Annual Report 2019

www.fsdkenya.org

fsd Kenya

Creating value through inclusive finance

fsd Kenya

The Financial Sector Deepening programme (FSD Kenya) was established to support the development of financial inclusion and inclusive financial markets in Kenya.

In 2005 we were constituted as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). Our aim is to help realise an inclusive financial system that supports Kenya's long-term economic development goals.

We work closely with Government, the financial services industry and other partners across key economic and social sectors. Our core development partners are currently the UK's Department for International Development (DFID), the Swedish International Development Agency (Sida), and the Bill & Melinda Gates Foundation.

Sida
SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

UKaid
from the British people

BILL & MELINDA GATES foundation

Annual Report
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Creating value through **inclusive finance**

1 Letter from the CEO

As we highlight our work from 2019 in this report, the world is facing a global pandemic of unprecedented scale.

The COVID-19 crisis is creating great uncertainty about what the future holds for the economy and well-being of all. But as I reflect on the stories that offer a snapshot into our work over the past year, I am amazed at how they point to the potential importance of finance in helping Kenyan households and businesses mitigate the impacts of this crisis.

Kenya is in a better position than many of our peers to leverage digital financial infrastructure to reduce physical interactions, keep trade going including through e-commerce, and unlock cash transfers for the most vulnerable. The progress made with the Ministry of Labour and Social Protection to deliver cash transfers provides a foundation for increased cash transfers in times of crisis. Leveraging digital platforms like DigiFarm to reach smallholder farmers with inputs, advice and finance can help keep agriculture going even in uncertain times. Despite the challenging times, the progress made in building livelihoods through the Marsabit pilot points to how cash transfers, paired with market linkages and skill building, can help households move into entrepreneurship.

However, there are other insights from our work that point to some of the challenges that will make this harder to navigate, such as the significant reduction in financial health reported by the FinAccess 19 results. We can only imagine how the financial health outcomes will further deteriorate in this crisis unless new solutions can be offered to improve the outcomes for Kenyans.

There is no doubt that Kenya will feel the impacts of this pandemic for many months and possibly years to come. However, at FSD Kenya, we will do our part to help the financial sector provide financial solutions to help Kenyan households and businesses manage day to day, deal with risk and even invest in the future in the recovery and rebuilding.

We hope that these stories about our work inspire you about the potential for inclusive finance. We also wish you good health as our country, and indeed the world at large, work hard to tackle the COVID-19 pandemic and its implications.

Tamara Cook
Chief executive officer

2 Our strategy

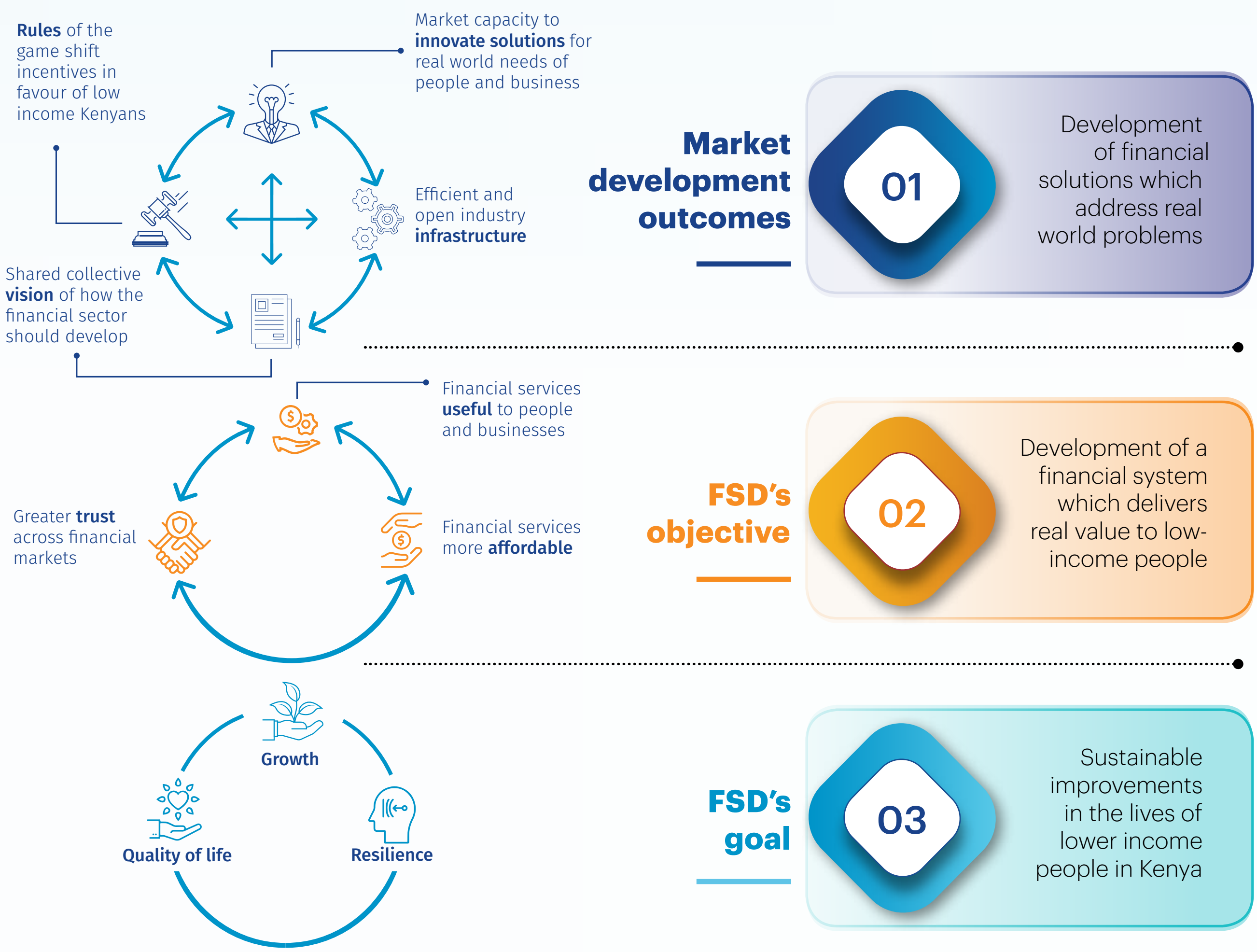
The Government of Kenya has established a long-term vision to "create a globally competitive and prosperous nation with a high quality of life by 2030".

Vision 2030 emphasises that all Kenyans should enjoy a high quality of life. The link between financial market development and poverty reduction is the sole rationale for the FSD programme. In looking to the future, we need to ask what constrains the sector from making a transformational impact on lower-income markets. For too long there has been an implicit assumption that the only binding constraint was cost.

While it is certainly true that reducing costs is an important objective, experience in Kenya and elsewhere has shown that it is not enough to realise far-reaching change. Furthermore we cannot focus only on the direct impact of finance on low-income households.

Improving economic opportunities and delivering vital services to the poor depend on the financing of critical economic and social sectors.Reiterating our approach to market development, we believe that inclusion depends on developing financial solutions which address real world problems. In other words, we need financial services which do useful things for people and businesses. Low levels of utilisation of many services often reflect that the current services are simply not especially useful. Services also need to be underpinned by a strong degree of trust.

Addressing these three elements we believe is the key to developing a financial system which delivers real value to low-income people. The result should be sustainable improvement in their lives through facilitating growth, improving resilience and allowing people to make better choices which directly improve their quality of life.



3 2019 **in review**

The Kenyan financial sector was marked by vibrant activity in 2019.
Key developments included the release of county level Gross County Product (GCP) data for the first time since Kenya adopted devolved governance in 2013.

The data provided more granular detail on county contribution to national Gross County Product (GCP) as well as their size and structure. The creation of a regulatory sandbox by the Capital Markets Authority (CMA) in March was important in creating a structure through which fintech development can be encouraged in the context of regulatory oversight that fosters responsible innovation. The Central Bank of Kenya (CBK) successfully concluded the demonetisation exercise, noted for the orderly way it was conducted, with no noticeable disruption to the macroeconomy. 2019 also saw a change in leadership at the National Treasury as well as several bank mergers, the largest being the creation of NCBA Bank which combined NIC Bank and the Commercial Bank of Africa (CBA). The year ended with the repeal of the interest rate cap, seen as a positive development that could restore access to credit by small and medium-sized enterprises (SMEs) in particular.

With regard to the digital finance landscape, the Data Protection Act was passed in November. Given the scale of digital financial activity in Kenya and concerns with data collection, handling and sharing, the Act provides a structure that could help strengthen consumer protection. The Ministry of Information, Communications and Telecommunication (ICT) launched Kenya's first Digital Economy Blueprint in which digital finance is a key anchor. The Ministry also released a blockchain and artificial intelligence (AI) taskforce report titled Emerging Digital Technologies for Kenya: Exploration & analysis, containing recommendations on how Kenya can leverage these technologies going into the future. The year also saw the National Treasury include provisions for the taxation of income accruing through a digital marketplace for the first time. This has raised concerns in relation to implementation, given the lack of clarity on the definition of 'digital marketplace' and possible negative knock-on effects on digital innovation, access to this marketplace, and economic activity.

