionable and it was pointed out (by KFS) that there was a likelihood the default loan product was erroneously being captured for almost all loans. There were instances of loans disbursed for which the loan repayment schedule was either non-existent or erroneous (based on loan parameters). Asset financing information is generally not well captured in the databases and specifically difficult to track in Kakeani.

Shareholding information had notable issues with instances of negative shareholding as referenced below. There were also congruency challenges while following the shares transaction trail for a number of accounts as referenced below.

Activity status for ***muungano*** members was also difficult to verify from the data provided. 92% of all ***muungano***s were identified as inactive from the MIS data analysis. Some of the ***muungano*** members identified as inactive from the data were reported to be active by our researchers.

Loan information

	Total No. of loans	No. of loan accounts without repayment info	No. of loan accounts without loan parameters	No. of loan accounts with erroneous repayment schedules
Bamba	6,572	504	10	43
Kakeani	23,894	35	-	3,302
Mukuyuni	26,988	291	626	1,194

Fixed deposits:

Fixed deposits are tracked in two main tables: Term Deposits Transactions (TDTrans) and Savings Transactions (SAVTA).

	Total No. of processed fixed deposit accounts	No. of fixed deposit accounts without interest info	No. of fixed deposit accounts not tracked in SAVTA
Bamba	236	8	0
Kakeani	764	31	111
Mukuyuni	2,718	99	74

Shares information

There were instances of accounts having negative shares and/or non-congruent current shareholding balances.

Account number (Accnr)	Shares as of date (sday)	Current balance (curbal)	Total shares (tshares)
CB/I/02477	1/15/2015 12:14	-3,900	-13
CB/I/03302	5/15/2015 18:10	-300	-1
CB/I/03217	6/18/2015 14:11	-600	-2
CB/B/00334	1/25/2017 17:15	-900	-3

Account number (Accnr)	Shares as of date (sday)	Current balance (curbal)	Total shares (tshares)
MU/I/00518	2/17/2016 19:03	-1,200	0
MU/I/00569	3/26/2016 11:05	-2,300	6
MU/I/00569	4/27/2016 20:34	-2,300	6
MU/I/00569	5/14/2016 10:32	-4,100	0

Non-congruent shares accounts: there were a few instances of shares balance computed based on transactions failing to be congruent with the FSA's reported shares balance.

FSA	No. of shares accounts	BFA computed share balance (Sharesbal)	FSA recorded share balance (Sharesbal)
Bamba	4	95	141
Kakeani	1	14	26
Mukuyuni	4	347	381

DATA USEFULNESS FOR MAKING BUSINESS DECISIONS

The FSA data while not at 100% in regards to integrity and administration is still useful for making business decisions. The accuracy however can be enhanced through data audits to ensure that the system users of the loan performer are adhering to FSA data policies. The issues with the data seem more related to different interpretations of the way to capture data, than problems with the system itself.

MIS ABILITY TO TAKE ON NEW TECHNOLOGY

Integrating SMS messaging and M-PESA paybill to the current MIS are feasible. Both integrations require web access to the MIS. FSAs are using Visual FoxPro database management system for the MIS and this would necessitate creating Visual FoxPro Active Document applications to avail views (URL endpoints) targeting the relevant use cases.

M-PESA paybill payments may be integrated to automatically reflect in the MIS by registering an URL endpoint with Safaricom's Broker platform. Payment notifications may then be received by FSA via the URL endpoint, processed and registered in the MIS.

In addition to maintaining a proper contacts list of customers, interactive SMS messaging may require:

- Application for a short code from the Communications Authority (CA) and from telecommunications operators.
- Bulk SMS subscription with a telecommunications operator or bulk SMS reseller.
- SMS gateway integration to the FSAs MIS URL endpoints.

FSD Kenya
Financial Sector Deepening

FSD Kenya is an independent trust established to support the development of inclusive financial markets in Kenya. **A** 3rd Floor, 9-Riverside Building, Riverside Drive • P O Box 11353 - 00100 Nairobi, Kenya • **T** +254 (20) 2923000
www.fsdkenya.org • info@fsdkenya.org • FSDKe