Over 2019, FSD Kenya made significant contributions to information on the financial sector including the 2019 FinAccess household survey which highlighted the importance of focusing on the quality of finance, not just the quantity or scale of access. A segmentation study conducted in partnership with the Consultative Group to Assist the Poor (CGAP) unpacked the 2019 FinAccess results, digging deeper into the nature and extent of financial inclusion gaps. The study identified seven segments of the population who have unmet financial needs while at the same time presenting viable business cases for financial services providers and offering potential for economic growth. These include market farmers (local and regional), businesses (small urban and sophisticated), urban aspirational youth and two employed segments (urban wage earners and public sector employees).

Kshs **4,419**
Annual average cost of running a bank account (about $44)

Kshs **969**
Average cost of closing an account is Kshs 969 ($9.7)

The study suggests that these segments can be better served through an ecosystem approach that integrates finance with investments in infrastructure value chain strengthening and improved human capability (skills building and health), and which leverages social as well as digital networks.

FSD also released a cost of banking report which highlighted the quality of financial services offered by the banking sector. The study found that the annual average cost of running a bank account is Kshs 4,419 (about $44) and Kshs 969 ($9.7) is the cost to close one, although digital channels offer significant cost savings to customers. While banks are making an effort to treat their customers better, the study found that there are gaps in price transparency and suitability of advice.

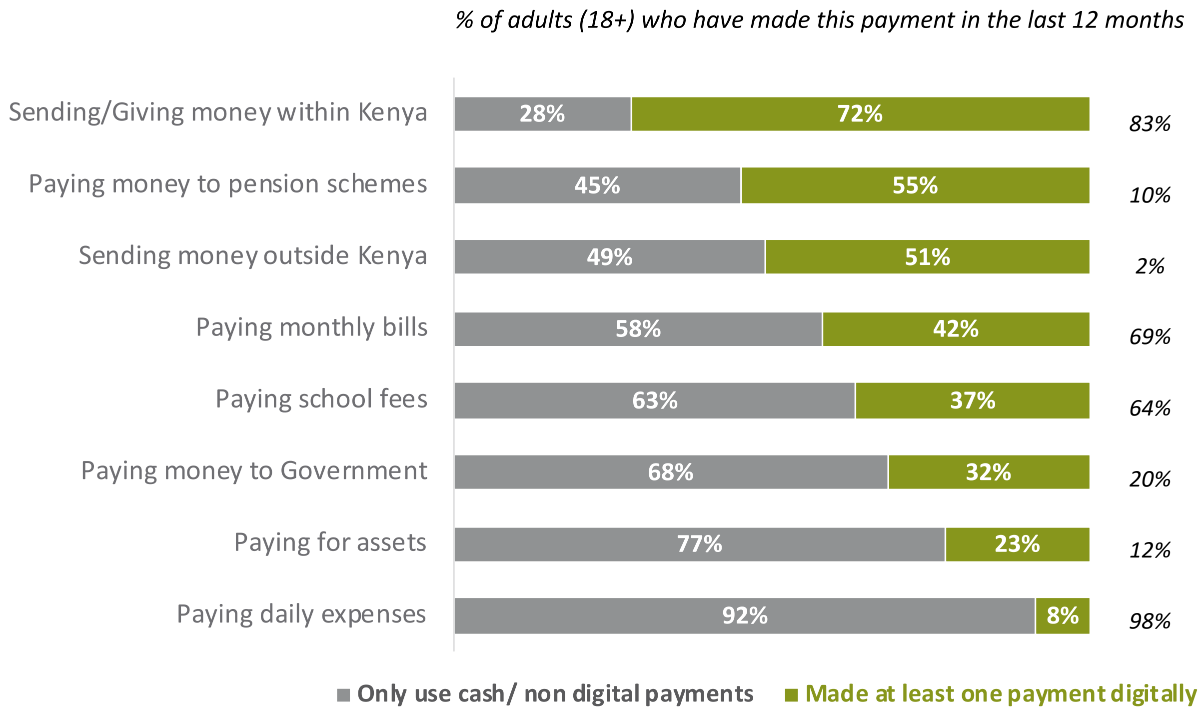
Lastly, FSD Kenya released a deep dive analysis of Kenya's digital credit market based on FinAccess data, as well as an audit of digital credit providers. We found that over six million Kenyans have borrowed at least one digital loan and that digital credit is increasingly used to finance non-routine needs such as school fees and healthcare. However, the expansion of digital credit and the proliferation of digital lenders has drawn attention to wider consumer protection issues such as credit pricing, credit information sharing, data privacy and ownership, inadequate regulation, and debt stress.

4 How Inclusive is Kenya's Financial landscape? **Results from the 2019 FinAccess Household Survey**

Kenya's financial services landscape is one of rapid change. According to FinAccess 2019, 83% of adult Kenyans own a formal financial account. The past few years have seen a substantial shift towards digitisation not only in payments, but also in the use of digital savings and credit. How have these impressive achievements contributed to Kenya's development objectives; and for whom?

The mobile money revolution leveraged a fast spreading mobile telephone communications network to develop a low-cost payments solution that quickly went viral with nearly 8 in 10 adults owning a mobile money account in just over a decade since its inception. Since then, aside from in-country remittances, digital payments are beginning to make in-roads into key transaction use cases such as paying monthly bills, receiving salaries, paying school fees and paying money to government through formal accounts rather than cash. However, digital transactions have not penetrated the 'daily economy'; where payments for goods and services are still largely in cash.

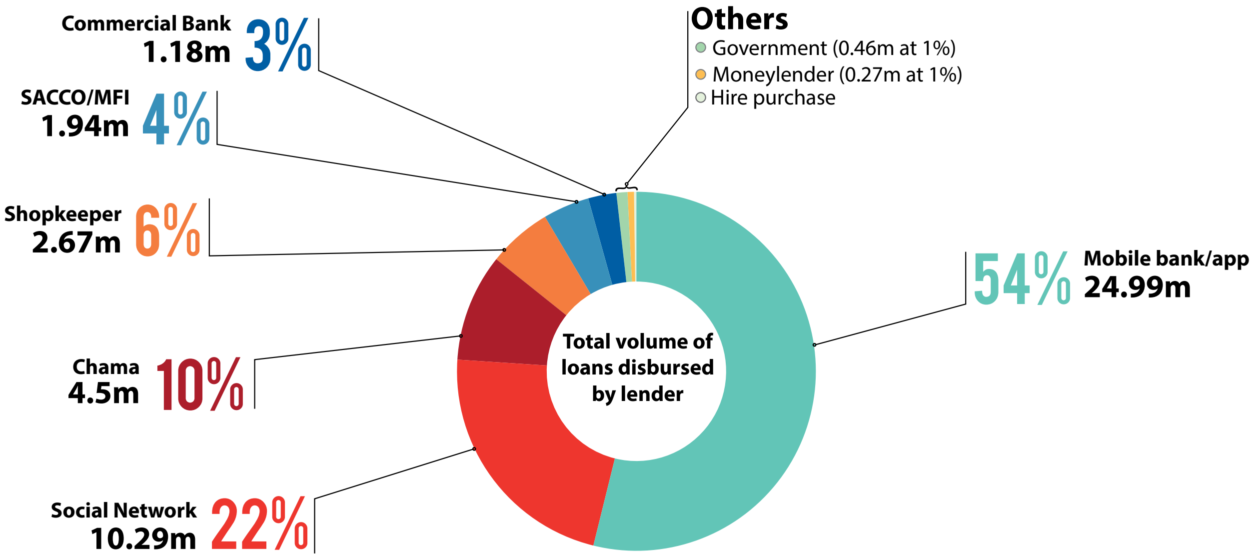
Use of digital payments by use case



Source: Kenya FinAccess 2019
*Via an account includes: Bank transfer, A mobile money account, A mobile banking account, Pay bill / Till number throu
(e.g. Lipa na M-Pesa, Pay Bill), Cheque, Credit or Debit card

Aside from revolutionising payments, digitisation has also formalised saving and borrowing. With 54% of the population claiming to save in their mobile accounts, mobile money wallets are now the most used savings device outcompeting informal alternatives. Digital borrowing is also on the rise, outpacing other forms of borrowing in terms of volume.

The market for digital loans in Kenya



These developments in the financial sector are also driving the digitisation of the wider economy, such that digital identity and digital channels are increasingly central not just to financial inclusion but also to economic inclusion. In this scenario, who is likely to be left out? Is (digital) financial inclusion pulling in marginalised populations to create a more inclusive economy? Or is it instead, deepening inequality?

In the digital age, where access to mobile phones is a major driver of access to finance, FinAccess 2019 data shows that nearly a quarter of rural adults (22%) do not own a mobile phone. This contrasts with only 8% of urban adults. What are the implications of this for financial innovations which seek to improve the resilience and growth of rural populations?

The next sections look at uptake of finance by region, livelihood and gender, highlighting the substantial variation across the population, in financial access. For finance to be truly inclusive, we need to understand how the financial sector can add value across the economy, and not just for the privileged few.

What is the reach of finance across Kenya's geography; and how is this related to poverty?

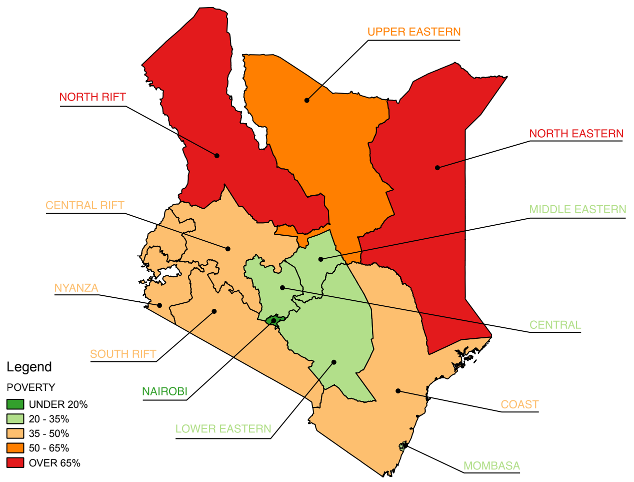
Beneath Kenya's upward trend in financial inclusion lies substantial regional variation. Unsurprisingly, central Kenya displays the highest rates of financial inclusion along with the lowest levels of poverty. In contrast, northern Kenya with high poverty rates has low levels of inclusion[1].

But the data shows some surprises in other areas of the country. For instance, south rift, western Kenya and the coastal region have relatively high levels of poverty (35% - 50% of the population are below the poverty line) but also display relatively HIGH levels of financial usage (70% - 80% of the population have used a digital account in the past 90 days). This may be influenced by cross border activity, remittances to or from migrant labourers (western Kenya and coast), as well as the tourist economy (coast). The question is, how can higher levels of access to finance in these areas be leveraged to alleviate poverty?

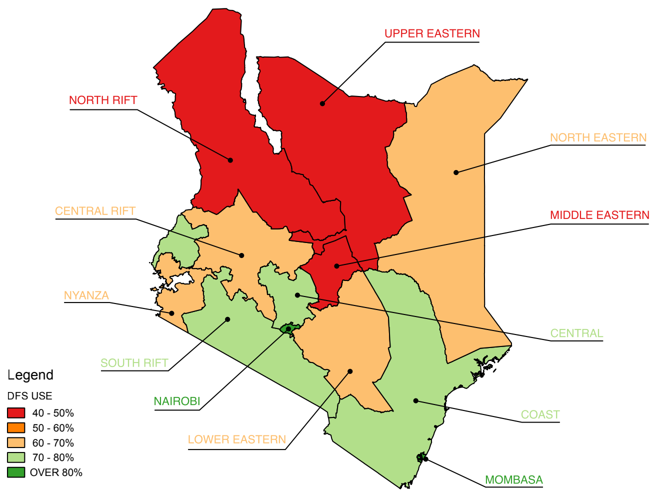
[1] An exception is north-eastern where uptake of mobile money jumped between 2016 and 2018, possibly due to cross border transactions.

Use of finance and poverty levels by region

%adult population (18+) who used a digital account in the past 90 days by region



% population below the poverty line region



Source: *Kenya National Bureau of Statistics & FinAccess 2019*

In other areas of the country, a contrasting picture emerges. The relatively wealthier lower and middle eastern regions (Meru, Tharaka, Embu, Kitui, Machakos, etc.) have surprisingly LOW levels of financial service use. Only 50% - 70% of these populations have used a digital account in the past 90 days. What are the barriers in these areas that impede a more intensive use of finance?

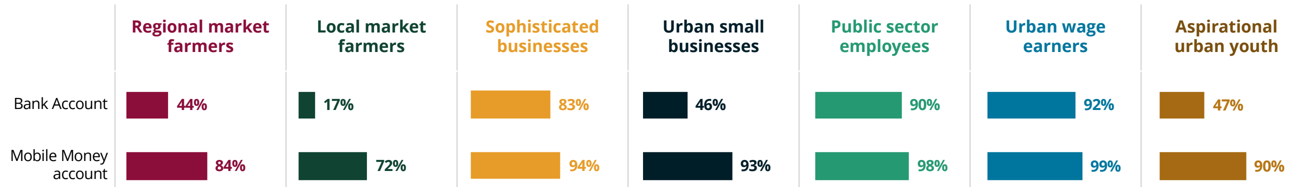
Understanding the connections between economic opportunity and patterns of poverty at the local level could help to improve the value of finance in supporting a more inclusive path to growth.

How is finance supporting Kenya's economically active segments?

Kenya's Vision 2030 was launched in 2008 as Kenya's development blueprint for 2008 to 2030. It aims to make Kenya a newly industrialising, "middle-income country providing high quality of life for all its citizens by the year 2030." The financial sector can play a role in catalysing these goals by providing access to meaningful financial solutions that empower individuals to meet their needs and contribute to economic development. However, the extent to which finance is supporting different livelihood segments varies substantially. A recent segmentation study illustrates this point. The study focuses on 7 segments that play a key role in driving growth: cash crop farmers, food crop farmers, sophisticated businesses, urban small businesses, public sector employees, urban waged labourers, and aspirational, educated youth.

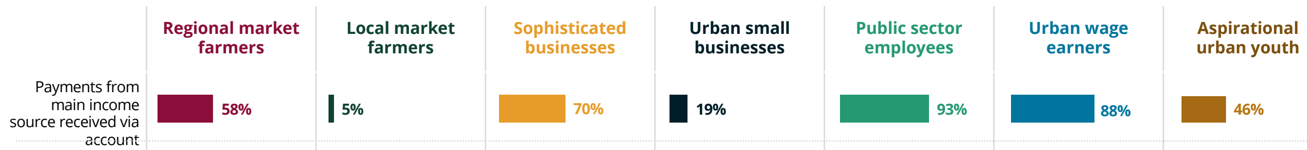
Public sector workers, the urban waged and sophisticated businesses have relatively high levels of bank account ownership (above 80%). In contrast, less than 50% of farmers, urban small businesses and urban educated youth have bank accounts. This suggests that banks are not serving these economically active populations, and are instead sticking to easy-to-reach wealthier markets with predictable income flows. Usage of mobile money on the other hand, is high across these segments. An exception is local market farmers, nearly 30% of whom did not own a mobile money account. This is by far the largest segment in terms of numbers, with 4.4 million individuals, suggesting a lost opportunity for mobile money providers.

ACCOUNT USAGE



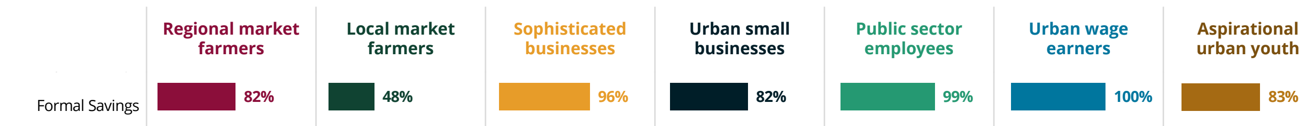
Despite relatively high levels of ownership of mobile money accounts, urban micro, small and medium enterprises (MSMEs) and farmers still conduct their livelihoods largely through cash. This makes many of them invisible to the wider economy, and compromising their access to other services such as credit, and diminishing the effectiveness of financial services in driving agricultural and business growth.

USE OF DIGITAL PAYMENTS FOR LIVELIHOODS



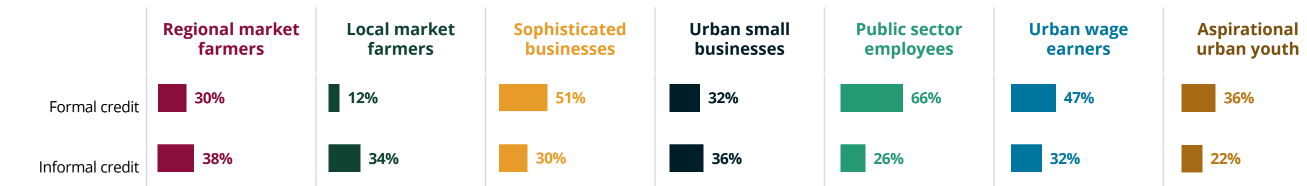
One area where formal services have clearly added value is through savings. Other than food crop farmers, a high proportion across all segments save through formal channels. The caveat is that these savings are still not being captured under interest bearing accounts, with many people instead preferring to save on their mobile wallets (see https://fsdkenya.org/publication/inclusive-finance/ for more details).

USE OF FORMAL SAVINGS



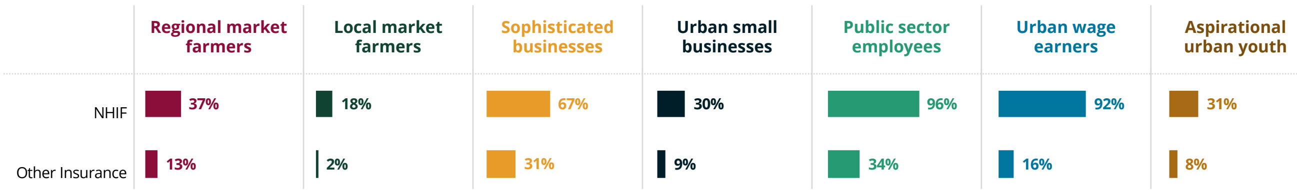
Access to credit is key for investment. Public sector employees and urban wage earners have high levels of credit uptake, much of which is invested in housing and land. Expanded access to formal credit is also supporting businesses, with high levels of uptake among sophisticated and small businesses (the latter mainly through mobile banking and digital apps). For farmers, however, informal credit still dominates, despite the fact that credit could be a helpful instrument in smoothing lumpy incomes and investment in agricultural economies.

USE OF FORMAL AND INFORMAL CREDIT



Across the population health shocks have a deleterious effect on people's financial lives, often sending economically active populations into a chronic poverty slide. Access to insurance is not just important for health but also for livelihoods, and is a crucial pillar of growth. . Aside from high uptake of (statutory) insurance for the employed, uptake of insurance for other segments is still low, with the exception of sophisticated businesses. Despite the fact that regional farmers have the highest incidence of health shocks, only 37% have NHIF. Local market farmers have by far the lowest levels of insurance, despite being vulnerable to climate shocks. This segment is also dominated by women who normally take on the burden of healthcare in the household.

INSURANCE

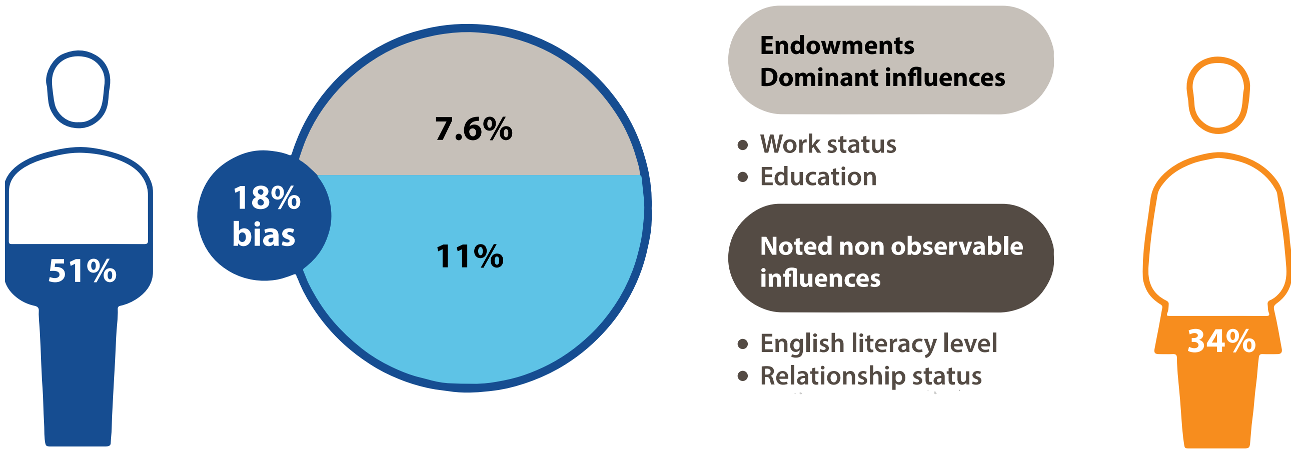


How is finance helping women to participate in growth?

Despite Kenya's impressive developments in financial inclusion which have helped to bring women into the formal fold, the gender divide in access to finance persists. Whereas the gap between men and women in access to mobile money is now only 6%, access to banking is a different story: only 34% of women have access to a bank account compared with 51% of men.

A recent study conducted by FinMark Trust finds that the gendered difference in bank account ownership is related to underlying sources of social and economic bias. For instance, men's higher uptake of banking is influenced by their higher likelihood of being employed and their higher levels of education.

Sources of bias in access to bank accounts by gender

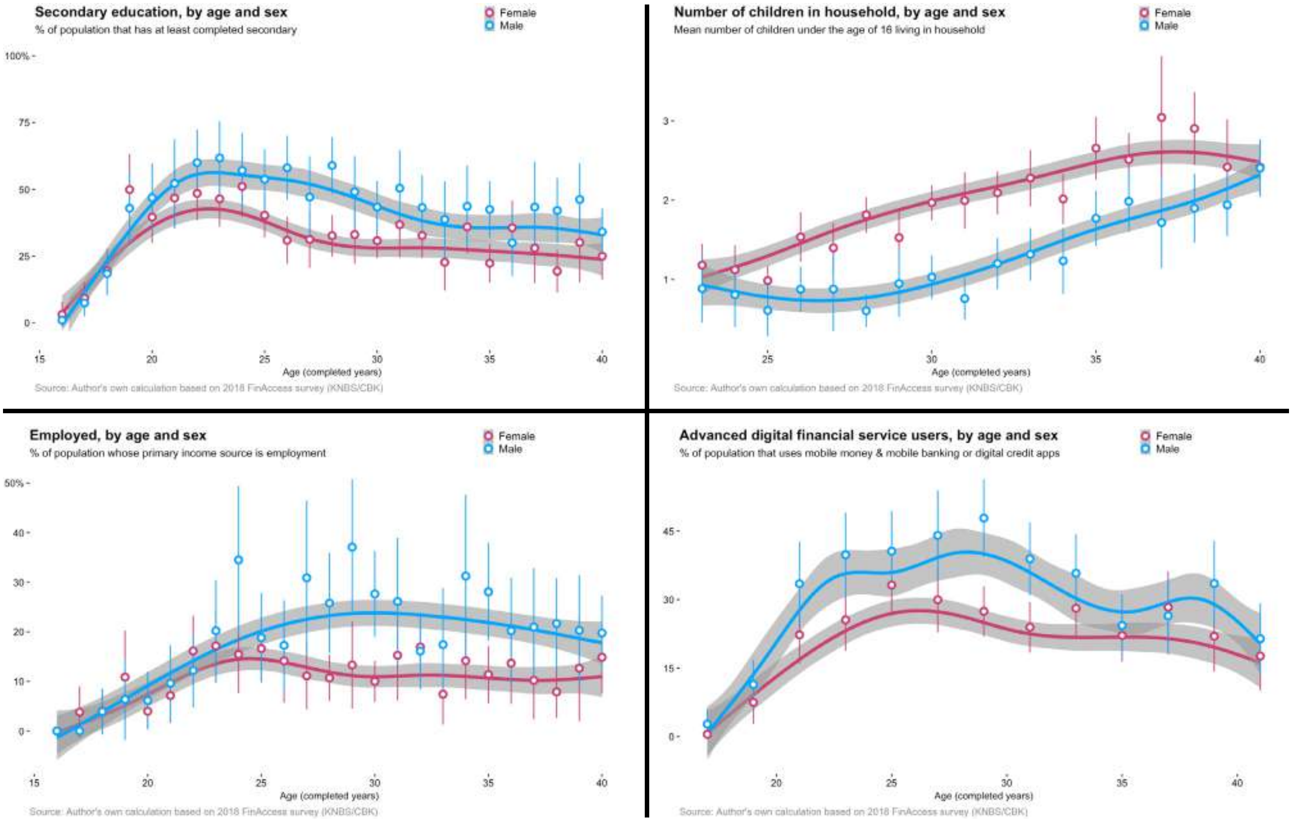


***Source:** Berkowitz, R., Weideman, J., Tizora, P., Robertson, G., Jeoffreys-Leach, S., 2020, Unpublished PowerPoint. Decomposing Gender Indicators using Fairlie's method. FinMark Trust.*

Analysis of FinAccess 2019 data upholds this point. From a young age young men and women have different opportunities in life which influence their financial choices as they get older.

The data shows that young men are not only more likely to be educated at secondary and tertiary levels than young women, they also have a higher likelihood of being formally employed, display more advanced use of digital finance and have substantially fewer dependents (children) in their 20's which leaves them freer to earn money.

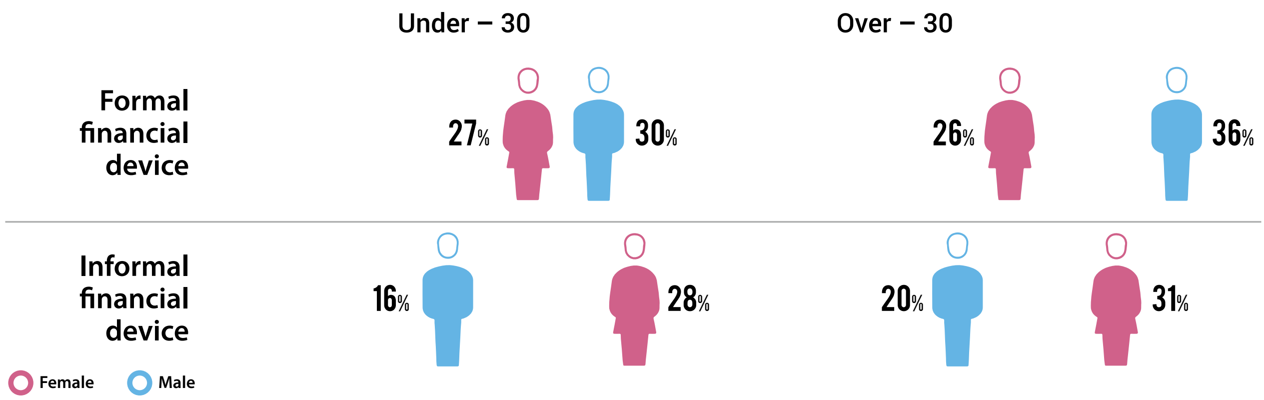
Differences in opportunity for young men and women



These factors appear to influence what then becomes a 'formal/informal divide', such that by their '30's, men are more likely to use formal finance and women are more likely to use informal finance to meet their life goals.

Gendered strategies for meeting goals

% of men and women who are investing in goals by type of financial device used



Digital finance may be changing this. Just as mobile money brought women into the formal fold, can digitisation support the innovation and ambition to elevate women and enable them to take a stronger place at the centre of Kenya's economic growth? For this to happen, Kenya will have to create a financial sector that supports equal access to education for girls and boys; stronger safetynets for young women who bear the brunt of family and other responsibilities; and better value for women's livelihoods, including small informal businesses which are the lifeblood of urban and rural economies.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5 Our **Portfolio**

FSD Kenya works to support the development of a financial system which delivers real value to low-income people and small enterprises by addressing their real-world needs. Our work is organised into four focal areas of work.

The next few pages include some selected highlights from our work in 2019.

Vision

A shared vision, across stakeholder groups, of how the financial system should develop to support national development objectives and specifically the reduction of poverty.

Regulation

A supportive policy and regulatory environment in which the formal rules that govern the financial system shift incentives in favour of low-income households and smaller-scale enterprises.

Industry Infrastructure

An efficient and open finance industry infrastructure supporting increased competition, expanded services, and lower costs.

Innovations

Market capacity and incentive to innovate financial solutions for real world problems of poor households and economies of the poor.

Digital finance, **digital economy and payments system**

Twelve years after the launch of M-Pesa, and its subsequent applications in areas such as health, education and agriculture, Kenya has been seeking to define its next fintech and innovation frontier.

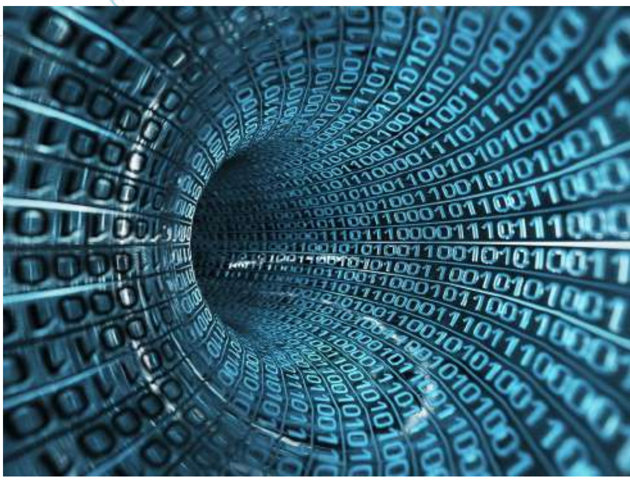
In the course of 2019, FSD Kenya worked to support various government initiatives aimed at defining the vision for the next phase of work around the digital economy, digital finance and payments. Without this collective vision, Kenya runs the risk of losing gains made in the last decade and being surpassed by other 'late comers.'

A number of policies prevent innovators and fintechs from launching products in the marketplace. While the advent of mobile money was a major turning point, some of these services remain relatively costly. Challenges from issues like cyber risks pose new threats that were not as prominent as they are today. Additionally, while integration of various digital and mobile solutions is mandated, it is yet to be fully realised, denying Kenyans the benefits of fully interoperable systems.

Thankfully, the government, led by bodies such as the National Treasury and Planning, Ministry of Information, Communications and Technology (ICT) and the Central Bank of Kenya, working together with a wide range of industry stakeholders, resolved to address these challenges.

In 2019, FSD Kenya continued its support for the development of a digital finance framework and national payments system strategy. FSD Kenya helped provide evidence of existing gaps and how to address them. Through our ability to convene stakeholders, we brought industry players and fintechs together to articulate key challenges, and importantly, propose solutions.

Major progress was made. For example, the first ever Digital Economy Blueprint was launched by President Uhuru Kenyatta at the Transform Africa Summit in Kigali, Rwanda. The Blueprint is also serving as an example that other African countries will model their strategies around,



showing that Kenya is still leading the region in matters digital. It has also paved the way for Kenya to develop its own Digital Economy Strategy, which will realise the Blueprint's vision and implement its programmes. FSD Kenya is part of the Taskforce appointed by the Ministry of ICT to make this happen.

These frameworks will enable the government, industry players and private sector to leverage modern technologies, create economic opportunities in the digital economy and finance sectors. From an inclusive finance perspective, the real promise of these strategies will be to enable a truly digital financial system, supported by a modern, trusted and resilient payment infrastructure.

Once completed, the digital economy, finance and payments strategies will pave the way for more work to address remaining challenges such as building needed capacity for implementation in order to achieve the set vision. A strong foundation has been laid in 2019 to make attainment of this vision a real possibility.

Digital **credit audit**

Since the introduction of M-Shwari in 2012, digital credit has undoubtedly been the fastest growing financial innovation in Kenya.

It has been instrumental in granting credit in ways inconceivable a decade ago, enabling households and small enterprises to meet their day-to-day and working capital needs. Following the early successes of M-Shwari, new entrants especially from outside the prudentially regulated sectors have emerged. While this has been instrumental in expanding access, it has also focused attention on wider consumer protection issues. The challenge has grown with the large numbers of first-time lower income borrowers entering the market. There are emerging signs of debt-stress with 14% of borrowers juggling two or more loans at any given time. This has disproportionately affected public sector employees[2], a third of whom typically spend more than half of their monthly incomes on debt repayment. Despite some improvements, there are concerns with price transparency with survey data revealing that 19% of borrowers did not fully understand the costs and fees associated with their loans. Fraudulent lenders that require the payment of a fee or a deposit before issuing a loan are targeting vulnerable borrowers. Finally, there is little oversight over how lenders mine, store and share borrowers' digital footprints.

Expectedly, there have been growing pressures to re-order the way that lenders relate with their customers. A key component of FSD Kenya's work is to undertake research, analysis and experimentation as mechanisms to improve effective market function. In 2019, FSD Kenya published the results of an audit study aimed at understanding the conduct and practices of digital lenders in Kenya. The objective was to generate the evidence required to underpin the development of practical approaches to protect low-income consumers.

There were five key takeaways from the study.

- First, the digital credit landscape has rapidly changed, enabled by the low entry requirements for non-bank lenders. As of September 2018, there were approximately 110 mobile applications by 74 unique lenders offering digital credit. As of April 2019, 65 of these applications had been pulled down while 47 new ones had emerged by the end of 2019.

- Second, there are lenders who are pushing the envelope of acceptable practice. Fraudulent practices observed include the requirement for the payment of a deposit or a registration fee before a loan can be considered.
- Third, most lenders offer their borrowers little control over their data, limiting the borrowers' rights to use, access and correct their own data.
- Fourth, compliance with credit reporting requirements is disparate across lenders, even for those legally required to submit full-file credit data.
- Lastly, the pricing of digital loans remains sticky downwards, even in the presence of supporting market infrastructure and competition from new entrants.

The findings highlight a clear case for policy action, providing the ex post evidence for success and the need for regulatory changes where required. The former is crucial to ensure that regulation does not stifle innovation while the latter is a powerful force in changing the lenders' incentives to adopt practices that are in the long-term interests of their customers.

[2]Public sector employees account for 27% of employees in Kenya (based on main income source) and 4% of Kenyans above 18 years old.

Platform take **on fixing agricultural challenges**

Productivity and incomes for Kenyan farmers are among the lowest in the world despite agriculture being a dominant sector, contributing close to 30% directly to GDP (over 50% including indirect) and employing over 60% of the labour force.

The sector attracts less than 3% of Kenyan private credit and less than 1% of households access agriculture insurance. Financial service providers face difficulties like accessing suitable user data to make accurate lending decisions, inherent risks like production and markets risks, high operational costs among others. Digital credit innovations are attempting to solve the lack of scoring data challenges. However, digital loans are mostly short tenure, meeting day to day needs and funding emergency cases. Less than 1% of the formal borrowers finance agricultural operations from the sources, necessitating a paradigm shift to avail the much-needed financial solutions to the sector.

DigiFarm platform promise and innovation

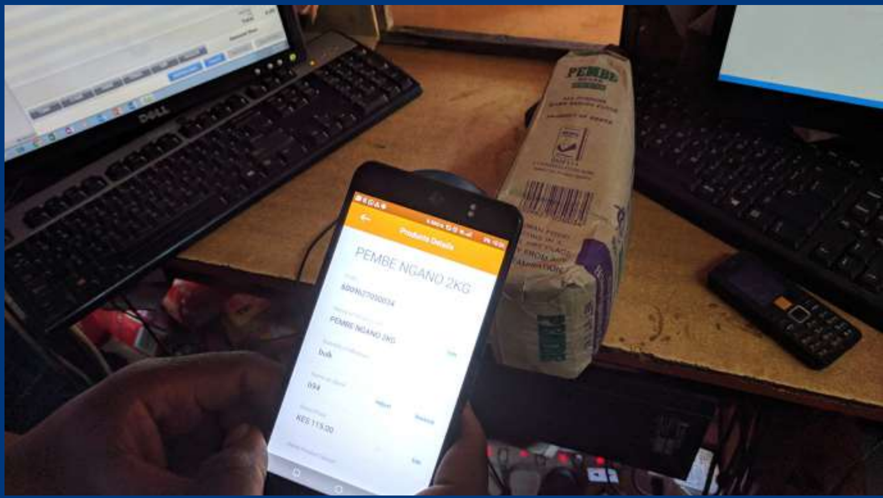
FSD Kenya partnered with DigiFarm to innovate solutions to challenges facing smallholder farmers. DigiFarm, a Safaricom subsidiary is partnering with iProcure - inputs suppliers - via a franchisee model, Arifu - digital learning and FarmDrive for loan management. FSD Kenya in partnership with Mercy Corps invested in the design work as well as the first seed and risk capital to test the lending to smallholder farmers. The core challenges that the DigiFarm innovation seeks to solve include low farmer productivity due to poor access of agronomic knowledge, inadequate and poor-quality inputs as a result of capital constraints, low incomes due to inefficient markets, and losses due to production risks.
The platform has close to a million registered farmers with close to 100,000 either accessing inputs through an e-voucher system, markets, extension and insurance.

Farmers apply for credit through USSD (scoring powered by Safaricom data) and redeem e-vouchers at iProcure agro-dealers in exchange for inputs. Arifu's digital learning platform offers agronomic trainings to farmers with the support of a light touch e-guided ground extension service (which doubles as mobiliser, educator and market access coordinator). The platform has an e-market component, DigiSoko, that links farmers to markets through partnership with produce buyers. DigiFarm provides production risk insurance to some farmers who access credit and benefits from the government's 50% premium subsidy. Credit offerings have evolved from a 30 days credit product, then 60 and 90 days to the current full season balloon payment credit product.

Early evidence

Early evidence suggests the use of quality inputs and know-how increases productivity and production. Risk transfer through insurance is an effective risk mitigation tool against adverse weather for smallholder farmers with low capabilities to use alternatives mechanisms such as irrigation to manage the risk. There is enough demand for input credit as evidenced by high number of applicants. The ability of digital platforms to facilitate end-to-end farmers facilitation has been tested but more work is required to refine credit scoring and collections models to enhance performance. Moving farmers to contracted farming from predominantly informal markets requires innovating on several fronts like aggregation, pricing, storage among others.
DigiFarm can surmount the challenges with continued innovations and partnerships. Undergoing efforts for improved aggregation models will enhance market linkages. Just like transport, accommodation and other sectors have been digitally disrupted, agriculture is no doubt a candidate for beneficial disruption.

Trade **facilitation**



International and domestic trade, the process of moving goods from producer to ultimate consumer, is an avenue for inclusive growth.

The multiple players in the trade ecosystem include primary producers, processors, brokers, aggregators, wholesalers, retailers, transporters, warehouses and financiers. In Kenya this ecosystem is opaque as many of the players straddle informality resulting in inefficiency wastage and increase in costs through the ecosystem.
The improvements in technology, increases in internet speeds and stability, and the ubiquity of payment systems has enabled us to envision a more efficient trading system that enables finance to play an appropriate role in creating value for players and customers. The possibility exists to introduce a nimble, user friendly, end-to-end platform that allows suppliers, retailers and service providers throughout the ecosystem to receive payment as soon as the final consumer has paid for the product.

Platforms have been trying to address these problems in the Kenyan trade ecosystem for a while. Many make the wrong assumptions about incentives across the value chains and rush for scale. An attitude of build it and they will come appears prevalent and most appear to be "solutions looking for problems". The incentives of players to get involved are not well understood and not aligned. Many platform plays in Kenya fail to invest in the research, development and experimentation that could reveal the real needs of potential platform and therefore tailoring of solutions to meet those needs. The result is that trading platforms in Kenya have yet to develop sustainable business models that will allow them to scale.

FSD Kenya is the facilitator of a public-private development partnership (PPDP) that includes the Kenya National Chamber of Commerce and Industry (KNCCI), BrandKe and a private sector technology provider. To solve the above, the partnership has agreed on a strategy of learning by doing. This entails running multiple pilots on the platform to rework the technology, understand the needs of the players and tailor solutions including credit, guarantees, insurance, storage and transport, that work for them. De-risking portions of the process in order to instil trust in the system is a central part of these pilots. Suppliers need to be comfortable with the payment system, retailers need to have faith in the re-order system and logistics players need to be assured of sufficient volumes to justify their involvement.

These pilots are developing a sustainable business model focusing on a lean cost structure and realistic revenue expectations. How well the implementation team learn from setbacks and success is key to increasing the probability that real value can be created through this or future attempts at digitising trade. Understanding the incentives of the players in digitising trade value chains will inform such work being undertaken across other innovation projects in FSDs portfolio. In partnership with KNCCI, FSD Kenya is looking to understand and overcome the constraints to women and youth participation in technology enabled trade. This has a direct bearing on FSD Kenya's desire to mainstream gender and youth across the programme. All of this is enabled by specific funding by SIDA, a principal funder of FSD Kenya.

Afro-Asia FinTech Festival 2019: **Enhancing market capacity to leverage new technologies for innovation**

Kenya has a track record in innovation and is at the forefront of discovering how finance can really matter in unlocking inclusive economic growth, resilience and improved well-being.

FSD Kenya has been working to highlight breakthroughs in several fields that are creating a new set of practical tools and techniques that can support innovation in financial services such as big data and machine learning. The inaugural Afro-Asia Fintech Festival christened "FinTech in the Savannah" held in Nairobi, Kenya, from 15th to 16th July 2019 offered an invaluable opportunity to convene the proverbial 'intrapreneurs' – innovators within financial institutions - and 'entrepreneurs' - fintech start-ups passionate about pushing the needle in the finance space in Kenya. The event, jointly organised by the Monetary Authority of Singapore (MAS) and the Central Bank of Kenya (CBK), saw close to 2,000 participants from 43 countries representing all five continents.

The festival was organised around a main fintech conference, fintech exhibition booths and break-out sessions for deep-dives into the applications of ideas around three key themes: i) technology for tomorrow, ii) social impact and iii) the spirit of innovation. FSD Kenya played its thought leadership role through curating and participating in key panel sessions. CEO Tamara Cook moderated a panel on *"Building A Thriving Ecosystem For Fintech"* deliberating on what is needed to move towards a thriving ecosystem for fintech across the continent in terms of incubation and acceleration of entrepreneurs, barriers to investment for start-ups and scaling-up of fintechs, getting the right talent, and policy environment. Victor Malu, Head - Future Financial Systems, shared his insights during a panel discussion session exploring

the *"Ingredients for Achieving Voluntary Micro-Pension Coverage and Persistency at Scale"*.

In partnership with the Bill & Melinda Gates Foundation, FSD Kenya sponsored 100 Kenyan students and fintech start-ups to participate as delegates to the conference. Thirty-nine African fintechs from 16 countries selected by their respective Central Banks also received support to attend the event in bid to enhance diversity, collaboration and exchange of ideas. A number of these fintechs competed in the *Global Fintech Hackcelerator @Kenya (Hackathon)*, launched at the event with sustainable development goals and financial sector problems as focus areas. Kwara – a Kenyan start-up offering secure online and mobile digital banking experience for Savings and Credit Cooperatives (SACCOs), and Bureau Vente – a Ugandan start-up offering AgriTech solutions were selected as winners, giving them access to pitch at the Demo Day of the Singapore Fintech Festival held in November 2019. Though neither of the two finalists was awarded, Pula, a Kenyan InsurTech offering smallholder farmer insurance solutions, was named winner at the Demo Day of the Singapore Fintech Festival.

The festival culminated with the signing of a FinTech Cooperation Agreement to support digital infrastructure development in Kenya between MAS and CBK. FSD Kenya has been working with MAS to support a training programme for Kenyan programmers to enhance the financial market's capacity to solve real economy challenges by leveraging Artificial Intelligence (AI). CBK and MAS plan to host the second Afro-Asia FinTech Festival (AAFF 2020), once again in Nairobi.

From dependents to entrepreneurs: **Impacts of FSD Kenya's building livelihoods project in Marsabit**

FSD Kenya's market-based graduation pilot in Marsabit is now in its final stages. This is an exciting point for the project, as we start to see the impacts of the project on the 1,200 beneficiaries and their communities.

Since 2016, the Marsabit pilot has experimented a modified graduation approach to help those living in extreme poverty build sustainable livelihoods through business. Our innovation on established graduation models has been to leverage government social protection programme and market linkages to reduce costs and improve sustainability. Through our partnership with CARE Kenya, FSD Kenya also invested in mobilising the beneficiaries into savings groups and training them in business and financial literacy. After four years of mentoring and coaching, training and support by community-based facilitators, beneficiaries have transformed from dependents into entrepreneurs.

"There are many things that have helped us: the saving that we didn't know before, the businesses and the profit that we save later, the loans and how to repay back the loan... We are not as we used to be... our teachers have enlightened us."

The project also linked the beneficiaries with market actors to support their businesses. FSD Kenya worked with players including Equity Bank, NRT Trading, the Kenya Livestock Marketing Council (KLMC) and local wholesalers to build linkages to markets. FSD Kenya supported Equity Bank to develop a new business model and credit product tailored to the needs of these low-income pastoralists, 87% of whom were women. Roughly half the project participants made the leap and took an Equity loan. Despite the challenges, especially drought, data shows that the loans have had a substantial impact on income and assets. From uneducated women previously dependent on the government social transfers, their husbands' livestock, and the better off within their community, the beneficiaries are now independent entrepreneurs, confident of their business

skills and taking repeat loans of up to Ksh 50,000 to support business ventures. They are proud of their ability to buy food and clothes for their families and take their children to school.

While the loans have powered the business ventures, the beneficiaries identify the knowledge they have gained as the primary benefit of the project. The project has enabled women to create new identities as 'businesspeople' opening up possibilities that were previously hard to imagine. It has given them the agency and choice that has shifted the community's perceptions of them from passive recipients to household decision makers managing the family finances. As the male-dominated livestock economy becomes increasingly commoditised, the agency of these new businesswomen will become a force for change.

> **"I am very happy today that people can borrow from me, they know I have something to give."**
> *~Marsabit pilot beneficiary*

Kenya's Social Protection **Payments comes of age**

Government payments directly impact any country's effectiveness in delivering core services, whether receiving payments such as taxes, paying out for services, or generally managing the economy.

Over the past decade, FSD Kenya has worked with various government agencies to support a policy move towards digitisation of all government services. Social payments present a huge opportunity to achieve this digitisation.

The delivery of social payments has historically been manual, expensive, porous and prone to numerous inefficiencies. Low interest by many financial services providers at the bottom of the pyramid and lack of innovation for low cost models for social payments have long impeded efficiency in the social payments sector. In many cases, resistance to change by government officials from manual to a digitised system makes it even harder to effect much needed changes.

In recognition of the importance of access to financial services to improving the financial status of its citizens, the Government of Kenya (GoK) has over the past decade endeavoured to work with relevant partners to improve the delivery of social payments. In 2008, the Hunger Safety Net Programme (HSNP) was launched as a joint GoK and DFID programme to transform Kenya's social protection sector. FSD Kenya was involved in developing a payment solution for HSNP, consistent with FSD Kenya's wider objective to "provide financial sector solutions to a range of government payments as a means to encourage the development of a cash-lite economy and expand financial inclusion."

HSNP has delivered social benefits to over 350,000 households in four of the poorest counties (Turkana, Wajir, Mandera and Marsabit) in northern Kenya using an agency banking model in partnership with four commercial banks. HSNP includes a scale up component that can quickly be activated during emergencies periods. It has also been leveraged to expand financial services across northern Kenya beyond social payments to any Kenyan that needs access to financial services. In 2019, the management of HSNP successfully transitioned to government after delivering over KShs 20 billion (about $ 200 million). It is now managed by the National Drought Management Authority (NDMA).

In parallel, FSD Kenya worked with the Ministry of Labour and Social Protection (ML&SP) to develop the Inua Jamii cash transfer model. A key component of Inua Jamii involved giving beneficiaries a choice of provider from among four contracted banks. This has introduced competition among the banks and is expected to improve the customer experience in the long term. The adoption of biometric identification has introduced an additional layer of security and made it possible to affirm proof of life every six months, significantly increasing efficiency, transparency and accountability while reducing instances of fraud.

Government commitment to social payments continues to increase. KShs 32 billion ($320 million) was allocated to social payments in the 2018/2019 budget and Inua Jamii currently supports over 1.2 million beneficiaries. The government's willingness to innovate and adopt transformative approaches was critical to the success of HSNP and Inua Jamii. Going forward, there is still a need to continue supporting the government in building the necessary skills and capacities to keep improving the management of social payments. It is also necessary to ensure the interoperability of social payments, which would further improve service delivery and reduce cost of access by the beneficiaries.

FSD Kenya's **2019 annual lecture**

Topic: Financing Kenya - 2020 hindsight for Vision 2030

The fifth edition of FSD Kenya's public annual lecture took place on Tuesday 19th November 2019 at the University of Nairobi. The lecture, titled "Financing Kenya: 2020 hindsight for Vision 2030," was delivered by Dr David Ferrand.

David is a man who wears two hats. He is a respected observer of the Kenyan financial sector with a unique front row perspective of the developments that have shaped the sector for over two decades. He was also FSD Kenya's director from 2005 till June 2019. It was therefore unsurprising that over 250 audience members attended his much-anticipated lecture. On Twitter, the event peaked at number two, topping national trends during a prime-time evening slot typically dominated by the news of the day.

Speaking from a public policy perspective, David lauded the exponential leap in financial inclusion as the standout success in Kenya's financial sector so far. "The development of a near ubiquitous mobile phone-based payments system provided the foundations for a further round of fintech innovation," he said. Paradoxically, these gains have not adequately yielded the envisioned developmental impact. David observed that while financial inclusion tripled from 27% in 2006 to 83% in 2019, financial health has dropped from 39% in 2016 to 22% in 2019. He cited lingering concerns over pricing, consumer protection, and low access to finance, all of which stymie the growth of smaller businesses. A similarly discrepancy is apparent on the macroeconomic level. Kenya's growth rate has averaged 5.6% per annum in the last decade, way below the 10% targeted in Vision 2030.

Turning his gaze to the future, David called for a concerted effort to nurture a financial sector that is realistically tailored to Kenya's economic development goals. He went on to make three propositions in this regard. The first proposal was for a financial system focussed on solving real-world problems. He gave the examples of M-Pesa and Equity Bank, both of which started off by innovating solutions to problems facing their customers. For M-Pesa, it was initially to enable Kenyans working away from their families, typically in urban areas, to get money back to support their relatives in the rural areas. Equity Bank created a loan product to enable rural tea farmers maintain liquidity in the period between the two tranches of payment that they receive. David's second proposition stressed the need to recognise that diverse problems need diverse solutions.

He cited the different roles that SACCOs, government and capital markets for instance play in the financial ecosystem. SACCOS can lend where banks fear to tread because they are driven more by their members' interests than profit, banks can provide the scale of finance necessary for business growth and investment; capital markets help take investment risks; and governments can make long-term commitments and bear uncertainties that the private sector cannot.

Finally, David vouched for the development of an open financial system. He pointed out successful examples of open finance in other parts of the world, such as India and the UK, which have spurred renewed innovation without imperilling consumers, clients or the economy. He concluded by urging policy makers to focus on incremental improvements to Kenyan financial sector rather than idealistic expectations. "Our aim is not 'utopia' which...means 'no place,' he said. "Rather it is 'eutopia' – which simply mean a 'better place.'"
The full lecture video, David's paper, photos and the presentation slides are available on the following link
www.fsdkenya.org/annual-lecture

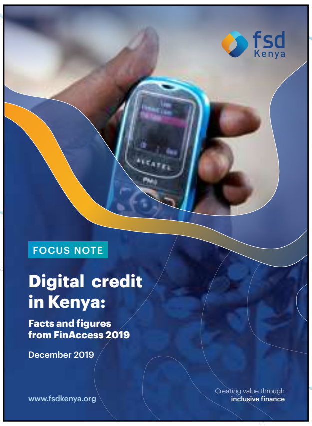
6 Key publications **and blogs**

Publications

Title: Cost of Banking, 2019
Type: Research report
Authors: Francis Gwer, Paul Gubbins, Edoardo Totolo and Jack Odero
Published: December 2019

Title: Financing Kenya: 2020 hindsight for Vision 2030
Type: Paper
Author: David Ferrand
Published: December 2019

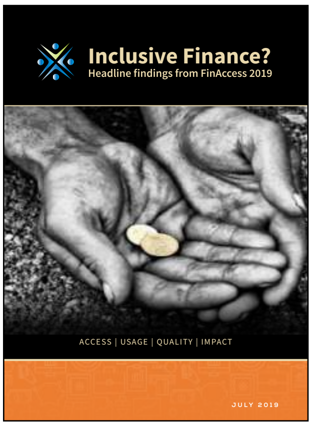
Title: Exploring the links between finance, technology and growth in Kenya
Type: Paper
Author: Paul Gubbins
Published: December 2019



Title: Digital credit in Kenya: facts and figures from FinAccess 2019
Type: Focus note
Author: Paul Gubbins
Published: December 2019

Title: Digital credit audit report: evaluating the conduct and practice of digital lending in Kenya
Type: Research report
Authors: Francis Gwer, Jack Odero and Edoardo Totolo
Published: November 2019

Title: Did you see my tweet? Monitoring financial consumer protection via social media
Type: Research report
Authors: Rafe Mazer and Dan Onchieku
Published: September 2019



Title: Inclusive Finance? Headline findings from FinAccess 2019
Type: Research report
Author: FSD Kenya
Published: July 2019

Title: The 2019 FinAccess household survey
Type: Survey report
Authors: Central Bank of Kenya (CBK), Kenya National Bureau of Statistics (KNBS) & FSD Kenya
Published: April 2019

BLOGS

01 TITLE
Reflections on FSD Kenya's 2019 annual lecture
Author: Anzetse Were
Published: 13th.12.2019

02 TITLE
Provider, Platform, Product: Which 'P' should regulators target?
Author: Gitau Mburu
Published: 17th.12. 2019

03 TITLE
Digital credit: Not every winner must create a loser
Author: Francis Gwer
Published: 13th.11.2019

04 TITLE
Kenya's economic structure: What's the optimal role of finance?
Author: Anzetse Were
Published: 12th.11.2019

05 TITLE
Is financial inclusion adding value for women; or is it the other way around?
Author: Amrik Heyer
Published: 25th.10. 2019

06 TITLE
Bridging the gender divide: implications for Kenya's 21st century pathway to inclusive growth
Author: Amrik Heyer
Published: 23rd.10. 2019

07 TITLE
Kenya's youth and the long road to skill-based work
Authors: Tim Mukata, Abigail Steinberg & Anne Gachoka
Published: 7th.9.2019

08 TITLE
Digital credit – the most pressing problem in Kenyan credit markets – really?
Author: James Kashangaki
Published: 30th.9.2019

09 TITLE
Did you see my Tweet? Kenyans' cries for financial consumer protection ring out on social media
Authors: Rafe Mazer & Dan Onchieku
Published: 4th.9.2019

10 TITLE
What's Twitter got to do with consumer protection?
Authors: Rafe Mazer & Dan Onchieku
Published: 4th.9.2019

11 TITLE
Please, no snails in my beer: Should a duty of care be introduced for financial service providers?
Author: Gitau Mburu
Published: 28th.8.2019

12 TITLE
Evolving agricultural credit: A combi-model for input and trade financing
Author: Michael Mbaka
Published: 13th.8.2019

13 TITLE
Inclusive finance? Not there yet…
Author: Tamara Cook
Published: 8th.8.2019

14 TITLE
What solutions would make a difference in education finance?
Authors: Felistus Mbole & Deborah Kimathi
Published: 8th.7.2019

15 TITLE
How poor households invest in their children's future
Authors: Felistus Mbole & Deborah Kimathi
Published: 5th.5.2019

16 TITLE
Building livelihoods using inclusive finance for chicken farming
Authors: Felistus Mbole, Wanjiku Karanja, Duncan Oyaro & Michael Mbaka
Published: 15th.5.2019

17 TITLE
Moving from financial access to inclusive finance
Author: David Ferrand
Published: 8th.4.2019

18 TITLE
When pricing is live, competition will thrive
Author: Rafe Mazer
Published: 2nd.4.2019

19 TITLE
What is good regulation and why does it matter for finance?
Author: Gitau Mburu
Published: 18th.2.2019

20 TITLE
Towards a financial system which works for Kenya
Author: David Ferrand
Published: 11th.2.2019

7 Key financial results

FSD Kenya's accumulated surplus reduced by **KShs 67 million** from a carried forward surplus of **KShs 947 million** to close the year with an accumulated surplus of **KShs 880 million**. Programmatic expenditure for the year stood at **KShs 568 million** and operational expenditure of **KShs 161 million**).

Financial Sector Deepening Trust Kenya
Income Statement -Unaudited
For the year ended 31st December 2019

	2019	2018
INCOME	**Kshs Millions****	**Kshs Millions****
Grants	**634**	**2,468**
Other Income	**-**	**62**
Finance income[1]	**22**	**20**
Unrealised foreign exchange gain	**6**	**-**
TOTAL INCOME	**662**	**2,550**
EXPENDITURE		
PROJECT EXPENSES		
Core Projects[2]	**424**	**410**
Designated Projects[3]	**144**	**2,067**
	568	**2,477**
ADMINISTRATIVE EXPENDITURE	**161**	**138**
TOTAL EXPENDITURE	**729**	**2,615**
Unrealised foreign exchange losses	**-**	**52**
TOTAL COSTS	**729**	**2,667**
SURPLUS FOR THE YEAR	**(67)**	**(117)**

** Columns do not add up due to rounding

1 Finance income includes interest earned on FSD funds.
2 Core/non-designated projects are funded by donors through unrestricted funds. Unrestricted funds have no conditions regarding the projects they can be used on.
3 Designated projects are funded through restricted funds. Restricted funds can only be used on the projects specified by donors.

Financial Sector Deepening Trust Kenya
Balance Sheet-Unaudited
As at 31st December 2019

	2019	2018
ASSETS	**Kshs Millions****	**Kshs Millions ****
Non-current assets		
Property and Equipment	19	28
Intangible assets work in progress	4	3
Long term loan	38	38
Total non-current assets	**61**	**69**
Current assets		
Receivables	18	13
Short term deposit	536	62
Prepayments	6	-
Bank and cash balances	898	1,700
Total current assets	**1,458**	**1,775**
Total Assets	**1,519**	**1,844**
RESERVES AND LIABILITIES		
Reserves		
Accumulated Fund	880	947
Current liabilities		
Unexpended projects fund	539	679
Accruals	25	143
Tax liability[1]	75	75
Total current liabilities	**639**	**897**
Total reserves and liabilities	**1,519**	**1,844**

** Columns do not add up due to rounding.

[1] This amount is an accrual of taxes on which FSD has applied for exemption from the government pending finalisation of the exemption application.

8 The Team

Anzetse Were
Economist

Amrik Heyer
Senior research advisor

Apphia Ndung'u
HSNP support officer

Duncan Oyaro
Innovations specialist

Eva Adongo
Finance specialist

Fausto Njeru
Finance and risk controller

Felistus Namboya
Senior economic inclusion advisor

Francis Gwer
Policy specialist

Gitau Mburu
Senior regulation advisor

James Kashangaki
Chief programme officer

Juliet Mburu
Senior digital payments specialist

Lukania Makunda
Research specialist

Lydiah Shiru Kamande
Office assistant/ housekeeper

Lydiah Kioko Njuguna
Operations manager

Martin Kimunya
Office assistant/driver

Michael Mbaka
Senior innovations specialist

Michael Njeru
Project manager

Milkah Chebii
Senior social protection payments specialist

Nancy Atello
Project manager

Philip Emase
Communications manager

Plounne Oyunge
Project manager

Rebeka Etuku
Senior office assistant

Tamara Cook
Chief executive officer

Ulla Balle
Chief operating officer

Valerie Mukuna
Senior measurement and results specialist

Victor Malu
Senior future systems advisor

Wanjiku Karanja
Graduation project manager

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